STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Administrative Protest Under the Sales and Use Tax Law of:	
AA RANCHO, INC. dba Rancho Del Oro 76	Account Number SR FHB 100-585543 Case ID 569479
Taxpayer	Oceanside, San Diego County

Type of Business: Gasoline station with mini-mart

Liability period: 06/17/05 – 03/31/08

Item	Disputed Amount
Unreported taxable sales	$2,032,597
Negligence penalty	$14,465

Tax as determined and protested	$144,650.31[1]
Interest through 08/31/15	91,457.68
Negligence penalty	14,465.03
Finality penalty	14,465.03
Total tax, penalties, and interest	$265,038.05
Payments	- 140.25
Balance due	$264,897.80
Monthly interest beginning 09/01/15	$ 722.55

This matter was scheduled for Board hearing in July 2013 and October 2013, but was postponed at taxpayer's request each time, first for additional time to prepare for the hearing and then because of a scheduling conflict. The matter was rescheduled for hearing in February 2014, but taxpayer did not respond to the Notice of Hearing, and the matter was scheduled for decision on the nonappearance calendar in March 2014. It was postponed from that calendar for settlement consideration. The matter was rescheduled for hearing in February 2015, but taxpayer did not respond to the Notice of Hearing, and the matter was scheduled on the nonappearance calendar for March 2015.

[1] The determined tax is net of a credit of $12,876.00 for unclaimed sales tax prepaid to a fuel distributor, which is not disputed. Thus, the total amount of protested tax on the unreported taxable sales of $2,032,597 is $157,526.31. Since taxpayer has not filed a claim for refund, a refund of the unclaimed sales tax prepaid to a distributor will not be made if taxpayer prevails in this matter.

The matter was then postponed at taxpayer's request due to family illness. It was rescheduled for hearing in June 2015, but taxpayer again did not respond to the Notice of Hearing, and the matter was scheduled for decision on the nonappearance calendar. However, Member Harkey requested that the matter be deferred for further review.

UNRESOLVED ISSUES

Issue 1: Whether any adjustments are warranted to the amount of unreported taxable sales. We find no adjustments are warranted.

Taxpayer operated a gas station with a mini-mart and an automotive repair shop from June 2005 through November 2009, when the business was discontinued with no successor. Taxpayer provided federal income tax returns, some auto repair sales invoices, monthly sales reports for the periods January 1, 2007, through September 30, 2007, and January 1, 2008, through March 31, 2008, and some gasoline purchase invoices for examination. The Sales and Use Tax Department (Department) found that the gross receipts reported on taxpayer's income tax returns exceeded total sales reported on sales and use tax returns by $691,094 for three years combined. Further, while taxpayer allegedly used its monthly sales reports to report its total sales, total recorded sales of $3,033,104 from the monthly sales reports for the period January 1, 2007, through September 30, 2007, exceeded total reported sales of $2,580,857 for the same period by $452,247.

The Department decided to use average retail prices for gasoline in the Los Angeles area posted on the U. S. Department of Energy's website (market prices) to establish audited taxable sales of gasoline. Using taxpayer's sales reports for 2007, the Department calculated ratios for taxpayer's sales of regular, mid-grade, and premium gasoline, which it used to calculate weighted average market prices for each quarter. The Department compared taxpayer's average pump prices shown in information obtained from the Oil Price Information Service and concluded that taxpayer's prices were nine cents per gallon higher, on average, than the market prices. However, based on additional information provided by taxpayer showing that it reduced its gasoline prices by approximately four cents per gallon for customers who paid cash, the Department concluded that the price differential for taxpayer's cash sales was only five cents per gallon. The Department estimated that 15 percent of taxpayer's sales of gasoline were cash sales, and then multiplied the number of gallons taxpayer

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purchased each quarter by the respective quarterly weighted average market price, increased by a price differential of nine cents per gallon for credit card sales or five cents per gallon for cash sales, which resulted in audited gasoline sales of $9,386,639, including sales tax reimbursement. The Department reduced audited gasoline sales by $146,911 for exempt sales of gasoline to the U. S. Government to establish audited taxable gasoline sales of $9,239,728, including sales tax reimbursement.

To establish taxpayer's other taxable sales, which included both taxable sales of mini-mart merchandise and taxable sales of repair parts, the Department began by scheduling taxpayer's total recorded sales of $4,085,719, including sales tax reimbursement, from the sales reports for the four quarters for which the reports were available. Next, the Department reduced this amount by $158,398 for nontaxable repair labor[2], $50,076 for recorded exempt sales to the U.S. Government, and $17,439 for recorded exempt food sales, to compute audited taxable sales of $3,859,806 for the four quarters, which it then reduced by audited taxable gasoline sales of $3,475,457 to establish other taxable sales of $384,350, including sales tax reimbursement. The Department divided other taxable sales of $384,350 by audited taxable gasoline sales of $3,475,457 to compute a ratio of 11.06 percent, and then multiplied that ratio by audited taxable gasoline sales of $9,239,728 to establish other taxable sales of $1,021,915, and audited taxable sales of $10,261,643 ($9,239,728 + $1,021,915), including sales tax reimbursement, for the audit period. After making adjustments to exclude sales tax reimbursement, the Department computed that audited taxable sales of $9,523,567 exceeded taxpayer's reported taxable sales by $2,032,597 for the audit period.

Taxpayer contends that the number of gallons of gasoline used in the audit is overstated by 74,823 gallons. We examined the spreadsheets taxpayer prepared listing its gasoline purchases by month to support this contention, but noted that taxpayer failed to record several of its gasoline purchases. Since the number of gallons used in the audit was computed from the prepaid sales tax taxpayer paid to its supplier, and we found no error in those computations, we find that no adjustment to the audited number of gallons is warranted. Taxpayer alleges that it provided customers with

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[2] Based on January 2008 sales invoices for vehicle repairs, the Department calculated a ratio of 49.21 percent for nontaxable sales of repair labor. The Department then multiplied total recorded repair sales for the four quarters by 49.21 percent to establish nontaxable sales of repair labor for that period.

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coupons for $5.00 to $20.00 off the purchase price of gasoline, and argues that audited taxable sales of gasoline should be reduced by $654,858 for cash discounts. However, the electronic copy of a sales tax worksheet for March 2008 that taxpayer provided to support this contention shows a comment explaining that the cash discounts of $1,498.75 for that month were computed by multiplying $59.95 by 18. Since this comment is not consistent with taxpayer's explanation that cash discounts ranged from $5.00 to $20.00, and taxpayer provided no other documentation, such as the actual discount coupons or cash register tapes, to support the alleged discounts, we conclude that no adjustments for this contention are warranted. Additionally, taxpayer contends that an adjustment to nontaxable sales of repair labor is warranted. Taxpayer provided copies of 131 repair invoices for March 2008 showing a nontaxable labor sales ratio of 75.70 percent, and argues that these invoices should be combined with the January 2008 invoices used to compute a nontaxable repair labor ratio of 49.21 percent in the audit. However, we noted gaps in the numeric sequence of the March 2008 invoices indicating that 59 invoices were missing, and also noted that the total of taxpayer's recorded repair sales for March 2008 is significantly higher than the total of the repair invoices provided for March 2008. Given strong evidence that taxpayer did not provide all of its repair invoices for March 2008, we reject taxpayer's contention that the nontaxable labor sales ratio should be recalculated, and conclude that no other adjustments are warranted.

Issue 2: Whether taxpayer was negligent. We conclude that it was.

The Department imposed the negligence penalty because taxpayer did not maintain adequate books and records. Taxpayer opposes the negligence penalty on the grounds this was taxpayer's first audit and the understatement was unintentional.

Taxpayer failed to provide sales reports for 21 of the 33 months in the audit, and failed to retain worksheets showing how it computed its sales for reporting purposes for 32 of the 33 monthly reporting periods. Also, taxpayer failed to provide any source documents (such as cash register tapes) showing its sales other than an incomplete set of repair sales invoices for two months. The Board's own regulation specifies that the failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax (Cal. Code Regs., tit. 18, § 1698, subd. (k)), and thus we find that taxpayer was negligent in recordkeeping. Moreover, while taxpayer

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allegedly used its monthly sales reports to report its total sales, the monthly sales reports that taxpayer provided for the period January 1, 2007, through September 30, 2007, showed recorded total sales of $452,247 that taxpayer failed to report. We find that taxpayer's failure to report all of the sales shown *in its own records* is clear evidence of negligence in reporting. The understatement of $2,032,597 for the audit period represents a reporting error rate of 27.13 percent, which we find is additional evidence of negligence in reporting. We also note that, while this technically was taxpayer's first audit, both taxpayer's president and its secretary were involved in other businesses that had been audited previously, and therefore petitioner's principals had prior audit experience.[3] In addition, given that taxpayer's corporate officers had substantial business experience, we find that taxpayer's failure to report all of its recorded sales is egregious, and conclude that the penalty was properly applied.

OTHER MATTERS

Since taxpayer did not pay the tax portion of the determination in full by August 9, 2010, the date the determination became final, a finality penalty in the amount of $14,465.03 was added to the liability. Although we informed taxpayer at the conference that it could file a request for relief of the finality penalty, provided a form that it could use to do so, and sent an email reminding taxpayer to return the form to us, taxpayer has not filed a request for relief. Therefore, we have no basis on which to consider recommending relief of the finality penalty.

Summary prepared by Lisa Burke, Business Taxes Specialist III

[3] Mr. Mahmoud Habhab was sole proprietor of A & M Auto Sales (SR FH 25-917623), which was audited for the period 1/1/98 to 9/30/00, resulting in a no change audit. Mr. Kaream A. Assi was an officer for Super Energy Inc., dba Claremont Mesa Mobil (SR FH 99-553106), which was audited for the period 7/1/99 to 6/30/02, resulting in a credit.

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