

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 Y.N.V. INC.,) Account Number SR AS 100-268572
 6 dba Bella Boutique) Case ID 573642
 6 Petitioner) Redondo Beach, Los Angeles County

7 Type of Business: Retailer of sportswear

8 Liability period: 01/01/08 – 12/31/10

9 Item Disputed Amount

10 Unreported taxable sales \$1,162,820

	<u>Tax</u>	<u>Penalty</u>
12 As determined	\$ 50,820.85	\$ 5,082.08
13 Pre-D&R adjustments	+ 54,597.47	+ 5,459.74
13 Post D&R adjustment	<u>00.00</u>	<u>- 10,541.82</u>
14 Proposed redetermination, protested	<u>\$105,418.32</u>	<u>\$ 00.00</u>
15 Proposed tax redetermination	\$105,418.32	
15 Interest through 2/28/15	<u>37,711.93</u>	
16 Total, tax and interest	\$143,130.25	
16 Payment	<u>- 11.02</u>	
17 Balance due	<u>\$143,119.23</u>	
18 Monthly interest beginning 3/31/15	<u>\$ 527.04</u>	

19 UNRESOLVED ISSUE

20 **Issue:** Whether any adjustments to the amount of unreported taxable sales are warranted. We
 21 conclude that no adjustments are warranted.

22 Petitioner began operating two sportswear clothing stores inside shopping malls in September
 23 and October 2003. It closed the store in Carson, California in October 2011, and closed the store in
 24 Redondo Beach in January 2012. Upon investigation, petitioner provided its federal income tax
 25 returns, financial statements, cash register Z-tapes, and bank statements. The Sales and Use Tax
 26 Department (Department) found that the gross receipts reported on petitioner's income tax returns for
 27 2008 and 2009 exceeded the total sales reported on its sales and use tax returns by \$322,704 and
 28 \$66,695, respectively. A comparison of petitioner's reported total sales with the costs of goods sold

1 reported on its income tax returns showed book markups of 2.63 percent for 2008 and 61.77 percent
2 for 2009. Although the Department considered the book markup for 2009 to be reasonable, it was
3 unable to verify the accuracy of petitioner's reported cost of goods sold due to the lack of purchase
4 records. Thus, the Department decided to prepare a bank deposit analysis to compute petitioner's
5 taxable sales, and, based on the results of this analysis, issued a Field Billing Order (FBO) to establish
6 unreported taxable sales of \$577,416.

7 In order to obtain additional information to respond to petitioner's appeal, the Department
8 requested petitioner's sales information from the managers of both malls. Using the Gross Sales
9 History reports provided by the mall managers, the Department compiled audited total sales of
10 \$1,409,155 for the Redondo Beach store and \$447,277 for the Carson store. Although petitioner had
11 claimed a deduction for taxable bad debts of \$9,167 on its return for the first quarter of 2008, the
12 Department did not allow the deduction because petitioner provided no documentation to support the
13 claimed bad debts. The Department compared taxable sales of \$1,856,432 ($\$1,409,155 + \$447,277$)
14 with petitioner's reported taxable sales, and issued an adjusted FBO to show the increased liability.
15 The Department then issued a second adjusted FBO to correct an error in the first adjusted FBO.
16 Results of the second FBO show unreported taxable sales of \$1,162,820 for the liability period.

17 Petitioner agrees with the taxable sales of \$447,277 for the Carson store, but contends that
18 taxable sales of \$1,409,155 for the Redondo Beach store are overstated. Petitioner states that the
19 manager of the Redondo Beach store probably reported its sales to the mall management by telephone,
20 and alleges that either the store manager reported inflated its sales amounts, or the mall management
21 inflated the sales amounts in order to attract potential tenants and to satisfy the credit requirements of
22 the mall owner(s). Petitioner asserts that the Department needs to have the sales amounts provided by
23 the mall management certified or sworn in under penalty of perjury before that information may be
24 used to establish its taxable sales. Instead, petitioner contends that its sales should be determined
25 based on bank deposits, and provided worksheets listing deposits from sales of \$601,281 for the
26 Redondo Beach store for the liability period, and \$498,619 for the Carson store. While petitioner
27 calculates that it understated its reported sales by \$397,121 based on its own bank deposit analysis,
28 petitioner does not concede that understatement. To support its contentions, petitioner provided

1 additional documentation for the Redondo Beach store, including a lease agreement, monthly invoices
2 showing rent payments of \$13,000 to \$14,000, and copies of cancelled checks for the liability period.

3 Our examination of the lease agreement provided for the Redondo Beach store shows that
4 petitioner was contractually required to report its sales to the mall management, and the mall
5 management states that it recorded the sales amounts provided to it over the telephone by an
6 unidentified person representing petitioner. We find no reason to doubt the integrity of the mall
7 management in this matter, and thus, we do not find it necessary for the mall management to swear in
8 the evidence under penalty of perjury. Moreover, petitioner has not provided any documentation to
9 show that the amounts of sales recorded by the mall management are in excess of the amounts of sales
10 reported to it by petitioner's employee, or to show that the employee deliberately inflated the sales
11 amounts. Therefore, we conclude that the sales amounts provided to the mall management by
12 petitioner's employee represent petitioner's actual sales. Further, we note that only two checks appear
13 to be missing from the canceled checks that petitioner provided on appeal, and all of the checks
14 provided were issued to the landlord, the Carson store, or City of Redondo Beach, with no check
15 payments for merchandise purchases or for employee wages or salaries. We conclude that either
16 petitioner had another bank account for the Redondo Beach store, or petitioner paid cash for its
17 merchandise purchases and wages or salaries. Given strong evidence that petitioner did not deposit all
18 of its proceeds from sales into the bank account in question, we reject petitioner's proposal to
19 determine its sales based on bank deposits, and recommend no adjustment.

20 **RESOLVED ISSUE**

21 The Department imposed the negligence penalty because petitioner's books and records were
22 inadequate, and because the understatement was substantial (168 percent) relative to petitioner's
23 reported taxable sales. On appeal, petitioner contends that it was not negligent because it relied on its
24 accountant to file its sales and use tax returns. In light of the fact that this is petitioner's first audit, and
25 that petitioner appears to have relied on an accountant in filing its returns, we give petitioner the
26 benefit of the doubt and conclude that it was not negligent, and thus we recommend that the penalty be
27 deleted.

28 Summary prepared by Lisa Burke, Business Taxes Specialist III