

OHIO BOARD OF TAX APPEALS

The Cygnus Group, Inc.,)
Appellant,) CASE NO. 2005-R-481
vs.) (SALES TAX)
William W. Wilkins,)
Tax Commissioner,) DECISION AND ORDER
Appellees.)

APPEARANCES:

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Entered August 4, 2006

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur.

This matter is before the Board of Tax Appeals upon a notice of appeal filed by The Cygnus Group, Inc. (“Cygnus”). Cygnus appeals a final determination of the Tax Commissioner, in which the commissioner denied the appellant’s petition for reassessment and affirmed a previously issued sales tax assessment, number 7040409712, as modified, for \$29,906.12, including tax, penalty, and interest, for the period October 1, 2001 through December 31, 2003. See S.T. at 1-2.

The following facts are uncontroverted. Cygnus is an S corporation owned by Daniel and Ellen Betting, husband and wife. S.T. at 81, 111, 115; Appellant's Ex. 2. Cygnus operates two fitness center franchises under Curves International, doing business as Curves for Women. S.T. at 1, 81. The first center is located in Brunswick, Ohio, and was opened in October 2001. S.T. at 4, 81. The second center is located in Berea, Ohio, and began operations in May 2003. S.T. at 81.

Cygnus sells fitness facility memberships as well as diet foods and vitamin supplements. S.T. at 81; H.R. at 12-13. A fitness facility membership allows members use of the hydraulic-based exercise equipment, receipt of spa treatments, and participation in weight loss classes and other programs. S.T. at 81; H.R. at 13. Members pay for these privileges in one of three ways. H.R. at 14, 38. First, they can pay monthly. H.R. at 14, 15, 38. Second, they can pay their initial sign-up fee and monthly use fees in one lump sum. H.R. at 14, 17, 38. Third, they can pay their initial sign-up fee immediately, and then pay their annual fee in monthly installments, with the payments automatically withdrawn from their checking accounts. H.R. at 14-15, 17-18, 38-39.

Mr. Betting testified that he was in charge of keying the membership transactions into the Quick Books software for the business. S.T. at 113-114; H.R. at 10. Further, Mr. Betting stated that when he initially keyed in a month-to-month membership, he incorrectly keyed in the value of all twelve months rather than just the one month he received. H.R. at 39, 42, 56, 57, 61, 64, 72. According to Mr. Betting, he prepared the

sales tax returns and the accountant prepared the federal income tax returns based only upon cash received. H.R. at 44, 45.

Mr. Betting testified that upon beginning operations, Cygnus sought advice on whether it needed to collect sales taxes on its membership fees. S.T. at 4; H.R. at 11-12. Its accountant called the state and was told that since Cygnus was a service provider, it did not need to charge sales tax. S.T. at 4, 84; H.R. at 11. However, after repeated attempts by the Cygnus' accountant to ascertain whether sales taxes needed to be charged, the accountant was told that this was a gray area. Therefore, to be safe, Cygnus should charge sales tax. S.T. at 84; H.R. at 12. In the fall of October 2003, Cygnus began collecting sales tax on its sales of physical fitness memberships. S.T. at 83; H.R. at 12, 76.

In December of 2003, the Ohio Department of Taxation received an anonymous letter stating that Cygnus was not collecting sales tax on its physical fitness memberships. S.T. at 81, 83. An initial review of the sales tax returns filed with the department showed that Cygnus remitted only a nominal amount of tax in comparison with its reported gross sales. S.T. at 83. Cygnus uses a cash basis of accounting for reporting purposes. S.T. at 4; H.R. at 24. However, according to Mr. Betting, its Quick Books accounting package is accrual based. H.R. at 25.

On January 12, 2004, the appellant received a notice of audit from the Tax Commissioner for sales tax. S.T. at 80, 84. The commissioner's agent reviewed appellant's membership agreements, sales journals, monthly sales summaries, federal

income tax returns, and chart of accounts. S.T. at 84. The agent prepared a summary recommending a sales tax assessment for tax, penalty, and interest in the amount of \$32,245.42. S.T. at 106, 110. A notice of assessment was issued on June 10, 2004. S.T. at 106.

On August 10, 2004, appellant filed a petition for reassessment, claiming that the commissioner's methodology was in error because the agent computed tax based on subscription amount without giving sufficient credit to discounts given from those subscription amounts and without taking into account the terminations of subscriptions. S.T. at 3-5. In other words, Cygnus argues that the tax computations were based on the gross amounts stated in its contracts with its customers rather than on amounts actually received by Cygnus. In addition, the appellant requested that the penalty be abated because of its reliance on erroneous information from the Department of Taxation as to whether the transactions in question were taxable.

Upon review, the Tax Commissioner found that the appellant did not collect sales tax on its taxable physical fitness membership charges until August 2003. S.T. at 1-2. Therefore, the assessment was affirmed except that part of the penalty was remitted. S.T. at 2. The commissioner stated that the taxpayer failed to provide sufficient primary evidence relating to the discounts, such as invoices or billing statements, indicating the amounts of the discounts. S.T. at 1. Furthermore, the Tax Commissioner found that the test check did account for discounts. S.T. at 1; H.R. at 63. The commissioner also noted

that the taxpayer did not substantiate and provide evidence of the claimed early terminations. S.T. at 2.

The appellant objects to the amount of the assessment, claiming that the tax agent overstated its sales tax liability by using Cygnus' accounting books and records, which were erroneous, instead of using the appellant's income tax returns and bank statements.

The matter is submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript ("S.T.") certified to the board by the Tax Commissioner, the record of the hearing ("H.R.") before this board, including exhibits, and the briefs of counsel. At the hearing before the board, Cygnus called Daniel Betting, appellant's vice president, as a witness on its behalf. The Tax Commissioner was represented by counsel, but presented no witnesses or documentation other than cross-examination.

First, the board notes that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121, 123. Consequently, it is incumbent upon a taxpayer challenging a determination of the Tax Commissioner to rebut that presumption. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135, 143; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138, 142. The taxpayer has the duty to come forward and prove the commissioner's findings are unreasonable, unlawful, or erroneous. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213, 215, *Manfredi Motor Transit Co. v. Limbach* (Aug. 17, 1990), BTA No. 1987-F-279, unreported. When no competent and probative evidence is presented by the

appellant to show that the commissioner's findings are incorrect, then the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Hatchadorian v. Lindley* (1986), 21 Ohio St.3d 66; *Averill v. Limbach* (Aug. 23, 1991), BTA No. 1990-C-1647, unreported.

The state of Ohio levies an excise tax on each retail sale made in Ohio, unless the transaction is specifically exempted. R.C. 5739.02(C). R.C. 5739.01(B) defines "sale" and "selling" as:

"Sale' and 'selling' include all of the following transactions for a consideration in any manner, whether absolutely or conditionally, whether for a price or rental, in money or by exchange, and by any means whatsoever:

"(3) All transactions by which:

"(n) Physical fitness facility service is or is to be provided.

R.C. 5739.01(MM) provides that:

"Physical fitness facility service' means all transactions by which a membership is granted, maintained, or renewed, including initiation fees, membership dues, renewal fees, monthly minimum fees, and other similar fees and dues, by a physical fitness facility such as an athletic club, health spa, or gymnasium, which entitles the member to use the facility for physical exercise."

Although the consumer is to pay the tax, each vendor is charged with the responsibility to collect the tax from the consumer, as trustee for the state of Ohio, and

remit the same to the state. R.C. 5739.03(A). Furthermore, each person making retail sales in the state of Ohio is required to file sales tax returns. R.C. 5739.12. To the extent a vendor either fails to collect or remit the sales tax, that individual will be personally liable. R.C. 5739.13(A). Specifically,

“(A) ***

“If any vendor fails to collect the tax or any consumer fails to pay the tax imposed by or pursuant to section 5739.02 *** of the Revised Code, on any transaction subject to the tax, the vendor or consumer shall be personally liable for the amount of the tax applicable to the transaction. The commissioner may make an assessment against either the vendor or consumer, as the facts may require, based upon any information in the commissioner’s possession.

“***

“The commissioner may make an assessment against any vendor who fails to file a return or remit the proper amount of tax required by this chapter, or against any consumer who fails to pay the proper amount of tax required by this chapter. When information in the possession of the commissioner indicates that the amount required to be collected or paid under this chapter is greater than the amount remitted by the vendor or paid by the consumer, the commissioner may audit a sample of the vendor’s sales or the consumer’s purchases for a representative period, to ascertain the per cent of exempt or taxable transactions or the effective tax rate and may issue an assessment based on the audit. The commissioner shall make a good faith effort to reach agreement with the vendor or consumer in selecting a representative sample.”

Each vendor is required to keep complete and accurate records of sales, including the sales tax collected. R.C. 5739.11. Ohio Adm. Code 5703-9-02 provides in part as follows:

“(A) Since all sales of tangible personal property in this State are presumed to be subject to Sales Tax until the contrary is established, the burden of proof rests upon each vendor to show what part, if any, of their gross receipts from sales resulted from nontaxable sales.

“Each vendor must maintain complete and accurate records which include both:

“(1) Primary records such as invoices, bills of lading, sales invoices, guest checks, exemption certificates, tax payment receipts, and cash register tapes;

“(2) Secondary records such as bank deposit receipts and day books, journals, or any other records in which accumulated data is recorded.

“Any record in which accumulated data is recorded by the vendor must be supported by complete detail records from which such data was accumulated.

“Sales invoices and cash register tapes for taxable sales must have separately stated thereon the total price and the tax amount charged, which amounts are to be accumulated and recorded in a secondary record. ***.”

In the present case, Cygnus provided the tax agent with some primary records of its retail sales; however, these records were not complete. S.T. at 82. Cygnus also provided the agent with financial data accumulated on its Quick Books software. Since this was the best information provided, in the tax agent’s opinion, the agent used the information from the appellant’s Quick Books to determine the amount of tax due. R.C. 5739.13(A).

The amount of gross sales shown on Cygnus’ federal tax returns and its bank statements did not match either the amounts shown on its Quick Books summaries or

on its sales tax returns. Furthermore, Cygnus was unable to show exactly what amount the discounts from gross sales totaled and what was the effect of any early membership terminations. S.T. at 2. In addition, the agent was able to determine that membership discounts were properly accounted for and considered in the audit calculations in the sample month. S.T. at 1, 86.

At the hearing before this board, Cygnus provided several sample membership agreements (Appellant's Ex. 1), its 2001, 2002, and 2003 federal income tax returns (Appellant's Ex. 2), copies of documents from its Quick Books (Appellant's Ex. 3),¹ and a summary showing the claimed differences from the tax assessment and the tax returns (Appellant's Ex. 4). However, for the most part, these documents and the testimony of Mr. Betting are not primary evidence and are not sufficiently detailed to establish gross sales actually collected less any discounts. Also, Mr. Betting filed sales taxes on a six-month rather than a monthly basis. S.T. at 82. It is unclear whether or not some of these "erroneous" keyings, as Mr. Betting characterizes instances in which he keyed in more than one monthly payment collected, should have been included in the six-month period from the information contained in the record. Therefore, in this board's opinion, the Tax Commissioner was justified in using Cygnus' Quick Books to determine the amount of tax due. R.C. 5739.13(A). Furthermore, the appellant failed to demonstrate exactly how the Tax Commissioner erred.

The Tax Commissioner's authority to abate penalties assessed pursuant to R.C. 5711.27 is discretionary. R.C. 5711.28; *Coleman Young Motors, Inc. v. Limbach*

(1988), 51 Ohio App.3d 117. Therefore, this board should not reverse the Tax Commissioner's decision unless the commissioner's actions constitute an abuse of discretion. *Id.*; *Moon v. Tracy* (Nov. 24, 1993), BTA No. 1993-B-157, unreported. Generally, the Tax Commissioner abuses his discretion when the record manifests that his decision is "unreasonable, arbitrary, or unconscionable." *Jennings & Churella Constr. Co. v. Lindley* (1984), 10 Ohio St.3d 67.

Relative to what constitutes an abuse of discretion, we note the Supreme Court of Ohio's decision in *Huffman v. Hair Surgeon, Inc.* (1985), 19 Ohio St.3d 83, 87, in which the court, quoting *State v. Jenkins* (1984), 15 Ohio St.3d 164, 222, stated:

"[A]n abuse of discretion involves far more than a difference in *** opinion ***. The term discretion itself involves the idea of choice, of an exercise of the will, of a determination made between competing considerations. In order to have an 'abuse' in reaching such determination, the result must be so palpably and grossly violative of fact and logic that it evidences not the exercise of will but perversity of will, not the exercise of judgment but the defiance thereof, not the exercise of reason but rather of passion or bias. ***."

Cygnus contends that the Tax Commissioner erred in failing to remit the penalty added to the sales tax assessment, because its accountant inquired of the state and was told that since Cygnus provided services, its membership fees were not taxable. The commissioner initially assessed a forty-five percent penalty, modifying it to thirty-five percent in the final determination. S.T. at 1-2, 87.

¹ Mr. Betting did not recognize or acknowledge that this document was something that he produced. H.R. at 27, 31.

The Tax Commissioner is authorized to remit such part of a penalty assessed, in whole or in part, as he may deem proper. *Jennings*, supra. This board's duty is to determine whether the Tax Commissioner abused his discretion in denying full abatement of the subject penalty, i.e., to determine whether the commissioner's decision was "unreasonable, arbitrary or unconscionable." *Jennings*, supra. See, also, *Huffman*, supra.

It is well settled in Ohio that the term "abuse of discretion" connotes more than an error of judgment. Instead, as the term implies, in relation to interfering with the discretionary power of administrative officers, it must be demonstrated that there has been a "perversity of will, passion, prejudice, partiality, or moral delinquency" that affected the decision-making process. *State ex rel. Shafer v. Ohio Turnpike Comm.* (1953), 159 Ohio St. 581, 590-591; *State ex rel. Commercial Lovelace Motor Freight, Inc. v. Lancaster* (1986), 22 Ohio St.3d 191, 193.

At the hearing before this board, Cygnus failed to establish abuse of discretion. Moreover, the record before us is devoid of any evidence that the Tax Commissioner abused his discretion by failing to remit the entire statutory penalty.

Also, although the appellant claims that its accountant was told by the Department of Taxation that sales taxes did not apply to Cygnus' activities, it is well settled that estoppel does not apply against the state of Ohio in making tax assessments, even where an employee makes a misleading or confusing statement. *American Handling Co. v. Kosydar* (1975), 42 Ohio St.2d 150; *Ormet Corp. v. Lindley* (1982), 69 Ohio St.2d

263. See, also, *Loveland Park Baptist Church v. Kinney* (May 25, 1983), Warren App. No. 126, unreported; *State ex rel. Cooker Restaurant Corp. v. Montgomery Cty. Bd. of Elections* (1997), 80 Ohio St.3d 302, 307.

Based upon the foregoing, the board finds that Cygnus did not demonstrate how the Tax Commissioner erred in making his assessment and how the commissioner acted unreasonably, arbitrarily, or unconscionably in failing to remit the full penalty. Accordingly, it is the decision and order of the Board of Tax Appeals that the decision of the Tax Commissioner must be, and hereby is, affirmed.

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