

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 CAPITAL CITY RESTAURANTS, INC.,) Account Number SR Y KH 100-260562
 6 dba's Crush 29 and T.G.I. Friday's) Case ID 522640
 7 Petitioner) Roseville, Placer County

8 Type of Business: Restaurants
 9 Audit period: 4/1/06 – 12/31/08

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
11 Taxable mandatory tips	\$ 532,800		
12 Taxable sales of fixed assets	\$2,500,000		
13 Taxable costs of self-consumed supplies	\$ 141,425		
14 As determined		\$285,451.98	\$28,545.19
15 Post-D&R adjustment		<u>- 45,045.64</u>	<u>-28,545.19</u>
16 Proposed redetermination, protested		\$240,406.34	<u>\$ 0.00</u>
17 Interest through 11/30/14		<u>130,365.32</u>	
18 Total tax and interest		<u>\$370,771.66</u>	
19 Monthly interest beginning 12/01/14		<u>\$1,202.03</u>	

20 A Notice of Appeals Conference was mailed to petitioner's address of record and was not
 21 returned by the Post Office. Petitioner did not respond to the notice or appear at the appeals
 22 conference, which was held as scheduled. We sent petitioner a letter offering it the opportunity to
 23 provide any additional arguments and evidence in writing it wished us to consider, but it did not
 24 respond. This matter was scheduled for Board hearing in March 2012, but petitioner did not respond
 25 to the Notice of Hearing, and the matter was scheduled for decision on the nonappearance calendar.
 26 Petitioner subsequently requested that the matter be rescheduled for hearing, and it was rescheduled for
 27 hearing in June 2012, but was postponed to allow petitioner additional time to submit an opening brief.
 28 It was rescheduled again for Board hearing in August 2012, and then again in December 2012, but was
 deferred at the Sales and Use Tax Department's request both times, first to allow time for further
 review, and then to allow additional time to complete a reaudit. The reaudit resulted in a reduction to

1 the amount of unreported taxable mandatory tips, from \$1,128,700 to \$532,800. This matter was
2 rescheduled again for hearing in May 2014, but petitioner did not respond to the Notice of Hearing.
3 Thus, the matter was scheduled for decision on the nonappearance calendar in May 2014, but
4 petitioner contacted the Board Proceedings Division and the matter was rescheduled for Board hearing
5 in July 2014. The hearing was again postponed at petitioner's request, due to a scheduling conflict.

6 UNRESOLVED ISSUES

7 **Issue 1:** Whether additional adjustments are warranted to the calculation of mandatory tips.

8 We conclude that no further adjustment is warranted.

9 Petitioner operated five "T.G.I. Friday's" (TGIF) restaurants and a "Crush 29" restaurant.

10 Petitioner did not collect tax reimbursement or report and pay tax on the 18 percent mandatory tips that
11 it charged for parties of eight or more at all of its locations. The TGIF accounting software did not
12 track that information, but the Crush 29 accounting software did. In the original audit, the Sales and
13 Use Tax Department (Department) computed Crush 29's mandatory tip ratios and applied them to
14 petitioner's reported sales for all of its locations to compute unreported taxable mandatory tips of
15 \$1,128,700 for the audit period. However, in response to petitioner's contention that the mandatory tip
16 ratio for Crush 29 was not representative of TGIF's mandatory tips, the Department conducted further
17 investigation and found third-party information indicating that the ratio of mandatory tips to total sales
18 for the TGIF restaurants was approximately 1.232 percent, which was significantly lower than the
19 mandatory tip ratio computed for Crush 29. Using the ratio of 1.232 percent to compute mandatory
20 tips for the TGIF restaurants in a reaudit resulted in a reduction to the amount of unreported taxable
21 mandatory tips, from \$1,128,700 to \$532,800.

22 Petitioner contends that the unreported mandatory tips should be based on cash sales instead of
23 total sales since some credit card customers tip less than 18 percent. However, since petitioner
24 provided no documentation to show that its credit card customers tend to tip less than the amounts
25 billed for mandatory gratuities, we conclude that no further adjustments are warranted.

26 **Issue 2:** Whether petitioner sold the restaurants. We conclude that petitioner sold the
27 restaurants and owes tax on the sale of the tangible personal property.

1 The Department found that petitioner sold the TGIF restaurants to TGIA Restaurants, Inc.
2 (TGIA) and to Ten Forward Dining, Inc. (TFD) on June 29, 2007, without reporting and paying sales
3 tax to the Board on the sale of the tangible personal property. The Department relied on purchase
4 agreements, escrow closing statements, and the federal income tax returns of TGIA and TFD in
5 establishing the \$2,500,000 measure of tax.

6 Petitioner contends that the sales were never consummated because it had not satisfied all the
7 conditions of the purchase agreement (e.g., the Internal Revenue Service had liens on the restaurants so
8 they could not be transferred free of liens, and petitioner had not filed federal and state income tax
9 returns for years 2003 through 2007, while the agreement required that all such returns be filed). We
10 find that the evidence indicates that the sales did occur. The escrow closing statements are signed and
11 certified by the title company, and at least one is signed by petitioner's president. TGIA and TFD's
12 federal income tax returns list purchase amounts for "furniture and décor" totaling \$2,500,000 which
13 indicates that the sales did occur. Since petitioner has not provided any documentation showing that
14 the purchase agreements or escrows were canceled, we conclude that the sales occurred and that
15 petitioner is liable for the tax due on those sales.

16 **Issue 3:** Whether an adjustment is warranted to the taxable cost of self-consumed supplies. We
17 conclude that no adjustment is warranted.

18 The Department found that petitioner purchased uniforms, menus, and cleaning products of
19 \$48,242 from out-of-state vendors who were not authorized to collect California use tax for 2008,
20 representing an error rate of 0.31146 percent when compared with petitioner's reported taxable sales of
21 \$15,488,994. The Department applied the error rate to petitioner's reported taxable sales for the audit
22 period to establish unreported taxable costs of self-consumed supplies of \$141,425. Petitioner argues
23 that it purchased its supplies tax-paid from Costco and that the audit approach in estimating the use tax
24 liability is not accurate.

25 We find that the Department established the amount of self-consumed supplies purchased from
26 unregistered out-of-state retailers using the best information available. Petitioner's books and records
27 for periods prior to 2008 were incomplete. The Department's use of a block sample and application of
28 sample results to the rest of the reporting period is authorized by Audit Manual section 405.20. Since

1 petitioner has not shown that it paid or reported tax on any of the purchases that were found to be
2 errors in the test, we find no basis for recommending any adjustments.

3 **RESOLVED ISSUE**

4 The Department imposed a negligence penalty because the books and records were incomplete.
5 Petitioner disputed the penalty, arguing only that the penalty was not warranted. We found that
6 petitioner was not negligent because: 1) the error ratio for unreported taxable sales is low
7 (2.54 percent); 2) petitioner reported its sales of food and beverages accurately; and 3) this was
8 petitioner's first audit, and the errors found do not seem unusually large for a first audit. Thus, we
9 recommended that the penalty be deleted.

10 **OTHER MATTERS**

11 None.

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14 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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