

**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:)
MI KYUNG PARK and V. YOUNG ROK PARK,) Account Number: SR AA 100-959698
dba R&M Liquor Mart) Case ID 620616
Petitioner) Los Angeles, Los Angeles County

Type of Business: Liquor store

Audit period: 07/01/08 – 12/31/11

<u>Item</u>	<u>Disputed Amount</u>		
Unreported taxable sales based on markup	\$261,731		
Negligence penalty	\$2,474		
		<u>Tax</u>	<u>Penalty</u>
As determined		\$25,156.42	\$2,515.62
Post-D&R Adjustment		- 250.02	- 25.04
Less bankruptcy discharge ¹		<u>- 166.74</u>	<u>- 16.67</u>
Proposed redetermination		\$24,739.66	\$2,473.91
Less concurred		<u>- 670.35</u>	<u>00.00</u>
Balance protested		<u>\$24,069.31</u>	<u>\$2,473.91</u>
Proposed tax redetermination		\$24,739.66	
Interest through 10/31/14		7,166.60	
Negligence penalty		<u>2,473.91</u>	
Total tax, interest, and penalty		<u>\$34,380.17</u>	
Monthly interest beginning 11/01/14		<u>\$ 123.70</u>	

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments are warranted to the amount of unreported taxable sales established on a markup basis. We conclude that no further adjustments are warranted.

Petitioner operated a liquor store from September 2007 until February 2012, when petitioner closed the business and filed bankruptcy. For audit, petitioner provided a federal income tax return for 2008 and merchandise purchase invoices for the period April 1, 2011, through June 30, 2011. In order to compute a book markup on taxable merchandise sales, the Sales and Use Tax Department

¹ The use tax liability was discharged for the period July 1, 2008, through March 31, 2009, because that period was more than three years prior to the bankruptcy petition date, and the Board did not file a pre-petition bankruptcy claim.

1 (Department) conducted a purchase segregation test in which it computed a taxable merchandise
2 purchase ratio, which it applied to costs of goods sold reported on the 2008 federal income tax return
3 to compute audited costs of taxable merchandise sold for 2008. The Department established a book
4 markup on taxable merchandise of 18.49 percent for 2008, which the Department considered low for
5 this business. Thus, the Department concluded that petitioner's recorded taxable sales were
6 understated and that a markup analysis was needed to establish audited taxable sales.

7 The Department established audited taxable merchandise purchases based on merchandise
8 purchase information obtained from petitioner's suppliers for the period July 1, 2008, through June 30,
9 2011. It then reduced audited taxable merchandise purchases by 2 percent for self-consumption, and
10 by 1 percent for shrinkage, to establish audited costs of taxable merchandise sold. The Department
11 was not able to compute petitioner's markup on taxable merchandise because the selling prices were
12 not posted and petitioner declined to provide the selling prices. The Department estimated a markup
13 on taxable merchandise of 30 percent. The Department added the estimated markup to audited taxable
14 cost of merchandise sold to establish audited taxable merchandise sales for the period July 1, 2008,
15 through June 30, 2011, calculating separate error ratios for each year. Because the audit period was
16 extended to include the period July 1, 2011, through December 31, 2011, the Department established
17 unreported taxable sales for those quarters using the error ratio computed for the first two quarters of
18 2011. In total, the Department established unreported taxable sales of \$264,255 for the audit period.
19 In a post-D&R reaudit to correct a computational error, this amount was reduced to \$261,731.

20 Petitioner argues that the estimated markup of 30 percent is too high and asserts that its markup
21 is between 15 percent and 20 percent. Petitioner also asserts the allowance for shrinkage should be
22 increased from 1 percent to 2 percent. Since petitioner has not provided any documentary evidence to
23 support a markup of 15 percent to 20 percent, we reject its contention the estimated markup is too high.
24 Further, we find petitioner has not provided any documentation to support an adjustment for shrinkage
25 greater than the 1 percent allowed. Accordingly, we recommend no additional adjustments to the
26 amount of unreported taxable sales.

27 **Issue 2:** Whether petitioner was negligent. We conclude that petitioner was negligent.
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1 The Department imposed the negligence penalty because the audited understatement is
2 substantial in comparison to petitioner's reported taxable sales and because it found the records
3 inadequate. Petitioner disputes the negligence penalty on the basis that it provided all available books
4 and records, and because it relied on its accountant.

5 A comparison of unreported taxable sales of \$261,731 with reported taxable sales of \$185,472
6 shows an error rate of 141.12 percent, which we find is strong evidence of negligence in reporting. We
7 also find that petitioner's failure to maintain and provide complete sets of sales and purchase records is
8 evidence of negligence in keeping records. Accordingly, although this was petitioner's first audit, we
9 conclude that petitioner was negligent and the penalty is appropriate.

10 **OTHER MATTERS**

11 None.

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13 Summary prepared by Ted Matthies, Business Taxes Specialist III
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MARKUP TABLE**Liquor Store**

Percentage of taxable vs. nontaxable purchases	unknown ²
Mark-up percentage - estimated	30%
Self-consumption allowed in dollars	\$7,247 for the audit period
Self-consumption allowed as a percent of taxable purchases	2%
Pilferage allowed in dollars	\$3,261
Pilferage allowed as a percent of taxable purchases	1%

² The Department scheduled taxable merchandise purchases from information obtained from petitioner's merchandise suppliers. The Department did not schedule non-taxable merchandise purchases or compute a percentage of taxable to total purchases.