

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION BOARD HEARING SUMMARY**

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3 In the Matter of the Petition for Redetermination )  
4 Under the Sales and Use Tax Law of: )  
5 LALEH ENTERPRISES INC. ) Account Number SR AC 100-045990  
6 ) Case ID 469308  
7 Petitioner ) North Hollywood, Los Angeles County

8 Type of Business: Convenience store

9 Audit period: 04/01/05 – 06/30/08

<u>Item</u>	<u>Disputed Amount</u>
10 Unreported taxable sales	\$561,760
11 Negligence penalty	\$ 4,635

	<u>Tax</u>	<u>Penalty</u>
12		
13 As determined and protested	\$65,393.45	\$6,539.37
14 Pre-D&R adjustment	-18,891.66	-1,889.15
15 Post-D&R adjustment	<u>- 156.52</u>	<u>- 15.67</u>
16 Proposed redetermination	<u>\$46,345.27</u>	<u>\$4,634.55</u>
17 Proposed tax redetermination	\$46,345.27	
18 Interest through 02/28/15	28,218.21	
19 Negligence penalty	<u>4,634.55</u>	
20 Total tax, interest, and penalties	\$79,198.03	
21 Less payments	<u>- 794.32</u>	
22 Balance Due	<u>\$78,403.71</u>	
23 Monthly interest beginning 03/01/15	<u>\$ 227.75</u>	

24 This matter was scheduled for Board hearing in June 2014, but was postponed as requested by  
25 petitioner due to a scheduling conflict. It was rescheduled for Board hearing in October 2014, but was  
26 postponed again at petitioner's request because of the tax season.

**UNRESOLVED ISSUES**

27 **Issue 1:** Whether additional adjustments to the amount of unreported taxable sales are  
28 warranted. We conclude that no further adjustments are warranted.

Petitioner has operated a convenience store since July 1, 2002. For audit, petitioner provided  
its federal income tax returns, sales and use tax returns, a profit and loss statement for 2007, bank

1 statements for 2007, purchase summaries for the period April 1, 2005, through December 31, 2007,  
2 and merchandise purchase invoices for 2007. The Sales and Use Tax Department (Department)  
3 computed book markups of 25.22 percent for 2005, 27.39 percent for 2006, and 29.27 percent for  
4 2008, which were lower than expected. Further, the Department found that petitioner's reported  
5 taxable sales represented 23 percent of its reported total sales for the audit period, which the  
6 Department also considered to be low. As a result, the Department decided to establish audited taxable  
7 sales using the markup method.

8         Initially, the Department used the purchases recorded in petitioner's purchase summaries for  
9 the period April 1, 2005, through December 31, 2007, to calculate that purchases of taxable  
10 merchandise represented 93.38 percent of petitioner's total recorded merchandise purchases.  
11 However, in a pre-D&R reaudit, the Department reduced the taxable merchandise purchase ratio to  
12 80 percent because taxable and nontaxable merchandise purchases were not accurately segregated in  
13 petitioner's purchase summaries. The Department then reduced audited taxable merchandise  
14 purchases by 1 percent for pilferage to establish audited costs of taxable merchandise sold for the  
15 period April 1, 2005, through December 31, 2007. The Department made no adjustments for costs of  
16 self-consumed taxable merchandise because, during the audit, and again at the appeals conference,  
17 petitioner stated that its self-consumption was negligible. The Department then conducted a shelf-test  
18 and computed a weighted average markup of 38.59 percent for taxable merchandise. In a post-D&R  
19 reaudit, the weighted average markup was reduced to 38.33 percent after corrections were made to the  
20 original shelf-test. The Department added the weighted average markup of 38.33 percent to audited  
21 costs of taxable merchandise sold to establish audited taxable sales of \$870,092 for the period July 1,  
22 2005, through December 31, 2007. A comparison of audited taxable sales of \$870,092 with  
23 petitioner's reported taxable sales for that period showed an error rate of 124.28 percent, which the  
24 Department applied to petitioner's reported taxable sales for the audit period to establish unreported  
25 taxable sales of \$561,760.

26         Petitioner contends that the audited cost of taxable merchandise sold is overstated because the  
27 taxable merchandise purchase ratio should be 15 percent (as opposed to 80 percent, as established in  
28 the pre-D&R reaudit). In addition, petitioner asserts that its markup on taxable merchandise is

1 25 percent (as opposed to 38.33 percent, as calculated in the shelf-test). Petitioner contends that its  
2 business is comparable to a market that sells a significant amount of exempt food products and juices.  
3 However, the Department states that, based on its visual observation of the business premises, it would  
4 describe the business as a liquor store because petitioner's inventory primarily consists of beer, liquor,  
5 wine, and cigarettes.

6 We find that petitioner has not provided any evidence to support its contention that the taxable  
7 merchandise purchase ratio is 15 percent. Moreover, we find that the Department's use of a taxable  
8 merchandise purchase ratio of 80 percent is reasonable given that petitioner's purchase summaries  
9 reflected a taxable merchandise purchase ratio of more than 93 percent. Further, petitioner has not  
10 provided any evidence to support its contention that its markup on taxable merchandise is 25 percent.  
11 In addition, we find that the shelf-test markup of 38.33 percent is based on selling prices provided by  
12 petitioner, and petitioner has not provided any evidence to show that the prices it provided are  
13 incorrect. Thus, we conclude that no further adjustments are warranted.

14 **Issue 2:** Whether petitioner was negligent. We conclude that it was negligent.

15 The Department imposed the negligence penalty because it found that the understatement was  
16 substantial. Petitioner contends that the amount of the understatement does not warrant a penalty.

17 A comparison of unreported taxable sales of \$561,760 with reported taxable sales of \$452,011  
18 shows an error rate of 124.28 percent, which indicates that petitioner reported less than half of its  
19 taxable sales. We find that the magnitude of the error rate is strong evidence of negligence in  
20 reporting. We also note that, while this was petitioner's first audit under this seller's permit,  
21 petitioner's president operated the business with a partner from August 1, 1996, through June 30, 2002,  
22 under a different seller's permit, and that business was audited. Thus, we find that petitioner's  
23 president had sufficient experience in this business to accurately report its sales. Further, petitioner  
24 failed to provide source documents, such as cash register tapes, in support of its reported taxable sales,  
25 which is evidence of negligence in recordkeeping. Given the magnitude of the error rate and the  
26 inadequacy of petitioner's records, we find that petitioner was negligent in both reporting and  
27 recordkeeping, and the penalty was properly imposed.

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**OTHER MATTERS**

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

**MARKUP TABLE**  
**Convenience Store**

Percentage of taxable vs. nontaxable purchases	80.00% <sup>1</sup>
Mark-up percentages developed	38.33%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	\$6,354.00
Pilferage allowed as a percent of taxable purchases	1.00%

<sup>1</sup> Initially, the Department computed a taxable merchandise purchase ratio of 93.38 percent using petitioner purchase summaries. Because the purchase summaries only categorized the entire purchase as taxable or nontaxable and did not include a detailed description of each item, the Department concluded the 93.38 percent was high and estimated a taxable sales ratio of 80 percent based on its experience in audits of similar businesses.