CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
JAGJIT SINGH BHANDAL, dba Sunny's Market	Account Number SR KH 101-104807 Case ID 535643
Petitioner	Sacramento, Sacramento County

Type of Business: Convenience store

Liability period: 08/13/08 – 09/30/09

Item	Disputed Amount	
Unreported taxable sales	$117,364	
Unreported taxable cigarette rebates	$ 8,319	
Tax, as determined		$10,711.70
Post-D&R adjustments		- 20.66
Proposed tax redetermination		$10,691.04
Less concurred		- 96.27
Balance protested		$10,594.77
Proposed tax redetermination		$10,691.04
Interest		1,476.57
Total tax and interest		$12,167.61
Payments		-12,167.61
Balance		$ 00.00

A Notice of Appeals Conference was mailed to petitioner's address of record and to his representative, and the notices were not returned by the Post Office. Petitioner did not respond to the notice or appear at the appeals conference, which was held as scheduled. We thereafter sent petitioner a letter offering him the opportunity to provide any additional arguments and evidence in writing he wished us to consider, but he did not respond. This matter was scheduled for Board hearing in November 2013, but was deferred as requested by the Appeals Division in order to issue a Supplemental Decision and Recommendation (SD&R).

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments to the amount of unreported taxable sales are warranted. We find that no additional adjustments are warranted.

Petitioner has operated the convenience store under this seller's permit since August 2008. For audit, petitioner provided his federal income tax return for 2008, purchase invoices, cash register tapes, profit & loss statements, general ledgers, and bank statements. The Sales and Use Tax Department (Department) compared the total sales shown in petitioner's profit and loss statements for the period January 1, 2009, through September 30, 2009, with the total sales reported on his sales and use tax returns for those three quarters, and found a difference of $6,783, which the Department attributed to income for setting up promotional shelf displays, cigarette rebates and lottery sales. The Department assessed the portion of the difference that related to unreported cigarette rebates as a separate measure of tax. The Department then compared the gross receipts reported on the 2008 federal return and the total sales shown in the profit and loss statements for the first three quarters of 2009 with the respective costs of goods sold to compute book markups of 25.34 percent for 2008, and 39.52 percent for 2009, which the Department considered to be reasonable. Using petitioner's purchase invoices for the entire audit period, the Department segregated the purchases into various product categories (purchase segregation test) and computed that 80.95 percent of petitioner's purchases were of taxable merchandise. The Department then multiplied total purchases included in the purchase segregation test by 80.95 percent to compute costs of taxable merchandise, which it compared with petitioner's reported taxable sales to compute book markups for taxable merchandise of -3.62 percent for 2008 and -41.22 percent for the first three quarters of 2009. The Department concluded that the negative markups indicated that reported taxable sales were substantially understated, and decided to prepare a markup analysis to establish audited taxable sales.

Using purchase invoices for September 2009, the Department compared the costs for items in the various product categories with their shelf prices to compute markups, and then applied the purchase ratio computed for each product category in the purchase segregation test to the average markup for that category to compute a weighted average markup of 20.56 percent. In the original audit, the Department reduced the computed cost of taxable merchandise by 1 percent for pilferage, but did not make an allowance for self-consumption. However, pursuant to our recommendation in an SD&R, the Department reduced the cost of taxable merchandise by $252 per quarter to allow for self-consumption. Adding the weighted average markup of 20.56 percent to audited costs of taxable merchandise sold resulted in audited taxable sales of $285,202 in a post-SD&R reaudit, which exceed reported taxable sales for the audit period by $117,364.

Petitioner contends that the cost of merchandise sold has not been properly adjusted for increasing inventory in the audit. Petitioner also contends that the taxable merchandise purchase ratio is overstated, but has not provided any documentation to support either contention.

We note that petitioner's federal return and his profit and loss statements show no change to his recorded inventory of $25,000 during the audit period. Since petitioner has not provided any documentation, such as physical counts of inventory performed by an independent inventory firm, to establish any change to his inventory during the audit period, we find that there is no basis for adjusting the cost of merchandise sold for increasing inventory. Since petitioner has not provided any documentation to support his contention that the taxable merchandise purchase ratio of 80.95 percent is overstated, and we found no errors in the audit calculations or audit procedures, we find that no adjustment is warranted.

Issue 2: Whether adjustments are warranted to the amount of unreported taxable cigarette rebates. We find that no adjustments are warranted.

The Department noted that petitioner recorded other income in his general ledger. After discussion with petitioner, the Department determined that recorded other income of $8,319 consisted of rebates from cigarette manufacturers, which petitioner failed to report on his sales and use tax returns.

Petitioner did not expressly agree to this measure of tax. It is undisputed that petitioner received rebate payments from someone other than petitioner's own cigarette vendors. We conclude that such rebate payments are subject to tax and were not included in the computation of unreported taxable sales of $118,743. Therefore, we recommend no reductions to the amount of unreported taxable cigarette rebates.

OTHER MATTERS

In the post-SD&R reaudit, the Department established unreported taxable costs of self-consumed merchandise of $1,142, which is equal to the reduction to audited costs of taxable merchandise to allow for self-consumption in the markup analysis. Petitioner has not stated specifically that he concedes the unreported taxable costs. However, since the net effect of the adjustments to both allow these costs as a reduction in the markup analysis and to establish unreported taxable costs is a benefit to petitioner, we presume that petitioner agrees with these adjustments.

Summary prepared by Lisa Burke, Business Taxes Specialist III

MARKUP TABLE
Convenience Store Taxable Sales

Percentage of taxable vs. nontaxable purchases	80.95%
Mark-up percentages developed	20.56%
Self-consumption allowed in dollars	$1,142
Self-consumption allowed as a % of cost of taxable goods sold	0.75%
Pilferage allowed in dollars	$2,401
Pilferage allowed as a % of cost of taxable goods sold	1.00%