STATE OF MINNESOTA | TAX COURT

COUNTY OF HENNEPIN | REGULAR DIVISION

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Conga Corporation, d/b/a
Conga Latin Bistro,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER FOR JUDGMENT ON REMAND**

Docket No. 8264 R

Filed: January 30, 2017

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This matter came before The Honorable Joanne H. Turner, Chief Judge of the Minnesota Tax Court, on remand from the Minnesota Supreme Court.

Appellant Conga Corporation is represented by Mark A. Pridgeon, Attorney at Law, Edina, Minnesota.

Appellee Commissioner of Revenue is represented on remand by Wendy S. Tien, Assistant Minnesota Attorney General.

Conga Corporation operates the Conga Latin Bistro, a restaurant, nightclub, and bar on East Hennepin Avenue in Minneapolis. In June 2010, the Commissioner assessed Conga Corporation $131,976.61 in additional sales, use, liquor, and entertainment taxes, plus late-filing and negligence penalties and interest, on the basis of an indirect audit that relied on various assumptions about Conga's operations, rather than on Conga's actual books and records. Conga timely appealed the Commissioner's assessment to this court. In April 2014, we filed findings of fact, conclusions of law, and an order reversing the Commissioner's assessment of sales and use tax. *Conga Corp. v. Comm'r of Revenue*, No. 8264-R, 2014 WL 1711795 (Minn. T.C. Apr. 24, 2014). The Commissioner appealed our decision and in August 2015 the Minnesota

Supreme Court reversed and remanded the matter to our court for further proceedings. *Conga Corp. v. Comm'r of Revenue*, 868 N.W.2d 41, 44 (Minn. 2015).

On remand, the parties declined the opportunity to submit additional evidence for our consideration, and filed supplemental post-trial briefs on April 25 and May 27, 2016. In September 2016, we convened a brief evidentiary hearing, at which we received evidence concerning the operation of Conga's point-of-sale system. Thereafter, each party filed amended supplemental proposed findings of fact.

The court, having heard the testimony of witnesses and the arguments of counsel, having reviewed the exhibits and written submissions, and deeming itself fully advised on the premises, now makes the following:

**FINDINGS OF FACT**

1. Appellant Conga Corporation, d/b/a Conga Latin Bistro, a Minnesota corporation, operates a restaurant, nightclub, and bar on East Hennepin Avenue in Minneapolis.[1]

2. The establishment has two rooms: the Conga dining room; and the Conga bar, which has a full-service bar, a dance floor, and a DJ booth.[2]

3. During the periods at issue here, the president, chief executive officer, and sole shareholder of Conga Corporation was Arsenio J. Thunstrom.[3]

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1 Stip. ¶¶ 3-4 (June 10, 2013).

2 Tr. 173.

3 Stip. ¶ 5.

4. Mr. Thunstrom opened the bistro in December 2000 with his then-wife.[4] Although Mr. Thunstrom is, by his own admission, "the only one that runs the whole place," Mr. Thunstrom spends 80 percent of his time at the restaurant in the kitchen.[5]

**Previous audits**

5. Although Mr. Thunstrom is an experienced restaurant operator, Conga did not initially file sales and use tax returns or pay sales and use tax.[6]

6. In 2002, Conga was audited by the Minnesota Department of Revenue for the period January 1, 2000, through September 30, 2002, resulting in an assessment of $129,877.05 in tax, penalties, and interest.[7] The 2002 audit was conducted on the basis of the corporation's actual books and records.[8]

7. In 2003, Mr. Thunstrom and his wife divorced, and Mr. Thunstrom moved to the Dominican Republic, leaving his parents to run the business.[9] Mr. Thunstrom's parents did not file or pay sales and use tax for the period during which they operated the business.[10] The business was then sold to another relative, who also did not file or pay sales and use tax.[11]

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4 Tr. 172; Stip. ¶ 3.

5 Tr. 174-75.

6 Tr. 252-53; Stip. ¶ 25.

7 Stip. ¶ 25; Ex. J38.

8 *See* Ex. J39.

9 Tr. 254-56.

10 Tr. 255.

11 Tr. 255; *see* Ex. J42, at 2.

8. In 2007, Conga was audited by the Minnesota Department of Revenue for the period September 1, 2003, through December 31, 2006, resulting in assessments totaling $205,695.15 in sales and use tax, penalties, and interest.[12]

9. Mr. Thunstrom entered into a payment arrangement with the Department of Revenue that covered the 2002 and 2007 assessments.[13]

**Minneapolis ordinance**

10. Conga's on-sale liquor license from the City of Minneapolis requires that the business "maintain, on a monthly basis, gross sales revenue during each fiscal year from the sale of food and beverages not containing alcohol in an amount of not less than sixty (60) percent of its total gross revenue from the sale of food and beverages." [14]

11. In 2008, Conga was out of compliance with the ordinance.[15] As a condition of maintaining the liquor license, the City of Minneapolis required Conga, among other things, to "provide a full service menu of food items during all hours of operation" and to "maintain 60/40 food/liquor sales requirements." [16]

12. To comply with the ordinance, Conga reduced the price of drinks.[17]

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12 Stip. ¶¶ 26-27; Exs. J41, J43.

13 Tr. 257. The details of the payment arrangement are not part of the record before us.

14 Stip. ¶ 7; Minneapolis Code of Ordinances, Title 14, § 362.395(b)(1) (repealed 2014).

15 Tr. 176; Ex. J36.

16 Ex. J36.

17 Tr. 176-177; Exs. J35, J36.

13. Conga also largely eliminated cover charges, which counted as liquor sales for purposes of the Minneapolis ordinance.[18] On Friday nights in 2008, ladies did not pay a cover charge.[19] On Saturday nights, there was no cover charge until midnight, or no cover charge if the customer purchased an appetizer.[20] For the last six months of 2008, customers paying a $5 cover charge received either a drink or an appetizer.[21]

14. Mr. Thunstrom's regular customers never paid a cover charge, nor did customers of the restaurant at Conga.[22]

15. To "keep the riffraff away," Conga sold tickets at the door on certain nights, which could be redeemed for a buffet but could not be exchanged for drinks.[23] Those tickets cost $5.00 on Friday nights and $10.00 on Saturday nights.[24]

16. Mr. Thunstrom's former sister-in-law, an employee of the business, collected the cash from ticket sales and cover charges, which were counted by the bar's manager and recorded in a separate ledger.[25]

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18 Tr. 176, 181.

19 Ex. J49.

20 Ex. J49.

21 Ex. J49.

22 Tr. 181.

23 Tr. 181-82.

24 Tr. 117-18.

25 Tr. 182-83; Ex. J21 (2008 ledger of ticket sales).

**Operation of the restaurant**

17. Conga used a Micro 3700 cash register system to record food and alcohol sales.[26]

18. Orders for food and drinks were entered into the Micro 3700 system.[27] Orders for alcoholic drinks were transmitted to the bar, where the drinks were prepared by the bartender.[28] Orders for food were transmitted to the kitchen, where the food was prepared.[29]

19. Each night, all servers turned in the cash collected from, and credit card slips signed by, their customers.[30] The bar manager reconciled these submissions daily with sales reported by the cash register.[31] Receipts were deposited daily into the corporation's bank account.[32]

20. Not all receipts, however, were deposited into the corporation's bank account.[33] Mr. Thunstrom retained some of the cash received at the door from ticket sales and either deposited the cash into his personal bank account or used it to pay personal expenses.[34]

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26 Stip. ¶ 8.

27 Tr. 178-79.

28 Tr. 178-79.

29 Tr. 178-79.

30 Tr. 179-80.

31 Tr. 178-80.

32 Tr. 180-81.

33 Stip. ¶ 11.

34 Stip. ¶ 11.

21. Conga prepared monthly profit and loss statements for the period January 2007 through June 2009 using QuickBooks.[35] Although Conga produced monthly profit and loss statements generated by QuickBooks to the Commissioner for the months of July 2009 through March 2010, none of those statements have any entries in them.[36] The profit and loss statements after April 2007 generally reflect only expenses, and not revenues.[37] If revenues are reported on the profit and loss statements, they are different from revenues reported on corresponding monthly sales and use tax returns.[38]

22. During the audit period, Conga filed monthly sales and use tax returns and paid the sales and use tax reported on those returns.[39] Mr. Thunstrom personally prepared the corporation's monthly sales and use tax returns from reports printed out from the Micro 3700 register system.[40]

23. Mr. Thunstrom included in the corporation's monthly sales and use tax returns the receipts from ticket sales, based on the information given to him by the bar manager.[41]

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35 *See.* Ex. J37.

36 Ex. J37.

37 Ex. J37.

38 *Compare* Ex. J37 *with* Ex. J18 *and* Ex. J19.

39 *See* Exs. J18 (monthly sales and use tax returns for 2008), J19 (monthly sales and use tax returns for 2009), J20 (monthly sales and use tax returns for January, February, and March 2010).

40 Tr. 183-186; Ex. J18.

41 Tr. 183; *compare* Ex. J18, at 1 (reporting "general rate sales" of $49,340 in January 2008) *with* Ex. J18, at 2 (showing "total sales" of $49,339.66, including "delivery & takeout" of $3,650.00) *and* Ex. J21, at 2-3 (showing "buffet cover" charges totaling $3,650 for "Enero [January] 2008").

24. During the audit period, Mr. Thunstrom paid both business and personal expenses using the same credit cards.[42] Mr. Thunstrom paid the credit card bills with funds from Conga's checking account.[43] On multiple occasions, Mr. Thunstrom also paid his home mortgage payment using funds from the corporation's checking account.[44]

**2009 audit**

25. In February 2009, the Minnesota Department of Revenue again selected Conga for a sales and use tax audit.[45]

26. The auditor began the audit process by requesting, from Department records, copies of the previous audit reports.[46]

27. On March 3, 2009, the auditor noted in an auditor log entry that Conga filed sales and use tax returns monthly, and that the corporation's returns for February 2008, December 2008, and January 2009 were late.[47]

28. Sometime after March 3 (and likely after August 2009), someone in the Department of Revenue altered the March 3 auditor log entry to indicate that Conga's returns for April and

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42 Stip. ¶ 10; Exs. J22, J23, J24, J25, J26, J27, J28.

43 Stip. ¶ 10.

44 Stip. ¶ 12.

45 Ex. J12, at 1.

46 Ex. J12, at 1.

47 Ex. J12, at 1.

August 2009 were also late.[48] The date of the audit log entry was not amended, however, meaning that the March 3 entry was not made on or about March 3.

29. Also on March 3, 2009, the auditor noted that Conga had not filed use tax, entertainment tax, or liquor gross receipts tax returns.[49] In fact, Conga had reported liquor gross receipts and paid liquor gross receipts taxes on those receipts.[50]

30. On June 5, 2009, the auditor notified Conga of the audit.[51]

31. On July 17, 2009, the auditor and "a couple of other auditors" had lunch at Conga Latin Bistro.[52] The party was "taxed correctly" for its meals.[53] This visit to the restaurant was the Commissioner's only evaluation of the business' internal controls.[54]

32. The auditor was told that the audit could be done "as a direct audit" and that there was no "need to reconstruct sales." [55]

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48 *See* Ex. J12, at 1.

49 Ex. J12, at 1.

50 *See* Exs. J18, J19, J20.

51 Ex. J12, at 1; Ex. J13 (June 5, 2009 letter).

52 Ex. J12, at 2.

53 Ex. J12, at 2.

54 *See* J12.

55 Ex. J12, at 2.

33. By letter dated July 22, 2009, the auditor requested records from Conga, including "Sales and Use Tax Filings and/or supporting documentation" and the corporation's federal income tax returns.[56]

34. Also on July 22, 2009, the auditor requested information about Conga's alcohol purchases from a database maintained by the Department of Revenue.[57] On July 28, 2009, the auditor received information from the Department's database, indicating alcohol purchases of $144,698 during 2008.[58]

35. On August 19, 2009, the auditor received records from Conga, including 2008 federal income tax returns and sales tax filings; 2008 and 2009 daily sales reports, "Z" tapes,[59] and credit card tapes; 2008 invoices; and 2008 and 2009 bank statements.[60] Conga did not, however, provide the auditor with the bar manager's log of cover charges.[61]

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56 Ex. J14.

57 Ex. J12, at 2.

58 Ex. J12, at 2.

59 "Z" tapes "contain the entire history of all transactions entered on" a particular point-of-sale machine. Internal Revenue Service, *Bars and Restaurants Audit Technique Guide* 2-5 (Nov. 2002). Although produced to the auditor, Z-tapes from the audit period are not part of our record.

60 Ex. J12, at 3.

61 Tr. 130.

36. Conga produced no records for tax year 2007. [62] According to the bar manager, Conga changed accounting firms after the 2007 tax year and did not get the 2007 records from its former accountant.[63]

37. During the auditor's initial review of Conga's records on August 20, 2009, she "did not really find any sales tax issues." [64] But she acknowledged that she "probably [did] not have complete records." [65] The auditor also noted that in 2005 and earlier, the business advertised live entertainment and cover charges.[66]

38. On August 27, 2009, the auditor compared total liquor purchases as shown by the invoices produced by Conga to purchases reported directly to the Department of Revenue by Conga's liquor suppliers.[67] One of Conga's suppliers, Quality Wine, reported sales to Conga totaling $52,906, but Conga's invoices from Quality Wine totaled $55,578.71. [68]

39. On September 10, 2009, the auditor compared Conga's bank deposits with its total revenues as reported on its 2008 federal income tax return.[69]

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62 Ex. J12, at 3.

63 Ex. J12, at 3.

64 Ex. J12, at 3.

65 Ex. J12, at 3.

66 Ex. J12, at 3.

67 Ex. J12, at 3.

68 Ex. J12, at 3.

69 Ex. J12, at 3; *compare* Ex. J10 *with* Ex. J45.

40. According to the auditor's calculations, Conga's bank deposits during 2008 totaled $1,028,262.84. [70] Its total revenues as reported on its 2008 federal income tax return were $741,848,[71] a difference of $286,414.84.

41. At some point, the auditor adjusted Conga's bank deposits for "non-sale" revenues.[72] After adjustment, Conga's total deposits exceeded its reported sales by $61,913.12. [73] Even after these adjustments, the corporation's bank deposits varied from its sales as reported on its sales and use tax returns. In some months, the corporation deposited thousands of dollars more than its reported sales, and in some months thousands of dollars less.[74]

42. According to Conga's 2008 federal income tax return, loans from shareholders increased during 2008 by $76,267. [75]

43. On September 10, 2009, the auditor also compared "the income tax and sales tax filings"; according to the auditor, "the numbers didn't match." [76]

44. Total sales for 2008 as reported on Conga's federal income tax return were $741,848.[77] Total sales for 2008 as reported on Conga's sales and use tax returns

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70 *See* Ex. J10.

71 Ex. J45, at 1.

72 *See* Ex. J10. The details of these adjustments are not part of the record before us.

73 *See* Ex. J10.

74 *See* Ex. J10.

75 Ex. J45, at Sch. L ($339,243 less $262,976).

76 Ex. J12, at 3.

77 Ex. J45, at 1.

were $735,515.[78] The difference between the two totals is $6,333, or less than one percent of reported sales.

45. Total sales for 2009 as reported on Conga's federal income tax return were $702,150.[79] Total sales for 2009 as reported on Conga's sales and use tax returns were also $702,150.[80]

46. On September 10, 2009, the auditor concluded that the audit was "looking like it will go to an indirect reconstruction of the sales." [81]

47. On September 10, 2009, the bar manager explained to the auditor that the business did not impose a cover charge, but sometimes charged $5 at the door for a ticket that could be exchanged for food.[82]

48. On September 16, 2009, the auditor "randomly selected" the month of November 2008 for further review.[83] She compared the daily sales reports to the monthly summary, and then traced the monthly summary to the corporation's sales tax filings.[84] The auditor noted that total sales reported to the Department matched total sales as reported on the

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78 *See* Ex. J18; *see also* Ex. J2, Sch. A, pt. 2.

79 Ex. J46, at 1.

80 *See* Ex. J19.

81 Ex. J12, at 3.

82 Ex. J12, at 4.

83 Ex. J12, at 4.

84 Ex. J12, at 4.

monthly summary generated by the business's Micro 3700 point-of-sale system.[85] In addition, the auditor noted that total taxes collected from customers, as reported by the bistro's point-of-sale system, were less than those calculated on the sales reported by the corporation to the Department.[86]

49. The auditor's review of the records for November 2008 left her with several questions: whether amounts reported on the monthly summary generated by the Micro 3700 cash register as "prep instructions" were taxable; whether amounts reported as "non-rev svc chg" were mandatory gratuities; whether amounts reported under "house account" and "management comp" were "liquor subject to use taxes"; and whether there were any cover charges for the month.[87]

50. On September 17, 2009, the auditor and David Luttrell of the Department met with Mr. Thunstrom and his manager.[88]

51. During the September 17 meeting, the auditor presented Mr. Thunstrom with a detailed questionnaire about the operation of the bar, requesting such information as drink prices, the percentage of drinks sold during happy hour, percentage of sales during happy hour by drink size, and the percentage of liquor sales (both rail and call drinks) "by pricing tier." [89]

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85 Ex. J12, at 4.

86 Ex. J12, at 4.

87 Ex. J12, at 4.

88 Ex. J12, at 4.

89 Ex. J15.

52. The questionnaire asked about Conga's then-current operations, and did not solicit any information about drink prices (or anything else) during 2007, 2008, or the first eight months of 2009.[90]

53. The auditor completed the bar audit questionnaire using information supplied by Mr. Thunstrom, and Mr. Thunstrom signed and dated the questionnnaire.[91] The auditor did not provide the questionnaire to Mr. Thunstrom before the September 17 meeting.[92]

54. Neither the auditor nor Mr. Luttrell informed Mr. Thunstrom of the use to which the information on the bar audit questionnaire would be put.[93] In addition, because the previous audits of Conga had been direct, rather than indirect, audits, Mr. Thunstrom had not previously completed a bar audit questionnaire.

55. According to the bar audit questionnaire signed by Mr. Thunstrom, bartenders at Conga were using a 3-count "free pour" of liquor in September 2009, resulting in a pour size of 1.5 ounces.[94]

56. According to the bar audit questionnaire, as of September 2009, 30% of beer sales then occurred during happy hours (Monday through Friday from 5 to 7 pm).[95] On weekends, the

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90 Ex. J15.

91 Ex. J12, at 4; *see* Ex. J15; Tr. 36 (testifying that the auditor wrote the answers on the questionnaire).

92 *See* Ex. J12.

93 *See* Ex. J12.

94 Ex. J15, at 1.

95 Ex. J15, at 1.

bar was offering 2-for-1 drinks and half-price appetizers.[96] Beer was sold in September 2009 in 14 ounce mugs for $4 per domestic tap and $4.50 per foreign tap, or by the bottle at a price of $4 for domestic beers and $5 for foreign beers.[97] Red wine was sold in September 2009 in 6.5 ounce glasses, white wine in 8 ounce glasses, for $5.50 per glass ($7 for "tier 2" wines).[98] Rail drinks were priced in September 2009 at $5 each, call drinks at $5.50 each.[99]

57. The auditor told Mr. Thunstrom she had not yet decided whether the audit would be performed by reconstructing sales, but if she so decided, she "would be contacting the liquor distributors to get more information." [100]

58. As of September 17, 2009, the auditor had already obtained information from some of Conga's liquor distributors through the Department's database.[101]

59. The auditor did not attempt during the September 17, 2009 meeting to clarify any of her questions about the November 2008 reports.[102]

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96 Ex. J15, at 1.

97 Ex. J15, at 2.

98 Ex. J15, at 2.

99 Ex. J15, at 2.

100 Ex. J12, at 3-4.

101 Ex. J12, at 3-4.

102 *See* Ex. J12, at 6 (indicating that the auditor treated amounts reported as "Non-Rev Svc Chg" as "mandatory gratuity," and further indicating that the auditor still did not know how to treat amounts reported as "Merchandise" and "Prep Instructions"); *compare with* Ex. J15.

60. The auditor did not ask Mr. Thunstrom during the September 17, 2009 meeting to explain why the corporation's sales tax returns for February 2008, December 2008, or January 2009 were late-filed. [103]

61. The auditor did not ask Mr. Thunstrom during the September 17, 2009 meeting to explain the business's internal controls.[104]

62. The auditor did not ask Mr. Thunstrom during the September 17, 2009 meeting to explain the differences between the corporation's reported revenues and its bank deposits. [105]

63. The auditor did not ask Mr. Thunstrom during the September 17, 2009 meeting to explain the differences between figures appearing on the corporation's federal income tax returns and its sales and use tax returns.[106]

64. The auditor did not ask Mr. Thunstrom during the September 17, 2009 meeting to explain the apparent discrepancy between liquor purchases as reported by Conga's suppliers to the Department of Revenue and the invoices for liquor purchases provided by Conga during the audit.[107]

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103 *See* Ex. J12.

104 *See* Ex. J12.

105 *See* Ex. J12.

106 *See* Ex. J12.

107 *See* Ex. J12.

65. The auditor had no further conversations with Mr. Thunstrom between September 17, 2009, and February 16, 2010, when she presented him with her preliminary audit report.[108]

66. By no later than September 17, 2009, the auditor had decided to conduct an indirect audit of Conga's sales for the period January 1, 2007, through March 31, 2010. [109]

67. As of September 17, 2009, the auditor's only examination of the internal controls of the business was her anonymous visit to the business for lunch on July 17, 2009.[110]

68. The auditor's decision to conduct an indirect audit of Conga for the period January 1, 2007, through March 31, 2010, was based on the following factors: (1) that Conga had been audited in the past; (2) that Conga had filed its sales and use tax returns late on five occasions; (3) that Conga had not filed returns of use tax, entertainment tax, or liquor gross receipt tax; (4) that Conga had no records for 2007; (5) that Conga's books reported $2,672.71 more in liquor purchases from one supplier than the supplier had reported to the Minnesota Department of Revenue; (6) that Conga's 2008 income tax and sales tax filings did not match; and (7) that the auditor did not understand certain entries in Conga's point-of-sales system.[111]

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108 *See* Ex. J12.

109 *See* Ex. J12.

110 *See* Ex. J12.

111 *See* Ex. J12, at 1-4.

69. By no later than September 17, 2009, the auditor knew that cover charges were not recorded in the Micro 3700 cash register system, but were "tracked separately." [112]

70. The auditor was mistaken that Conga had not filed returns of liquor gross receipts taxes.

71. The auditor selected 2008 as the sample year of the indirect audit, a decision that Conga does not challenge.[113]

72. On October 14, 2009, the auditor sent letters to Conga's liquor distributors requesting information about Conga's purchases of liquor, beer, and wine.[114] A schedule showing Conga's alcohol purchases during the period in question was introduced as Exhibit J3.[115]

**Service charges**

73. Conga introduced no evidence disputing the Commissioner's assessment of tax on $1,274 of service charges shown on Conga's point-of-sale records in 2008.[116]

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112 *See* Ex. J12, at 6 (noting on December 28, 2009, the auditor's "understanding that these sales are tracked separately and are not included in the Micros report"); *but see* Ex. J12, at 4-6 (noting no further contact between the auditor and anyone associated with Conga between September 17 and December 28).

113 Stip. ¶ 19.

114 Ex. J12, at 5.

115 Tr. 11 (stipulating that Exhibit J3 is accurate).

116 *See* Ex. J18.

**Cover charges**

74. During 2008, a Conga employee collected cover charges at the door and turned them over to the bar manager at the end of the night.[117] The bar manager accurately recorded in a log the amount of cash received and the number of customers.[118] The log of cover charges was not produced to the Department during the audit.

75. Exhibit J21 is an accurate and contemporaneous record of the number of customers in the establishment during 2008, as well as the amount of cover charges collected during 2008.

76. The auditor assumed that Conga collected service charges on both Friday and Saturday nights throughout 2008, 52 Fridays and 52 Saturdays in all.[119]

77. On Saturday nights, Conga did not charge a cover charge until midnight.[120] Nor was there a cover charge on April 4, April 18, May 30, August 1, October 31, or December 26, 2008.[121]

78. The auditor further assumed there were 100 customers in the establishment on Friday nights in 2008 and 200 customers on Saturday nights, evenly divided between men (assumed to have paid a cover charge each night) and women (assumed to have paid a cover charge only on Saturday nights).[122]

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117 Tr. 395.

118 Ex. J21.

119 Ex. J9 (Worksheet 2).

120 Ex. J49.

121 Ex. J21; Tr. 394-95.

122 Ex. J9.

79. Conga's regular customers never paid a cover charge, nor did customers of the restaurant or the banquet rooms.[123]

80. The auditor overestimated the number of customers in the establishment on any given weekend night and the number of nights on which cover charges were collected. As a result, the Commissioner's Order overstates the amount of cover charges collected during 2008.

81. Total cover charges collected were $45,500 in 2007; $49,702 in 2008; $32,270 in 2009; and $6,560 in the first three months of 2010.[124]

82. Conga included cover charges in its sales and use tax returns in 2008, 2009, and 2010.[125] In 2008, 2009, and 2010, Conga sometimes treated cover charges as food purchases subject to sales tax, rather than as alcohol sales subject to liquor gross receipts tax, regardless of whether at the time collected they could be used to purchase alcohol.[126]

83. Conga did not report or pay taxes on cover charges collected during 2007.

**2008 revenues from liquor sales**

84. The auditor calculated that Conga purchased 143,711 ounces of liquor during 2008.[127]

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123 Tr. 181.

124 Exs. J18, J19, J20. For 2007, in the absence of evidence to the contrary, we use the Commissioner's figure of $45,500.

125 Exs. J18, J19, J20.

126 See. Exs. J18, J19, J20.

127 Ex. J5.

85. The auditor misclassified several brands of wine purchased by Conga in 2008 (Ecco Domani Pinot Grigio Collezioni, Ecco Domani Pinot Grigio, Diseno Malbec, and Manyana Tempranillo) as liquor.[128] As a result, the Commissioner's Order overstates liquor purchases, and understates wine purchases, by 3,643.2 ounces.

86. The auditor wrongly included in liquor purchases 2,822.4 ounces of certain liqueurs (Chambord, Cointreau, Dek Curaçao Blue, and Midori Melon) that are used exclusively as mixers.[129] As a result, the Commissioner's Order overstates by another 2,822.4 ounces the amount of liquor available for sale and subject to liquor tax.

87. Conga's 2008 liquor purchases totaled 137,245.4 ounces.

88. From July to December 2008, customers who paid a cover charge could choose between a drink or food.[130]

89. Cover charges were not in effect every Friday and Saturday night in 2008. There was no cover charge until midnight on Saturday nights from January to June.[131] There was no cover charge on April 14 or 18, or on May 30, July 11 or 25, August 1 or 15, October 31, or December 26, 2008.[132]

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128 *See* Ex. J3.

129 *See* Ex. J3 (purchase detail); Ex. J5; Tr. 477-78 (Mr. Luttrell testifying that the Department of Revenue excludes those that are "exclusively mixes," namely, that always "would be served with some other sort of alcohol"); Ex. J3 (list of liquor purchases).

130 Ex. J49.

131 Ex. J49.

132 Ex. J21.

90. The auditor assumed there were 290 customers on the premises over the course of each and every Friday and Saturday night in 2008 (30,160 customers in all), each of whom received a free drink or appetizer.[133] A total of only 5,353 customers paid cover charges on Friday or Saturday nights between July and December 2008.[134]

91. Half of those customers, or 2,676 customers, chose a drink.

92. Conga advertised free drinks only on Monday nights (well drinks and margaritas), only for women, and only from January to August 2008.[135] One percent of liquor purchased in 2008 (1,372.5 ounces) was so used.

93. Ten percent (10%) of liquor purchased during 2008 was lost to spillage.

94. Conga sold 122,148 ounces of liquor during 2008.

95. Considering the popularity of mixed drinks such as Long Island iced teas (and its variations) with Conga's customers, Conga's average pour size for liquor was 2.0 ounces.

96. Seventy percent of Conga's liquor purchases (after reductions for spillage) were sold in rail or well drinks and 30% in premium or call drinks. The regular price of a rail drink was $5.00. The regular price of a call or premium drink was $5.50 and the promotional price was $2.75.

97. Conga heavily advertised liquor and mixed drinks at discounts of more than 50% during 2008, offering promotions on liquor of one kind or another on every night but Thursdays. During 2008, Conga regularly advertised well drinks and margaritas for $1 or $2, tequila for $1,

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133 Ex. J9.

134 Ex. J21.

135 Ex. J49.

discounted shots, and other unspecified drink specials.[136] Considering the many promotions and specials offered, the average promotional price of a rail or well drink was $1.75.

98. Seventy percent of all liquor sales were made at promotional prices during 2008. By limiting herself to a specific "happy hour" and failing to consider promotions at other times of operation,[137] the Commissioner underestimated the amount of time during which liquor was sold at a discount. As a result, the Commissioner's Order overstates revenues from liquor sales.

99. During 2008, liquor sales totaled $182,001. Conga reported 2008 liquor sales of $176,546.[138]

**2008 wine sales**

100. The auditor assumed that Conga purchased 35,556 ounces of wine during 2008.[139] The auditor misclassified certain purchases of wine as liquor;[140] as a result, the Commissioner's Order understates wine purchases by 3,643 ounces. Conga purchased 1,415 bottles (39,199 ounces) of wine during 2008.[141]

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136 Ex. J49.

137 *See* Ex. J6, J15.

138 *See* Ex. J18. In making this calculation, we noted small discrepancies between alcohol sales as reported by Conga's point-of-sale system and alcohol sales as reported in Conga's sales and use tax reports. For example, in June 2008 Conga's point-of-sale system reported total alcohol sales of $28,017.83, but Conga reported sales subject to liquor gross receipts tax of $31,868. Ex. J18. The state's sales and use tax reporting system does not require taxpayers to distinguish among various types of alcohol sold (beer, liquor, wine). We have generally credited those differences to liquor sales, rather than to beer or wine sales.

139 Ex. J6.

140 *See* Ex. J3.

141 *See* Ex. J3.

101. The auditor assumed that Conga's wine purchases were evenly divided between red and white wines.[142] During 2008, Conga's red wine purchases totaled 23,911 ounces, or 61% of wine purchases, and white wine purchases totaled 15,288 ounces.[143] As a result, the Commissioner's Order further misstates revenues from wine sales.

102. The auditor assumed that all wine was sold by the glass and did not even inquire about sales of wine by the bottle.[144] Conga advertised half-priced bottles of wine on Tuesday nights during the latter half of 2008.[145] Seventy percent of Conga's wine purchases (990 bottles during 2008) were sold by the bottle at an average price of $20 per bottle. As a result, the Commissioner's Order misstates revenues from wine sales.

103. Conga used a pour size of 6.5 ounces for red wines and 8 ounces for white wine.[146] Considering the percentage of red and white wine sold, Conga's average pour size was about 7 ounces.

104. The per-glass price of tier 1 wines (both red and white) was $5.50; the per-glass price of tier 2 wines (both red and white) was $7.00.[147] Conga's wine sales were evenly divided

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142 Ex. J6.

143 *See* Ex. J3.

144 Ex. J6; *see* Ex. J12, J15.

145 Ex. J49.

146 Ex. J6; Ex. J15.

147 Ex. J6.

between tier 1 and tier 2 wines,[148] resulting in an average sales price per ounce of about $1.78.[149] The auditor assumed that wine sold by the glass was discounted by half during happy hour and that half of all wine sold by the glass was sold during happy hour.[150] Wine sold by the glass was not discounted during the audit period.[151] As a result, the Commissioner's Order further misstates revenues from wine sales.

105. Of Conga's wine purchases, 14,152 ounces were available to be sold by the glass. Half of those purchases were lost to spillage or went bad before they could be sold. Conga gave away no wine during 2008.

106. Conga reported $14,158 in revenues from wine sales during 2008.[152] The Commissioner assumed Conga's revenues from wine sales during 2008 were $18,769.88.[153] Conga's revenues from wine sales during 2008 totaled $32,413.

**2008 revenues from bottled beer sales**

107. During 2008, Conga purchased 7,296 bottles of "regular" or domestic beer (8.28% of total purchases), and 80,784 bottles of premium beer (91.72% of total purchases).[154]

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148 Ex. J6.

149 Ex. J6.

150 Ex. J6.

151 *See* Ex. J49.

152 Ex. J6.

153 Ex. J6.

154 Ex. J4. Conga purchased beer in kegs and bottles, but not in cans.

108. The auditor assumed that 70% of all beer sales occurred at promotional prices of $2.00 for regular beer and $2.50 for premium beer.[155] Of Conga's 2008 purchases of bottled beer, more than 61% (58,728 bottles) were Corona, a premium beer that Conga heavily advertised at the discounted price of $2.00 per bottle.[156] Virtually all Corona sales were at a price of $2.00 per bottle.

109. Considering Conga's heavily advertised specials, the average price of a bottle of domestic beer was $2.00 and the average price of a bottle of "other" premium beer was $3.25. The Commissioner's Order misstates revenues from sales of bottled beer.

110. Ten percent of bottled beer purchased during 2008 was lost to breakage.

111. Conga generated $183,610 from the sale of bottled beer during 2008.

**Estimate of 2008 revenues from tap beer sales**

112. The auditor assumed that sales of tap beer generated $15,424.60 in revenues in 2008.[157]

113. The auditor assumed all tap beer was sold in 14-ounce glasses at a regular price of $4.00 for domestic beers ($2.00 when discounted) and $4.50 for premium beers ($2.25 when discounted).[158] The auditor further assumed that 70% of all tap beer was sold at promotional prices.[159]

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155 Ex. J4.

156 Ex. J3; Ex. J49.

157 Ex. J56.

158 Ex. J56.

159 Ex. J56.

114. The auditor allowed 15% for spillage and another 6.38% for giveaways to customers on Friday and Saturday nights.[160]

115. Tap beer was not given away during 2008.[161]

116. Conga failed to overcome the prima facie validity of the auditor's assumed 15% spillage rate.

117. During 2008, Conga generated $15,424.60 from the sale of tap beer.

118. During 2008, Conga reported total beer sales (bottled and tap) of $86,663.[162]

**Estimate of total revenues from the 2008 sale of alcohol, cover charges, and service charges**

119. In all, the Commissioner assumed that Conga's sales of beer, wine, and liquor generated a total of $475,706.80 in before-tax revenues during 2008.[163] The Commissioner therefore assumed that Conga failed to report $45,500 in cover charges; $198,344 in alcohol sales;[164] and $1,274 in service charges during 2008.[165]

120. The Commissioner compared assumed alcohol sales of $475,706.80 to sales reported by Conga in 2008, and determined that Conga had under-reported $198,344.80 in alcohol

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160 Ex. J56.

161 *See* Ex. J49.

162 Ex. J18

163 Ex. J7.

164 Ex. J7.

165 Ex. J2, at Sch. A, pt.1.

sales during 2008.[166] The Commissioner's Order overstates the amount of revenue generated by the sale of alcohol during 2008.

121. The Commissioner assumed that Conga owed Minnesota, Hennepin County, Minneapolis, and transit sales taxes on unreported alcohol sales, cover charges, and service charges totaling $245,118.80.[167]

122. The Commissioner assumed that Conga owed liquor gross receipts sales tax on $198,344.76 of unreported 2008 alcohol sales.[168]

**Estimate of unpaid Minneapolis entertainment tax**

123. Conga offered live entertainment during 3% of the hours that Conga was open for business.[169]

124. Conga paid no entertainment tax during the audit period.[170]

125. The Commissioner added her estimate of Conga's unreported 2008 sales to 2008 sales as reported by Conga to determine Conga's total 2008 sales, and multiplied the resulting sum by 3% (her calculation of the percentage of business hours during which the business offered live

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166 Ex. J7.

167 Ex. J2, at Sch. A, pt. 1 (general sales tax); Ex. J2, at Sch. E, pt. 1 (Hennepin County sales tax); Ex. J2, at Sch. G, pt. 1 (Minneapolis sales tax); Ex. J2, at Sch. I, pt. 1 (transit improvement sales tax).

168 Ex. J2, at Sch. B, p. 1 (liquor gross receipts tax).

169 Ex. J49 (advertising live entertainment on Sunday, Monday, Thursday, Friday, and Saturday nights); see Ex. J2, at Sch. K (the auditor applying a 3% apportionment factor).

170 See Exs. J18, J19, J20.

entertainment).[171] The Commissioner's estimate of Conga's total 2008 sales (reported and unreported) was $933,859.76, of which she assumed $28,015.77 occurred during hours when live entertainment was offered.[172] Multiplied by the entertainment tax rate of 3%, the Commissioner assumed that Conga owed Minneapolis entertainment tax of $840.53 for 2008.[173]

**Estimate of unpaid Minnesota, Hennepin County, Minneapolis, and transit improvement use taxes**

126. The Commissioner determined that during 2008, Conga made $204,713.01 in purchases of goods (excluding alcohol) as to which no sales taxes were paid.[174] The Commissioner assumed no sales taxes were paid if she did not "recognize the vendor" or if she "could not tell the purchase of [sic, likely "reason for"] the payment."[175]

127. The Commissioner included portions of payments to credit card companies (including U.S. Bank, Bank of America, Chase Card Services) in her calculation of purchases for which no sales taxes were paid.[176]

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171 Ex. J2, at Sch. K, pt. 1.

172 Ex. J2, at Sch. K, pt. 1.

173 Ex. J2, at Sch. K, pt. 1.

174 Ex. J2, at Sch. C, pt. 1 (Minnesota use tax); Ex. J2, at Sch. F, pt. 1 (Hennepin County use tax); Ex. J2, at Sch. H, pt. 1 (Minneapolis use tax); Ex. J2, at Sch. J, pt. 1 (transit improvement use tax).

175 Ex. J12, at 12.

176 Ex. J2, at Sch. C, pt. 1 (Minnesota use tax); Ex. J2, at Sch. F, pt. 1 (Hennepin County use tax); Ex. J2, at Sch. H, pt. 1 (Minneapolis use tax); Ex. J2, at Sch. J, pt. 1 (transit improvement tax).

128. During the audit, the Commissioner reduced the amount of 2008 non-alcohol purchases on which use tax was to be assessed from $204,713.01 to $72,113.50.[177]

129. The correct amount of sales tax was paid with respect to all but $25,812.96 of (non-alcohol) goods purchased during 2008.

130. The Commissioner assumed that Conga gave away $14,015.68 in alcohol during 2008, or about 5% of total reported alcohol sales.[178]

131. Total alcohol giveaways during 2008 were 1% of liquor purchases, or $8,283.00.[179] No beer or wine was given away during 2008.

**Extrapolation from 2008 to other years**

132. In all, the Commissioner assumed that Conga failed to report $45,500.04 in cover charges; $198,344.76 in alcohol sales; and $1,274 in service charges during 2008.[180]

133. By comparing her calculation of total unreported revenues ($245,118.80) to Conga's reported revenues for 2008 ($735,515), the Commissioner determined that Conga had under-reported 33.326% of its total revenues in 2008.[181]

134. The Commissioner applied the under-reporting factor of 33.326% to sales revenues reported by Conga to the Department of Revenue during calendar years 2007, 2009, and first quarter 2010 to determine that Conga under-reported revenues for the entire audit period

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177 Ex. J57 (second amended Sch. C, part 1).

178 In the absence of a specific breakdown of the cost of liquor purchases, we rely on Ex. J8, Worksheet C1, showing total 2008 purchases of liquor and wine of $82,829.72.

179 *See* Ex. J8 (Worksheet C1).

180 Ex. J2, at Sch. A, pt. 1.

181 Ex. J2, at Sch. A, pt. 2.

(January 1, 2007, to March 31, 2010) totaling $814,650.66, on which $1,221.96 in county sales tax, $4,073.24 in Minneapolis sales tax, and $1,046.74 in transit improvement sales tax were due.[182]

135. To estimate Minneapolis entertainment tax for the balance of the audit period, the Commissioner compared her estimate of revenues generated during live entertainment ($28,015.77) to her estimate of reported 2008 revenues generated during live entertainment ($22,065.45), and determined that reported revenues generated during live entertainment should be increased by a factor of 1.26966683.[183]

136. The Commissioner then multiplied her estimate of revenues generated during live entertainment (3% of revenues) by a factor of 1.26966683 to determine that Conga generated a total of $93,110.21 in revenues during live entertainment during the entire audit period.[184] At a tax rate of 3%, the total assessment for entertainment tax for the audit period was $2,793.41.[185]

137. To estimate unpaid use tax, the Commissioner assumed that Conga purchased goods totaling $204,712.81 (excluding alcohol) each year during the audit period on which it paid no sales tax.[186] Total purchases for the audit period (excluding alcohol) were therefore assumed

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182 Ex. J2, at Sch. A, pt.3; Ex. J2, at Sch. E, pt. 3; Ex. J2, at Sch. G, pt. 3; Ex. J2, at Sch. I, pt. 3.

183 Ex. J2, at Sch. K, pt. 2.

184 Ex. J2, at Sch. K, pt. 3.

185 Ex. J2, at Sch. K, pt. 3.

186 *See* Ex. J2, at Sch. C, pt. 3 (Minnesota use tax); Ex. J2, at Sch. F, pt. 3 (Hennepin County use tax); Ex. J2, at Sch. H, pt. 3 (Minneapolis use tax); Ex. J2, at Sch. J, pt. 1 (transit improvement use tax).

to be $710,868.18, on which the Commissioner calculated that Conga owed Minnesota use tax totaling $46,206.47, Hennepin County use tax totaling $1,066.28, Minneapolis use tax totaling $3,554.48, and transit improvement use tax of $926.51 for the audit period.[187]

**The Commissioner's Order and Conga's appeal to the tax court**

138. The auditor met with Mr. Thunstrom and his bar manager on February 16, 2010, to review the preliminary results of the audit.[188] During this meeting, Mr. Thunstrom and his manager gave inconsistent explanations of the accounting treatment of ticket sales.[189]

139. During the February 16, 2010 meeting, the auditor suggested ways for the business to track spillage and the amount of wine used in the kitchen.[190] The auditor also asked for credit card statements with respect to the assessment of use tax.[191]

140. Conga provided no further information to the auditor and on June 7, 2010, the auditor closed the audit.[192]

141. By order dated June 11, 2010, the Commissioner assessed Conga $131,976.61 in additional sales, use, liquor gross receipts, and entertainment taxes, plus penalty and interest.[193]

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187 Ex. J2, at Sch. C, pt. 3; Ex. J2, at Sch. F, pt. 3; Ex. J2, at Sch. H, pt. 3; Ex. J2, at Sch. J, pt. 3.

188 *See* Ex. J12, at 8-9.

189 Ex. J12, at 9.

190 Ex. J12, at 8.

191 Ex. J12, at 9.

192 Ex. J12, at 13-14.

193 Ex. J2, at 3.

Taxes assessed for calendar year 2007 totaled $42,678.53.[194] Negligence penalties for calendar year 2007 totaled $4,267.85 (additional tax assessed ($42,678.53), multiplied by 10%).[195]

142. The auditor left the Department of Revenue in the summer of 2012, before the trial of this matter.[196]

143. Conga timely appealed the Commissioner's June 11, 2010 order to this court.[197]

## CONCLUSIONS OF LAW

1. Appellant Conga Corporation presented sufficient evidence to overcome the prima facie validity of the Commissioner's assessments for tax years 2008, 2009, and the first quarter of 2010.

2. By amending Schedule C before trial, the Commissioner conceded the prima facie validity of her assessments of Minnesota, Hennepin County, Minneapolis, and transit improvement use tax for the audit period, including tax year 2007.

3. The Commissioner's Order overstates Conga's liability for general Minnesota sales tax.

4. The Commissioner's Order overstates Conga's liability for liquor gross receipts sales tax.

5. The Commissioner's Order overstates Conga's liability for Minnesota use tax.

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194 *See* Ex. J2, at Ex. 1.

195 Ex. J2, at Ex. 1; *see* Minn. Stat. § 289A.60, subd. 5 (providing a 10% penalty for "negligence or intentional disregard of the applicable tax laws or rules of the commissioner").

196 Tr. 18.

197 Ex. J1.

6. The Commissioner's Order overstates Conga's liability for Minnesota liquor gross receipts use tax.

7. The Commissioner's Order overstates Conga's liability for Hennepin County sales tax.

8. The Commissioner's Order overstates Conga's liability for Hennepin County use tax.

9. The Commissioner's Order overstates Conga's liability for Minneapolis sales tax.

10. The Commissioner's Order overstates Conga's liability for Minneapolis use tax.

11. The Commissioner's Order overstates Conga's liability for transit improvement sales tax.

12. The Commissioner's Order overstates Conga's liability for transit improvement use tax.

13. The Commissioner's Order overstates Conga's liability for Minneapolis entertainment tax.

14. The Commissioner properly imposed negligence and late-filing penalties.

**ORDER**

1. Schedule A of the Commissioner's Order is affirmed as modified to reflect unreported alcohol sales and service charges of $320,758 in 2007; $136,905 in 2008; $100,872 in 2009; and $24,902 in first quarter 2010 subject to general Minnesota sales tax.

2. Schedule B of the Commissioner's Order is affirmed as modified to reflect unreported alcohol sales of $273,984 in 2007; $135,631 in 2008; $99,598 in 2009; and $23,628 in first quarter 2010 subject to liquor gross receipts tax.

3. Schedule C of the Commissioner's Order is affirmed as modified to reflect purchases and alcohol giveaways of $86,129 in 2007; $34,096 in 2008; $34,096 in 2009; and $8,524 in first quarter 2010 subject to Minnesota use tax.

4. Schedule D of the Commissioner's Order is affirmed as modified to reflect alcohol giveaways of $14,016 in 2007; $8,238 in 2008; $8,283 in 2009; and $2,071 in first quarter 2010 subject to Minnesota liquor gross receipts use tax.

5. Schedule E of the Commissioner's Order is affirmed as modified to reflect unreported alcohol sales and service charges of $320,758 in 2007; $136,905 in 2008; $100,872 in 2009; and $24,902 in first quarter 2010 subject to Hennepin County sales tax.

6. Schedule F of the Commissioner's Order is affirmed as modified to reflect purchases and alcohol giveaways of $86,129 in 2007; $34,096 in 2008; $34,096 in 2009; and $8,524 in first quarter 2010 subject to Hennepin County use tax.

7. Schedule G of the Commissioner's Order is affirmed as modified to reflect unreported alcohol sales and service charges of $320,758 in 2007; $136,905 in 2008; $100,872 in 2009; and $24,902 in first quarter 2010 subject to Minneapolis sales tax.

8. Schedule H of the Commissioner's Order is affirmed as modified to reflect purchases of goods and alcohol giveaways of $86,129 in 2007; $34,096 in 2008; $34,096 in 2009; and $8,524 in first quarter 2010 subject to Minneapolis use tax.

9. Schedule I of the Commissioner's Order is affirmed as modified to reflect unreported alcohol sales and service charges of $68,453 in 2008 (July through December); $100,872 in 2009; and $24,902 in first quarter 2010 subject to transit improvement sales tax.

10. Schedule J of the Commissioner's Order is affirmed as modified to reflect purchases of goods and alcohol giveaways of $8,726 in 2008 (July through December); $34,096 in 2009; and $8,524 in first quarter 2010 subject to transit improvement use tax.

11. Schedule K of the Commissioner's Order is affirmed as modified to reflect sales of food and alcohol in the amount of $1,096,112 in 2007; $872,420 in 2008; $834,018 in 2009; and $141,867 in first quarter 2010 subject to Minneapolis entertainment tax.

12. The Commissioner shall re-compute Conga's total liability, including tax, penalty, and interest, consistent with this order, and shall file and serve the re-computation no later than February 22, 2017.

13. No later than ten days after service of the Commissioner's re-computation, Conga may file and serve objections, if any, that address only the consistency of the Commissioner's re-computation with this order.

14. If Conga files no objection to the Commissioner's re-computation, the court will promptly file a final order for judgment. If Conga does file objections, the court will determine the appropriate re-computation and then file a final order for judgment. Post-trial motions, if any, may be filed and served only after the court files its final order.

IT IS SO ORDERED.

BY THE COURT:

Joanne H. Turner, Chief Judge
MINNESOTA TAX COURT

DATED: January 30, 2017

## MEMORANDUM

At issue in this case is the Commissioner's assessment of additional sales, use, and entertainment tax for the period January 1, 2007, through March 31, 2010, against Conga Corporation, which operates the Conga Latin Bistro nightclub and restaurant in Minneapolis.

Arsenio Thunstrom, Conga Corporation's sole shareholder and president, opened Conga Latin Bistro with his then-wife in December 2000.[198] Although Mr. Thunstrom is an experienced restaurant operator, Conga Corporation did not initially file sales and use tax returns or pay sales and use tax.[199] In 2002, the corporation was audited by the Minnesota Department of Revenue for the period January 1, 2000, through September 30, 2002, resulting in an assessment of $129,877.05 in taxes, penalties, and interest.[200]

In 2003, Mr. Thunstrom and his wife divorced.[201] Mr. Thunstrom returned to the Dominican Republic, leaving his parents to run the business.[202] Mr. Thunstrom's parents did not file or pay sales and use tax for the period during which they operated the business.[203] The business was then sold to another relative, who also did not file or pay sales and use tax.[204] From the record

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198 Tr. 172, 174, 252; Stip. ¶¶ 3, 5 (filed June 10, 2013).

199 *See* Tr. 253, Stip. ¶ 25.

200 Stip. ¶ 25; Ex. J38.

201 Tr. 254.

202 Tr. 255-56.

203 Tr. 255.

204 Tr. 256; *see* Ex. J42 at 2.

before us, though, it appears that the corporation has filed sales and use tax returns since November 2005.[205]

In 2007, Conga Corporation was audited by the Minnesota Department of Revenue for the period September 1, 2003, through December 31, 2006, resulting in assessments totaling $205,695.15 in sales and use tax, penalties, and interest.[206] Mr. Thunstrom, by then again operating the business, entered into a payment arrangement with the Department of Revenue that covered the 2002 and 2007 assessments.[207]

In February 2009, the Minnesota Department of Revenue again selected Conga for audit.[208] The 2009 audit resulted in an assessment of $160,105.37 in sales and use tax, penalties, and interest for the period January 1, 2007, through March 31, 2010.[209] Conga Corporation's appeal of the assessment is the matter before us here.

The 2009 audit was conducted indirectly, using 2008 as a "test" or "sample" year.[210] Rather than review the accounting books and records kept by Conga, the Commissioner obtained records from Conga's suppliers of the business's 2007 and 2008 liquor purchases.[211] The

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205 *See* Ex. J42 at 1.

206 Stip. ¶¶ 26-27; Exs. J41, J43.

207 *See* Tr. 257. The details of this payment arrangement are not part of the record before us.

208 Ex. J12.

209 Ex. J2 at 3. The Commissioner's assessment was reduced at trial to a total of $122,145.38 in tax, penalties, and interest to June 13, 2013. *See* Tr. 10; Ex. J57 (second amended Schedule C).

210 *See* J12, at 3.

211 Ex. J12, at 6; Exs. J50-J55.

Commissioner then projected the total revenues that those liquor purchases should theoretically have generated, making assumptions about Conga's operations.[212] The Commissioner compared the total revenues that the business should theoretically have generated under those assumptions with the sales actually reported by the business, and assessed various sales and use taxes and penalties on the difference.[213]

The Commissioner then extrapolated the 2008 results of the audit to the entire audit period (January 1, 2007, through March 31, 2010).[214] To do so, the Commissioner compared her estimate of revenues Conga theoretically generated from its 2008 alcohol purchases to Conga's reported sales and calculated the percentage of 2008 sales that were allegedly unreported to the Department of Revenue. The Commissioner then applied that percentage to Conga's reported sales in 2007, 2009, and 2010. For example, the Commissioner calculated that Conga had theoretically generated a total of $475,706.80 in liquor sales from its 2008 liquor purchases, but reported only $277,362 to the Department of Revenue, a difference of $198,344.80.[215] On that assumption, the Commissioner calculated that for every dollar of alcohol sales *reported* in 2008, another $0.715 in alcohol sales were *unreported*.[216] The Commissioner applied that percentage to Conga's reported alcohol sales across the audit period to conclude that in addition to Conga's $911,865 in alcohol sales *reported* between January 1, 2007, and March 31, 2010, there were

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212 *See* Exs. J4, J5, J6, J7, J8, J9, J12, J15.

213 *See* Ex. J2.

214 Ex. J2.

215 Ex. J7.

216 Ex. J7; *see also* Ex. J2, at Sch. B, part 2.

another $652,085.18 of alcohol sales that were *unreported.* [217] The Commissioner applied the same technique to use taxes, first calculating the amount of purchases made in 2008 as to which no sales tax was apparently paid, and applying the same figure to 2007, 2009, and first quarter 2010.[218]

By order dated June 11, 2010, the Commissioner assessed Conga Corporation $131,976.61 in additional tax; $13,979.85 in penalties; and $14,148.91 in interest, for a total assessment of $160,105.37.[219] The Commissioner's Order comprises Schedules A through K and supporting worksheets, each schedule reflecting a different type of tax:

- Schedule A assesses $53,633.41 in general Minnesota sales tax on a total of $814,650.66 of cover charges, alcohol sales, and service charges allegedly unreported to the Department of Revenue during the audit period.
- Schedule B assesses $16,302.16 in liquor tax on $652,085.18 of alcohol sales allegedly unreported to the Department of Revenue during the audit period.
- Schedule C assesses $46,206.47 in Minnesota use tax on $710,868.18 of purchases of goods made during the audit period on which allegedly no Minnesota sales tax was paid.
- Schedule D assesses $1,151.95 in liquor use tax on $46,078.30 of alcohol allegedly given away or personally consumed during the audit period.

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217 Ex. J2, at Sch. B, part 3.

218 *See* Ex. J2, at Sch. C, F, H, J.

219 Ex. J2.

- Schedule E assesses $1,221.96 in Hennepin County sales tax on $814,650.66 in alcohol sales, cover charges, and service charges allegedly unreported during the audit period.
- Schedule F assesses $1,068.28 in Hennepin County use tax on $710,868.18 of purchases of goods made during the audit period on which allegedly no Hennepin County sales tax was paid.
- Schedule G assesses $4,073.24 in Minneapolis sales tax on $814,650.66 in alcohol sales, cover charges, and service charges allegedly unreported during the audit period.
- Schedule H assesses $3,554.48 in Minneapolis use tax on $710,868.18 of purchases of goods made during the audit period on which allegedly no Minneapolis sales tax was paid.
- Schedule I assesses $1,046.74 in transit improvement sales tax on $814,650.66 in alcohol sales, cover charges, and service charges allegedly unreported during the audit period.
- Schedule J assesses $926.51 in transit improvement use tax on $710,868.18 of purchases of goods made during the audit period on which allegedly no transit improvement sales tax was paid.
- Schedule K assesses $2,793.41 in Minneapolis entertainment tax on a combined total of $93,110.21 of alcohol sales reported to the Department of Revenue during the audit period on which no entertainment tax was paid and alcohol sales allegedly unreported to the Department of Revenue during the audit period.

The schedules are supported by various worksheets:

- Worksheet A1 lists Conga's purchases of alcohol (liquor, beer, and wine) during 2008 by vendor, product, date, and quantity (but not the cost of each purchase).
- Worksheet A2 is the Commissioner's calculation of revenues Conga should theoretically have generated from sales of tap beer.
- Worksheet A3 is the Commissioner's calculation of revenues Conga should theoretically have generated from sales of bottled beer.
- Worksheet A4 is the Commissioner's calculation of revenues Conga should theoretically have generated from sales of liquor.
- Worksheet A5 is the Commissioner's calculation of revenues Conga should theoretically have generated from sales of wine.
- Worksheet A6 is a summary of the Commissioner's calculation of allegedly unreported sales of alcohol (beer, liquor, and wine) during the audit period.
- Worksheet C1 is the Commissioner's calculation of use tax owed on alcohol allegedly given away or personally consumed during the audit period.
- Worksheet 2 is the Commissioner's calculation of unreported cover charges and alcohol giveaways.

Conga timely appealed the Commissioner's assessment to our court, alleging (among other things) that the Commissioner of Revenue "erred in using an indirect reconstruction of liquor sales to determine that [Conga] failed to fully report the sales subject to sales tax." [220] We heard testimony in July 2013. After the parties filed post-trial briefs and proposed findings of fact and

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220 Not. Appeal (filed Aug. 10, 2010).

conclusions of law, we heard closing arguments. On April 24, 2014, we filed findings of fact, conclusions of law, and an order for judgment.[221] *Conga Corp. v. Comm'r of Revenue*, No. 8264 R, 2014 WL 1711795 (Minn. T.C. Apr. 24, 2014).

We first addressed Conga's contention that "[t]he Commissioner erred in using an indirect reconstruction of liquor sales to determine that [Conga] filed to fully report the sales subject to sales tax." *Id.* at *13. Finding "no specific statutory standard for our review of the decision to conduct an indirect audit," we looked to the Administrative Procedures Act, Minn. Stat. § 14.69 (2016), for the standard by which a court may reverse or modify an agency decision. *Conga*, 2014 WL 1711795, at *15. Under the Administrative Procedures Act, a court may reverse or modify an agency decision if, among other things, the decision exceeds the agency's statutory authority or jurisdiction, is unsupported by substantial evidence, or is arbitrary or capricious. Minn. Stat. § 14.69(b), (e), (f).

Because Conga had produced no books or records for tax year 2007 from which the auditor could have conducted a direct audit, we concluded that the Commissioner's use of the indirect audit method was authorized for that year, and we affirmed the Commissioner's assessment of sales tax, penalties, and interest with respect to calendar year 2007. *Conga*, 2014 WL 1711795, at *22, *26. But as to the other years, for which Conga *had* produced books and records, we concluded that the auditor's decision to conduct an indirect, rather than a direct, audit was unsupported by substantial evidence and was arbitrary and capricious. *Id.* at *22. We therefore reversed the Commissioner's assessment with respect to those years. *Id.*

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[221] *Conga Corp. v. Comm'r of Revenue*, No. 8264 R, 2014 WL 171195 (Minn. T.C. Apr. 24, 2014).

On the Commissioner's appeal, the Minnesota Supreme Court reversed our decision, concluding that we had erred in applying Minn. Stat. § 14.69 to the Commissioner's decision to conduct an indirect audit. *Conga Corp. v. Comm'r of Revenue*, 868 N.W.2d 41, 47 (Minn. 2015). Rather, the supreme court held that we should have applied the standard found in Minn. Stat. § 271.06, subd. 6 (2016), namely, *de novo*:

> The Tax Court shall hear, consider, and determine without a jury every appeal de novo. . . . All such parties shall have an opportunity to offer evidence and arguments at the hearing; provided, that the order of the commissioner or the appropriate unit of government in every case shall be prima facie valid.

*Conga*, 868 N.W.2d at 47. The supreme court proceeded to "examine whether the Commissioner's decision to use an indirect audit based on the unit volume method is supported by the record." *Id.* at *52 (citing Minn. Stat. § 271.10, subd. 1 (2016)).[222] The court concluded "that the Commissioner's decision to use an indirect audit to assess taxes was supported by the record" because the Commissioner had determined that Conga's books and records "were not adequate and complete, and were not accurate or reliable." *Conga*, 868 N.W.2d at 52. The court nevertheless agreed with us "that Conga presented substantial evidence that, if believed, could overcome the Commissioner's presumptively valid assessment order." *Id.* at 53. But the court was "unable to determine whether Conga in fact overcame that presumption." *Id.* The court therefore remanded the matter to our court "for further proceedings consistent with" its opinion. *Id.* at 54.

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[222] Minnesota Statutes § 271.10, subdivision 1 (2016), is the standard by which the supreme court reviews decisions of *this court*:

> A review of any final order of the Tax Court may be had upon certiorari by the Supreme Court upon petition of any party to the proceedings before the Tax Court. Such review may be had on the ground that the Tax Court was without jurisdiction, that the order of the Tax Court was not justified by the evidence or wat not in conformity with law, or that the Tax Court committed any other error of law.

***Scope of remand.*** On remand, a trial court must abide by the appellate court's mandate "strictly according to its terms," with no power to alter, amend, or modify the mandate. *Halverson v. Village of Deerwood*, 322 N.W.2d 761, 766 (Minn. 1982). Within the mandate, however, we have "broad discretion to determine how to proceed on remand," and "may act in any way not inconsistent with the remand instructions provided." *Janssen v. Best & Flanagan, LLP*, 704 N.W.2d 759, 763 (Minn. 2005).

Here, the supreme court provided us few specific instructions on remand. Rather, the court's opinion outlined the areas in which it concluded that we erred and remanded "for further proceedings consistent with" its opinion. *Conga*, 868 N.W.2d at 54. The court agreed with us that Conga had "presented substantial evidence that, if believed, could overcome the Commissioner's presumptively valid assessment order." *Conga*, 868 N.W.2d at 53. The court was unable, however, "to determine whether Conga in fact overcame the presumption." *Id.* First, the court concluded that our willingness to defer to the Commissioner "inhibited a proper, thorough analysis of the Commissioner's audit and the conclusions regarding Conga's total sales, revenues, deductions, and taxable income." *Id.* at 53-54. We therefore presume that the matter has been remanded to us to conduct "a proper, thorough analysis of the Commissioner's audit and the [Commissioner's] conclusions regarding Conga's total sales, revenues, deductions, and taxable income." *Id.*

Second, the court concluded that we had "improperly shifted the burden of proof to the Commissioner," in the process "fail[ing] to apply the presumption that all sales are taxable" and "fail[ing] to enforce the taxpayer's burden to prove that any additional sales were not subject to tax." *Id.* at 54. We therefore presume that the matter has been remanded to us to "presum[e] that

all sales are taxable" and "to enforce the taxpayer's burden to prove that any additional sales were not subject to tax." *Id.*

Finally, the court concluded that we "failed to independently weigh . . . conflicting evidence regarding Conga's total sales and revenues, taxable income, and total taxes owed." *Id.* We therefore presume that the matter has been remanded to us to "independently weigh" the evidence "regarding Conga's total sales and revenues, taxable income, and total taxes owed." *Id.*

But these mandates pose an immediate problem. We must follow the supreme court's mandate "strictly according to its terms." *Halverson*, 322 N.W.2d at 766. That is, we must presumably: analyze the Commissioner's "conclusions regarding Conga's total sales, *revenues, deductions, and taxable income*;" "enforce the taxpayer's burden to prove that any *additional sales* were not subject to tax;" and "independently weigh . . . the evidence regarding Conga's total sales and *revenues, taxable income*, and total taxes owed." *Conga*, 868 N.W.2d at 53-54 (emphasis added). This is an audit of *sales and use tax* returns, however, not *income tax* returns. The Commissioner did not determine Conga's non-sales "revenues," its "deductions," or its "taxable income," [223] and, as a result, Conga did not appeal such determinations to our court. Nor, beyond Conga's state and federal income tax returns, is there any evidence in our record concerning Conga's total revenues, its deductions, or its taxable income. Because Conga's total revenues, its deductions, and its taxable income were not the subject of the Department's audit, were not part of the Commissioner's order from which Conga appealed, and were not part of the decision appealed by the Commissioner to the Minnesota Supreme Court, we must consider the court's reference to them no more than dicta. We therefore respectfully decline on remand to make any

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223 *See* Ex. J2. Nor was the dispute here over whether "additional sales were not subject to tax." Indeed, there is no dispute here that any unreported sales of alcohol *are* subject to tax. Rather, the dispute here is over whether there *were* such unreported sales.

findings concerning Conga's non-sales revenues, its deductions, its taxable income, or its liability for anything but sales and use taxes.

Finally, the supreme court chided us for not making findings of fact to support our reversal of the negligence penalties. *Conga,* 868 N.W.2d at 54-55. Negligence penalties are a percentage of the assessment. Minn. Stat. § 289A.60, subd. 5 (2016). Because we reversed the Commissioner's assessment in its entirety with respect to tax years 2008, 2009, and first quarter 2010, we deemed it unnecessary to specifically address the Commissioner's assessment of negligence penalties for those years. *Conga*, 2014 WL 1711795, at *25-26. On remand, the supreme court instructs us to further consider "the issue of penalties." *Conga*, 868 N.W.2d at 54-55. We do this at the end of this decision.

## I. PRIMA FACIE VALIDITY OF THE COMMISSIONER'S ASSESSMENT

Under Minn. Stat. § 271.06, subd. 6 (2016), the Commissioner's assessment is "prima facie valid." *See also* Minn. Stat. § 270C.33, subd. 6 (2016) ("A return or assessment of tax made by the commissioner is prima facie correct and valid."). "[A] prima facie case simply means one that prevails in the absence of evidence invalidating it." *Tousignant v. St. Louis Cty.*, 615 N.W.2d 53, 59 (Minn. 2000) (quoting *Trudeau v. Sina Contracting Co.*, 241 Minn. 79, 87, 62 N.W.2d 492, 498 (1954)); *see also Conga*, 868 N.W.2d at 53 (observing that the Commissioner's order is dispositive only in the absence of evidence rebutting it). Because the Commissioner's order is presumptively valid, the taxpayer bears "the burden of doing forward with evidence to rebut or meet it." *Id.* (citing *S. Minn. Beet Sugar Coop v. Cty. of Renville*, 737 N.W.2d 545, 558 (Minn. 2007)). Our first task on remand is to determine whether Conga overcame the prima facie validity of the assessment.

In a property tax setting, the taxpayer can overcome the prima facie validity of the county's estimated market value by showing "that the county's assessed value does not reflect the true market value of the property." *S. Minn. Beet Sugar Coop,* 737 N.W.2d at 559 (internal quotation omitted). The taxpayer can do so "by, for example, presenting evidence of truly comparable sales that the county had not considered or showing that the county taxed property that is not taxable." *Id.* at 559-60. That is, the taxpayer can overcome the prima facie validity of a property tax assessment by demonstrating that, for example, the assessment relies on the wrong tax base. Here, the taxpayer can similarly overcome the prima facie validity of the Commissioner's assessment by demonstrating errors in any of its factors.

We conclude that Conga has carried its burden to overcome the prima facie validity of each element (but one) of the Commissioner's assessment for 2008, 2009, and first quarter 2010:

- As we have explained, the Commissioner's order assesses Minnesota, Hennepin County, Minneapolis, and transit improvement sales tax on allegedly unreported cover charges.[224] Conga has overcome the prima facie validity of those assessments with evidence that it reported all cover charges collected during 2008, 2009, and the first quarter of 2010.
- The Commissioner's order assesses Minnesota sales tax, Minnesota liquor gross receipts tax, Hennepin County sales tax, Minneapolis sales tax, and transit improvement sales tax on allegedly unreported alcohol sales, calculated as percentages of Conga's alcohol purchases.[225] Conga has overcome the prima facie

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224 Ex. J2, at Schs. A, E, G, I.

225 Ex. J2, at Schs. A, B, E, G, I.

validity of those assessments with (among other things) evidence that the Commissioner incorrectly calculated Conga's alcohol purchases.

- The Commissioner's order assesses Minnesota, Hennepin County, Minneapolis, and transit improvement use tax on purchases of goods as to which no sales tax was allegedly paid.[226] The Commissioner abandoned her original assessment at trial by introducing a new schedule of purchases on which she alleged Conga had not paid sales tax and alcohol giveaways.[227] Conga has overcome the prima facie validity of both assessments with evidence that sales tax was paid.[228]

On remand, the Commissioner appears to contend that Conga can overcome the prima facie validity of the assessment only by "prov[ing] what it believes to be the correct number." [229] We disagree. In *Southern Minnesota Beet Sugar Coop*, the county similarly argued that its property tax assessment must be affirmed because the taxpayer "did not meet its burden to prove another value." 737 N.W.2d at 557. The supreme court rejected the county's argument:

> [T]o meet its burden to overcome the presumed validity of the county's estimated market value, [taxpayer] need not necessarily put forth evidence that would allow the tax court to determine the market value of the subject property. Rather, [the taxpayer] need only put forth evidence to show that the county's assessed value does not reflect the true market value of the property.

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226 Ex. J2, at Sch. C, F, H, J.

227 Ex. J57.

228 As noted, the Commissioner assessed Minnesota sales tax, Hennepin County sales tax, Minneapolis sales tax, and transit improvement sales tax on service charges as reported to the Department of Revenue. Ex. J2, at Schs. A, E, G, I. Conga presented no evidence concerning these service charges, and we therefore affirm the Commissioner's assessments of tax with respect to them.

229 Comm'r's Opening Post-Remand Br. 13.

*Id.* at 559. Similarly, in this case, Conga can overcome the prima facie validity of the Commissioner's assessment with evidence that the Commissioner's assessment does not reflect its true tax liability. We conclude that Conga has met that burden.

The Commissioner also argues that in making an assessment, she is not bound by "mathematical certainty" and, therefore, the presumptive validity of her assessment cannot be overcome merely by demonstrating errors in that assessment.[230] Again, we disagree. As the supreme court explained in *Southern Minnesota Beet Sugar Coop*, a taxpayer can overcome the validity of a property tax assessment *precisely* by showing errors in the assessment: "for example, presenting evidence of truly comparable sales that the county had not considered or showing that the county taxed property that is not taxable." 737 N.W.2d at 559-60. Analogously, the taxpayer can overcome the validity of a sales tax assessment by showing, for example, that the Commissioner assessed sales tax on the wrong amount of sales or applied the wrong sales tax rate.

In summary, we conclude that Conga has overcome the prima facie validity of the Commissioner's assessment of tax for 2008, 2009, and first quarter 2010.

## II. CALCULATION OF CONGA'S LIABILITY

"When a taxpayer presents substantial evidence that the Commissioner's assessment order is invalid or incorrect, the presumption of validity is overcome, and the case is decided by the trier of fact the same as if the presumption had never existed. The taxpayer, however, continues to bear

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230 Comm'r's Responsive Post-Remand Br. 4 ("the Supreme Court made clear that rebutting the presumption is not simply a matter of presenting evidence, particularly in a sales tax matter such as this where additional burdens, presumptions, and duties apply to the taxpayer. Furthermore this Court has not required mathematical certainty in the Commissioner's assessment but has stated that the Commissioner's method must be reasonable.") (citing *HKD Lo., Inc. v. Comm'r of Revenue*, No. 8028, 2011 WL 1049196, at *5 (Minn. T.C. Mar. 21, 2011). In *HKD Lo*, we were referring to the Commissioner's "method of audit," not the assessment itself. 2011 WL 1049196, at *5.

the burden of proof in the proceeding." *Conga*, 868 N.W.2d at 53. We "examine the evidence presented by both parties." *Id.* "Ultimately, [we] may conclude that the taxpayer owes the amount of taxes assessed in the Commissioner's order, or owes the amount of taxes contended by the taxpayer, or owes some different amount of taxes." *Id.*

On remand, Conga argues that because the record "contains no independent evidence to confirm the validity of the Commissioner's assessment," it must be reversed. Appellant's Opening Br. Remand 11. We disagree. Under *Southern Minnesota Beet Sugar Coop*, once the prima facie validity of the assessment has been overcome, the taxpayer's burden to prove the value of its property remains. *S. Minn. Beet Sugar Coop*, 737 N.W.2d at 559. We could not simply assume that because the validity of the assessment has been overcome, the property has no value and the taxpayer owes no property tax whatsoever. Similarly, once the prima facie validity of the Commissioner's assessment has been overcome, we cannot simply assume the taxpayer owes nothing. The taxpayer must still prove the amount of its liability—even if that liability is zero. *See Conga*, 868 N.W.2d at 53.

On the other hand, if we are to affirm the Commissioner's assessment in any respect, we must find "independent support" for it in the record. *Id.* (citing *S. Minn. Beet Sugar*, 737 N.W.2d at 559). Put another way, once the presumptive validity of the assessment has been overcome, it is simply no longer relevant. *See, e.g.*, *EOP-Nicollet Mall, L.L.C. v. Cty. of Hennepin*, 723 N.W.2d 270, 283 (Minn. 2006) ("the assessed value of property for tax purposes is not relevant to the question of that same property's market value."). Having determined that the presumptive

validity of the Commissioner's assessment has been overcome, we decide the amount of the taxpayer's liability (if any) on the evidence presented.[231]

As a threshold matter, we reject the Commissioner's suggestion that her assessment must be affirmed unless Conga proves it is *unreasonable*.[232] The notion that a tax assessment need only be "reasonable" finds no support in statute. To the contrary, under Minn. Stat. § 271.06, subd. 6 (2016), the Commissioner's assessment is only *prima facie* valid, an evidentiary presumption meaning that the assessment "is dispositive [only] in the absence of evidence rebutting it." *Conga*, 868 N.W.2d at 53. When there is "substantial evidence that the Commissioner's assessment order is invalid or incorrect, the presumption of validity is overcome, and the case is decided by the trier of fact the same as if the presumption had never existed." *Id.* (internal quotation omitted).

In this case, the supreme court may have found the Commissioner's choice of an indirect audit *method* to have been reasonable under the circumstances, but nothing in the supreme court's opinion speaks to the *outcome* of that method. In fact, as we have noted, the supreme court

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231 On remand, Conga argues that because the record "contains no independent evidence to confirm the validity of the Commissioner's assessment," it must be reversed. Appellant's Opening Br. Remand 11. We disagree.

Under *Southern Minnesota Beet Sugar Coop*, once the prima facie validity of the assessment has been overcome, the taxpayer's burden to prove the value of its property remains. *S. Minn. Beet Sugar Coop*, 737 N.W.2d at 559. We could not simply assume that because the validity of the assessment has been overcome, the property has no value and the taxpayer owes no property tax whatsoever. Similarly, once the prima facie validity of the Commissioner's assessment has been overcome, we cannot simply assume the taxpayer owes nothing. The taxpayer must still prove the amount of its liability—even if that liability is zero. *See Conga*, 868 N.W.2d at 53.

232 Comm'r's Responsive Post-Trial Br. 6 (arguing that "Conga has not met its burden to prove the Commissioner's determination of its sales and use tax liability is unreasonable.").

acknowledged "that Conga presented substantial evidence that, if believed, could overcome the Commissioner's presumptively valid assessment order," and remanded the matter to us specifically for "a proper, thorough analysis of the Commissioner's audit" and its conclusions. *Conga*, 868 N.W.2d at 53-54. Such an instruction is hardly consistent with the notion that the Commissioner's assessment need only be "reasonable" to be affirmed, or the suggestion that the taxpayer must prove the Commissioner's assessment not only "invalid or incorrect," *id.* at 53, but "unreasonable" as well.

The Commissioner further contends that her assessment must be affirmed unless Conga proves "*each* of the Commissioner's determinations made using the unit volume method regarding Conga's alcohol sales is erroneous." [233] In other words, the Commissioner contends that her *total* assessment must be affirmed even if *only one* of its constituent parts is affirmed. Again, we disagree. Under *Southern Minnesota Beet Sugar Coop*, the taxpayer may overcome the prima facie validity of the overall assessment by showing an error in any one of its constituent parts, for example, "evidence of truly comparable sales that the county had not considered" under the sales comparison approach *or* "that the county taxed property that is not taxable." 737 N.W.2d at 559-60. Nothing in *Southern Minnesota Beet Sugar Coop* requires a property taxpayer to demonstrate errors in each and every element of the county's assessment. Similarly, the Commissioner's assessment in this sales and use tax assessment is the sum of its constituent parts; an error in any one of its components results in an erroneous total. Following *Southern Minnesota Beet Sugar Coop*, once the prima facie validity of the assessment is overcome, we affirm the Commissioner's total assessment only if there is independent evidence in the record to support *each* of its elements.

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233 Comm'r's Opening Post-Remand Br. 13 (emphasis added).

To determine Conga's liability, we turn to the independent evidence in the record concerning Conga's liability for additional tax on its sales and purchases. The parties agreed to use 2008 as a test year and we do the same, determining Conga's liability for 2008 and extending that result to 2009 and first quarter 2010.

**A. Taxes on revenue from cover charges**

A "cover charge" is generally defined as "a fixed amount added to the bill at a nightclub or restaurant for entertainment or services." COVER CHARGE, The American Heritage College Dictionary (3d ed. 1997); *see also* Minnesota Revenue Fact Sheet, *Minneapolis Special Local Taxes* (rev. Sept. 2015) ("A 'cover' or 'minimum charge' (collected either at the door or later) entitles the customer to dancing privileges, entertainment, or the option to buy meals, drinks or other items."). The Commissioner considers cover charges to be "admission fees" subject to state sales tax, Hennepin County sales tax, Minneapolis sales tax, transit improvement tax, and entertainment tax. *See id.*

In this case, the Commissioner assumed that Conga failed to report revenue from cover charges during the period at issue. The Commissioner therefore first estimated the amount of cover charges Conga theoretically collected during the period at issue, then assessed state sales tax, Hennepin County sales tax, Minneapolis sales tax, and transit improvement tax (but not Minneapolis entertainment tax) on the assumed omitted cover charge revenue.[234] The Commissioner's estimates of theoretically collected but unreported cover charges also affected her calculations of allegedly unreported alcohol sales and her assessments of additional state and local

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234 Ex. J2 at Sch. A (general sales tax), E (Hennepin County sales tax), G (Minneapolis sales tax), I (transit improvement sales tax).

sales and use taxes.[235] We conclude that Conga has overcome the prima facie validity of the Commissioner's assessments with respect to cover charges. We further conclude that Conga has established that it reported all collected revenue from cover charges to the Department during 2008, 2009, and first quarter 2010.

**1. The amount of cover charges**

**a. The Commissioner's calculation.** The Commissioner assumed that the business generated $3,791.67 per month in cover charges during the audit period (a total of $45,500.04 for the 2008 sample period).[236] To reach this amount, the Commissioner assumed that Conga collected cover charges on both Friday and Saturday nights in 2008; that men paid a cover charge of $5.00 each night; that women paid a cover charge of $2.50 on Saturday nights but paid no cover charge on Friday nights; that customers on each night were evenly divided between men and women; and that there were 52 Fridays and 52 Saturdays in 2008.[237] The Commissioner further assumed there were 100 customers in the establishment on Friday nights in 2008 and 200 customers on Saturday nights.[238] In other words, the Commissioner assumed that there were 50 cover-charge-paying men in the establishment on Friday nights but 200 cover-charge-paying customers (both men and women) in Saturday nights.[239] In all, the Commissioner assumed that

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235 *See, e.g.*, Ex. J2, at Worksheet C1 (use tax summary), Worksheet A6 (on-sale sales summary).

236 Exs. J9, J2 at Sch. A, pt. 1.

237 Ex. J9. When in effect, cover charges were $5.00 on Friday nights and $10.00 on Saturday nights. Tr. 117-18 (Mr. Thunstrom acknowledging the correct cover charge and the auditor's error).

238 Ex. J9.

239 Ex. J9.

Conga collected $875 in cover charges each and every weekend in 2008, for a total of $45,500 in cover charges for the year, then extrapolated to the balance of the audit period.[240] The Commissioner assessed general sales tax, county sales tax, Minneapolis sales tax, transit improvement sales tax (but not Minneapolis entertainment tax) on cover charges she assumed were collected but not reported.[241]

**b. The independent evidence.** Conga presented evidence that both overcomes the prima facie validity of that portion of the 2008, 2009, and 2010 assessments concerning cover charges and establishes by a preponderance of the evidence that it reported the correct amount of cover charges in 2008, 2009, and first quarter 2010, and paid Minnesota sales tax, Hennepin County sales tax, and Minneapolis sales tax on those receipts. In discovery, the taxpayer produced a written log of 2008 cover charges kept by the bar's manager, which log was introduced as a joint exhibit at trial.[242] According to that log, total receipts for cover charges in 2008 were $49,702. [243] Conga's 2008 records establish that it reported $49,702 in cover charges to the Department of Revenue during 2008 and paid Minnesota sales tax, Hennepin County sales tax, and Minneapolis sales tax on them as reported. [244] Conga's records for 2009 and 2010 show

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240 Ex. J9. Had the auditor used the correct amounts for cover charges—$5.00 on Friday nights and $10.00 on Saturday nights—the auditor presumably would have estimated total cover charges of $91,000 for the year.

241 *See* Ex. J2, at Sch. K. Schedule K assesses Minneapolis entertainment tax on alcohol sales as reported and on unreported alcohol sales, but not on unreported cover charges.

242 Ex. J21; Tr. 321.

243 *See* Ex. J21.

244 Ex. J21; Ex. J18.

that it similarly reported cover charges to the Department of Revenue and paid Minnesota sales tax, Hennepin County sales tax, and Minneapolis sales tax on them as reported.[245] This evidence is sufficient both to overcome the prima facie validity of the Commissioner's assessment with respect to cover charges and to establish the correct amount of cover charges. *See S. Minn. Beet Sugar Coop*, 737 N.W.2d at 559-60.

On remand, the Commissioner argues that the written log "is not credible evidence of Conga's cover charges" because it is "hearsay within hearsay." [246] The Commissioner further argues that because the written log is the bar manager's personal notebook, it is not admissible under the business records exception to the hearsay rule, Minn. R. Evid. 803(6).[247] Yet the

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245 Ex. J22 (2009); Ex. J23 (2010).

246 Comm'r's Opening Post-Remand Br. 24.

247 Comm'r's Opening Post-Remand Br. 24. Rule 803(6), Minn. R. Evid., an exception to the hearsay rule, allows the admission of:

> [a] memorandum, report, record, or data compilation, in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation, all as shown by the testimony of the custodian or other qualified witness, unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness. . . .

In this case, the bar manager recorded in Exhibit J21 the amount of cash she received from the employee collecting cover charges. Certainly the bar manager had first-hand knowledge of the amount she received.

Moreover, contrary to the Commissioner's argument, Rule 803(6) explicitly allows the admission of business records made either "by, or from information transmitted by, a person with knowledge." In other words, Rule 803(6) does *not* limit admissible business records to those prepared by a person with direct knowledge of the transaction to be recorded. Rather, Rule 803(6)

Commissioner herself proffered Exhibit J21 as a joint exhibit without objection to its admissibility.[248] Nor did the Commissioner appeal our admission of Exhibit J21 on certiorari. In light of these facts, we will not revisit the admissibility of Exhibit J21.

The Commissioner further argues that Exhibit J21's "accuracy . . . is questionable" because it was not produced to the Commissioner during the audit.[249] We understand the Commissioner to be suggesting that the exhibit was created only *after* the audit. We disagree. Our examination of the log finds no evidence of recent fabrication. To the contrary, the log bears the hallmarks of a well-used notebook: for example, its cover and pages are worn; the entries in the log use several types of ink; and the handwriting in the entries varies across its pages, as handwriting naturally varies over time. *See Keogh v. Comm'r of Revenue*, No. 5492, 1991 WL 67532, at *8 (Minn. T.C. Apr. 22, 1991) (accepting federal income tax returns as proof of an operating loss and operating loss carryforward, even though the returns were not produced to the auditor during the audit).

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allows the admission of business records that are based on information transmitted to the preparer of the record *from* "a person with knowledge."

In *City of Fairmont v. Sjostrom*, the Minnesota Supreme Court limited the scope of Rule 803(6) by requiring that the business record nevertheless be based on information provided by one with "the business duty of transmitting such information." 280 Minn. 87, 93, 157 N.W.2d 849, 853 (1968). Under *Sjostrom*, therefore, a business record can be prepared from information received from another person, provided the other person had a business duty to transmit the information to be recorded.

In this case, an employee of the club (since deceased) collected cover charges at the door and gave the funds to the bar manager at the end of the night. Tr. 395. The bar manager recorded the amount she received in Exhibit J21. Tr. 394-95. The requirements of *Sjostrom* are satisfied: the record is based on information provided by one with a business duty of transmitting the information to someone with a business duty to record it.

248 *See* Joint Ex. List (filed June 10, 2013).

249 Comm'r's Opening Post-Remand Br. 23.

The Commissioner also contends that Exhibit J21 "is inconsistent with other evidence regarding cover charges." [250] If true, it goes only to the relative weights to be accorded the two pieces of conflicting evidence. But the Commissioner's example of inconsistency fails of its own weight. The Commissioner points to an entry in the log on Friday, September 5, 2008, showing $395 in cover charges received.[251] According to the Commissioner, that translates to 79 men, each paying a $5 cover charge.[252] Further according to the Commissioner, "there are usually more women than men on a Friday night," meaning (according to the Commissioner) there must have been at least 80 women in the establishment that night.[253] The Commissioner's only claim of inconsistency is this: that including so-called "VIPs" who paid no cover charge, "there were approximately 196 people in the bar that Friday night rather than the 100 person estimate provided by Mr. Thunstrom." [254] But the Commissioner provides no citation to the record whatsoever for Mr. Thunstrom's alleged testimony.[255] Nor is there any evidence in the record that there were *always* more women than cover-charge-paying men in the bar *every night.* We find no inconsistency.

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250 Comm'r's Opening Post-Remand Br. 24.

251 Comm'r's Opening Post-Remand Br. 24-25 (citing Ex. J21).

252 Comm'r's Opening Post-Remand Br. 24.

253 Comm'r's Opening Post-Remand Br. 24.

254 Comm'r's Opening Post-Remand Br. 24.

255 According to the auditor's log notes, Mr. Thunstrom told the auditor there *might* be 100 people in the bar on a Friday night and 200 people on a Saturday night. Ex. J12, at 12. Nowhere in the record did Mr. Thunstrom testify that there were precisely 100 people in the bar on the specific date of September 5, 2008.

For all of these reasons, we find that Conga has overcome the prima facie validity of the Commissioner's assessment with respect to cover charges and has established that total cover charges collected were $49,702 in 2008; $32,270 in 2009; and $6,560 in the first three months of 2010. For 2007, in the absence of any evidence to the contrary, we affirm the Commissioner's figure of $45,500.

**c. Assessment of tax on cover charges as reported**

Minneapolis entertainment tax of 3% is owed on food and drinks sold during live entertainment and on all cover charges. Act of June 6, 1969, ch. 1092, § 3, 1969 Minn. Laws 2226, 2227. Conga included cover charges in its reported sales but did not remit entertainment tax on sales.[256] Because Conga did not pay entertainment tax on the amounts it reported to the Department of Revenue,[257] the Commissioner's Order includes an assessment of entertainment tax on reported sales, including cover charges.[258] We affirm the Commissioner's assessment of entertainment tax on Conga's cover charges *as reported* for 2008, 2009, and the first three months of 2010.[259]

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256 *See* Exs. J18 (Minnesota sales and use tax returns for 2008), J19 (Minnesota sales and use tax returns for 2009), J20 (Minnesota sales and use tax returns for first quarter 2010).

257 *See* Exs. J18, J19, J20 (Conga's Minnesota sales and use tax returns for 2008, 2009, and first quarter 2010).

258 Ex. J2, at Sch. K (assessing entertainment tax on "reported general rate sales").

259 As we have indicated, the Commissioner assumed that Conga had not reported revenues from cover charges, but did not assess entertainment tax on those allegedly unreported cover charges. *See* Ex. J2, at Sch. K (calculating entertainment tax on "reported general sales" and on "non-reported liquor sales" but not on unreported cover charges). In her post-trial brief, the Commissioner urges us to make our own assessment of entertainment tax on cover charges. Comm'r's Second Amended Proposed Findings of Fact ¶ 55 ("The Commissioner's Order does not include an assessment for entertainment tax on cover charges. Accordingly, the assessment

Transit improvement tax is owed on "retail sales and uses taxable under" Minn. Stat. ch. 297A. Minn. Stat. § 297A.992, subd. 2(a) (2016). As we have found, Conga included cover charges in its reported sales in 2008, 2009, and 2010 and remitted transit improvement tax on those reported sales.[260] We therefore reverse the Commissioner's assessment of transit improvement tax on reported cover charges in 2008, 2009, and 2010.

In summary, the record before us establishes that Conga reported the correct amount of cover charges during 2008 and paid general sales tax, Hennepin County sales tax, Minneapolis sales tax, and Minnesota transit improvement tax on them. We therefore reverse the Commissioner's assessment of general sales tax, Hennepin County sales tax, Minneapolis sales tax, and transit improvement tax with respect to cover charges. The record before us further establishes that Conga failed to pay Minnesota entertainment tax on reported cover charges. We affirm the Commissioner's assessment of entertainment tax on cover charges *as reported* on Conga's sales and use tax returns for 2008, 2009, and first quarter 2010. In the absence of evidence

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should be adjusted to account for the additional 3% entertainment tax on all additional cover charges calculated during the audit."); Comm'r's Response Appellant's Opening Post-Trial Mem. Law 19 ("the Commissioner's Order should be adjusted to include an assessment of entertainment tax for cover charges"). We conclude that Conga *did* report revenues from cover charges and we therefore do not reach the question of whether we have authority to assess entertainment tax on unreported cover charges, given the Commissioner's failure to do so.

260 Ex. J18 (Minnesota sales and use tax returns for 2008); J19 (Minnesota sales and use tax returns for 2009); J20 (Minnesota sales and use tax returns for first quarter 2010). Transit improvement tax became effective July 1, 2008. *See* Ex. J2, at Part 1, Sch. I. As a result, there is no transit improvement tax owed in 2007, or for the first half of 2008.

to the contrary, we affirm the Commissioner's assessment of 2007 entertainment tax on cover charges.

### B. Taxes on revenues from alcohol sales

The lion's share of the Commissioner's assessment stems from taxes on allegedly unreported sales of alcohol (liquor, wine, and beer). Here again, we conclude that Conga overcame the prima facie validity of the assessment. With respect to sales of liquor, wine, and beer, the evidence establishes that the Commissioner's assessment relies on inaccurate calculations of purchases; drink sizes and drink prices unsupported by the evidence; and unsupported assumptions about giveaways, spillage, waste, and theft. Using the correct amounts of purchases; accurate drink sizes and prices; and assumptions about giveaways, spillage, waste, and theft that are supported by the evidentiary record, we make findings as to revenues from the sale of alcohol.

#### 1. Liquor sales

##### a. The Commissioner's calculation: liquor sales.

Worksheet A4 (Exhibit J5) is the Commissioner's estimate of revenues theoretically generated from liquor sales. The Commissioner assumed Conga's 2008 liquor purchases totaled 143,711 ounces.[261] The Commissioner further assumed an average liquor pour size of 1.75 ounces.[262] Based on the answers recorded by the auditor on the Bar Audit Questionnaire (Exhibit J15), the Commissioner assumed that 70% of liquor sold were well or rail drinks and 30% premium or call drinks.[263] Also based on answers recorded by the auditor on the Bar Audit

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261 Ex. J5.

262 Ex. J5.

263 Ex. J5. A "well" or "rail" drink designates a drink made with lower-cost liquor stored in the "speed well" or "speed rail" of the bar (that is, within the bartender's easy reach) because the

Questionnaire, the Commissioner assumed liquor prices (including sales tax) of $5.00 for rail drinks ($2.50 during happy hour) and $5.50 for premium or call drinks ($2.75 during happy hour).[264] The Commissioner further assumed that half of all liquor sales occurred at promotional prices.[265] Weighting those prices accordingly, the Commissioner arrived at an average price for mixed drinks of $5.15 ($2.575 during happy hour).[266] The Commissioner assumed that 9% of liquor purchases were "given away" to those customers who paid cover charges.[267] The Commissioner allowed another 10% for spillage and other non-revenue events, as to which there are no sales or use tax consequences.[268] Employing these assumptions, the Commissioner estimated that Conga presumptively generated $256,930.48 from sales of liquor during 2008.[269] During 2008, Conga reported liquor sales of $176,546 in its 2008 sales and use tax returns.[270]

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customer has not specified a particular brand of liquor. In contrast, a premium or call drink usually designates one made with premium or "top shelf" (higher-priced) liquor stored out of easy reach (perhaps literally on the "top shelf" behind the bar).

264 Ex. J5.

265 Ex. J5.

266 Ex. J5.

267 Ex. J5.

268 Ex. J5.

269 Ex. J5.

270 *See* Ex. J18.

### b. 2008 liquor purchases

In applying the unit-volume method, the Commissioner obtained records from Conga's suppliers of its 2008 alcohol purchases and entered those purchases into a spreadsheet, classifying each purchase as one of liquor, wine, or beer (and, if beer, either "premium" or "regular").[271] In the process, the Commissioner misclassified several brands of wine (Ecco Domani Pinot Grigio Collezioni, Ecco Domani Pinot Grigio, Diseno Malbec, and Manyana Tempranillo) as liquor.[272] In total, Worksheet A1 (Purchase Detail; Ex. J3) overstates liquor purchases, and understates wine purchases, by 3,643.2 ounces. This misclassification overcomes the prima facie validity of the Commissioner's assessment with respect to both liquor and wine.[273]

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271 Ex. J3 (Worksheet A1 – Purchase Detail).

272 Ex. J3, at 4-8; *see* Tr. 369-73. At trial, Ms. Brinkman testified that Hardy's Stamp Chardonnay (a white wine) was also miscategorized as liquor. Tr. 372. Our review of the Commissioner's spreadsheet of alcohol purchases (Ex. J3) indicates that the Commissioner deleted purchases of Hardy's Stamp Chardonnay altogether and, for that reason, we make no adjustment for it.

273 The Commissioner contends that Conga cannot "prove any portion of the alcohol purchases in Worksheet A1 are erroneous" because "Conga stipulated at trial it does not dispute the listing of purchases as set forth in Worksheet A1." Comm'r's Opening Post-Remand Br. 14 ("Although Appellant attempted to question the liquor purchases at trial, its right to do so was waived by stipulating to the purchases at the start of trial, particularly since Appellant failed to raise these issues during discovery."). We disagree.

In pretrial discovery, the Commissioner asked Conga to admit that the liquor purchase detail (Worksheet A1) to the Commissioner's Order "accurately sets forth the alcohol purchases made by Appellant during 2008." Ex. J58, at 24 (Conga's response to the Commissioner's request for admission 5). Conga denied the request. Ex. J58, at 24. Conga did "confirm[] that the vendors listed" on Worksheet A1 "appear to be an accurate listing of the vendors from whom the Appellant has purchased beer, wine and liquor." Ex. J58, at 10 (Conga's response to Interrogatory 23). Based on the record before us, Conga preserved its right to dispute the Commissioner's categorizations of its alcohol purchases.

At trial, Conga's counsel stipulated that Worksheet A1 "is the list" of alcohol purchases. Tr. 11. But we do not understand Conga to have agreed that *the auditor's classifications* of those

The Commissioner agrees that beverages that are always "served with some other sort of alcohol" should be excluded.[274] But the Commissioner included in her spreadsheet purchases of peach schnapps and Chambord, Cointreau, Dek Curaçao Blue, and Midori Melon liqueurs.[275] The bar manager testified that peach schnapps, Chambord, Cointreau, Dek Curacao Blue, and Midori Melon liqueurs are used exclusively as mixers.[276] In response, auditor Luttrell testified that "maybe peach schnapps is not sold individually," but excluding schnapps from liquor purchases risks may exclude "a drink that contained four different types of schnapps."[277] We exclude from liquor purchases those types of alcohol that are always mixed and sold with another type of *alcohol*; we include in liquor purchases those types of alcohol which may represent the only alcohol in a drink. A "fuzzy navel"—peach schnapps and orange juice—is one popular mixed drink that uses schnapps as the only alcohol. On that basis, we include schnapps in liquor

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purchases was necessarily correct. Indeed, Conga's witness testified (without objection from the Commissioner) that those classifications were not always correct. Tr. 369-73. Indeed, the Commissioner elicited testimony of her own witnesses concerning those classifications. Tr. 470-78 (Mr. Luttrell testifying as to the categorization of mixers).

"Where the parties stipulate as to what the facts are," we are bound by the stipulation. *Gethsemane Lutheran Church v. Zacho*, 253 Minn. 469, 479-80, 92 N.W.2d 905, 913 (1958). But where the parties "abandon such stipulation and proceed to try the issue," however, "they are bound by the results of that trial." *Id.* at 480, 92 N.W.2d at 913. Even if these parties stipulated to the accuracy of Worksheet A1, including its classifications of purchases, they abandoned the stipulation at trial.

274 Tr. 477-78 (Mr. Luttrell testifying that the Department of Revenue excludes those that are "exclusively mixes," namely, that always "would be served with some other sort of alcohol").

275 *See* Ex. J3.

276 Tr. 368-69, 372-73.

277 Tr. 477.

purchases but exclude the other indicated liqueurs. During 2008, Conga purchased 455.4 ounces of Chambord; 405.8 ounces of Cointreau; 236.6 ounces of Dek Curaçao Blue; and 1,724.6 ounces of Midori Melon Liqueur.[278] We therefore reduce 2008 liquor purchases to 137,245.4 ounces.

**c. Liquor giveaways**

To reach the amount of liquor sold during 2008, the Commissioner further reduced 2008 liquor purchases by the amount of liquor presumed to have been "given away." [279] In particular, the Commissioner assumed that every customer in the establishment on a Friday or Saturday night in 2008 could choose between a free drink or free food, and that half of them choose a "free" drink.[280] We review next the Commissioner's estimate of those giveaways.

Starting with the total occupancy of the building (258 persons), the Commissioner assumed the building was at 75% occupancy on Friday and Saturday nights and that customers "turned over" at the rate of 1.5 times per night.[281] In all, then, the Commissioner assumed that there were 290 customers on the premises over the course of each and every Friday and Saturday night during 2008, or 30,160 customers over the course of the entire year.[282]

The Commissioner further assumed that half of all customers in the establishment on a Friday or Saturday night in 2008 received a free drink, whether or not the customer paid a cover

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278 Ex. J3.

279 Ex. J5. As will be seen, the Commissioner assessed use tax on the amount of alcohol presumed to have been "given away." We separately address this part of the assessment.

280 Ex. J9 (Worksheet 2 – Calculation of Cover Charges and Give Aways).

281 Ex. J9.

282 Ex. J9 (290 customers multiplied by 52 weekends).

charge.[283] In other words, the Commissioner estimated that there were 30,160 customers over the course of the year who could choose a free drink or free appetizer, and that half of them (15,080 customers) chose a free drink.[284] The Commissioner then assumed that 49% of those choosing a free drink over the course of the year (7,389 customers in all) chose liquor.[285] Using a pour size of 1.75 ounces, the Commissioner calculated that 12,931.1 ounces of liquor were given away (not sold), amounting to 9.0% of all liquor she calculated was purchased during 2008. [286]

The record before us overcomes the prima facie validity of the Commissioner's assumptions in multiple respects. First, as we have explained, the Commissioner miscalculated the amount of liquor purchased in 2008. The Commissioner calculated that Conga purchased 143,711 ounces of liquor during 2008, but Conga actually purchased only 137,245.4 ounces. Even if the Commissioner's estimate of the percentage of liquor "given away" is correct, it was applied to the wrong amount of purchases. *See S. Minn. Beet Sugar Coop*, 737 N.W.2d at 559-60 (noting that a taxpayer can overcome the prima facie validity of a property tax

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283 Ex. J9. The Commissioner assumed, for example, 145 men in the establishment each and every Friday night, all of whom received either a free drink or free food, but only 50 men paying a cover charge. Similarly, the Commissioner assumed 145 men in the establishment each and every Saturday night, all of whom received either a free drink or free food, but only 100 of which paid a cover charge. *See* Ex. J9.

284 Ex. J9.

285 Ex. J9. The Commissioner assumed that another 3% of customers (or 452 customers) chose tap beer, another 3% (452 customers) chose wine, and the remaining 45% (or 6,786 customers) chose bottled beer. Ex. J9.

286 Ex. J9. As we will explain, the Commissioner similarly calculated the amount of tap beer, wine, and bottled beer given away. *See* Ex. J12, at 12 (pour size).

assessment by showing that tax was applied to the wrong tax base, that is, by "showing that the county taxed property that is not taxable").

Second, the drinks the Commissioner assumed were "free" were in fact paid for. Conga advertised a "free" drink on Friday and Saturday nights only to customers who paid a cover charge of $5.00.[287] Under the Department of Revenue's own definition, a "cover charge" entitles the customer to "*the option to buy* meals, drinks, or other items." Minnesota Revenue Fact Sheet 164M, *Minneapolis Special Local Taxes* (emphasis added). Under the Department's definition, there are two revenue streams to be taxed: the cover charge; and (if purchased), the meal or drink. In this case, however, there is no separate purchase of a drink: it is *included* in the cover charge. In calculating the amount of liquor sold, we therefore do not reduce liquor purchases by the amount of liquor presumably poured in connection with cover charges.[288]

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[287] Ex. J49.

[288] There is no evidence that Conga offered a drink to every customer in the establishment each Friday and Saturday night during 2008. To the contrary, the evidence shows that Conga offered a choice of drink or appetizer on Friday and Saturday nights only between July and December. Ex. J49, at July 2008 – December 2008 (advertising "$5 cover get free drink or appetizer!!!"). Moreover, there is no evidence that Conga offered a free drink to every customer on those nights. Rather, only those paying a cover charge could choose a "free" drink. Ex. J49. Nor was there a cover charge every Friday and Saturday night: Conga advertised no cover charge until midnight on Saturday nights from January to June. Ex. J49. On other nights, according to the log of cover charges, otherwise applicable cover charges were not collected. *See, e.g.*, Ex. J21, at July 11 and August 1 (indicating no cover charge). According to the record before us, a total of 5,353 customers paid cover charges on Friday or Saturday night between July and December 2008. Ex. J21. Assuming (as the Commissioner does) that half of those customers chose a drink, that amounts to 2,676 customers in 2008, not 15,080.

In addition, the Commissioner's calculation of the number of cover-paying customers in the establishment on any given Saturday night lacked foundation to begin with. The Commissioner's calculation began with the occupancy for the entire building, apparently according to the Minneapolis fire marshal. Ex. J9; Ex. J12 (auditor log), at 1/29/10 (indicating that the auditor left a message for the Minneapolis Fire Department for building occupancy);

But Conga did advertise free well drinks and margaritas for ladies on Monday nights from January to August 2008.[289] Mr. Thunstrom testified credibly that the purpose of the promotion was to increase the number of women in the bar on Monday nights—otherwise a slow day for business—and thereby increase the number of men in the bar as well.[290] To account for giveaways of well drinks and margaritas to women customers one night a week for eight months in 2008, we find that 1% of liquor purchased during 2008, or 1,372.5 ounces, was so used.

This evidence overcomes the prima facie validity of the assessment with respect to liquor giveaways and establishes the correct amount of liquor giveaways.

**d. Spillage, waste, and theft**

The Commissioner typically assumes liquor spillage of only 3%. [291] In this case, the Commissioner allowed 10% for spillage and other non-revenue events, as to which there are no sales or use tax consequences.[292] At trial, Mr. Thunstrom testified that a 10% spillage rate was

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Ex. J12, at 2/6/10 (auditor indicating an "actual occupancy load" of 258). That is, the Commissioner assumed that all customers in the building on any Friday or Saturday night received either a free appetizer or a free drink.

In fact, Conga's business premises has a "white tablecloth" dining room, the Conga nightclub with a full-service bar and dance floor, and several banquet rooms. Tr. 173; Ex. J12, at 12. By basing her estimate of cover charges on the capacity of the entire building, the Commissioner effectively assumed that all customers paid cover charges. But customers of the dining room and the banquet rooms did not pay cover charges. Tr. 181 (Mr. Thunstrom testifying that "people coming in that want to go dancing, they pay five bucks for [the] buffet" but "if you come in for—to eat at my place, you don't have to pay a cover."), 357 (Mr. Thunstrom testifying that customers of the restaurant paid neither a cover charge or a door charge).

289 *See* Ex. J49.

290 Tr. 190.

291 Tr. 97.

292 Ex. J5; *see* Tr. 82-83 (Mr. Luttrell testifying that spillage has "no tax ramifications").

"too low," noting that he once had a bartender who liked to "flip" bottles of liquor (apparently not always successfully) but offering no specific alternative rate.[293] We adopt the Commissioner's 10% spillage rate.

The Commissioner contends that *sales* tax is owed on inventory thefts, that is, instances in which an employee pockets the customer's payment without entering it into the point-of-sale system.[294] We disagree. Minnesota law imposes a sales tax on "the gross receipts from retail sales . . . made in this state." Minn. Stat. § 297A.62, subd. 1 (2016). "Gross receipts" is defined in Minn. Stat. § 297A.61, subd. 8 (2016): "the total amount *received*, in money or by barter or exchange, for all sales at retail as measured by the *sales price*." (Emphasis added.) "Sales price" is defined in Minn. Stat. § 297A.61, subd. 7(a): "the total amount of consideration, including cash, credit, personal property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether *received* in money or otherwise . . . ." (Emphasis added.) Under the statutory scheme, there can be no sale if the consideration never actually reaches the retailer. Where an employee serves a drink but pockets the customer's payment for it, Conga receives

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293 Tr. 197.

294 Comm'r's Response Appellant's Opening Post-Trial Mem. Law 16:

> [T]he weight of evidence shows Appellant has no specific information regarding how possible employee theft should affect the Commissioner's Order. Minnesota sales tax is imposed on gross receipts, which are measured by the "sales price." Minn. Stat. §§ 297A.61, subd. 8 & 297A.62, subd. 1. The "sales price" is the amount of consideration for which an item is sold. Minn. Stat. § 297A.61, subd. 7(a). Thus, once an item is sold, it is subject to sales tax. . . . Appellant has offered no legal explanation for why the State suffers the loss of revenue rather than Appellant. . . .

nothing. We conclude, relying on the plain language of the statute, that such events are not "retail sales" on which sales tax may be assessed.[295]

In all, then, we find that Conga sold 122,148 ounces of liquor during 2008. We next determine the amount of revenue generated by those sales.

**e. Liquor pour size**

The Commissioner assumed a theoretical liquor pour size of 1.75 ounces, based on Mr. Thunstrom's assertion that Conga bartenders use a 3-count "free pour."[296] At trial, Mr. Thunstrom testified credibly that Conga's average liquor pour size was more than 1.75 ounces because of the variety of drinks sold. Specifically, Mr. Thunstrom testified that 70% of Conga's mixed drink sales are Long Island Ice Teas, which use four or five different types of alcohol that, at least according to Mr. Thunstrom, total 7 ounces.[297] Other popular drinks served at Conga—Long

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295 Presumably, theft is taxable as income to the employee involved; at least the Internal Revenue Service thinks so. *See* IRS, Taxable and Nontaxable Income (Pub. 525) (2015), at 34, available at www.irs.gov/pub/irs-pdf/p525.pdf (last viewed January 25, 2017) ("If you steal property, you must report its fair market value in your income in the year you steal it unless in the same year, you return it to its rightful owner."). We therefore see no reason the state should suffer a loss of revenue, as the Commissioner contends, because it is free to collect the tax from the employee.

Moreover, the Commissioner is simply wrong to assert that under her theory (as opposed to Conga's), the business suffers no "loss of revenue." *See* Comm'r's Response Appellant's Opening Post-Trial Mem. Law 16. After all, the business has been deprived of revenues from the sale.

296 Ex. J5; *see* Ex. J12 (auditor log notes), at 12 ("We said that we would take the pour size to 1.75 ounces based simply on the fact that they have a free pour."). *See also* Ex. J15 (Bar Audit Questionnaire). The auditor's entries on the Bar Audit Questionnaire are contradictory. One notation indicates a pour size of 1.5 ounces. Ex. J15. Another notation indicates a pour size of "9 oz." during happy hour and "12 oz." elsewhere. Ex. J15.

297 Tr. 194-96.

Tokyo, French Connection, and Incredible Hulk—also use four or five different types of alcohol in a 16-ounce glass.[298]

Conga's manager testified credibly that, because of the variety of drinks sold, Conga's average liquor pour size is more than 1.75 ounces. Specifically, the manager testified that Conga's bartenders generally pour 2 ounces of each type of liquor in a mixed drink, meaning a total of 8 ounces in a Long Island Ice Tea (2 ounces each of rum, triple sec, vodka, and gin), 9 ounces in a Long Tokyo (2 ounces each of rum, triple sec, vodka, and gin and 1 ounce of midori), and 4 ounces in a French Connection (2 ounces each of rum and Hennessy), all in 16-ounce glasses.[299] The manager estimated that Long Island Iced Tea amounted to 40% of Conga's mixed drink sales, and Long Tokyo, French Connection, and martinis amounted to another 20 or 25 percent.[300]

We conclude that this evidence overcomes the prima facie validity of the auditor's presumed liquor pour size of 1.75 ounces. *See New Corner Bar, Inc. v. Comm'r of Revenue*, No. 7221-R, 2001 WL 1007811 (Minn. T.C. Aug. 29, 2001) (accepting as "specific and plausible" the taxpayer's claimed pour size of 2.6 ounces "knowing that wide distribution of this decision may cause a rush of new customers" to the business). Even if Conga bartenders used a 3-count free pour, the record establishes that Conga regularly sold mixed drinks containing more than 1.75 ounces of alcohol.

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298 Tr. 195-97.

299 Tr. 364-67.

300 Tr. 364, 368; *see* Ex. J49 (showing Conga advertised discounted or free margaritas, martinis, and mixed drinks throughout 2008).

The Commissioner argues that because of Conga's "duty to keep adequate and complete records of its sales," the presumptive validity of her assumed pour size can be refuted only by "documentary support." [301] We disagree. By law, our review of the Commissioner's order is *de novo*, and each party is to "have an opportunity to offer evidence and arguments at the hearing." Minn. Stat. § 271.06, subd. 6. Accordingly, we have previously credited testimony as evidence of the taxpayer's liability. In *New Corner Bar*, for example, we credited the taxpayer's testimony as to pour size over the Commissioner's assumption. No. 7221 R, 2001 WL 1007811, at *5 (Minn. T.C. Aug. 29, 2001). In *Bryan v. Commissioner of Revenue*, which concerned an indirect sales and use tax audit of a Dairy Queen franchise, we credited testimony of two officers of International Dairy Queen (the franchisor) over the Commissioner's assumption as to the amount of revenue to be generated from a gallon of ice cream mix. Nos. 4985, 4986, 1989 WL 8391, at *5 (Minn. T.C. Jan. 17, 1989).

Moreover, the only basis cited by the Commissioner for Conga's duty to maintain records is Minn. R. 8130.7500 (2015).[302] Rule 8610.7500 requires, in pertinent part, that "[e]very seller, retailer, and person storing, using, or otherwise consuming" tangible personal property in Minnesota "keep adequate and complete records showing," among other things, "gross receipts from sales . . . of tangible personal property . . . made within Minnesota." *Id.*, subp. 6.A. The rule further provides that such records

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301 Comm'r's Opening Post-Remand Br. 16; *see also id.* at 17 (arguing that "Conga cannot escape the duty to keep evidence of its transactions, including prices, by providing unsubstantiated and self-serving testimony"). As one judge has acknowledged, the testimony of "virtually any party to any litigation" are self-serving. *Moore v. Indehar*, 514 F.3d 756, 766 (8th Cir. 2008) (Beam, J., dissenting); *see Maroko v. Werner Enterprises, Inc.*, 778 F. Supp. 2d 993, 1001 n.9 (D. Minn. 2011) ("Affidavits submitted by plaintiffs are inherently 'self-serving,' for why else submit them?"). That does not make such testimony incompetent. *Id.*

302 Comm'r's Opening Post-Remand Br. 16-17.

> must include the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question, together with all bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account as well as all schedules or working papers used in connection with the preparation of tax returns.

Minn. R. 8130.7500, subp. 6. If the taxpayer "maintains any records on an electronic data processing media" that "summarize[e] accounting transactions and records," the rule requires the taxpayer to maintain (among other things) "invoices, vouchers, and other records which support the summary accounting data." *Id.* subp. 8. In addition, the Commissioner emphasizes, Rule 8130.7500 requires the taxpayer to maintain "records which provide the opportunity to trace any transactions back to the original source or forward to a final total." Minn. R. 8130.7500, subp. 6.C. It is these records, the Commissioner emphasizes, that Conga lacks and without which, the Commissioner contends, it cannot overcome the prima facie validity of the assessment.

But the statutory requirement on which Rule 8610.7500 was based—to "keep such records . . . as the commissioner may from time to time prescribe"—was repealed in 1990 and not recodified elsewhere.[303] Under Minnesota law, "[i]f a law authorizing rules is repealed, the rules adopted pursuant to that law are automatically repealed on the effective date of the law's repeal . . . ." Minn. Stat. § 14.05, subd. 1 (2016). Rule 8610.7500, subparts 6 and 8, no longer have any force or effect.

Second, the Commissioner cites Minn. Stat. § 297A.665(a) and (b) (2016) for the proposition that it is the taxpayer's burden "to prove that any additional sales were not subject to

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303 *See* Minn. Stat. § 297A.27, subd. 3 (1988) ("Every person liable for any [general sales tax], or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules, as the commissioner may from time to time prescribe."). Section 297A.27 was repealed in its entirety in 1990. Act of April 24, 1990, ch. 480, art. 1, § 45, 1990 Minn. Laws 1033, 1092.

tax." [304] We do not understand Conga to dispute that any unreported sales of alcohol are subject to tax. The issue here, rather, is whether there are any unreported sales *in the first place*, an issue that section 297A.665 does not address.

Third, what section 297A.665 *does* address is the means by which a seller may prove "that a sale is not a taxable retail sale." Minn. Stat. § 297A.665(b). In particular, the seller can prove that a particular sale is not subject to tax by producing "a fully completed exemption certificate" or, in the absence of such a certificate, "by other means." Minn. Stat. § 297A.665(b)(1), (b)(2)(ii). If a seller can prove "by other means" that a particular sale is not subject to tax, we see no reason a seller cannot similarly prove "by other means" that such sale did not occur or occurred in a different amount than the Commissioner assumed.

We emphasize that the Commissioner's assessment remains prima facie valid, and it is up to the taxpayer to prove otherwise. Such burden is more easily met with written records than with testimony alone. Our point is simply that there is no basis in law for limiting the means by which the taxpayer may meet its burden in this court and, to the contrary, Minnesota law countenances a variety of proof.

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[304] Comm'r's Opening Post-Remand Br. 16. Minnesota Statutes § 297A.665(a) provides:

> For the purpose of the proper administration of [Minn. Stat. ch. 297A] and to prevent evasion of the tax, until the contrary is established, it is presumed that:
>
> (1) all gross receipts are subject to the tax; and
>
> (2) all retail sales for delivery in Minnesota are for storage, use, or other consumption in Minnesota.

According to the Commissioner, "Conga does not appear to dispute the serving sizes for tap beer, *canned beer*, and wine." Comm'r's Opening Post-Remand Br. 16. Conga did not sell canned beer, only bottled and tap beer. Ex. J15 at 2 (Bar Audit Questionnaire).

Mr. Thunstrom estimated during trial that Conga's average liquor pour size (considering both mixed drinks and shots) was 4 ounces.[305] We reject that estimate as implausible. An average pour size of 4 ounces, based on Conga's 2008 liquor purchases and drink prices, would result in total liquor revenues during 2008 of only $107,445—roughly $70,000 less than Conga actually reported as its liquor sales during 2008. Considering the undisputed testimony that a significant portion of Conga's liquor sales were Long Island Ice Teas (and similar drinks); considering that such drinks were sold in 16-ounce glasses; and considering that such drinks have a higher liquor content than, for example, shots, we use instead an average pour size of 2.0 ounces.

**f. Rail vs. call drinks**

Based on the answers recorded by the auditor on the Bar Audit Questionnaire (Ex. J15), the Commissioner assumed that 70% of liquor purchased was sold in rail or well drinks and 30% in premium or call drinks.[306] Conga has not challenged this assumption.

**g. Drink prices and discounts**

Also based on the answers recorded by the auditor on the Bar Audit Questionnaire (Ex. J15), the Commissioner assumed liquor prices of $5.00 for rail or well drinks ($2.50 during promotions) and $5.50 for premium or call drinks ($2.75 during happy hour).[307] Weighting these prices assuming 70% rail drinks and 30% premium or call drinks, the Commissioner arrived at a presumed average price for mixed drinks of $5.15 ($2.575 during happy hour).[308]

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305 Tr. 197.

306 Ex. J5.

307 Ex. J5.

308 Ex. J5.

The record indicates, however, that liquor was much more heavily discounted than the Commissioner assumed. During 2008, Conga regularly offered well drinks and margaritas for just $1 or $2, tequila for $1, discounted shots, and other unspecified drink specials. For example, during January, February, and March 2008, Conga advertised $1 well drinks on Sunday nights from 9 p.m. to close; free well drinks and margaritas for women on Monday nights; $2 well drinks on Wednesday nights; $1 tequila and other drink specials on Friday nights; and "shot specials every hour" on Saturday nights.[309] During April, May, and June 2008, Conga advertised $1 rum and rail mixed drinks; during the last four months of the year, Conga advertised $3 margaritas and $4 martinis on Monday nights.[310]

The Commissioner further assumed that only half of all liquor sales were discounted, having been made during a limited "happy hour." [311] The evidence indicates, however, that during 2008 Conga offered promotions on liquor (of one kind or another) on every night but Thursdays.[312] As we have explained, well drinks were discounted on Sunday and Wednesday nights; well drinks and margaritas were free on Monday nights for women; rum and rail liquor was discounted on Tuesday nights; and margaritas and martinis were discounted on Monday nights.[313]

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309 Ex. J49.

310 Ex. J49.

311 Ex. J5. As we have previously explained, the software program used by the Commissioner in an indirect audit uses the term "happy hour" to refer to "any promotional pricing," rather than to a specific time period. *More, Inc. v. Comm'r of Revenue*, Docket No. 8395-R, 2016 WL 715004, at *7 (Minn. T.C. Feb. 19, 2016). There is no reason for the Commissioner to have limited her estimate of the percentage of drinks sold at promotional prices to those sold during a specific time period.

312 Ex. J49.

313 Ex. J49.

Conga's pattern of liquor purchases reflect these discounts. For example, during 2008 Conga advertised Don Julio tequila at $1 each on Fridays throughout 2008 (March and April being the only exceptions);[314] for the year, Conga purchased 7,337 ounces of Don Julio, or more than 5% of its total liquor purchases for the year.[315] We conclude that virtually all of it was sold at $1 per drink. During March and April, when it advertised Patron at $1 each on Fridays, Conga purchased 961.4 ounces of Patron Silver Bar;[316] we similarly conclude that virtually all of it was sold for $1 per drink.

In light of the many documented discounts, we find that 70% of all liquor purchases were sold at promotional prices during 2008.

The Commissioner asserts that Conga "agreed" to the various discount percentages used in the assessment.[317] The record does not support the Commissioner's assertion. According to the auditor's log notes, Mr. Thunstrom requested "that the happy hour percentage [for tap beer sales] be changed from the 30% stated at the first meeting to 70%" and "we" agreed.[318] Mr. Thunstrom requested that the happy hour percentage for bottled beer sales be changed to 70% as well, and "we" agreed.[319] Similarly, Mr. Thunstrom requested that the same 70% happy hour sales

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314 Ex. J49.

315 Ex. J3.

316 Ex. J49; Ex. J3.

317 Comm'r's Opening Post-Remand Br. 17 ("the happy hour percentages were reached in agreement with Conga").

318 Ex. J12, at 11.

319 Ex. J12, at 11.

percentage be applied to liquor sales, but "[w]e agreed" to increase it to only 50%. [320] In each instance—indeed, throughout the auditor's log notes—the term "we" means the auditor and her supervisor, rather than the auditor and Mr. Thunstrom.[321] There is no evidence in the record before us that Conga agreed that only 50% of liquor was sold at a discount, or that Conga waived its right to challenge the Commissioner's assessment on this point.

**h. Findings regarding liquor sales**

During 2008, Conga reported total liquor sales to the Department of Revenue of $176,546.[322] The Commissioner estimated Conga should theoretically have generated $256,930.48 in sales based on liquor purchases of 143,711 ounces and employing the assumptions we have described.[323] Relying on the findings outlined above, we conclude that Conga's 2008 revenues from liquor sales were $182,001. Conga thus underreported liquor sales during 2008 by $5,455. We reduce the Commissioner's assessment accordingly.

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320 Ex. J12, at 11.

321 For example, the auditor writes that "we" met with Mr. Thunstrom and his attorney and that "we" discussed the preliminary report that "we" had presented to Mr. Thunstrom several months before. Ex. J12, at 11. Elsewhere, the auditor's log notes are even more specific in referring to "the taxpayer" and "we" as separate parties to the discussion. For example, with respect to spillage of tap beer, "[t]he taxpayer asked for 20%. We agreed to 15%." Ex. J12, at 11. Similarly, with respect to spillage of bottled beer, "[t]hey asked for 20%. We agreed to 10%." Ex. J12, at 11. With respect to liquor, "the taxpayer again requested the 70% happy hour sales percentage. . . . We agreed to take the happy hour percentage to 50%." Ex. J12, at 11.

322 Ex. J18.

323 Ex. J5.

### 4. Revenues from wine sales

#### a. The Commissioner's calculation

Worksheet A5 (Exhibit J6) is the Commissioner's estimate of revenues theoretically generated from wine sales. The Commissioner assumed that wine was sold only by the glass. The Commissioner further assumed an average wine pour size of 7.25 ounces and four prices for wine: $5.50 per glass for tier 1 wines ($2.75 during happy hour) and $7.00 for tier 2 wines ($3.50 during happy hour) regardless of pour size.[324] The Commissioner further assumed that wine sales were evenly divided between 6.5-ounce (red wine) and 8-ounce (white wine) glasses, and evenly divided between promotional and non-promotional prices.[325] Based on these assumptions, the Commissioner calculated an average price per ounce of wine sold of $.65355.[326] Starting with 35,556 ounces of wine purchased during 2008, the Commissioner subtracted 10% for spillage and another 9.22% for giveaways to arrive at a presumed 28,720 ounces of wine sold. Multiplying the presumed number of ounces sold by the presumed $.65355 price per ounce, the Commissioner calculated that Conga generated $18,769.98 in revenues from the sale of wine during 2008.[327] Conga's reported revenues from wine sales during 2008 were $14,158.11.[328]

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324 Ex. J6.

325 Ex. J6.

326 Ex. J6.

327 Ex. J6.

328 *See* Ex. J18.

### b. Findings regarding wine sales

As we have noted, the Commissioner assumed 2008 wine purchases of 35,556 ounces,[329] but understated the amount of wine purchased in 2008 by 3,643 ounces. The correct total for wine purchases in 2008 is 39,199 ounces. This overcomes the prima facie validity of the Commissioner's assessment with respect to revenues from wine sales. The Commissioner further assumed that wine sales were equally weighted between red and white wines.[330] More than half of Conga's wine purchases (61%) were of red wine, however.[331] This also overcomes the prima facie validity of the Commissioner's assessment with respect to wine sales. The Commissioner further assumed that all wine was sold by the glass.[332] Mr. Thunstrom estimated that 75% of Conga's wine is sold by the bottle, at prices ranging from $20 to $40 per bottle.[333] Indeed, Conga advertised half-priced bottles of wine on Tuesday nights during the last six months of 2008.[334] This overcomes the prima facie validity of the Commissioner's assessment with respect to wine sales.

During 2008, Conga purchased 1,415 bottles of wine.[335] Based on Mr. Thunstrom's testimony (including that lower-priced wines were more popular among Conga's clientele), and

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329 Ex. J6.

330 *See* Ex. J6.

331 *See* Ex. J3.

332 There is no indication on either the Bar Audit Questionnaire (Ex. J15) or the audit log notes (Ex. J12) that the auditor even inquired about wine sales by the bottle.

333 Tr. 198; Tr. 9 (Sept. 20, 2016).

334 Ex. J49.

335 Ex. J2, at Worksheet A1 (alcohol purchase detail).

accounting for specials on wine, we conclude that 990 bottles of wine were sold by the bottle, rather than by the glass, at an average price of $20 per bottle, generating revenues of $19,800 in 2008.[336] Of the 39,199 ounces of wine purchased during 2008, we therefore conclude that only 14,152 ounces were available to be sold by the glass.

As with liquor sales, the Commissioner's calculation of wine giveaways (9.22%) assumed that wine was, in fact, given away. As we have explained, during certain months in 2008 Conga advertised a "free" drink in return for payment of a $5 cover charge. We consider such drinks to have been purchased for $5.00, rather than having been "given away." Conga advertised some free drinks on Monday nights in certain months, but they were limited to well drinks and margaritas. There is no evidence that Conga gave away wine at any time during the year, and we make no reduction for wine giveaways.

Conga contends the Commissioner's estimate of wine lost to spillage and other causes (10% of wine purchased) was low. The bar's manager estimated Conga's spillage rate on wine is 50%, that is, half of all wine purchased was never sold.[337] We reject that figure as implausible. Again, Mr. Thunstrom estimated that 75% of wine purchases were sold by the bottle, as to which there would be little or no spillage or spoilage. Although the bar manager testified credibly that, given the relatively small volume of wine sold by the glass, open bottles frequently went bad before the entire bottle could be sold,[338] that testimony necessarily relates to only wine sold by the glass, or only 25% of Conga's wine purchases. Put another way, even if half of all

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336 Tr. 9 (Mr. Thunstrom testifying that bottles of wine sold between $20 and $40 per bottle).

337 Tr. 379.

338 Tr. 378-79.

wine not sold by the bottle went bad, that would be only 12.5% of Conga's total wine purchases. We apply Conga's figure of 50% spoilage to wine sold by the glass, but not to all wine purchased.

As to pour sizes, we weight the undisputed pour sizes of red (6.5 ounces) and white (8.0 ounces) according to the proportion of wine available and arrive at a weighted average pour size of approximately 7 ounces. As to the price of wine, the Commissioner assumed that wine was discounted by half during "happy hour," and that half of all wine was sold at a discount.[339] With the exception of discounts on wine sold by the bottle, there is no evidence in our record that wine was discounted, and we therefore find that all wine sold by the glass was sold at non-promotional prices ($5.50 per glass for tier 1 wines, $7.00 per glass for tier 2 wines). The Commissioner assumed that wine purchases were evenly divided between tier 1 and tier 2 wines, and finding nothing in our record to the contrary, we employ the same assumption.

Relying on the findings outlined above, we find that Conga's 2008 revenues from wine sales were $32,413. During 2008, Conga actually reported wine sales of $14,158.11.

**5. Revenues from beer sales**

Worksheet A3 (Exhibit J4) is the Commissioner's estimate of revenues generated from sales of bottled beer; Worksheet A2 (Exhibit J56) is the Commissioner's estimate of revenues generated from sales of tap beer.[340] In all, the Commissioner assumed that Conga's 2008 beer

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339 Ex. J6.

340 The Commissioner's post-trial briefing occasionally refers to sales of "canned" beer. *See, e.g.*, Comm'r's Opening Post-Remand Br. 16. The Commissioner's assessment did not assume sales of beer by the can, and there is no evidence in our record that Conga sold beer by the can at any point during the years at issue.

purchases generated a total of $247,101.31 in revenues.[341] Conga reported total revenues from the sale of beer (both tap and canned) during 2008 of only $86,663, based on its point-of-sale system.[342] We consider the record concerning tap beer sales and bottled beer sales separately.

**a. Revenues from bottled beer sales**

The Commissioner assumed a total of 88,080 bottles of beer purchased during 2008 (7,296 bottles of "regular" or domestic beer; 80,784 bottles of premium beer).[343] The Commissioner further assumed 70% of bottled beer was sold at a discount.[344] The Commissioner assumed regular prices of $4.00 per bottle of domestic beer and $5.00 per bottle of premium beer, with a happy hour discount of 50% ($2.00 per bottle of domestic, $2.50 per bottle of premium).[345] Based on these assumptions, the Commissioner calculated a weighted average price of $3.19616 per bottle. The Commissioner further assumed 10% of all bottled beer purchased was lost to spillage and breakage, and another 7.7% was given away in exchange for cover charges.[346] Applying these assumptions, the Commissioner calculated that Conga should have theoretically generated revenues of $231,676.71 from sales of bottled beer during 2008.[347] Again, during 2008, Conga

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341 Ex. J7.

342 See Ex. J18. Conga's point-of-sale system does not distinguish between tap beer and bottled beer sales. *See* Ex. J18, J19, J20.

343 Ex. J4.

344 Ex. J4.

345 Ex. J4.

346 Ex. J4.

347 Ex. J4.

reported revenues from sales of all types of beer (bottled and tap) of only $86,662.78, based on its point-of-sale system.[348]

Several of the Commissioner's assumptions are contrary to the factual record. First, the Commissioner assumed a discounted price on "premium" beer of $2.50 per bottle.[349] Of Conga's 2008 purchases of bottled beer, 58,728 bottles (more than 61%) were Corona,[350] a premium beer that Conga heavily advertised at the discounted price of $2.00 per bottle.[351] We find that virtually all Corona sales were at $2.00 per bottle. The Commissioner also assumed that the discounted sales price of regular or domestic beer was $2.00 each.[352] But Conga advertised domestic beer for $1.50 per bottle, for $1.00 per bottle, and 5 for $5.00 throughout 2008.[353]

During 2008, Conga purchased 88,080 bottles of beer: 58,728 bottles of Corona; 22,056 bottles of other premium beers; and 7,296 bottles of domestic beer.[354] Given Conga's extensive specials on Corona, we find that its total revenues from sales of Corona were $117,456, that is, an average sale price of $2.00 each. We further find that the average price of a bottle of "other"

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348 *See* Ex. J18.

349 Ex. J4.

350 *See* Ex. J3.

351 *See* Ex. J49. For example, Conga advertised Coronas for $2 each and buckets of Corona (5 for $10) on Sunday, Friday, and Saturday nights throughout 2008. Ex. J49.

352 Ex. J4.

353 Ex. J49. For example, Conga advertised $1.50 domestic beer on Monday nights, $5 buckets of domestic beer on Thursday nights, and $1.00 domestic beer on Friday and Saturday nights throughout 2008. Ex. J49.

354 Ex. J3.

premium beer was $3.25, using the Commissioner's weights of 70% promotional and 30% nonpromotional prices. For domestic beer, and again considering Conga's extensive specials on domestic beer, we find that the average sale price was $2.00 per bottle. We apply a breakage rate of 10%. In all, then, we find that Conga generated $183,160 in revenues from the sale of bottled beer during 2008.

**b. Revenues from tap beer sales**

Worksheet A2 (Exhibit J56) is the Commissioner's estimate of revenues generated from the sale of tap beer. The Commissioner assumed that all tap beer was sold in 14-ounce glasses at a regular price of $4.00 for domestic beers ($2.00 when discounted) and $4.50 for premium beers ($2.25 when discounted).[355] The Commissioner further assumed that 70% of all tap beer was sold at promotional prices.[356] After allowing 15% for spillage and another 6.38% for giveaways, the Commissioner assumed that Conga generated $15,424.60 in sales of tap beer during 2008.[357]

Conga challenges only one factor in the Commissioner's calculation: the spillage rate. According to Conga's witnesses, it should be much higher than 15%—perhaps as high as 50% considering the loss of beer to excessive foaming as the keg nears empty.[358] The Commissioner allowed 15% for spillage, and we find that Conga has failed to present substantial evidence to overcome the presumptive validity of that allowance. For the reasons already set forth, we decline

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355 Ex. J56.

356 Ex. J56.

357 Ex. J56.

358 Tr. 192, 374-75.

to adopt the Commissioner's assumption that tap beer was given away in return for cover charges. We therefore find that Conga generated $15,425 in revenues in 2008 from the sale of tap beer.

**c. Revenues from beer sales**

The Commissioner estimated that Conga generated $274,101.31 from the sale of beer during 2008. We find that Conga generated $15,425 from the sale of tap beer and $183,160 from the sale of bottled beer in 2008. During 2008, Conga reported total revenues from beer sales of $86,663. Conga thus underreported 2008 beer sales by $111,922.

**8. Total revenues.** The Commissioner concluded that under the unit-volume method, Conga should have reported total revenues during the sample period (January 1, 2008, to December 31, 2008) of $945,147.71.[359] We find that Conga's 2008 revenues were $872,420: $49,702 in cover charges; $412,999 from the sale of alcohol; $408,445 from the sale of food; and $1,274 in service charges. During 2008, Conga underreported revenues from the sale of alcohol to the Department of Revenue by $136,905, nearly all due to unreported sales of bottled beer.

## C. USE TAX ON ASSET PURCHASES AND ALCOHOL GIVEAWAYS

We turn to the Commissioner's assessment for unpaid use taxes. The Commissioner initially assessed Conga for $14,862.53 in Minnesota, Hennepin County, Minneapolis, and transit improvement use taxes on a total of $204,713.01 in 2008 purchases for which, according to the

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[359] The auditor assumed taxable cover charges of $45,500.04 (*see* Ex. J2 at Sch. A, pt. 1) and total alcohol sales of $522,801.77 (*see* Ex. J7), and accepted the taxpayer's reported food sales of $376,845.90 (*see* Ex. J18 (Daily Consolidated System Sales Details); J12, at 11 (indicating that the auditor elected "to not do any reconstruction on the food sales")).

Commissioner, there was no evidence that Conga had paid sales tax.[360] By the time of trial, the Commissioner had abandoned her original 2008 state use tax assessment, reducing it to $4,687.38 on a total of $72,113.50 in purchases and giveaways.[361] The Commissioner assessed an additional $1,019.64 in Minnesota, Hennepin County, Minneapolis, and transit improvement use taxes on a total of $14,015.64 of alcohol that the Commissioner assumed was "given away" during 2008 in exchange for payment of cover charges.[362]

We first address the assessment of use tax on purchases of goods, finding that Conga overcame prima facie validity of the assessment and established that the correct amount of sales tax was paid with respect to all but $25,812.96 in goods purchased during 2008.

The Commissioner's ultimate assessment was based on three categories of payments: (1) payments to 18 different individuals; (2) payments to businesses; and (3) payments to credit card companies and banks.

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360 Ex. J2, at Sch. C, part 1 (Minnesota use tax), Sch. F, part 1 (Hennepin County use tax), Sch. H, part 1 (Minneapolis use tax), Sch. J, part 1 (transit improvement use tax). Transit improvement use tax was in effect during 2008 only after June 30.

361 Ex. J57 (second amended Sch. C, part 1). Our record does not include similarly amended calculations of Hennepin County, Minneapolis, or transit improvement use taxes, but we assume the Commissioner intended to amend those assessments as well. On $72,113.50 in purchases, Hennepin County use tax is $108.17 and Minneapolis use tax is $360.57. Transit improvement use tax was in effect during 2008 only after June 30. By our calculations, of the purchases included in the second amended Schedule C, $44,051.10 were made before (and $28,062.40 after) the transit improvement tax took effect. *See* Ex J57. Transit improvement use tax of 0.25% on purchases of $28,062.40 totals $70.16.

362 *See* Ex. J2, at Sch. D, pt. 1; *see also* Ex. J57. Again, transit improvement use tax was in effect only after June 30, 2008.

With respect to payments to individuals, Mr. Thunstrom credibly testified that payments to twelve of them were for services.[363] With respect to the remaining six individuals (Teresa Villegas, Lory Sieraha, Lorenzo Chuma, Claudia Carrera, Alex Velez, and Avila Luna), however, there was no testimony as to the purpose of the payment. Payments to those individuals total $2,391.00.[364]

With respect to most of the payments to businesses, Mr. Thunstrom credibly testified that sales tax was included in the payment.[365] There were, however, three businesses (McKee Sign Services, Majic Works, and Seating Expert) with respect to which Mr. Thunstrom did not know or did not testify that sales tax was included in the payment.[366] Payments to those three businesses total $6,654.27.[367] In addition, on October 14, 2008, Conga made a single payment of $638.64 to a vendor or individual identified by the Commissioner as "unknown." [368] There was no testimony or other evidence concerning this payment.

Finally, during 2008 Conga made payments on no fewer than five separate credit card accounts.[369] Credit card statements for some (but not all) of these accounts for some (but not all) of 2008 are part of our record.

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363 Tr. 217-21.

364 *See* Ex. J57.

365 Tr. 217-52.

366 Tr. 217-52.

367 *See* Ex. J57.

368 *See* Ex. J57.

369 *See* Ex. J57.

With respect to the Chase MasterCard account (Ex. J22), there were seven payments in 2008 totaling $2,179.24 as to which Mr. Thunstrom did not know or did not testify that sales tax was included in the charge.[370] Those charges are as follows: $49.35 to Fermata Music Studios on January 7; $99.98 to MSCN on January 30; $140.89 to PK Graphics on May 7;$122.02 to Minneapolis Oxygen Co. on July 16; $109.00 to ClubDJPro on September 28; and $158.00 to PK Graphics on December 17.[371] We affirm the Commissioner's assessment of Minnesota, Hennepin County, Minneapolis, and transit improvement use taxes with respect to those charges.

With respect to the WorldPoints account there were four payments in 2008 totaling $3,045.08 as to which Mr. Thunstrom did not know or did not testify that sales tax was included in the charge.[372] Those payments are as follows: $1,500 to Circuit City (Miami) on September 6; $1,500 to Circuit City (Miami) on September 9; $5.00 to Allied Parking on October 6; and $40.08 to Peninsula on November 3.[373] In addition, there were two payments to Bank of America, issuer of the card: $5,203.99 in January and $3,106.81 in February.[374] The payments made to Bank of America in January and February were presumably payments on charges made in 2007 with the WorldPoints credit card,[375] but the statements of charges underlying those payments are not part of our record. Nor was there any testimony concerning the charges on

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370 Tr. 217-52.

371 *See* Ex. J57.

372 Tr. 217-52.

373 Ex. J28.

374 *See* Ex. J57, J27 (showing January and February payments).

375 *See* Ex. J27.

that card during 2007, much less testimony as to whether the charges included sales tax. We therefore affirm the Commissioner's assessment with respect to those payments.[376]

Mr. Thunstrom testified credibly that the other payments were for services (as to which sales tax does not apply), for goods as to which sales tax was collected by the seller, or for personal use.[377] The Commissioner offered no evidence to the contrary. We reduce the Commissioner's assessment with respect to Minnesota use tax (6.5%), Hennepin County use tax (0.15%), Minneapolis use tax (0.5%), and transit improvement tax (0.25%) to a total of $1,867.43 on 2008 purchases of $25,812.96.[378]

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376 We decry the dearth of information in our record with respect to the Commissioner's assessment of use tax on purchases made with credit cards. For example, the Commissioner assessed use tax on $3,801.99 paid to Chase Card Services on February 26, 2008. *See* Ex. J57. Conga paid Chase Card Services a total of $5,543.22 in that February 26 payment. *See* Ex. J22, at 2 (unnumbered). In other words, there were apparently $1,741.23 of charges to the Chase credit card on which no use taxes were assessed. But there is nothing in our record to indicate which charges the Commissioner taxed as part of the assessment and which were eliminated during the audit.

Nor, as importantly, is there anything in our record to indicate that the Commissioner informed *Conga itself* of the particular credit card charges included in the use tax assessment. If due process does not require the taxpayer be so informed, surely common courtesy must. Moreover, the Commissioner's failure to so inform Conga meant that Conga was obligated to elicit testimony about virtually purchase made with a credit card during 2008, whether that purchase was included in the assessment or not—a waste of time for both the parties and the court.

377 Tr. 217-52. For example, Mr. Thunstrom testified that 43 of the payments on which use tax was assessed (totaling $17,435) were payments for services. Tr. 217-20. Indeed, the Commissioner's schedule of "purchases subject to MN use tax" specifically labels six of those payments either "Flamenco" (payments to Conga's flamenco dancer) or "Services." *See* Ex. J57.

378 We apply transit improvement use taxes to only those purchases made after June 30, 2008. By our calculations, of the $25,812.96 in purchases made in 2008, $8,725.56 were made after June 30, on which the tax is $21.81.

The Commissioner contends that Conga "provided no *additional* evidence at trial showing [it] paid sales tax on the remaining purchases subject to use tax in Schedule C or that any of the sales were exempt from sales tax." [379] Although acknowledging Mr. Thunstrom's testimony, the Commissioner's memorandum dismisses that testimony as "evidence," arguing that this court can accept only "receipts" or "invoices" as proof of payment of sales tax.[380]

We disagree. The Commissioner effectively contends that the taxpayer must produce the "best evidence," that is, receipts and invoices, of payment of sales tax. We do not disagree that receipts and invoices would be stronger evidence of payment of sales tax. But, as the supreme court has held, "[a] party is not required to produce the best, in the sense of the most trustworthy and credible, evidence at his command." *Buffalo Ins. Co. v. United Parking Stations, Inc.*, 277 Minn. 134, 138-39, 152 N.W.2d 81, 84 (1967). "He may prove his case by weak and inconclusive circumstantial evidence though he may have in his power clear, direct, and conclusive evidence." *Id.* at 139, 152 N.W.2d at 84 (internal quotation omitted).

Indeed, the appeal in *Buffalo Insurance Co.* arose precisely because the district court dismissed an insurer's subrogation claim for the insurer's failure to produce a cancelled check as "best evidence" of its payment for the loss, despite its insured's testimony that the insurer paid for repairs. *Id.* at 135-38, 152 N.W.2d at 82-84. In reversing the dismissal and ordering a new trial,

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[379] Comm'r's Second Amended Proposed Findings of Fact and Conclusions of Law ¶ 61 (emphasis added).

[380] Comm'r's Second Amended Proposed Findings of Fact and Conclusions of Law ¶¶ 61 ("Although Mr. Thunstrom testified Appellant likely paid sales tax on many of the transactions on the credit card statements, he admitted Appellant has no receipts for the purchases and provided no other substantiation for his claims."), 62 ("Although Mr. Thunstrom testified many of the payments in Schedule C were to employees or for other non-taxable services, he was unable to provide invoices or other proof of the purchase of these payments.").

the supreme court noted: "The present 'best-evidence' rule is merely a name for the rule which requires the contents of a writing to be proved by the writing itself if it is available. It is not a broad, general principle applicable throughout the law of evidence." *Id.* at 138, 152 N.W.2d at 84. Moreover, it is not "the contents of a writing" that is at issue here; rather, as in *Buffalo Insurance Co.*, it is whether there was a payment of sales tax.

In support of her position, the Commissioner cites our decision in *Keogh v. Commissioner of Revenue*, No. 5492, 1991 WL 67532 (Minn. T.C. Apr. 22, 1991), a case involving the sales tax returns of a business, the income tax returns of the same business, and the income tax returns of the owners of the business.[381] In *Keogh* we said: "Except in those cases where obvious expenditures have occurred, in which case a reasonable amount will be allowed, mere testimony of the appellants unsupported by receipts or other documentation will usually not be sufficient." *Id.* at *5. *Keogh* is no support for the Commissioner's position here, for several reasons.

First, the question here is not whether "expenditures have occurred;" they unquestionably have. Rather, the question is whether those expenditures included sales tax and, if not, why not. Second, Mr. Thunstrom's testimony is *not* "unsupported by receipts or other documentation." Indeed, the Commissioner's assessment of use tax on payments to various vendors relies entirely on Conga's books and records. Third, having said in *Keogh* that "mere testimony . . . unsupported by receipts or other documentation will usually not be sufficient," we proceeded to accept *just that* in *Keogh* on several points, such as appellants' monthly expenditures for food and whether appellants owned any life insurance policies or paid premiums on such policies. *Id.* at *7. *Keogh* cannot be read as a blanket rejection of witness testimony. Finally, as we have explained, our

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381 Comm'r's Opening Post-Remand Br. 21.

review of the Commissioner's order is *de novo* and both parties are to be allowed to present evidence. Nothing in chapter 271 purports to limit the kind of evidence that either party can introduce.

The Commissioner also assessed use taxes totaling $1,151.95 on $46,078.30 of alcohol assumed to have been given away during 2008 in return for payment of a cover charge.[382] As we have previously explained, the record demonstrates that, when cover charges were in effect, they were used to *purchase* food and alcohol. Nevertheless, Conga advertised free well drinks and margaritas for some customers on Monday nights during certain months in 2008, which (we have concluded) amounted to 1% of liquor purchased during 2008, or $8,283.00. We reduce the Commissioner's assessment of liquor gross receipts use tax (2.5%), Hennepin County use tax (0.15%), Minneapolis use tax (0.5%), and transit improvement use tax (0.25%) on 2008 liquor purchases accordingly.

## D. ASSESSMENTS FOR 2007, 2009, AND FIRST QUARTER 2010

Having determined Conga's liability for sales and use tax for 2008, we turn to the other years included in the audit. The parties agreed that 2008 would function as a "test" or "sample" year.[383] Therefore, the Commissioner extrapolated to 2007, 2009, and first quarter 2010 the results of her calculations for 2008. For example, the Commissioner determined that Conga had underreported revenues subject to Minnesota's general sales tax by $245,118.80 in 2008 alone.[384]

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382 *See* Ex. J8 (Worksheet C1).

383 Stip. ¶ 19 ("Appellant does not dispute the Commissioner's use of 2008 as a sample year for purposes of the audit at issue.").

384 Ex. J2, at Sch. A, part 2.

Given that Conga reported 2008 sales subject to general sales tax of $735,515, the Commissioner figured that Conga's *actual* sales exceeded its *reported* sales by 33.326146% (that, is, $245,118.80 divided by $735,515).[385] The Commissioner applied that percentage to Conga's sales as reported for 2007, 2009, and first quarter 2010 to arrive at Conga's unreported sales for the balance of the audit period.[386] For 2007, Conga reported sales subject to general sales tax of $822,128; the Commissioner assumed those sales were underreported by 33.326146%, or $273,983.52.[387] For 2009, Conga reported sales subject to general sales tax of $735,515; the Commissioner assumed those sales were underreported by 33.326146%, or about $237,332.[388] Similarly, for first quarter 2010 Conga reported sales subject to general sales tax totaling $174,686;[389] the Commissioner assumed those sales were also underreported by 33.326146%, or $58,216.11.[390]

The same technique applied to other taxes as well. For example, in 2008 Conga reported liquor sales of $277,362.[391] The Commissioner calculated Conga's actual 2008 liquor sales to be $475,706.76, meaning that Conga underreported its liquor sales by 71.511151%.[392] The Commissioner applied that percentage to Conga's liquor sales as reported for 2007, 2009, and first

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385 Ex. J2, at Sch. A, part 2.

386 Ex. J2, at Sch. A, part 3.

387 Ex. J2, at Sch. A, part 3.

388 Ex. J2, at Sch. A, part 3.

389 Ex. J2, at Sch. A, part 3.

390 Ex. J2, at Sch. A, part 3.

391 Ex. J2, at Sch. B, part 2.

392 Ex. J2, at Sch. B, part 2.

quarter 2010 to arrive at Conga's presumed unreported liquor sales for the balance of the audit period. For example, Conga reported liquor sales of $340,112 in 2007; the Commissioner assumed those sales were underreported by 71.511151%, or $273,983.58.[393] Conga reported liquor sales of $237,943 in 2009; the Commissioner similarly assumed those sales were underreported by 71.511151%, or $170,155.79.[394] In the first quarter of 2010, Conga reported liquor sales of $56,448; the Commissioner assumed those sales had also been underreported by 71.511151%, or $40,366.62.[395] Because our record includes little information about 2009 or first quarter 2010, we conclude that each of the parties is content to have us also use 2008 as a "test" or "sample" year, as the Commissioner did.

As explained above, Conga's unreported sales for 2008, 2009, and 2010 are entirely attributable to unreported sales of alcohol: the Commissioner assumed that Conga correctly reported all sales of food during the audit period, and we have determined that Conga reported revenues from cover charges during the audit period. For 2008, we have found that Conga underreported alcohol sales subject to Minnesota's general sales tax by a total of $136,905, or about 41.86%, due largely to unreported sales of bottled beer. During 2009, Conga reported alcohol sales of $237,943 and reported no service charges. We apply the percentage to conclude that Conga underreported 2009 alcohol sales by $99,598. We find Conga underreported 2009 service charges by $1,274. Those figures represent Conga's unreported 2009 revenues subject to Minnesota general sales tax, Minnesota liquor gross receipts tax, Hennepin County sales tax,

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393 Ex. J2, at Sch. A, part 3.

394 Ex. J2, at Sch. B, part 3.

395 Ex. J2, at Sch. B, part 3.

Minneapolis sales tax, and transit improvement sales tax. For first quarter 2010, Conga reported alcohol sales of $56,448. We apply the same percentage to conclude that Conga underreported alcohol sales during the first quarter of 2010 by $23,628. That figure represents Conga's unreported 2010 revenues subject to Minnesota general sales tax, Minnesota liquor gross receipts tax, Hennepin County sales tax, Minneapolis sales tax, and transit improvement sales tax. For 2007, we adopt the Commissioner's figure for unreported alcohol sales of $273,984. That figure represents Conga's unreported 2007 revenues subject to Minnesota general sales tax, Minnesota liquor gross receipts tax, Hennepin County sales tax, and Minneapolis sales tax.[396] In all, we find that Conga underreported revenues to the Department of Revenue totaling $583,437 across the audit period. We reduce the Commissioner's assessment of sales taxes to the following:

| | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| General Minnesota sales tax | $20,849.27 | $8,898.81 | $6,745.82 | $1,712.01 |
| Liquor gross receipts tax | $6,849.60 | $3,390.77 | $2,489.95 | $590.70 |
| Hennepin County sales tax | $481.14 | $205.36 | $151.31 | $37.35 |
| Minneapolis sales tax | $1,603.79 | $684.52 | $504.36 | $124.51 |
| Transit improvement sales tax | N/A | $171.13 | $252.18 | $62.25 |

With respect to use taxes, we have determined that during 2008, Conga purchased only $25,812.96 in goods as to which sales tax was owed but not paid. We use the same figure for 2009 and for the first quarter of 2010 (prorated appropriately). For 2007, we use the Commissioner's amended figure of $72,113.50.

The Commissioner assumed that Conga gave away a total of $46,078.30 in alcohol during the audit period. We have determined that Conga gave away only $8,283 of alcohol during 2008, or 1% of its 2008 liquor purchases. In the absence of any other information in our record, we

396 Transit improvement sales tax applies only after June 30, 2008.

assume that Conga gave away the same amounts (that is, 1% of alcohol purchases) in 2009 and the first quarter of 2010 (prorated).[397] For 2007, we use the Commissioner's figure of $14,015.68. In all, then, we conclude that Conga gave away $32,652.43 of alcohol during the audit period.

Using these figures, we reduce the Commissioner's assessment of use taxes to the following:

| | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| General Minnesota use tax | $5,598.40 | $2,216.24 | $2,216.24 | $554.06 |
| Liquor use tax | $350.39 | $207.08 | $207.08 | $51.78 |
| Hennepin County use tax | $129.19 | $51.14 | $51.14 | $12.79 |
| Minneapolis use tax | $430.65 | $170.48 | $170.48 | $42.62 |
| Transit improvement use tax | N/A | $21.81 | $85.24 | $21.31 |

To assess Minneapolis entertainment tax, the Commissioner assumed that Conga offered live entertainment during 3% of the hours it was open for business.[398] The Commissioner therefore applied Minneapolis entertainment tax to 3% of Conga's total sales revenues (both reported and unreported). Conga has not challenged the Commissioner on this point, nor is our record sufficient to distinguish between sales made during live entertainment and sales made at other times. We therefore apply the same assumptions, namely, that Minneapolis entertainment tax applies to 3% of Conga's total sales (both reported and unreported) across the audit period. We reduce the Commissioner's assessment accordingly:

| | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Mpls. entertainment tax | $986.50 | $784.03 | $750.62 | $127.68 |

397 *See* Ex. J8 (Worksheet C1, Use Tax Summary). Our record includes alcohol purchase records provided by a number of local vendors, but only for 2007 and 2008. *See* Ex. J50, J51, J52, J53, J54, J55.

398 *See* Ex. J2, at Sch. K.

## E. PENALTIES

The Commissioner assessed penalties for negligence and for late-filed sales and use tax returns.[399] There being no dispute that certain sales and use tax returns were not timely filed, we affirm the imposition of late-filing penalties. With respect to penalties for negligence, we also affirm. Under Minn. Stat. § 289A.60, subd. 5 (2016), a 10% penalty is assessed "[i]f part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws." Conga has provided us with no evidence to the contrary.

## F. CONCLUSION

In all, we reduce the Commissioner's assessment of tax from $131,976.61 to $71,041.76. We instruct the Commissioner to recalculate penalties and interest on the modified assessment consistent with our decision.

J.H.T.

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399 *See* Ex. J2.