STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: BHARWANI CORP., dba Keg Liquor Petitioner	Account Number SR DFB 101-297252 Case ID 740667 Delano, Kern County

Type of Business: Liquor store

Audit period: 01/01/10 – 12/31/12

Item	Disputed Amount
Unreported taxable sales	$673,040
Negligence penalty	$ 6,165

	Tax	Penalty
As determined	$71,587.13	$7,158.73
Post-D&R adjustment	- 9,933.50	- 993.36
Proposed redetermination	$61,653.63	$6,165.37
Less concurred	- 1,648.89	00.00
Balance protested	$60,004.74	$6,165.37

Proposed tax redetermination	$61,653.63
Interest through 08/31/15	16,676.12
Negligence penalty	6,165.37
Total tax, interest, and penalty	$84,495.12
Monthly interest beginning 09/01/15	$ 308.27

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 it the opportunity to provide any additional arguments and evidence in writing it wished us to consider, but petitioner did not respond.

This matter was scheduled for Board hearing in June 2015, but petitioner 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 additional adjustments to the amount of unreported taxable sales are warranted. We conclude that no additional adjustments are warranted.

Petitioner operated a liquor store from October 2009 until July 2013, when it sold the business. For audit, petitioner provided its federal income tax returns, merchandise purchase invoices, and sales ledgers for 2010 and 2011, and its sales and use tax returns. The Sales and Use Tax Department (Department) found that the gross receipts reported on petitioner's income tax returns substantially exceeded the total sales reported on its sales and use tax returns, but concluded that the differences resulted from lotto sales and nontaxable sales of money orders that petitioner had reported on its federal income tax returns. The Department compared the reported gross receipts with the costs of goods sold reported on the income tax returns, and computed a book markup of 27.21 percent, which seemed somewhat low to the Department. The Department decided to prepare a markup analysis to establish audited taxable sales.

Petitioner did not maintain complete records of its merchandise purchases, so the Department was unable to verify the amounts of petitioner's reported costs of goods sold. Based on a review of the purchase invoices provided, the Department concluded that beer and liquor purchases represented a significant portion of petitioner's taxable merchandise purchases. The Department obtained summaries of petitioner's beer purchases from the known beer suppliers, and computed audited beer purchases of $1,246,295 for the audit period. The Department then segregated petitioner's merchandise purchases for February 2011 and October 2011 into various product categories (purchase segregation test), and calculated that beer purchases represented 52.843 percent of petitioner's total merchandise purchases. The Department also calculated that petitioner's purchases of taxable merchandise represented 91.326 percent of its total merchandise purchases. The Department divided audited beer purchases by the beer-to-total merchandise purchase ratio of 52.843 percent to establish audited total merchandise purchases of $2,358,500 (rounded) for the audit period, which it multiplied by the taxable merchandise purchase ratio of 91.326 percent to establish audited taxable merchandise purchases of $2,153,924. Audited taxable merchandise purchases were reduced by $6,000 per year to

allow for self-consumption, and by 2 percent to allow for pilferage, which resulted in audited costs of taxable merchandise sold of $2,092,845 for the audit period.

The Department then compared petitioner's selling prices for items from each product category on March 1, 2013, with the respective costs shown in the February 2011 purchase invoices to compute average markups for each product category. Using the purchase ratios calculated in the purchase segregation test, the Department established a weighted average markup of 16.40 percent for taxable merchandise. The Department added the weighted average markup to the audited costs of taxable merchandise sold to establish audited taxable sales of $2,436,072, which exceeded petitioner's reported taxable sales for the audit period by $783,590. However, correcting errors in the compilation of audited taxable merchandise purchases to allow for purchase discounts resulted in a reduction to the amount of unreported taxable sales, from $783,590 to $673,040.

Petitioner contends that the audited amount of unreported taxable sales is overstated because no adjustments to the audited costs of taxable merchandise sold were provided to allow for changes in merchandise inventory, and no allowance for breakage was provided. Additionally, petitioner contends that errors in the selling prices used to compute the audited weighted average markup resulted in an overstated markup.

We note that petitioner has not provided any documentary evidence to show that its merchandise inventory either increased or decreased during the audit period. Therefore, we conclude that no adjustment to the audited cost of merchandise sold is warranted. Regarding petitioner's contention that an additional adjustment for breakage of taxable merchandise is warranted, we find that the allowance of 2 percent for pilferage already provided in the audit is sufficient to cover other losses of taxable merchandise, such as losses from breakage. Petitioner has not provided any documentation or identified any specific errors to support its contention that there were errors in the selling prices used to compute the audited weighted average markup. We find that the markup of 16.40 percent already is lower than expected, and conclude that no adjustments are warranted.

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

The Department imposed the negligence penalty because petitioner did not provide adequate records to support its reported amounts, and because the understatement is large relative to petitioner's reported taxable sales. Petitioner has made no specific arguments regarding the issue of negligence.

We note that the audited understatement of $673,040 represents an error ratio of 40.73 percent when compared to reported taxable sales of $1,652,480. We find that petitioner's failure to report more than one-fourth of its taxable sales is strong evidence of negligence in reporting. We note that petitioner failed to provide any sales records for 2012, and provided no source documents, such as cash register tapes, to support the sales recorded in its sales ledgers for 2010 and 2011. Further, petitioner failed to provide merchandise purchase invoices for most of the audit period. 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. Thus, we conclude that petitioner was negligent and the penalty was properly imposed, even though petitioner had not been audited previously.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III