

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for)
 4 Redetermination and Claim for Refund)
 Under the Sales and Use Tax Law of:)
 5) Account Number SR EH 97-148319
 6 SHRI RANCHHOD CORPORATION, dba Gas Up) Case ID's 775263, 771276
 7 Petitioner/Claimant) Colton, San Bernardino County

8 Type of Business: Gasoline station with mini-market

9 Audit period: 01/01/10 – 06/30/13

10 Item Disputed Amount11 Unreported taxable gasoline sales (07/01/10 – 06/30/13)¹ \$3,889,838

12 Unreported taxable sales other than gasoline (07/01/10 – 07/30/11) \$ 380,974

13 Unreported taxable sales (01/01/10 – 06/30/10) \$1,198,173

14 Unreported taxable sales-mini mart and propane (07/01/11 – 06/30/13) \$ 592,907

15 Negligence penalty \$ 17,866

16 Tax as determined and protested \$178,863.89²

17 Interest through 08/31/15 44,695.04

18 Negligence penalty 17,886.4319 Total tax, interest, and penalty \$241,445.3620 Monthly interest beginning 09/01/15 \$ 894.32

21 UNRESOLVED ISSUES

22 **Issue 1:** Whether adjustments are warranted to the audited understatements of reported taxable
 23 sales. We find no adjustment is warranted.

24 ¹ The understatement of reported sales of gasoline for periods beginning July 1, 2010, is stated as a separate audit item because, effective July 1, 2010, legislation was enacted that increased the state excise tax rate for gasoline and made a corresponding reduction to the sales tax rate. Accordingly, for periods beginning July 1, 2010, the sales and use tax rate applied to sales of gasoline is 2.25 percent plus applicable district taxes. The legislation that effected the reduction in the sales and use tax rate is referred to as the fuel tax swap.

25 ² The determined tax represents an understatement of tax of \$297,313.89, computed on an understatement of reported taxable measure of \$6,122,069, less a credit for unclaimed sales tax prepayments to fuel vendors of \$118,450.00. Petitioner concurs with the following determined understatements of reported taxable measure: unreported sales of diesel fuel of \$63,974 (\$31,125 + \$32,849), unreported cost of self-consumed merchandise of \$11,945, and unreported sales of propane of \$13,004. Thus, the amount of concurred tax is approximately \$7,336 [(\$63,974 + \$11,945 + \$13,004) x 8.25%], and the amount of disputed tax is approximately \$289,978 (\$297,314 – \$7,336), which exceeds the amount of determined tax. Consequently, we show the entire amount of determined tax as disputed. Petitioner also concurs with the credit for unclaimed sales tax prepayments to fuel vendors. Since petitioner has filed a claim for refund, a refund will be made if petitioner prevails in this matter.

1 Petitioner operated a gasoline station with a mini-mart from November 1997 through June
2 2013. For audit, petitioner provided federal income tax returns (FITR's) for 2010, 2011, and 2012,
3 purchase invoices for the period January 1, 2010, through December 31, 2012, and a sales report for
4 the third quarter 2012 (3Q12) from petitioner's Point of Sale cash register system (POS report). Since
5 the records were incomplete, the Sales and Use Tax Department (Department) used alternative
6 methods to establish audited taxable sales, as explained below.

7 Audited Gasoline Sales

8 The Department compiled gasoline purchases from purchase invoices for the period January 1,
9 2010, through December 31, 2012. Using information from the 3Q12 POS report, the Department
10 computed a markup of 8.58 percent for gasoline sales. However, in order to give petitioner the benefit
11 of the doubt, the Department decided to use the markup of 5.27 percent established in the prior audit to
12 establish gasoline sales for the years 2010, 2011, and 2012 of \$6,701,291.

13 Since petitioner did not provide records from which the cost of gasoline purchases could be
14 developed for the first two quarters of 2013, the Department established sales of gasoline for those
15 quarters using the number of gallons of gasoline purchased and the selling prices published by the
16 U. S. Department of Energy (DOE). The Department weighted the DOE selling prices using
17 percentages reflected in the 3Q12 POS report, 85.61 percent regular gasoline, 10.56 percent mid-grade,
18 and 3.82 percent premium. The Department then compared petitioner's selling prices, reported on
19 www.sanbernardinogasprices.com, for three days in May 2013 to the prices published by DOE and
20 computed a pricing differential of 18 cents per gallon. Therefore, the Department reduced the average
21 quarterly DOE prices by 18 cents before applying the selling prices to gallons of gasoline purchased to
22 compute gasoline sales for 1Q13 and 2Q13 of \$956,567.

23 Audited Diesel Fuel Sales

24 The Department computed diesel sales on a markup basis of \$31,125 for the period January 1,
25 2010, through December 31, 2012, using a markup of 27.11 percent. For 1Q13, the Department used
26 the gallons of diesel fuel purchased and prices published by DOE to establish sales of diesel fuel of
27 \$32,849. Petitioner did not sell diesel fuel in 2Q13. Petitioner concurs with the amount of audited
28 diesel fuel sales.

1 Audited Taxable Sales of Mini-Mart Merchandise and Propane

2 The Department obtained information regarding purchases of taxable mini-mart merchandise
3 and propane from known vendors for the period January 1, 2010, through December 31, 2012. It
4 compiled the total purchases for the three-year period in the categories of liquor and wine, beer, soda,
5 cigarettes and tobacco products, periodicals, other taxable merchandise (sundry), and propane.

6 The Department performed shelf tests, using costs from available purchase invoices and selling
7 prices posted on the shelves or obtained orally from petitioner to compute audited markups of
8 24.10 percent for liquor and wine, 16.54 percent for beer, 31.55 percent for soda, 10.18 percent for
9 cigarettes, 11.11 percent for newspapers, 73.54 percent for sundry merchandise, and 41.18 percent for
10 propane. Since petitioner had stopped selling periodicals sometime in 2011, the Department used the
11 markup of 20.62 percent from the prior audit to compute sales of periodicals and newspapers in 2010.

12 To establish the audited taxable sales of propane, the Department added the markup of
13 41.18 percent to the total purchases for the years 2010, 2011, and 2012. Petitioner concurs with the
14 audited sales of propane.

15 To establish the audited taxable sales of mini-mart merchandise, the Department first reduced
16 the total purchases compiled from vendors' information by an estimated cost of self-consumption and
17 an estimated cost of losses due to pilferage, computed at 1 percent and 3 percent, respectively. It then
18 added the audited markups to compute audited taxable sales. The Department computed sales of
19 taxable mini-mart merchandise and propane for the period January 1, 2010, through December 31,
20 2012 of \$1,161,119, and it computed an average of \$96,760 per quarter, which it used to establish
21 audited taxable sales of taxable mini-mart merchandise and propane for 1Q13 and 2Q13.

22 Unreported taxable sales

23 Because the sales and use tax rate for sales of fuel was reduced effective July 1, 2010, as a
24 result of the fuel tax swap, the Department segregated the aforementioned amounts of audited taxable
25 sales into various periods. For the first two quarters of 2010, the Department combined audited taxable
26 sales of all product categories, which totaled \$1,383,006. That amount exceeded reported taxable sales
27 of \$184,833 for 1Q10 and 2Q10 by \$1,198,173.

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1 For the period July 1, 2010, through June 30, 2013, the Department established a separate
2 measure of tax for unreported taxable sales of gasoline by comparing audited gasoline sales, on a
3 quarter-by-quarter basis, to the gasoline sales subject to the fuel tax swap exemption (which
4 represented petitioner's reported gasoline sales). For the 2Q12, 3Q12, 4Q12, and 1Q13, reported
5 gasoline sales exceeded audited gasoline sales, and petitioner was unable to explain the credit amounts.
6 Consequently, the Department concluded that reported gasoline sales were accurate for those quarters.
7 For the period July 1, 2010, through January 31, 2012, and 2Q13, the Department found that audited
8 gasoline sales exceeded reported amounts by \$3,889,838.

9 For the period July 1, 2010, through June 30, 2011, the Department combined audited taxable
10 sales of diesel fuel, taxable mini-mart merchandise, and propane to compute audited taxable sales
11 excluding gasoline of \$460,954, which exceeded reported taxable sales other than gasoline of \$79,980
12 by \$380,974.

13 For July 1, 2011, through June 30, 2013, the Department established separate amounts of sales
14 of diesel fuel and of taxable sales of mini-mart merchandise and propane. As stated previously,
15 petitioner does not dispute the audited understatement of reported sales of diesel fuel. To establish the
16 audited understatement of taxable sales of mini-mart merchandise and propane, the Department
17 compared the audited amount of \$743,136 to the reported amount of \$150,229, to compute an
18 understatement of \$592,907.

19 Petitioner contends that the audited markup for gasoline of 5.27 percent should be reduced and
20 that the audited price differential of 18 cents used to compute gasoline selling prices for 1Q13 and
21 2Q13 should be increased. Petitioner states that the selling prices published on
22 www.sanberardinogasprices.com are not reliable. In addition, petitioner contends that the pilferage
23 allowance used to establish the cost of taxable mini-mart sales should be increased from 3 percent to at
24 least 5 percent, arguing that the business is located in a high crime area.

25 With respect to the audited markup for gasoline sales, we note that the Department used
26 petitioner's POS report and gasoline purchase invoices for 3Q12 to compute a markup of 8.58 percent.
27 However, the Department used the markup of 5.27 percent computed in the prior audit. We find that
28 the Department's use of 5.27 percent rather than 8.58 percent was conservative. Petitioner has not

1 provided evidence to support a further reduction to the audited markup for gasoline, and we find no
2 further adjustment is warranted. Regarding the 18-cent price differential, petitioner has provided no
3 evidence to show that the selling prices on the www.sanbernardinogasprices.com website are
4 unreliable. Further, the selling prices obtained from that website support a price differential of
5 18 cents, which is a fairly high difference between average DOE prices and actual selling prices.
6 Petitioner has provided no evidence to support an increase in the price differential, and we find no
7 adjustment is warranted.

8 Regarding petitioner's assertion that the pilferage allowance should be greater than 3 percent,
9 we note that the typical allowance for shrinkage is 1 percent. (Audit Manual, § 0407.10). When a
10 taxpayer claims pilferage in excess of 1 percent, he or she is expected to provide documentation (i.e.,
11 police reports, reports by regularly employed security guards, or insurance claims). In this case, the
12 Department has made an adjustment of 3 percent for pilferage and shrinkage without any supporting
13 documentation. Petitioner has provided no evidence to support an increase in the pilferage allowance,
14 and we find no adjustment is warranted.

15 **Issue 2:** Whether petitioner was negligent, we conclude that it was.

16 The Department imposed the negligence penalty because the records provided for audit were
17 inadequate and the understatement was substantial. Petitioner disputes the penalty, asserting that its
18 sole corporate officer is not a sophisticated business person and does not have a background in
19 accounting. On that basis, petitioner claims that any understatements of reported taxable sales were
20 the result of misunderstanding rather than negligence.

21 Petitioner did not provide basic summary records or complete source documents for the
22 majority of the audit period. Also, the understatement of reported taxable sales of \$6,110,124 is
23 substantial, and represents an error ratio of 193 percent in comparison to reported taxable sales plus the
24 claimed fuel tax swap exemption ($\$415,042 + \$2,746,806 = \$3,161,848$). We find that the inadequate
25 records and the magnitude of the understatement are clear evidence of negligence, particularly since
26 petitioner had been audited previously, and the amount of understatement increased from \$3,755,588
27 in the prior audit to \$6,110,124 in this audit. Accordingly, we find that the negligence penalty was
28 properly applied.

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RESOLVED ISSUE

Petitioner has filed a claim for refund of sales tax prepayments to vendors of fuel that were not claimed on sales and use tax returns during the audit period. The Department has recommended a tax credit of \$118,450.00 for unclaimed prepaid sales tax on fuel purchases, and petitioner concurs with that amount. Accordingly, the claim for refund has effectively been granted. However, since the audited tax deficiencies exceed the amount of the credit, a liability remains, and no refund is due.

OTHER MATTERS

None.

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

MARKUP TABLE (1/1/10 – 12/31/12)

Percentage of taxable vs. nontaxable purchases	Gasoline, diesel fuel and propane-100% Mini-mart-unknown*
Mark-up percentages developed	5.27% -gasoline 27.11%- diesel fuel 41.18%-propane 24.10%-liquor/wine 16.54%-beer 31.55%-soda 10.18%-tobacco 73.54%-sundry Periodicals 20.62% - 2010 11.11% - 2011/2012
Self-consumption allowed in dollars for the period 1/1/10-12/31/12	Gasoline, diesel fuel and propane-none** \$ 40-liquor/wine \$5,665-beer \$ 408-soda \$3,686-tobacco \$ 339-sundry \$ 101-periodicals
Self-consumption allowed as a percent of taxable purchases of merchandise other than gasoline, diesel fuel and propane	1%
Pilferage allowed in dollars for the period 1/1/10-12/13/12	Gasoline, diesel fuel and propane-none*** \$ 120-liquor/wine \$16,993-beer \$ 1,228-soda \$11,056-tobacco \$ 1,017-sundry \$ 307-periodicals
Pilferage allowed as a percent of taxable purchases of merchandise other than gasoline, diesel fuel and propane	3%

* For this audit, the Department compiled purchases of taxable mini-mart merchandise from information provided by petitioner’s vendors. The Department did not compile purchases of exempt food products, and we do not have the information to compute a percentage.

** The Department did not make an adjustment for self-consumption of gasoline because, while petitioner stated there may have been some self-consumption, it stated the effect on the audit would be minimal because of the low markup for gasoline. The Department did not make adjustments for self-consumption of diesel fuel or propane because petitioner did not state there was any personal use of those products.

*** The Department did not make adjustments for pilferage of gasoline, diesel fuel, or propane because those products were stored in a secured storage tank and thefts were unlikely.