

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 AHMED KABIR,)
6 dba Salomi Indian & Bangladesh Restaurant)Account Number SR AC 100-615820
Case ID 763931

7 Petitioner)

North Hollywood, Los Angeles County

8 Type of Business: Restaurant

9 Audit period: 01/01/10 – 12/31/12

10 <u>Item</u>	<u>Disputed Amount</u>
11 Unreported taxable sales	\$703,415
12 Negligence penalty	6,525
13 Tax, as determined and protested	\$65,247.01
14 Interest through 11/30/15	20,566.14
15 Negligence penalty	<u>6,524.77</u>
16 Total tax, interest, and penalty	<u>\$92,337.92</u>
17 Monthly interest beginning 12/01/15	<u>\$ 326.24</u>

18 UNRESOLVED ISSUES

19 **Issue 1:** Whether adjustments to the amount of unreported taxable sales are warranted. We
20 conclude that no adjustments are warranted.

21 Petitioner operated a restaurant serving Indian-style cuisine from April 2005 through December
22 2014. The restaurant had seating for 63 people, and made some sales for resale to other restaurants
23 through online ordering. For audit, petitioner provided his federal income tax returns (FITR's) for
24 2010 and 2011, merchant statements showing credit card deposits, and bank statements. The Business
25 Tax and Fee Department (Department), formerly the Sales and Use Tax Department, found that the
26 gross receipts reported on petitioner's FITR's exceeded the total sales reported on his sales and use tax
27 returns by \$140,696 for 2010, and by \$95,531 for 2011. The Department then compared the gross
28 receipts with the costs of goods sold reported on the FITR's, and computed book markups that were
inconsistent for the two years. Due to the inadequacy of the records provided for examination,
material discrepancies between reported gross receipts and reported total sales, and the inconsistency

1 of the book markups, the Department decided that further investigation was warranted. The
2 Department considered establishing audited sales based on petitioner's bank deposits. However, based
3 on its finding that credit card deposits represented 90.49 percent of petitioner's bank deposits, the
4 Department concluded that petitioner did not deposit all of his cash receipts into the bank, and
5 therefore, a bank deposit analysis would not be useful. The Department decided to establish audited
6 sales using a credit card sales ratio analysis.

7 The Department conducted an observation test on May 23, 2013, from 11:30 a.m. to 10:00
8 p.m., and asked petitioner to provide its guest checks and credit card receipts for May 26, May 27 and
9 May 28, 2013. Based on the combined guest checks and credit card receipts for those four days, the
10 Department computed a credit-card-sales-to-total-sales ratio (credit card sales ratio) of 83.69 percent,
11 and also calculated that tips represented 11.95 percent of petitioner's credit card deposits. The
12 Department subtracted 11.95 percent from the electronic deposits of \$1,198,216 shown in petitioner's
13 bank statements for the audit period, and made adjustments to exclude sales tax reimbursement, which
14 resulted in audited credit card sales of \$965,564.

15 The Department noted that some of petitioner's orders were delivered through five companies
16 (Restaurant on the Run, LaBite, Eat24Hours, BeyondMenu, and Delivery.com), and that petitioner
17 claimed those orders as nontaxable sales for resale. The Department contacted all five companies, and
18 found that Restaurant on the Run held a valid seller's permit, issued a valid resale certificate, and
19 electronically deposited the payments collected from customers, net of sales tax reimbursement and
20 commission fees, into petitioner's bank account. Given adequate supporting documentation, the
21 Department allowed sales to Restaurant on the Run totaling \$2,289 as valid nontaxable sales for resale.
22 The other four companies informed the Department that they deducted commission fees from
23 customers' payments, and electronically deposited the remaining funds into petitioner's bank account.
24 In the absence of resale certificates or other supporting documentation, the Department disallowed the
25 remaining claimed nontaxable sales for resale of \$87,809 for the audit period.

26 The Department subtracted sales for resale of \$2,289 from audited credit card sales of \$965,564
27 to establish audited taxable credit card sales of \$963,276. Dividing audited taxable credit card sales by
28 the credit card sales ratio of 83.69 percent resulted in audited taxable sales of \$1,151,006, which

1 exceeded petitioner's reported taxable sales by \$703,415.

2 Petitioner claims that he was an absentee owner, and contends that the audit was not adequate.
3 Petitioner also contends that sales for resale to catering trucks were not taken into consideration, and
4 that his claimed nontaxable sales for resale of \$87,809 that the Department disallowed were valid.

5 We examined the audit procedures, and found that the audit was conducted in accordance with
6 the Audit Manual, and that the four-day test that was used to compute the audited credit card sales ratio
7 was sufficient to produce a representative result. Regarding the disallowed claimed nontaxable sales
8 for resale, we noted that petitioner did not provide resale certificates or other documentation
9 supporting his claimed nontaxable sales. In considering whether or not these transactions could be
10 considered sales for resale in fact, we found that we were required to make a determination of whether
11 or not an agency relationship existed between petitioner and the four companies in order to determine
12 whether it was proper to regard petitioner (and not the other companies) as the retailer of the food sold
13 to customers. Petitioner provided no documentation, such as service agreements, to clarify the nature
14 of his business relationship with the companies, and while he argued that the companies did not
15 deposit any sales tax reimbursement into his bank account, he failed to provide any evidence
16 supporting this assertion. Based on the websites for the four companies, we found that the companies
17 all market themselves as food delivery service providers, and not as retailers. Given that the
18 companies indicate in their websites that sales tax reimbursement is charged, and given that the
19 companies informed the Department that they only deducted their commission fees before depositing
20 funds into petitioner's bank account, it appears that these companies collected sales tax reimbursement
21 on petitioner's behalf and transferred this tax reimbursement to petitioner, which is indicative of an
22 agency relationship. In the absence of any evidence to the contrary, we concluded that an agency
23 relationship existed between petitioner and LaBite, Eat24Hours, BeyondMenu, and Delivery.com, and
24 that petitioner was the retailer of the food delivered by these companies. In the absence of
25 documentation or other evidence supporting petitioner's contention that he made nontaxable sales for
26 resale to catering truck operators or to others, we concluded that no adjustments are warranted.

27 **Issue 2:** Whether petitioner was negligent. We conclude that he was.
28

1 The Department imposed the negligence penalty because petitioner did not retain any source
2 documents, such as guest checks or cash register tapes, to support his reported amounts, and because
3 the understatement is substantial in comparison to reported taxable sales. Petitioner opposes the
4 penalty because this was his first audit.

5 We find that petitioner's failure to provide basic records, such as sales journals, cash register
6 tapes, guest checks, and purchase records, is evidence of negligence in recordkeeping. Given that there
7 were substantial discrepancies between the amounts that petitioner reported for income tax purposes
8 and the amounts he reported for sales and use tax purposes, we find that there is evidence of
9 negligence in reporting. Additionally, we note that a comparison of unreported taxable sales of
10 \$703,415 with petitioner's reported taxable sales of \$447,591 shows an error rate of 157 percent, and
11 find that petitioner's failure to report more than 60 percent of his taxable sales for the audit period
12 ($\$703,415 \div (\$703,415 + \$447,591) = 61.1$ percent) is additional evidence of negligence in reporting.
13 We find that petitioner's bookkeeping and reporting errors (the inadequacy of records, the
14 discrepancies between amounts reported for income tax purposes and for sales and use tax purposes,
15 and the magnitude of the understatement) cannot be attributed to petitioner's bona fide and reasonable
16 belief that his bookkeeping and reporting practices were sufficiently compliant with the requirements
17 of the Sales and Use Tax Law. Under such circumstances, the imposition of a negligence penalty in a
18 first-time audit is appropriate. (*Cf. Independent Iron Works, Inc. v. State Bd. of Equalization* (1959)
19 167 Cal.App.2d 318, 321-324.)

20 OTHER MATTERS

21 None.

22
23
24
25 Summary prepared by Lisa Burke, Business Taxes Specialist III
26
27
28