

Texas Comptroller of Public Accounts STAR System

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201511714H

SOAH DOCKET NO. 304-15-3960.13  
CPA HEARING NO. 112,081

RE: \*\*\*\*\*  
TAXPAYER NO.: \*\*\*\*\*  
AUDIT OFFICE: \*\*\*\*\*  
AUDIT PERIOD: January 1, 2008 THROUGH December 31, 2008

Franchise Tax/RDT

BEFORE THE COMPTROLLER  
OF PUBLIC ACCOUNTS  
OF THE STATE OF TEXAS

GLENN HEGAR  
Texas Comptroller of Public Accounts

JANICE CAHALANE  
Representing Tax Division

\*\*\*\*\*  
Representing Petitioner

SOAH DOCKET NO. 304-15-3961.13  
CPA HEARING NO. 112,082

RE: \*\*\*\*\*  
TAXPAYER NO.: \*\*\*\*\*  
AUDIT OFFICE: \*\*\*\*\*  
AUDIT PERIOD: January 1, 2009 THROUGH December 31, 2009

Franchise Tax/RDT

BEFORE THE COMPTROLLER  
OF PUBLIC ACCOUNTS  
OF THE STATE OF TEXAS

GLENN HEGAR  
Texas Comptroller of Public Accounts

JANICE CAHALANE  
Representing Tax Division

\*\*\*\*\*  
Representing Petitioner

COMPTROLLER'S DECISION

This decision is final on November 30, 2015, unless a motion for rehearing is timely filed. SEE Administrative Procedure Act, Tex. Gov't Code SECTION 2001.142, .144, .146; 34 Tex. Admin. Code SECTION 1.29, .31, .32. A party that files a motion for rehearing must file it with the Deputy Comptroller through the Special Counsel for Tax Hearings at P.O. Box 13528, Austin, Texas 78711-3528 or by facsimile at 512-936-6190. A copy of the motion must be served on the opposing party. The failure to timely file a motion for rehearing may result in adverse legal consequences.

Administrative Law Judge (ALJ) Peter Brooks of the State Office of Administrative Hearings (SOAH) issued a Proposal for Decision (PFD) that includes Findings of Fact and Conclusions of Law. SOAH served the PFD on each party and each party was given an opportunity to file exceptions and replies with SOAH in accordance with SOAH's rules of procedure. The ALJ recommended that the Comptroller adopt the PFD as written.

After review and consideration, IT IS ORDERED that the PFD is adopted as changed pursuant to Texas Government Code SECTION 2003.101(e) and (f).

The results from this Decision are Attachments A. The ALJ's letter to the Comptroller is Attachment B. The PFD as changed is Attachment C. Attachments A, B, and C are incorporated by reference.

Attachments A reflect liabilities.

Pursuant to Texas Tax Code SECTION 111.0081(c), the total sum of the tax, penalty and interest is due and payable 20 days after a comptroller's decision becomes final. If such sum is not timely paid, an additional penalty of 10 percent of the taxes due will accrue.

SIGNED on this 5th day of November 2015.

GLENN HEGAR  
Texas Comptroller of Public Accounts

by: Mike Reissig  
Deputy Comptroller

Attachments A, Texas Notifications of Hearing Results  
Attachment B, ALJ's letter to the Comptroller  
Attachment C, Proposal for Decision as changed

ATTACHMENT C

SOAH DOCKET NO. 304-15-3960.13  
TCPA HEARING NO. 112,081

\*\*\*\*\*  
Taxpayer No. \*\*\*\*\*

v.

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

SOAH DOCKET NO. 304-15-3961.13

TCPA HEARING NO. 112,082

\*\*\*\*\*

Taxpayer No. \*\*\*\*\*

v.

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION

\*\*\*\*\* (Petitioner) is the reporting entity for the combined group that includes several affiliates that brew or market beer. The Tax Division (Staff) of the Texas Comptroller of Public Accounts (Comptroller) audited Petitioner for franchise tax compliance for the report years 2008 and 2009 and assessed a tax liability consisting of tax and interest. Penalties were waived. In this Proposal for Decision (PFD), the Administrative Law Judge (ALJ) finds that Petitioner failed to demonstrate that it was entitled to the cost of goods sold (COGS) deduction as originally claimed on its 2008 and 2009 franchise tax reports. Therefore, the ALJ recommends that the audit assessment be affirmed without change.

I. PROCEDURAL HISTORY, NOTICE, AND JURISDICTION

On May 21, 2015, Staff referred these matters to the State Office of Administrative Hearings (SOAH) for a hearing based on the parties' written submissions. The ALJ granted Staff's Unopposed Motion for Joinder of Hearings after finding that the cases involve the same issues of law and fact, and ordered the cases joined for purposes of issuing a single PFD. Petitioner was represented by its domestic tax manager, \*\*\*\*\* , and Staff was represented by Assistant General Counsel Janice Cahalane. The record closed on August 6, 2015.

There are no contested issues of notice or jurisdiction. Therefore, these matters are set out in the Findings of Fact and Conclusions of Law without further discussion.

II. REASONS FOR DECISION

A. Evidence Presented

Staff submitted the administrative record consisting of the pleadings filed prior to the referral of the cases to SOAH and submitted the following exhibits:

1. Texas Notification of Audit Results for Report Year 2008;
2. Texas Notification of Audit Results for Report Year 2009;
3. Sixty-Day Letter for Report Year 2008;
4. Sixty-Day Letter for Report Year 2009;
5. Penalty and Interest Waiver Worksheet for Report Year 2008;
6. Penalty and Interest Waiver Worksheet for Report Year 2009;
7. Audit Report for Report Year 2008;
8. Audit Report for Report Year 2009;
9. Audit Plan for Report Year 2008;
10. Audit Plan for Report Year 2009;
11. Independent Audit Review (IAR) Conference Report;
12. Examples of Petitioner's Utility Bills; and
13. Petitioner's Master Brewing Agreement.

Petitioner submitted as its Exhibit 1, the same utility bills included in Staff's Exhibit 12, and submitted as its Exhibit 2 a table listing the amounts recorded on those utility bills. Petitioner also offered as an evidentiary exhibit a letter it addressed to Staff, dated May 5, 2015, which is deemed part of the administrative record. The submitted exhibits are admitted without objection.

#### B. Agreed Adjustments

Staff did not agree to make any adjustments to the audit assessment.

#### C. Background and Issues Presented

Staff audited Petitioner for franchise tax compliance for report years 2008 and 2009. The audit adjustments that are in dispute in this proceeding involve the auditor's disallowance of certain sewage costs that Petitioner included in its calculation of the COGS deduction for both report years. [ENDNOTE: (1)] The auditor rejected Petitioner's arguments that the costs were for water that was used as a consumable in the brewing process and that the sewer charges qualified as deductible COGS because any services provided by a public utility company were automatically included in the definition of a deductible utility cost. [ENDNOTE: (2)] The auditor noted that Petitioner had not provided any documentation verifying that the disallowed costs actually represented water billed by a public utility. [ENDNOTE: (3)] The auditor disallowed sewer charges of \$8,367,279 and \$8,083,033 included as the COGS deduction reported respectively on Petitioner's franchise tax reports for report years 2008 and 2009. [ENDNOTE: (4)] The auditor, however, included 100% of the disallowed sewer costs as indirect costs subject to the 4% cap for indirect or administrative overhead costs under Texas Tax Code SECTION 171.1012(f). The disallowance of the sewer charges resulted in an assessment of tax in the

amount of \$8,710 and \$8,213 respectively for report years 2008 and 2009.

The auditor also disallowed costs that had been booked to Petitioner's shipping accounts. [ENDNOTE: (5)] The auditor had concluded that these shipping costs represented outbound distribution costs, which he determined were not deductible as part of Petitioner's COGS, because they did not qualify as handling costs. The auditor found that the shipping costs were allocated based on the Master Brewing Agreement entered into by members of the group. \*\*\*\*\* (COMPANY) that develops and markets brands of beer and two breweries. According to the Master Brewing Agreement, title to the beer and risk of loss transferred from the breweries to COMPANY simultaneously with the transfer of title from the Master Distributor (Petitioner) to its distributors or other purchasers of the beer. [ENDNOTE: (6)] COMPANY purchased the beer as it left the breweries and was loaded onto a waiting distributor vehicle or common carrier for delivery to the distributor or other third party. [ENDNOTE: (7)] The auditor concluded that these shipping costs were non-deductible distributions. [ENDNOTE: (8)] The auditor relied on 34 Texas Administrative Code SECTION 3.588(g)(2) and (3), which provides. that the costs of loading the beer onto the distributors' trucks at the breweries' docks are non-deductible distribution costs. [ENDNOTE: (9)] The auditor's disallowance of the shipping costs resulted in the assessment of tax in the amounts of \$27,337 for report year 2008 and \$40,231 for report year 2009. [ENDNOTE: (10)]

As a result of the franchise tax audit, on January 13, 2014, Staff issued Texas Notifications of Audit Results to Petitioner assessing tax and interest for report years 2008 and 2009 respectively in the amounts of \$86,507.63 (consisting of tax in the amount of \$69,875.81 and accrued interest in the amount of \$16,631.82) and \$157,110.87 (consisting of tax in the amount of \$132,671.74 and accrued interest in the amount of \$24,439.13). Petitioner requested redetermination.

Petitioner contends that the approximately \$16 million booked as sewer costs are not the costs paid to a utility for the discharge of sewage. It argues instead that they represent charges for the release or discharge of industrial wastewater. Petitioner contends that these costs are deductible as a COGS because they are expenditures for utilities directly used in the production of the beer. Although this is Petitioner's primary contention, it has also raised the following additional contentions that the sewer costs are deductible under the following statutory provisions:

1. Texas Tax Code SECTION 171.1012(c)(2): "Cost of materials that are an integral part of specific property produced." According to Petitioner, the sewer charges include water that became the most significant component part of the brewed beer, and thus are deductible as incorporated materials.
2. Texas Tax Code SECTION 171.1012(c)(3): "Cost of materials that are consumed in the ordinary course of performing production activities." According to Petitioner, the sewer charges include water charges that are deductible because the water is consumed in brewing process.
3. Texas Tax Code SECTION 171.1012(d)(3): "Spoilage and abandonment, including the costs of rework labor, reclamation, and scrap." According to Petitioner, water that is not incorporated into beer, or consumed when brewing beer, is discharged from the brewing facility's sewer line, incurring a "sewer," "waste water," "effluent" charge on a utility bill, which it argues is an allowable additional direct cost.

4. Texas Tax Code SECTION 171.1012(d)(2): "Obsolescence of the goods." According to Petitioner, brewed beer that cannot be marketed is dumped into the brewing facility's sewer line, incurring a "sewer," "waste water," "effluent" charge on a utility bill, which it argues is an allowable direct cost.

5. Texas Tax Code SECTION 171.1012(d)(1): "Deterioration of the goods." According to Petitioner, badly brewed beer, or beer that cannot be marketed, is discharged through the facility's sewer line incurring a "sewer," "waste water," "effluent" charge on a utility bill that is an allowable additional direct cost.

Petitioner also contends that the \$53.5 million in shipping costs recorded on the books of the entities operating the brewing facilities should not have been disallowed as nondeductible distribution costs but rather constituted ~~storage and handling~~ and storage costs deductible, respectively, under Texas Tax Code SECTION 171.1012(c)(4) and (c)(5). Petitioner describes the disputed shipping costs as consisting of the costs incurred after the beer "comes off the production line" and "when loaded onto the independent distributor's trucks." [ENDNOTE: (11)]

Based on the IAR Conference Report, it appears that Petitioner produced evidence for that conference. For example, Petitioner apparently provided the general ledger postings for selected accounts for purchased water and sewer, selected utility billings, an article from the CITY Business Journal titled "How \*\*\*\*\* wrung 90 million gallons of water out of the CITY brewery," a "\*\*\*\*\* Sewer Water Rule Chart" describing the products of the brewing process, and a power point presentation, "Brewing Process Flow Diagram, detailing industrial wastewater byproducts of the brewing process. None of these documents were offered into evidence by either party in this contested tax case proceeding. Petitioner has not provided any evidence for this contested tax proceeding. For example, with respect to the sewer costs, there is no evidence in the record that describes how the discharged industrial wastewater was used in the brewing process.

Similarly, in the case of the shipping costs, no evidence was provided to substantiate Petitioner's contention that the costs were incurred before the beer arrived on the loading docks and was loaded on the distributor's trucks. Petitioner's pleadings reference a Master Distribution Agreement, but that document was not offered into evidence.

#### D. ALJ's Analysis and Recommendation

The franchise tax is imposed on each taxable entity that does business in this state or that is chartered or organized in this state. Tex. Tax Code SECTION 171.001. The taxable margin of a taxable entity is determined by calculating 70% of total revenue from the entity's total business, or by subtracting, at the election of the taxpayer, either the COGS or compensation deduction. Tex. Tax Code SECTION 171.101(a)(1), .1011, .1012, and .1013.

In this case, there is no disagreement regarding the fact that Petitioner was authorized to use the COGS methodology in its franchise tax reporting. Thus, Petitioner properly chose to apply the COGS methodology in its franchise tax reports for the 2008 and 2009 report years. The questions presented are whether the utility charges for the discharge of industrial wastewater by its breweries and the costs booked as shipping charges on the Petitioner's accounting records were properly includable as direct costs in the COGS deduction claimed by

Petitioner on the franchise tax reports for report years 2008 and 2009.

Generally, the burden rests on the taxpayer to show audit error by a preponderance of the evidence. 34 Tex. Admin. Code SECTION 1.40(2)(B). However, the courts treat a franchise tax deduction as tantamount to an exemption and therefore construe the provisions strictly against the taxpayer and in favor of the taxing authority. SEE Tex. Utils. Elec. Co. v. Sharp, 962 S.W.2d 723 (Tex. App.–Austin 1998, pet. denied); SEE ALSO Comptroller’s Decision Nos. 108,064 and 108,065 (2013), 110,183 (2015), and 108,066 (2015) (treating a taxable entity’s COGS deduction as tantamount to an exemption and applying the clear and convincing burden of proof). Therefore, Petitioner must show entitlement to the COGS deduction by clear and convincing evidence. 34 Tex. Admin. Code SECTION 1.20(2)(A).

Texas Tax Code SECTION 171.1012(d)(8) provides that the COGS deduction includes all direct costs of acquiring or producing goods, including: “the cost of utilities, including electricity, gas, and water, directly used in the production of the goods.” SEE ALSO 34 Tex. Admin. Code SECTION 3.588(e)(8) (which reiterates the statutory language). The dearth of evidence in the record precludes the ALJ from finding that the industrial wastewater was used in the production of the beer. The same lack of evidence prevents the ALJ from finding that the sewer charges included the costs of incorporated materials that became an integral part of the beer or were consumed in the beer production activities. SEE Tex. Tax Code SECTION 171.1012(c)(2) and (c)(3). And finally, Petitioner’s claims that the sewer charges also include such costs as spoilage and abandonment, obsolescence, and deterioration are unsupported by the record. Consequently, Petitioner has failed to show by clear and convincing evidence that it is entitled to the disallowed COGS deduction attributable to sewer costs.

Texas Tax Code SECTION 171.1012(c)(4) and (5) provide that the COGS deduction includes all direct costs of acquiring or producing the goods, such as handling costs, which include costs attributable to processing, assembling, repackaging, and inbound transportation costs; and storage costs, which include the costs of carrying, storing, or warehousing property. Subsections 171.1012(e)(3) and (6) exclude from COGS distribution costs, including outbound transportation costs, and rehandling costs.

The cost of transporting goods from a distribution center to a retail store may be included in a the retail store’s COGS deduction because those costs are deemed to be handling (or inbound transportation) costs. SEE Comptroller’s Decision Nos. 108,064 and 108,065 (2013) and 108,959 (2013). ALSO SEE State Tax Automated Research (STAR) Document No. 201101084L (January 1, 2011). The Comptroller also relies on definitions set out in Treas. Reg. SECTION 1.263A-3(c)(4), which describe handling costs as including the costs attributable to processing, assembling, repackaging, and transporting goods acquired for resale. Examples of these costs include the cost of dispatching trucks, loading and unloading shipments, depreciation on trucks and equipment, and the costs of fuel, insurance, labor and similar costs. Id. Costs incurred in transporting goods from a vendor to a taxpayer, between the taxpayer’s storage facilities, or from the taxpayer’s storage facility to a retail sales facility are treated as allowable handling costs. SEE Comptroller’s Decision No. 108,959. The COGS deduction does not include costs associated with selling, distribution (including outbound transportation), and rehandling. SEE Tex. Tax Code SECTION 171.1012(e). Distribution costs include any transportation cost incurred outside a storage facility in delivering goods to a customer, and costs incurred on a loading dock are treated as incurred outside a storage

facility). ALSO SEE Comptroller's Decision Nos. 108,064 and 108,065 (2013), which cite Treas. Reg. SECTION 1.263A-3(c)(4)(vi)(1).

Petitioner's accounting records booked the costs that Petitioner asserts are handling or storage costs, as shipping costs, which is counter-indicative of inbound transportation. The descriptions found in the Master Brewing Agreement also support the auditor's conclusion that the shipping costs are outbound transportation or distribution costs. Petitioner vigorously denied that characterization, but it did not provide any evidence rebutting the auditor's conclusion. Mere assertions in its pleadings do not constitute evidence substantiating Petitioner's claims that the costs represent handling costs incurred before the beer was loaded onto a distributor's trucks. SEE BAKER V. BULLOCK, 529 S.W.2d 279 (Tex. Civ. App. – Austin 1975, writ ref'd n.r.e.); and ALSO SEE Comptroller's Decision No. 107,916 (2013) (holding that the petitioner's case was based on a bare assertion, which was insufficient to meet its burden of proving by a preponderance of the evidence that the auditor erred). An affidavit from a plant manager or engineer, familiar with the facility's operations, might have substantiated Petitioner's representations, but no such evidence was submitted. Consequently, the ALJ finds that Petitioner failed to show that it was entitled to a COGS deduction for the shipping costs at issue. Thus, no audit adjustments are recommended.

Petitioner failed to provide evidence or arguments that demonstrate that the auditor erred or that it was entitled to the COGS deduction as originally claimed on its 2008 and 2009 franchise tax reports. Therefore, the ALJ recommends that the audit assessment be affirmed without change.

### III. FINDINGS OF FACT

1. \*\*\*\*\* (Petitioner) is the reporting entity for the combined group that includes several affiliates that brew or market beer.
2. The Tax Division (Staff) of the Texas Comptroller of Public Accounts (Comptroller) audited Petitioner for franchise tax compliance for report years 2008 and 2009. The audit adjustments that are in dispute involve the auditor's disallowance of certain sewer and shipping costs included in the calculation of Petitioner's cost of goods sold (COGS) deduction.
3. Petitioner did not provide any credible evidence verifying that the disallowed sewer charges were for industrial wastewater used in the brewing of the beer.
4. Petitioner did not provide any credible evidence verifying that the disallowed costs represented water charges billed by a public utility.
5. Petitioner did not provide any credible evidence demonstrating that the sewer costs included water charges that represented the cost of incorporated materials that were an integral part of the beer.
6. Petitioner did not provide any credible evidence demonstrating that the sewer costs included water charges that represented the cost of consumable materials that were consumed in brewing of beer.
7. Petitioner did not produce credible evidence establishing that the sewer charges included costs for beer discharged from the brewing facility's sewer line, incurring a "sewer," "waste water," or "effluent" charge on a utility bill.



8. Petitioner did not produce credible evidence establishing that the sewer charges included costs for brewed beer that could not be marketed and was dumped into the brewing facility's sewer line.
9. Petitioner did not produce evidence establishing that the sewer charges included costs for badly brewed beer, or beer that could not be marketed and was discharged through the facility's sewer line incurring "a sewer," "waste water," "effluent" charge on a utility bill.
10. The auditor disallowed costs that had been booked to Petitioner's shipping accounts.
11. These shipping costs were allocated based on the Master Brewing Agreement entered into by members of the combined group, \*\*\*\*\* (COMPANY), that develops and markets brands of beer, and two breweries. According to the Master Brewing Agreement, title to the beer and risk of loss transferred from the breweries to COMPANY simultaneously with the transfer of title from the Master Distributor (Petitioner) to its distributors or other purchasers of the beer. COMPANY purchased the beer as it left the breweries and was loaded onto a waiting distributor vehicle or common carrier for delivery to the distributor or other third party.
12. Petitioner did not provide evidence demonstrating that these shipping costs were incurred before the beer arrived on the breweries' loading docks and was loaded on the distributor's trucks.
13. As a result of the franchise tax audit, on January 13, 2014, Staff issued a Texas Notifications of Audit Results to Petitioner assessing tax and interest for report year 2008 in the amount of \$86,507.63 (consisting of tax in the amount of \$69,875.81 and accrued interest in the amount of \$16,631.82).
14. As a result of the franchise tax audit, on January 13, 2014, Staff issued a Texas Notification of Audit Results to Petitioner assessing tax and interest for report year 2009 in the amount of \$157,110.87 (consisting of tax in the amount of \$132,671.74 and accrued interest in the amount of \$24,439.13).
15. Petitioner requested redetermination.
16. On May 21, 2015, Staff referred the cases to the State Office of administrative Hearings (SOAH) for hearings based on the parties' written submissions.
17. Staff issued Notices of Hearing by Written Submission. The notice of hearing contained a statement of the nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.
18. The cases were joined by order of the Administrative Law Judge because they involved common issues of law and fact.
19. The record closed on August 6, 2015.

#### IV. CONCLUSIONS OF LAW

1. The Comptroller has jurisdiction over this matter pursuant to Texas Tax

Code ch. 111.

2. SOAH has jurisdiction over matters related to the hearing in this matter, including the authority to issue a proposal for decision with findings of fact and conclusions of law pursuant to Texas Government Code ch. 2003.
3. Staff provided proper and timely notice of the hearing pursuant to Texas Government Code ch. 2001.
4. A franchise tax is imposed on each taxable entity that does business in this state or that is chartered or organized in this state. Tex. Tax Code SECTION 171.001.
5. The taxable margin of a taxable entity is determined by calculating 70% of total revenue from the entity's total business, or by subtracting, at the election of the taxpayer, either the COGS or compensation deduction. Tex. Tax Code SECTION 171.101(a)(1), .1011, .1012, and .1013.
6. Generally, the burden rests on the taxpayer to show audit error by a preponderance of the evidence. SEE 34 Tex. Admin. Code SECTION 1.40(2)(B).
7. The franchise tax deduction is tantamount to an exemption and therefore the provisions are construed strictly against the taxpayer and in favor of the taxing authority. SEE Tex. Utils. Elec. Co. v. Sharp, 962 S.W.2d 723 (Tex. App.-Austin 1998, pet. denied); SEE ALSO Comptroller's Decision Nos. 108,064 and 108,065 (2013), 110,183 (2015), and 108,066 (2015) (treating a taxable entity's COGS deduction as tantamount to an exemption and applying the clear and convincing burden of proof). Therefore, Petitioner must show by clear and convincing evidence that it is entitled to the COGS deduction. SEE 34 Tex. Admin. Code SECTION 1.40(2)(A).
8. Texas Tax Code SECTION 171.1012(d)(8) provides that the COGS deduction includes all direct costs of acquiring or producing goods, including: "the cost of utilities, including electricity, gas, and water, directly used in the production of the goods. SEE ALSO 34 Tex. Admin. Code SECTION 3.588(e)(8) (which reiterates the statutory language).
9. COGS includes all direct costs of acquiring or producing the goods, including the cost of materials that are an integral part of the specific property produced. Tex. Tax Code SECTION 171.1012(c)(2).
10. COGS includes all direct costs of acquiring or producing the goods, including materials that are consumed in the ordinary course of performing production activities. Tex. Tax Code SECTION 171.1012(c)(3).
11. In addition to the amounts includable under Texas Tax Code SECTION 171.1012 (c), the cost of goods sold includes the following costs in relation to the taxable entity's goods: (1) deterioration of the goods; (2) obsolescence of the goods; and (3) spoilage and abandonment, including the costs of rework labor, reclamation, and scrap. Tex. Tax Code SECTION 171.1012(d).
12. Petitioner failed to show that the disallowed sewer charges were for the discharge of industrial wastewater used in the production of the beer. Tex. Tax Code SECTION 171.1012(e)(8).
13. Petitioner failed to show that the sewer charges included the costs of incorporated materials that became an integral part of the beer. SEE Tex. Tax

Code SECTION 171.1012(c)(2)).

14. Petitioner failed to show that the sewer charges included the costs of materials that were consumed in the beer production activities. Tex. Tax Code SECTION 171.1012(c)(3).

15. Petitioner failed to show that the sewer charges also include such costs as spoilage and abandonment. Texas Tax Code SECTION 171.1012(d)(3).

16. Petitioner failed to show that the sewer charges also included such costs as, obsolescence. Tex. Tax Code SECTION 171.1012 (d)(2).

17. Petitioner failed to show that the sewer charges also included such costs as deterioration Tex. Tax Code SECTION 171.1012 (d)(1).

18. Petitioner failed to show that the auditor erred in disallowing the sewer costs and that it was entitled to deduct the sewer costs as COGS. Therefore, no adjustments to the audit assessment are warranted.

19. COGS includes all direct costs of acquiring or producing the goods, such as handling costs, which include costs attributable to processing, assembling, repackaging, and inbound transportation costs. Tex. Tax Code SECTION 171.1012(c)(4).

20. COGS includes storage costs, which include the costs of carrying, storing, or warehousing property. Tex. Tax Code SECTION 171.1012(c)(5).

21. COGS does not include distribution costs, including outbound transportation costs. Tex. Tax Code SECTION 171. 1012(e)(3).

22. Petitioner failed to show that the disallowed shipping costs included handling costs or storage costs.

23. Petitioner has failed to show that the auditor erred in disallowing the shipping costs that Petitioner included in the cost of goods sold, and that it was entitled to deduct the shipping costs as COGS. Therefore no adjustments to the audit assessment are warranted.

24. The audit assessments should be affirmed without change.

SIGNED August 11, 2015.

PETER BROOKS  
ADMINISTRATIVE LAW JUDGE  
STATE OFFICE OF ADMINISTRATIVE HEARINGS

ENDNOTE(S)

(1) Staff's Exhibits 9 and 10, Audit Plans for 2008 and 2009, at 11.

(2) Id.

(3) Id.

(4) Staff's Exhibit 11, Internal Audit Review (IAR) Conference Report, at 1.

- (5) Id.
- (6) Staff's Exhibit 13, Master Brewing Agreement, at Article 4.1(b).
- (7) Id.
- (8) Staff's Exhibits 9 and 10, at 11.
- (9) Id.
- (10) Staff's Exhibit 11, at 6.
- (11) See Petitioner's Reply to Staff's Position Letter, at 3.

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