CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Administrative Protests Under the Sales and Use Tax Law of: JAMES J. BARBERA, JR., dba Starving Artists; SF Black & White Taxpayer	Account Number SR X BH 97-753282 Case ID's 526563, 526564, 526565 City and County of San Francisco

Type of Business: Delicatessen and sales of artwork

Liability periods: 07/01/04 – 12/31/06 (Case ID 526565)
01/01/07 – 08/31/07 (Case ID 526563)
07/01/01 – 08/31/07[1] (Case ID 526564)

Item	Case ID 526565	Case ID 526563	Case ID 526564
Unreported taxable sales	$ 39,302	$ 10,449	$ 387,256
Negligence penalty			$ 1,095
Determined tax	$3,356.00	$ 891.00	$32,916.84
Interest through 05/31/14	2,257.54	336.71	24,540.57
Failure-to-file penalty	335.60	89.10	2,196.90
Negligence penalty			1,094.78
Amnesty double negligence penalty			1,094.78
Finality penalty	335.60	89.10	3,291.68
Amnesty double finality penalty			1,094.78
Amnesty interest penalty			930.51
Total tax, interest, and penalty	$6,284.74	$1,405.91	$67,160.84
Payments		- 809.00	- 1,280.00
Balance Due		$ 596.91	$65,880.84
Monthly interest beginning 06/01/14	$ 16.78	$ 0.41	$ 158.18

This matter was scheduled for Board hearing in May 2012, but was deferred at the request of the Appeals Division in order to issue a supplemental D&R. It was rescheduled for Board hearing in November 2013, but was postponed at taxpayer's request due to a medical emergency. The matter was then scheduled for Board hearing in March 2014, but taxpayer did not respond to the Notice of Hearing. The matter was scheduled for decision on the nonappearance calendar in April 2014, but

[1] This determination, issued October 29, 2009, was timely for the periods July 1, 2001, through June 30, 2003 (under the amnesty program's 10-year limitations period), and July 1, 2004, through August 31, 2007 (under the 8-year limitations period for deficiencies where no return was filed). The determination includes no deficiency for FYE 2004 (the determination would not have been timely for FYE 2004 because taxpayer filed a return for that period and it was not covered by the amnesty program.)

taxpayer contacted the Board Proceedings Division and the matter was rescheduled to the next month's hearing calendar.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the audited amounts of unreported taxable sales. We find no adjustments are warranted.

Taxpayer operated an art gallery, four mall kiosks, and a delicatessen. The effective start date of the seller's permit was September 1, 2000, and taxpayer filed annual returns for fiscal years ending (FYE) June 30, 2001, 2002, 2003, and 2004. In April 2005, after taxpayer failed to file sales and use tax returns for the third and fourth quarters of 2004,the Sales and Use Tax Department (Department) contacted taxpayer's landlord, who told the Department that taxpayer no longer was operating from his address of record. The Department closed taxpayer's seller's permit effective June 30, 2004, but discovered in February 2007 that taxpayer had continued to operate. Taxpayer's businesses were all closed by August 31, 2007.

Three Notices of Determination are at issue. The Department issued the first two determinations for periods during which taxpayer operated but did not file returns. Subsequently, the Investigations and Special Operations Division (ISOD) issued a third determination because it concluded that the amounts estimated by the Department were too low. The Department's estimates were established using the number of days in each quarter and an average amount of daily sales of $43, computed using amounts reported on returns for FYE 2001, 2003, and 2004 (it is unclear why the Department excluded FYE 2002). The Department issued determinations for the periods July 1, 2004, through December 31, 2006, and January 1, 2007, through August 31, 2007, establishing unreported taxable sales of $39,302 and $10,449, respectively.

When ISOD became involved and requested records, taxpayer provided only the most minimal records, including a lease agreement, a few pages of documentation regarding a lawsuit filed against his landlord, and, for the years 2003 through 2008, the first page of each California income tax return. Taxpayer's explanation for providing virtually no records was that his records had been destroyed due to a sewage leak at the art gallery on January 24, 2005. ISOD determined that the amount taxpayer had paid for rent exceeded taxpayer's reported sales and, for the period that he did not file returns,

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

exceeded the amounts estimated by the Department for the first two determinations. Thus, ISOD concluded that further investigation was warranted. Also, taxpayer had not participated in the amnesty program so ISOD decided to review the amounts reported for the period July 1, 2001, through June 30, 2003, since the statute of limitations for issuing a determination for those years was 10 years from the last day of the month following the reporting periods.

Regarding sales at the art gallery, there was a sewer leak at the gallery on January 24, 2005, and the gallery was apparently closed for the next five months. In a letter to his landlord, taxpayer indicated that he had lost $10,000 of sales for each of those months. ISOD used $10,000 as an estimate to compute $130,000 of sales by the gallery during the thirteen months of January 2005 and August 2005 through July 2006, the month the gallery was closed. Prior to 2005, taxpayer had paid lower rents, and ISOD decided to establish sales for those earlier periods using known rent payments and a ratio of sales to rent of 323.49 percent ($10,000.00 estimated monthly sales ÷ $3,091.25 rent, in effect in 2005 and 2006). ISOD established audited taxable sales at the art gallery of $326,781 for the period of the determination, excluding FYE 2004.

Regarding taxable sales at the mall kiosks, ISOD found that for two of the kiosks, the rent was a certain percentage of gross sales (20 percent for one and 15 percent for the other). To establish taxable sales for those kiosks, ISOD used the amounts of rent provided by the mall management and the related percentage. For the other two spaces, a fixed monthly rent was charged. ISOD estimated that the amount of rent would be equal to each of the following elements of profit and loss: cost of goods sold, other expenses, and gross profit. Therefore, ISOD concluded that the gross sales at each of those kiosk spaces would be equivalent to the amount of rent paid, as stated by the mall management, multiplied by four (such that sales would be equivalent to the total amount of rent, cost of goods sold, other expenses, and gross profit). ISOD computed sales at the kiosks of $72,581, which it added to audited gallery sales of $326,781 to establish audited sales of artwork of $399,362. Based on its computations, ISOD concluded that the amounts reported by taxpayer or estimated by the Department as the basis of the first two determinations were substantially accurate for the second quarter 2005 and for the period October 1, 2006, through August 31, 2007. However, ISOD established additional

unreported taxable sales of artwork of $332,856 for the periods July 1, 2001, through June 30, 2003, July 1, 2004, through March 31, 2005, and July 1, 2005, through September 30, 2006.

Regarding taxpayer's delicatessen sales, taxpayer's landlord informed ISOD that taxpayer sold hot sandwiches and carbonated drinks. ISOD thus regarded all of the sales by the delicatessen as taxable. However, ISOD accepted taxpayer's assertion that the delicatessen location was used for storage from February 1, 2005, through June 30, 2007, due to the sewer leak at the gallery two doors down the street, and did not compute taxable delicatessen sales for that period. ISOD used the same procedure described previously of multiplying the amounts of rent paid by four to establish audited taxable sales of food products of $6,800 per month, or $54,400 for the eight-month period of June 2003 and July 2004 through January 2005. In sum, ISOD established unreported taxable sales (in excess of the amount established in the two determinations issued by the Department) of $387,256 ($332,856 + $54,400), and issued a Notice of Determination for the additional deficiency for the period July 1, 2001, through August 31, 2007 (with no understatement established for FYE 2004).

Taxpayer contends that the estimated amounts of taxable sales of artwork include non-taxable service fees, such as income from design and photography services. Also, in his request for reconsideration, taxpayer states that he ran multiple businesses from the gallery, and his primary sales were sales of office supplies in interstate commerce. However, taxpayer claims that, since the business location was zoned for retail, he needed to give the impression of a retail business, which he did by pretending to sell photography. Taxpayer also asserts that some gallery sales were nontaxable, such as sub-leases of wall space to other artists. On this issue, taxpayer has provided unsupported estimates of his sales from the art gallery: 30 percent sales of office supplies in interstate commerce; 10 percent retail sales of photography; 20 percent commercial photography services; 15 percent graphic design services; 10 percent sub-leasing wall space; and 15 percent sub-leasing the gallery. Thus, taxpayer argues that only 10 percent of the sales from the gallery location were taxable sales of artwork. Also, taxpayer claims that there were additional floods, and, as a result he paid only partial rents in 2004, asserting that the payment of partial rents would impact the computed amounts of sales. Taxpayer also states that he reported everything he thought represented taxable sales. As support, he provided

various documents, none of which are accounting records showing the amounts of sales (for instance, he provided telephone bills, an agreement for renting wall space, and an invoice for licensing fees).

Regarding the delicatessen, taxpayer argues that it was never in full operation, stating that he rented the space for storage and used the kitchen to prepare complimentary appetizers for events that took place at the gallery. Regarding the kiosks, taxpayer asserts that the sales were minimal, arguing that he occupied certain kiosks at the request of mall management to fill empty spaces during a remodeling and expansion process. As an argument regarding the entire liability, taxpayer argues that he co-owned the business with another individual, and he should be held liable for only one-half of any liability that is ultimately established. Further, taxpayer states that, based on a discussion with a Board employee at the time he closed out this permit after the sewage leak, he understood he owed nothing further to the State.

Taxpayer provided virtually no books and records. He provided almost no documentation, such as sales invoices or contracts, to support his assertion that some of his receipts represented amounts not subject to sales tax. Although ISOD notes, and we concur, that the gallery may have made some nontaxable sales, taxpayer has not provided sufficient records to establish the amount of those sales or to determine whether they are included in the sales established in the FBO. Also, it is possible that the delicatessen made exempt sales of cold food to go, although no evidence has been provided from which the amount of such sales could be established. However, ISOD notes that it found information on the Internet that, contrary to taxpayer's assertion that the delicatessen location was only used for storage during the period July 2005 through September 2007, the delicatessen was operated throughout that period. Therefore, since no sales from the delicatessen during the 26 months of that period are included in the determination, we find that any potential adjustments for nontaxable sales in the art gallery or exempt sales of cold food from the delicatessen would be more than offset by the amount of taxable sales from the delicatessen for those 26 months. As for taxpayer's assertion that the sales from the mall kiosks were minimal, we note that, for two of the kiosks, the sales amounts were established using the amounts of rent and the relevant percentages of sales that the mall charged for rent (15 percent and 20 percent of sales for the two kiosks). For the other two kiosks, taxpayer paid a set amount of rent, which ranged from $3,000 to $4,000 for one kiosk and was $500 for the other

kiosk. The Department multiplied the rent by four to establish sales, which seems reasonable. Taxpayer has provided no evidence to show that the sales established by the Department are excessive. Also, particularly for the kiosk renting at $3,000 to $4,000 per month, it seems unlikely that taxpayer would continue to pay such high rents if the sales were only minimal.

In short, we find that ISOD has used the best available information, which was sorely limited due to taxpayer's failure to provide records, to establish the amounts of taxable sales, and taxpayer has failed to providesufficient evidence to support any adjustments.

With respect to taxpayer's comment regarding a discussion with a Board employee, we note that relief from tax may be granted when a taxpayer's failure to pay the correct amount of tax is the result of his reasonable reliance on *written* advice from the Board. (Rev. & Tax. Code, § 6596, subd. (a).) Taxpayer has neither provided evidence of advice in writing nor asserted that such written advice exists. Accordingly, we find no adjustments are warranted.

Regarding taxpayer's assertion that he operated the business with a partner, and should be held liable for only half of the determined amount, we note that the relevant seller's permit was issued to taxpayer as a sole proprietor, and taxpayer has provided no documentation to show that the businesses were owned and operated by a partnership.

Issue 2: Whether taxpayer was negligent. We conclude that he was.

ISOD imposed the negligence penalty for the period July 1, 2001, through June 30, 2003, because taxpayer provided virtually no records and the understatement was substantial. Taxpayer disputes the penalty on the grounds that the lack of records was the result of a flood that occurred on January 24, 2005, and that all taxable sales were properly reported.

As noted previously, taxpayer provided only the most minimal records. Also, the understatement of $121,997 ($153,983 established by ISOD less $31,986 reported) for the period July 1, 2001, through June 30, 2003, is a substantial amount and represents an understatement of almost 400 percent in comparison to reported sales. We are not persuaded by taxpayer's explanation that his records were destroyed in the flood. If taxpayer had records for the period after the flood occurred, his assertion that the earlier records were once available but had been lost in the flood would be more credible, but he has provided no records for any of the periods under review. We find that

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

taxpayer's failure to provide any accounting records and the substantial understatement are strong evidence of negligence. Thus, we find that the penalty was properly applied, even though taxpayer had not been audited previously.

OTHER MATTERS

Since taxpayer did not file sales and use tax returns for periods after June 30, 2004, the determinations issued for the periods July 1, 2004, through December 31, 2006, and January 1, 2007, through August 31, 2007, include failure-to-file penalties of $335.60 and $89.10, respectively, and the determination issued for the period July 1, 2001, through August 31, 2007, includes a failure-to-file penalty of $2,196.90 for July 1, 2004, through August 31, 2007. Also, since taxpayer did not timely pay any of the determinations or file timely petitions for redetermination, finality penalties of $335.60, $89.10, and $3,291.68 have been added to the determinations for the same respective periods. In addition, since taxpayer did not participate in the amnesty program, an amnesty double negligence penalty and amnesty double finality penalty, each $1,094.78, and an amnesty interest penalty of $930.51 have been applied to the amnesty-eligible periods included in the determination for the period July 1, 2001, through August 31, 2007. In a post-conference letter, we explained to taxpayer that he could file a request for relief of the failure-to-file, finality, and amnesty-related penalties, and provided forms he could use to do so. However, taxpayer has not returned the completed forms or otherwise filed a written request for relief of penalties, signed under penalty of perjury. Accordingly, we have no basis to consider relief of the penalties.

Summary prepared by Lisa Burke, Business Taxes Specialist III