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:	
CALIFORNIA RESTAURANT AUTHORITY, INC., dba Pearl	Account Number SR AS 100-271926 Case ID 485060
Taxpayer	West Hollywood, Los Angeles County

Type of Business: Restaurant and bar

Liability period: 04/01/05 – 12/31/07

Item	Disputed Amount
Disallowed claimed “other” deduction	$357,684
Unreported taxable sales based on difference between recorded and reported sales tax and estimated for quarter with no return filed	$202,830
Unreported taxable sales based on difference between gross receipts reported on income tax returns and total sales reported on sales and use tax returns	$644,689
Unreported taxable sales based on difference between bank deposits and gross receipts reported on income tax returns	$304,272
Unreported sale of capital assets	$ 50,000

	Tax	Penalty
As determined	$209,427.87	$20,942.80
Add finality penalty		20,942.79
Pre-D&R adjustment	- 48,725.97	- 9,745.19
Post-SD&R adjustment	- 32,045.15	-17,456.99
Proposed redetermination, protested	$128,656.75	$14,683.41

Tax, as adjusted	$128,656.75
Interest through 11/30/15	89,947.28
Failure-to-file penalty	1,817.73
Finality penalty	12,865.68
Total tax, interest, and penalty	$233,287.44
Monthly interest beginning 12/01/15	$ 643.28

This matter was scheduled for Board hearing in October 2011 and January 2012, but was postponed each time at taxpayer’s request, first to allow additional time for a newly-retained representative to prepare for the hearing and then to allow additional time for the representative to obtain additional documents from the Sales and Use Tax Department (Department) and to prepare for the hearing. The matter was rescheduled for hearing in April 2012, but was deferred at the request of the Appeals Division in order to issue an SD&R. It was rescheduled in October 2014, but was deferred at the request of the Department for further review. As a result of that review, the Department recommended an increase in the adjusted understatement of reported taxable measure from $1,533,004, established in the second adjusted Field Billing Order (FBO) to $1,559,475, established in the third FBO. The specifics of that adjustment are incorporated into the analysis of the unresolved issues. The matter was then scheduled for Board hearing in June 2015, but taxpayer 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. The matter was scheduled on the Adjudicatory Calendar at the Board meeting in August 2015, but it was deferred again for further review at Member Harkey's request.

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments are warranted to the disallowed claimed "other" deduction. We find no further adjustment is warranted.

Taxpayer operated a restaurant and bar from July 2003 until the business closed. Although taxpayer requested that its seller's permit be closed out effective September 30, 2007, the Department found evidence that the business continued to operate at least through the end of 2007, and it closed the seller's permit effective December 31, 2007.[1]

The Department noted various discrepancies in the available records. As relevant to this issue, the Department found no evidence to support taxpayer's deduction, identified as "other" of $456,773. After the Notice of Determination (NOD) was issued, taxpayer provided evidence that $99,089 of the claimed "other" deduction represented nontaxable rentals of taxpayer's premises with no sales of

[1] The Department noted that the Request for Clearance Release dated March 27, 2008, filed by the escrow agent responsible for the sale of the business, showed an approximate last day of operation of May 1, 2008. Also, the successor obtained taxpayer's alcoholic beverage control license on January 24, 2008, and it requested a seller's permit with an effective start date of February 11, 2008. On the basis of these facts, the Department concluded that taxpayer operated the business at least until the end of 2007.

tangible personal property. Specifically, taxpayer provided contracts for rental of the venue for which no food or beverages were provided by taxpayer. Accordingly, the Department reduced the disallowed amount of "other" deduction by $99,089 to $357,684.

Taxpayer contends that further adjustments are warranted for nontaxable rentals of its premises included in the claimed "other" deduction. As support, taxpayer has provided additional contracts purportedly for rental of the premises. However, the Department found various discrepancies in those contracts. For instance, the Department found that the charge per person for one event was over $69 per person, which the Department considered too high to represent a rental of the premises only. For other contracts, taxpayer's customers were renting the Restaurant Room of the business during the dinner hour, and the Department found it unlikely that no food was served. With respect to one of the latter contracts, the Department found an advertisement in the customer's newsletter which described a dinner buffet at a charge of $35 per person. In short, the Department concluded that the additional contracts do not provide persuasive evidence of additional rentals of the premises with no sales of tangible personal property, and we concur. Accordingly, we find no further adjustment is warranted.

Issue 2: Whether additional adjustments are warranted to the amounts of unreported taxable sales. We find no further adjustment is warranted.

The Department used three different methods to establish the amounts of unreported taxable sales. First, the Department computed a difference of $4,604 between the recorded sales tax accrued and reported sales tax for the first quarter 2006 (1Q06) through 3Q07, and established unreported taxable sales of $55,777 for those seven quarters based on that difference. To establish unreported taxable sales for 4Q07, for which taxpayer did not file a return, the Department added unreported taxable sales of $55,777 to reported taxable sales for the audit period to establish audited taxable sales, and established the quarterly average as unreported taxable sales for 4Q07. In the FBO, the Department added $55,777 to the estimated unreported taxable sales for 4Q07 to establish unreported taxable sales of $271,009, but in the third adjusted FBO, the Department revised its computation of the estimated sales for 4Q07, which reduced this understatement of reported taxable sales from $271,009 to $202,830.

The second method used by the Department was a comparison of total sales reported on sales and use tax returns and gross receipts reported on federal income tax returns (FITR's), adjusted for sales tax included. In the FBO, the Department established that difference at $849,060. In the first adjusted FBO, the Department reduced that difference to $664,500, based on additional evidence that some of the gross receipts reported on FITR's represented nontaxable venue rental fees. In the second adjusted FBO, the difference was reduced to $647,248, and it was reduced to $644,689 in the third adjusted FBO.

The third method was a comparison of bank deposits to gross receipts reported on FITR's, and the Department established a difference of $911,677 in the FBO. The amount was reduced to $604,708 in the first adjusted FBO and to $207,063 in the second adjusted FBO, after the Department reviewed evidence taxpayer provided of additional funds from non-sales sources that had been deposited in the bank account. In the third adjusted FBO, the Department used actual bank deposits for 1Q06 and 4Q07 which were not available when the FBO was issued, and the difference was increased from $207,063 to $304,272.

Taxpayer continues to disagree with all three of the understatements of reported taxable sales, arguing that further adjustments are warranted for nontaxable venue rental, charges for staff and security, and for valet parking fees. We find that the Department has made all adjustments for which taxpayer has provided adequate documentation. Accordingly, we find no further adjustment is warranted.

Issue 3: Whether adjustments are warranted to the unreported sales of capital assets. We find no adjustment is warranted.

Taxpayer sold the business in 2008, and the escrow documents indicate that the restaurant furniture and equipment were sold for $50,000. Taxpayer did not report the final sale of capital assets, and the Department included the $50,000 as an amount subject to sales tax in the FBO. Taxpayer has not provided evidence that the sale of fixtures and equipment was exempt or excluded from taxation or that the established selling price was excessive. Accordingly, we find no adjustment is warranted.

RESOLVED ISSUE

The Department imposed a negligence penalty because taxpayer provided records that were incomplete and inadequate and because the understatement is substantial. Taxpayer disputes the penalty on the basis that it was not negligent. We note that taxpayer's source documents and records were incomplete, and taxpayer did not keep documents to support $357,604 in sales claimed as "other" nontaxable sales on its returns. We also note that taxpayer failed to report sales tax reimbursement of $4,604 that it collected, for which taxpayer has failed to provide a non-negligent explanation. Further, a comparison of unreported taxable sales of $1,559,475 with taxpayer's reported taxable sales of $2,096,546 shows a reporting error rate of 74 percent, which is substantial. For these reasons, we concluded in the D&R and SD&R that the penalty was properly applied. However, upon further consideration, while the inadequacy of taxpayer's records and its reporting errors constitute evidence of negligence, we find that taxpayer is entitled to leniency because this was its first audit. We therefore recommend that the negligence penalty be deleted.

OTHER MATTERS

A failure-to-file penalty was applied to the understatement of tax for 4Q07, and the amount of that penalty after the most recent adjustments is $1,817.73. Also, a finality penalty was added because taxpayer did not timely pay the determined tax or file a petition for redetermination before the liability became final. After the most recent adjustments, the finality penalty is $12,865.68. At the appeals conference, we explained to taxpayer that it could request relief of both those penalties and provided a form it could use, but taxpayer has failed to do so. Consequently, we have no basis on which to consider relief of the failure-to-file penalty or the finality penalty.

Summary prepared by Lisa Burke, Business Taxes Specialist III