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:

HAJA, LLC,
dba Tacone Manhattan Beach

Petitioner

Account Number SR AS 100-869762
Case ID 674641

Manhattan Beach, Los Angeles County

Type of Business: Restaurant

Audit period: 10/01/08 – 07/13/12

Item	Disputed Amount
Understatement of reported taxable sales	$440,969

	Tax	Penalty
As determined	$41,495.73	$4,149.61
Post-D&R adjustments	- 00.00	-4,149.61
Proposed redetermination	$41,495.73	$ 00.00
Less concurred	- 920.15	
Balance protested	$40,575.58	
Tax, as proposed to be redetermined	$41,495.73	
Interest through 11/30/15	12,798.78	
Total tax and interest	$54,294.51	
Payments	- 8,000.00	
Balance due	$46,294.51	
Monthly interest beginning 12/01/15	$ 167.48	

Notices of Appeals Conference were mailed to petitioner's addresses of record, and the notices were 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, and petitioner responded to our letter in an email dated October 16, 2014.

This matter was scheduled for Board hearing in June 2015, but petitioner did not respond to the Notice of Hearing, and it 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 ISSUE

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

Petitioner operated a fast-food franchise restaurant serving Mexican-style food from February 2007 through July 2012, when it sold the business. The restaurant was located in a shopping mall and shared eating facilities with another business. For audit, petitioner provided its federal income tax returns (FITR's) for 2008 and 2009, and bank statements for the period October 1, 2010, through February 28, 2012. Petitioner told the Sales and Use Tax Department (Department) that its sales data for the audit period was not available because its computers were stolen during burglaries in 2011 and 2012. The Department found that the gross receipts reported on petitioner's FITR for 2008 exceeded the total sales reported on its sales and use tax returns by $10,000, but found no difference for 2009. The Department then compared the reported gross receipts with the costs of goods sold from the FITR's, and computed book markups of 174.25 percent and 193.67 percent for 2008 and 2009, respectively, which were somewhat lower than expected. The Department noted that petitioner's FITR's reflected large net losses in both years, with no reported compensation to members, and only a small amount of reported wages in 2008, and no wages in 2009. The Department concluded that the information reported in the FITR's was unreliable, and additional testing would be required.

The Department observed petitioner's business on Tuesday, June 5, 2012, Thursday, June 7, 2012, and Saturday, June 9, 2012, from 10:00 a.m. to 8:00 p.m. or 9:00 p.m., and recorded food and beverage sales, sales tax reimbursement, discounts, and whether the sale was paid by cash or credit card. Petitioner charged sales tax reimbursement on all of its sales on those days, and the Department noted that the credit card slips did not include space for adding tips. The Department compared the recorded credit card sales with the recorded total sales for those three days, and computed a credit card sales ratio of 50.83 percent. The Department used that percentage and the credit card deposits shown in the available bank statements to establish audited total sales. The Department then deducted petitioner's claimed nontaxable sales for resale and made adjustments to exclude sales tax reimbursement to establish audited taxable sales of $504,938 for the period October 1, 2010, through March 31, 2012, which represented an error ratio of 57.96 percent when compared to petitioner's reported taxable sales of $319,631 for the same period. The Department applied the error ratio of 57.96 percent to reported taxable sales for the remaining quarters, and established unreported taxable sales of $440,969 for the audit period.

Petitioner contends that the results of the observation tests are not representative of its sales throughout the audit period because the tests were conducted during June, one of the two months with the highest volume of sales. However, petitioner states it is unable to provide additional documentation to support a reduction due to the theft of its computers. Petitioner also states that it sold the business at a loss, and since the new owners have not made payments on a note it carried as part of the sale, it is unable to pay the liability.

We find that the Department computed audited taxable sales based on the best available information. We note that the Department observed petitioner’s business for three entire days, one of which was a weekend day, and also note that the Department discussed the selection of the observation test days with petitioner in advance. Even if petitioner’s sales volume in June 2012 was higher than its usual volume, we would expect the ratio of sales paid for with credit cards in June to be consistent with the credit card sales ratios in other months with lower sales volumes. Petitioner has not provided any evidence to show that its true credit card sales ratio was greater than the audited ratio of 50.83 percent. Therefore, we find no basis for recommending a reduction to the amount of unreported taxable sales.

Regarding petitioner’s statement that it is unable to pay the liability, we recommended that petitioner contact the Department to discuss a payment plan, or contact the Offer in Compromise office for additional information about that option.

RESOLVED ISSUE

The Department imposed the negligence penalty because petitioner failed to maintain its records, and because the understatement is large relative to petitioner’s reported taxable sales. Petitioner did not provide any specific arguments regarding the issue of negligence. While petitioner alleges that all its sales data for the audit period was lost when its computers were stolen, we note that taxpayers are required to maintain hard copy records, even when computer records are maintained. In the D&R, we found that petitioner was negligent in recordkeeping. The audited understatement of $440,969 represents an error ratio of 57.97 percent when compared to reported taxable sales of

$760,740, and in the D&R, we found that petitioner's failure to report more than one-third of its sales constituted strong evidence of negligence in reporting. However, upon further consideration, we continue to find that the inadequacy of petitioner's records and its reporting errors constitute evidence of negligence, but, since petitioner is entitled to leniency because this was its first audit, we now recommend that the negligence penalty be deleted.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III