

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:)
PRITPAL S. WALIA, dba Fast & Easy Mart #14) Account Number SR CH 100-565052
Petitioner) Case ID 609568
Fremont, Alameda County)

Type of Business: Mini-mart

Audit period: 07/01/08 – 06/30/11

<u>Item</u>	<u>Disputed Amount</u>
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Unreported taxable sales	\$567,890
Negligence penalty	\$ 5,531

	<u>Tax</u>	<u>Penalty</u>
As determined and proposed to be redetermined	\$55,311.89	\$5,531.27
Less concurred	<u>- 1,045.41</u>	<u>00.00</u>
Balance, protested	<u>\$54,266.48</u>	<u>\$5,531.27</u>
Proposed tax redetermination	\$55,311.89	
Interest through 11/30/14	16,320.19	
Negligence penalty	<u>5,531.27</u>	
Total tax, interest, and penalty	\$77,163.35	
Payments	<u>- 176.00</u>	
Balance Due	<u>\$76,987.35</u>	
Monthly interest beginning 12/01/14	<u>\$ 275.68</u>	

A Notice of Appeals Conference was mailed to petitioner's address of record, and the notice was 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. In response, petitioner requested that the settlement process be initiated, and we referred that request to the Settlement Division. However, that division previously had considered petitioner's settlement proposal, and had been unable to reach a mutual agreement with petitioner. Thus, the settlement case had been closed in September 2013.

UNRESOLVED ISSUES

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2 **Issue 1:** Whether adjustments are warranted to the amount of unreported taxable sales. We
3 find no adjustment is warranted.

4 Petitioner operated a mini-mart as a sole-proprietorship from May 2005 through December
5 2013, when the business was reorganized as a partnership. For audit, petitioner provided federal
6 income tax returns, bank statements and sales summary sheets for the audit period, and merchandise
7 purchase invoices for the second quarter 2010 (2Q10) and October 2011. The Sales and Use Tax
8 Department (Department) found discrepancies among the various records and decided to establish
9 taxable sales on a markup basis.

10 The Department conducted a purchase segregation test, using purchase invoices for 2Q10, and
11 computed percentages of merchandise purchases in various categories. The Department then
12 conducted shelf tests to compute audited markups for each category of merchandise, using costs from
13 invoices for October 2011 and selling prices on the shelf or provided by petitioner on November 2,
14 2011. The Department used the percentages computed in the purchase segregation test and the audited
15 markups for the various categories to compute an audited weighted markup of 24.74 percent.

16 Based on its review, the Department concluded that the available purchase invoices were
17 incomplete. The Department also did not have adequate records to verify the amounts of merchandise
18 purchases claimed on the federal income tax returns. Accordingly, the Department requested purchase
19 information from petitioner's known vendors. Using the data provided by the vendors, the Department
20 compiled purchases of taxable merchandise. To compute the audited cost of taxable goods sold, the
21 Department made adjustments of 3 percent for pilferage and spoilage (combined) and 1 percent for the
22 cost of self-consumed merchandise. The Department used the audited cost of taxable goods sold and
23 the audited weighted average markup to compute audited taxable sales, which exceeded reported
24 amounts by \$567,890 for the audit period.

25 Petitioner contends that the amount of unreported taxable sales should be reduced because the
26 audited markup is too high, and because there should be adjustments to the audited cost of goods sold
27 for merchandise that remained in inventory because it was unsalable. However, petitioner has
28 provided no evidence to support these contentions.

1 The Department used shelf tests to compute the audited markups, and a shelf test is a Board-
2 approved method for computing markups. Petitioner has provided no evidence to establish that there
3 were errors in the shelf tests or that the audited weighted average markup is excessive. With respect to
4 petitioner's assertion that merchandise remained in inventory that was too damaged to sell, we note
5 that the Department has already made an adjustment to the cost of goods sold of 3 percent, for
6 pilferage and spoilage. That adjustment exceeds the routine adjustment of 1 percent for shrinkage, and
7 petitioner has provided no evidence to establish that the spoiled merchandise exceeded the amount of
8 the adjustment. Moreover, the beginning inventory on petitioner's 2008 federal return and the ending
9 inventory on his 2010 federal return reflect a decrease in inventory of \$125,000. However, the
10 Department did not make adjustments for that decrease in inventory. If the amounts claimed on
11 petitioner's federal returns are adequate, the decrease in inventory represents the cost of additional
12 sales. Accordingly, we find that the available evidence suggests that the audited cost of goods sold
13 may be understated, rather than overstated. Consequently, we find no adjustments are warranted to the
14 amount of unreported taxable sales.

15 **Issue 2:** Whether petitioner was negligent. We conclude that he was.

16 The Department imposed the negligence penalty because petitioner provided inadequate
17 records, and the errors identified in this audit were the same types of errors found in the prior audit.
18 Although petitioner protests the entire amount determined, he has raised no arguments directly related
19 to the penalty.

20 Petitioner did not provide a complete set of sales and purchase records, which is evidence of
21 negligence in recordkeeping. Also, the understatement of \$567,890 represents an error ratio of more
22 than 76 percent when compared to reported taxable sales of \$741,977. That substantial understatement
23 is evidence of negligence in reporting. Moreover, petitioner had been audited previously, and the
24 errors in this audit are the same types of errors found in the prior audit. Accordingly, we find there is
25 clear evidence of negligence, and the penalty was properly applied.

26 OTHER MATTERS

27 None.

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

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	91.06%
Mark-up percentages developed	24.74%
Self-consumption allowed in dollars	\$10,938 for the audit period
Self-consumption allowed as a percent of taxable purchases	1%
Shrinkage allowed in dollars	\$32,815 for the audit period
Shrinkage allowed as a percent of taxable purchases	3%