



# LEGISLATIVE BRIEF

## RETAIL ACCOUNTABILITY PROGRAM OVERVIEW

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### Introduction

The Retail Accountability Program (RAP) was created by legislation in 2012 for the purpose of improving sales tax compliance among retailers of beer and tobacco products.

The program was created during an era when annual budget reductions were required to meet the state government's constitutional obligation to enact a balanced state budget. As a means of improving sales tax compliance, one of the program's intended effects was to improve the state's financial position. Accurate reporting and remittance of sales tax by retailers is particularly important to Tennessee because the state is more dependent on sales tax revenues than most states. The state's general sales tax as well as taxes on alcohol and tobacco accounted for 65 percent, or \$14.3 billion, of state government revenue in the 2022-23 fiscal year.

This publication provides a legislative history and overview of RAP. Later this year, the Comptroller's Office will publish an efficiency and effectiveness review of the program as required by state law. The review is due by November 1, 2024.

The Retail Accountability Program identifies retailers that underreport, either willfully or accidentally, the amount of sales taxes collected and remitted to the state.

Through the program, the reported sales of wholesalers to retailers are compared with retailers' reported sales. The amount of sales taxes that should have been collected by a retailer based on a conservative estimate and thresholds set by the Tennessee Department of Revenue is compared with the actual amount collected to identify underreporting.

### Research methods

OREA reviewed relevant sections of state law, obtained financial information from the Tennessee Department of Revenue (TDOR), and interviewed an official from the department. OREA also interviewed leadership of the Beverage Association of Tennessee and the Tennessee Grocers and Convenience Store Association. The Tennessee chapter of the National Association of Independent Business (NAIB) provided OREA with written input about the program.

### Program history

Tennessee looked to the example of Texas in creating the Retail Accountability Program. A 2005 audit found 227 Texas convenience stores owed a total of \$28.6 million in tax revenues to the state. (The audit was conducted by the State of Texas and examined 272 convenience stores with sales that consisted largely of beer, wine, and tobacco products.) In 2007, Texas passed legislation to allow the state's comptroller to require wholesalers and distributors of many alcoholic and tobacco products to submit monthly reports to the state of their sales to retailers. The sales figures in the wholesalers' reports and sales figures in the retailers' reports could then be cross-referenced to identify retailers not paying sales tax in full.

Around the same time, similar issues were identified in Tennessee, with 80 percent of the cases referred by TDOR staff to the department's special investigations unit coming from beer and tobacco retailers. Tennessee's RAP was created in 2012 to identify beer and tobacco retailers that underreport the amount of sales taxes collected and submitted to the state. Through the program, the reported sales of wholesalers are compared with retailers' reported sales to the public. The amount of sales taxes that should have been collected by a retailer is then compared with the actual amount collected to identify underreporting.

In 2015, the General Assembly widened the program’s scope beyond beer and tobacco sales (later to be considered RAP 1 products) to include other items likely to be sold at convenience stores and gas stations. The 2015 expansion brought nonalcoholic beverages, soft drinks, candy, and certain foods (referred to as RAP 2 products) within the program’s scope.

One year after the program expanded to cover RAP 2 products, the General Assembly made changes to the program. Among those changes were:

- clarifying that the program’s scope did not include perishable or frozen food products,
- identifying which wholesalers and retailers were required to submit documentation to the Department of Revenue, and
- allowing wholesalers and retailers to submit the required documentation using a paper or electronic format. (Under an earlier provision, an electronic format was required.)

**Exhibit 1: The General Assembly widened the Retail Accountability Program’s scope beyond beer and tobacco in 2015**

<b>RAP 1 products (2012-present)</b>	<b>RAP 2 products (2015-present)</b>
Beer	Nonalcoholic beverages
Tobacco	Soft drinks
	Candy
	Nonperishable food (excluding frozen foods, produce, and similar items)

Note: The 2015 product expansion brought nonalcoholic beverages, soft drinks, candy, and certain foods within the program’s scope.  
 Source: Tennessee Department of Revenue.

In 2022, the General Assembly extended the program’s sunset date to 2025. The statute was also updated to require that the Comptroller of the Treasury “determine the effectiveness and efficiency of the program.”

**The Retail Accountability Program process**

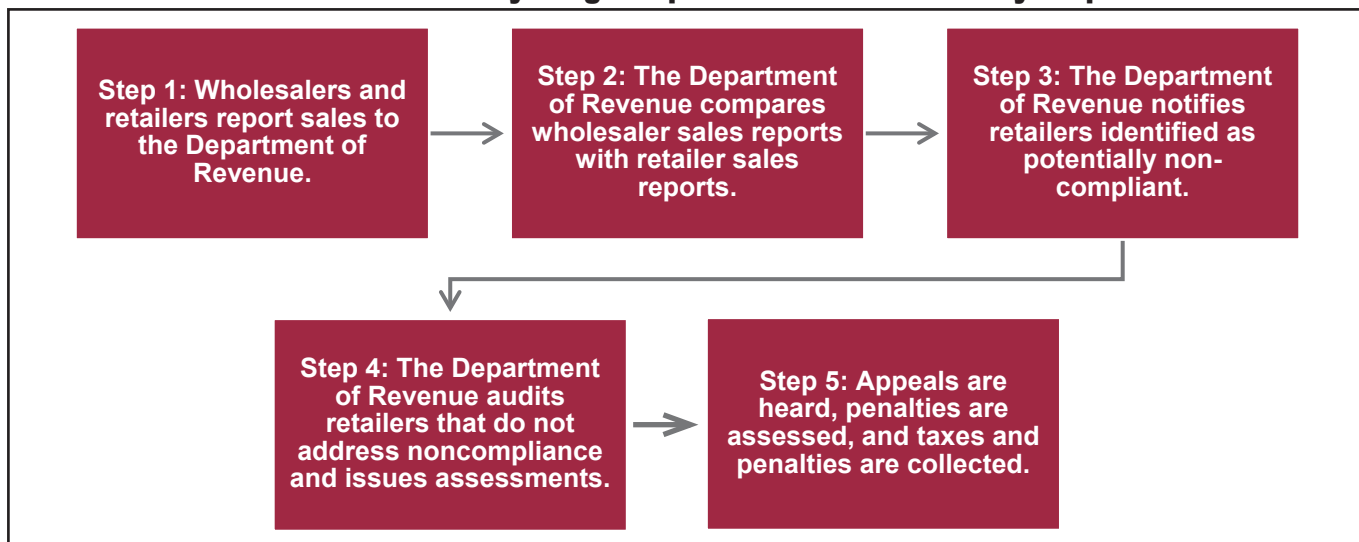
The Retail Accountability Program process involves three primary stakeholders:

- Retailers are businesses that sell goods to the public (e.g., convenience stores and gas stations).
- Wholesalers are businesses that sell goods to retailers (e.g., a wholesaler sells goods to convenience stores).
- Tennessee Department of Revenue (TDOR) is the state agency that operates RAP. The department contains an audit division that, among other duties, audits retailers that do not appear to be submitting the correct amount of sales taxes to the state.

These stakeholders are involved in each step of the RAP process in different roles. The process includes five steps:

1. Retailers and wholesalers report sales to TDOR;
2. TDOR compares wholesaler sales reports with retailer sales reports;
3. TDOR notifies retailers identified as potentially noncompliant;
4. TDOR audits retailers that do not address noncompliance and issues assessments; and
5. Any appeals are heard and adjudicated and TDOR collects unremitted sales taxes and any assessed penalties on retailers found to owe taxes. TDOR assesses penalties on wholesalers found to have submitted incorrect information or failed to submit required documentation.

**Exhibit 2: The Retail Accountability Program process involves five key steps**



Source: OREA.

**Step 1: Retailers and wholesalers report sales to the Department of Revenue**

Retailers must file a sales and use tax return to TDOR following the end of each reporting period.<sup>A</sup> This reporting requirement existed prior to the implementation of RAP. If retailers have any goods damaged or stolen, they are expected to submit the relevant documentation so that damaged and stolen goods are not counted with sold goods when assessing potential noncompliance.

Wholesalers that sell RAP-covered items to retailers file a monthly or quarterly sales report with TDOR. Wholesalers that do not sell beer or tobacco products or sell \$500,000 or more annually of the other items covered by RAP are exempt from the program. Wholesalers that sell RAP-covered items to an affiliated retailer are also exempt from the program.<sup>B</sup>

**Step 2: The Department of Revenue compares wholesaler sales reports with retailer sales reports**

TDOR uses software to compare and evaluate the amount of sales taxes collected by retailers relative to a conservative estimate of the amount of sales tax that should have been collected. The conservative estimate takes the amount of sales reported by the wholesaler and applies a 15 percent markup to account for the retailer’s profit on beer and tobacco. A markup of 15 percent on beer and tobacco is considered conservative as retailers typically apply a markup on these goods of between 40 and 100 percent according to TDOR. No markup is applied to the other RAP items of nonalcoholic beverages, soft drinks, candy, and nonperishable food.

The department’s software uses various thresholds to identify retailers that may not be remitting the necessary amount of sales taxes to the state. Given the thresholds and the conservative markup, those retailers identified through RAP are, according to TDOR, likely to be out of compliance, whether accidentally or purposefully.

<sup>A</sup> Taxpaying retailers submit sales and use taxes either monthly, quarterly, or annually on the 20th day of the month following the period. The default filing frequency is monthly, which applies to most taxpayers. Taxpayers with an average annual sales tax liability of \$1,000 or less per month may choose to file quarterly. Those filing annually are generally manufacturers, wholesalers, and marketplace sellers that solely make sales through a marketplace facilitator collecting state sales and use tax.

<sup>B</sup> An affiliate is a retailer that is wholly or partially (i.e., 50 percent or more) owned by the wholesaler, or vice versa. Wholesalers who sell to an affiliated retailer are large entities that necessitate an audit by TDOR’s field audit team to reconcile tax remittance discrepancies.

### **Step 3: The Department of Revenue notifies retailers identified as potentially noncompliant**

Retailers found to be potentially noncompliant receive an inquiry letter from the department and are provided with an opportunity to address the issue.

Addressing the issue can take the form of submitting the missing sales tax collections to TDOR – as human error may be the cause – or submitting missing information about their purchases and sales. In other cases, some of a retailer’s goods may have been stolen, but the retailer has not filed a police report and submitted the necessary documentation to TDOR.<sup>C</sup> Other retailers may maintain they collected and submitted the correct amount of sales taxes and that the department erred in identifying them as potentially noncompliant.

### **Step 4: The Department of Revenue audits noncompliant retailers**

Retailers that do not adequately address the reason they were identified as potentially noncompliant or maintain they remitted the correct amount of sales tax are then audited by TDOR to determine if the retailer is compliant. If the audit determines that a retailer has not remitted sales tax in full, the retailer is issued a Notice of Proposed Assessment (NOPA) that quantifies the tax owed.

### **Step 5: Appeals are heard, penalties are assessed, and taxes and penalties are collected**

If the retailer maintains that this proposed assessment is incorrect, they may request an informal conference to appeal their case to TDOR’s Administrative Hearing Office. This appeal process can result in the RAP tax assessment and associated penalties being cancelled, changed, or upheld (with RAP decisions most commonly being upheld). If retailers continue to dispute the discrepancy, the issue could then be legally contested in the court system.

If the applicable review entity determines that the retailer owes taxes following the audit, the retailer must submit the assessed taxes owed and pay any applicable penalties assessed by TDOR.

Penalties for noncompliance include negligence penalties and fraud penalties. For the first three infractions, negligence is assumed, and retailers are required to pay the missing taxes as well as a negligence penalty, which amounts to 10 percent of the amount of taxes owed. Beginning with the fourth infraction – and for all subsequent infractions – attempted fraud is assumed.<sup>D</sup> Retailers must pay the missing taxes as well as a fraud penalty, which amounts to 100 percent of the amount of taxes owed.

Wholesalers may also receive financial penalties if they fail to submit required documentation or submit inaccurate information to TDOR.<sup>E</sup> The wholesaler’s penalty begins at \$250 each month with the penalty capped at no more than \$2,500 per month. Wholesaler penalties are generally waived after the wholesaler submits the required sales reports as the purpose of the wholesaler penalty is for TDOR to receive the sales data.

<sup>C</sup> Any goods damaged or stolen are excluded from sold goods and thus are not included when calculating the amount of sales tax owed to the state. Retailers must submit relevant documentation to the state to classify goods as damaged or stolen.

<sup>D</sup> Circumstances other than the number of infractions could also trigger a fraud penalty.

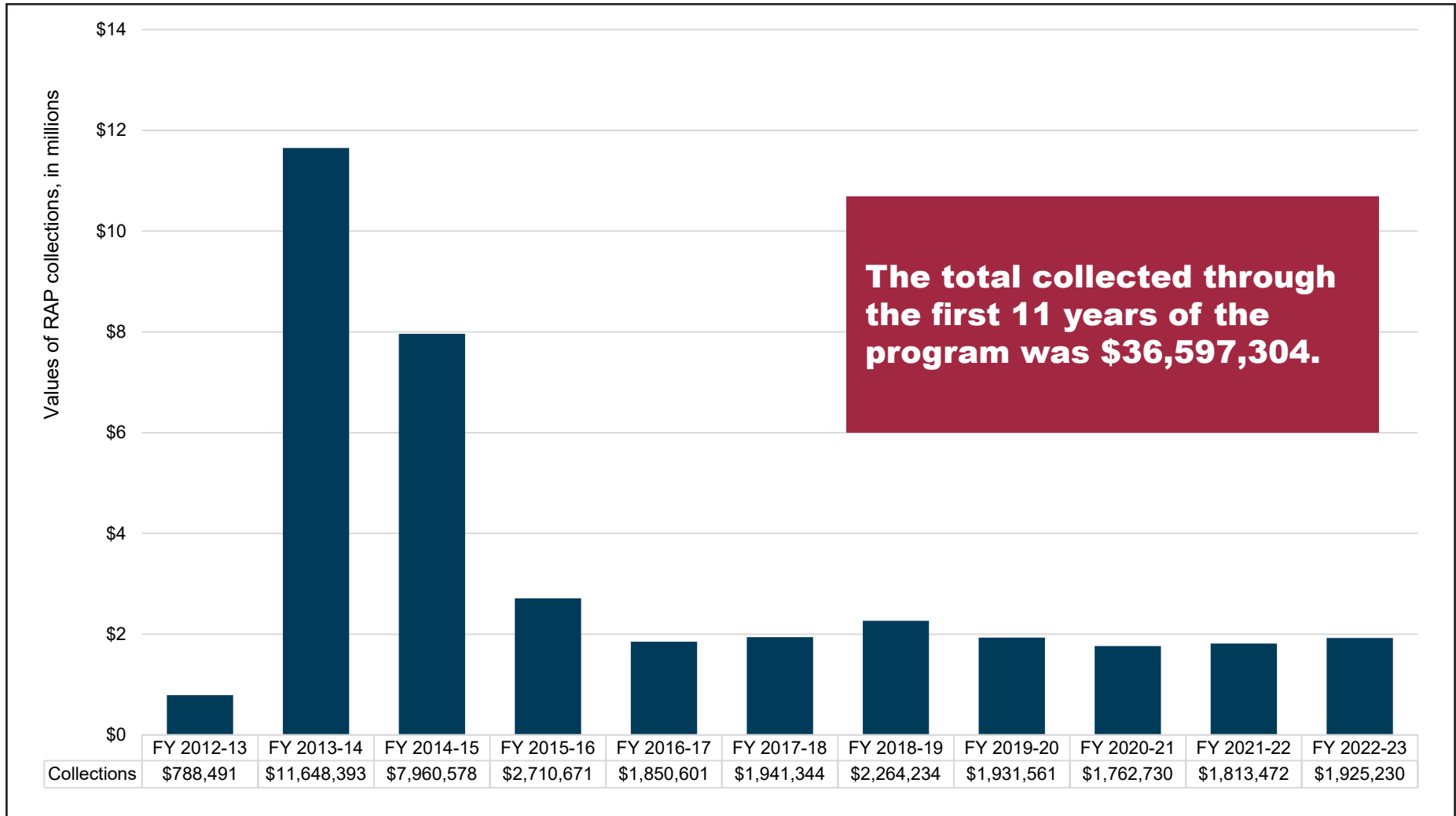
<sup>E</sup> Wholesalers may be penalized for submitting inaccurate information either knowingly or due to negligence.



## **Upcoming review of the program**

The Comptroller's Office will also publish an efficiency and effectiveness review of the program as required by state law. The review is due by November 1, 2024.

**Appendix A: Retail Accountability Program collections and assessments have generated an average of about \$1.94 million in sales tax revenue collections per year over the past five fiscal years**



Source: Tennessee Department of Revenue.

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