CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
NAGIB ABDULSAEED SHARIFF, dba Golden 7 Food Store	Account Number SR CH 100-006032 Case ID 715384
Petitioner	Oakland, Alameda County

Type of Business: Mini-mart

Audit period: 04/01/09 – 11/17/11

Item	Disputed Amount
Understatement of reported taxable sales	$578,599
Negligence penalty	$ 5,608

	Tax	Penalty
As determined	$62,930.53	$6,293.07
Pre-D&R adjustment	+ 303.25	+ 30.32
Post-D&R adjustment	- 7,150.88	- 715.06
Proposed redetermination	$56,082.90	$5,608.33
Less concurred	- 2,845.70[1]	00.00
Balance, protested	$53,237.20	$5,608.33

Proposed tax redetermination	$56,082.90
Interest through 08/31/16	20,302.16
Negligence penalty	5,608.33
Total tax, interest, and penalty	$81,993.39
Monthly interest beginning 09/01/16	$ 280.41

This matter was scheduled for Board hearing in March 2015, but was postponed at petitioner's request due to a scheduling conflict. It was rescheduled for a Board hearing in May 2015, but was postponed for settlement consideration.

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments are warranted to the audited understatement of reported taxable sales. We find no further adjustment is warranted.

[1] The concurred amount represents tax related to $3,157 in unreported costs of self-consumed taxable merchandise conceded at the appeals conference, and $26,362 in unreported taxable sales conceded in petitioner's exhibit dated May 15, 2015, for the May 2015 Board hearing.

Petitioner operated a mini-mart from April 2002, through November 17, 2011.[2] For audit, petitioner provided a federal income tax return (FITR) for 2011 and purchase invoices for the third quarter 2009 (3Q09).

The Business Tax and Fee Department (Department), formerly the Sales and Use Tax Department, found that reported total sales substantially reconciled with the gross receipts reported on the FITR for 2011. Also, the Department computed a book markup of 34.87 percent for total sales, which was within the range of markups expected for this type of business (25 to 35 percent). Thus, it appeared to the Department that reported total sales were substantially accurate.

The Department used purchase invoices for 3Q09 to perform a purchase segregation test. Since there appeared to be missing purchase invoices,[3] the Department also contacted petitioner's vendors to obtain purchase information. Using available purchase invoices and information from vendors, the Department computed that 82.78 percent of the purchases for 3Q09 represented taxable merchandise. The Department also computed the percentages of purchases in each merchandise category.

The Department then performed a shelf test for each category of taxable goods sold, using costs from purchase invoices for August and September 2012 and selling prices posted on the store shelves on September 19, 2012. When the selling price was not posted, the Department asked a store employee. However, the Department found that some of the selling prices provided by the store employee appeared to be low. Further, when staff from the Department made purchases of those items, the selling prices charged were higher than the prices stated by the employee. Consequently, the Department used the prices actually charged on sales of the items in question, along with the other prices obtained during the shelf test, to compute markups for each category of merchandise. It used the percentages computed in the purchase segregation test to compute a weighted average markup of 26.76 percent.

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[2] The successor to this business is petitioner's wife, Hamdiah Saleh Aldahebi (SR CH 102-153927).

[3] Specifically, the Department noted that petitioner made some purchases on a periodic basis (such as once a week or once a month). For some days on the periodic pattern when petitioner routinely made purchases, there were no purchase invoices. Accordingly, the Department found it likely that there were invoices missing.

To establish the audited cost of taxable merchandise sold for 3Q09, the Department reduced audited taxable purchases for that quarter by $100 per month for an estimated cost of self-consumed taxable merchandise and by 1 percent for pilferage. It added the audited markup of 26.76 percent and computed audited taxable sales that exceeded the reported amount by 116.98 percent. The Department applied that error rate to reported taxable sales for the periods April 1, 2009, through June 30, 2010, and July 1, 2011, through November 17, 2011. For the period July 1, 2010, through June 30, 2011, the Department noted that reported taxable sales were significantly lower than the amounts reported in the remainder of the audit period. Therefore, the Department used the quarterly average audited taxable sales for the remainder of the audit period to establish audited taxable sales for 3Q10, 4Q10, 1Q11, and 2Q11. At the appeals conference, the parties agreed that reported taxable sales for the partial quarter 4Q11 appeared to be substantially accurate. Also, in the D&R, we recommended some revisions in the computation of the quarterly average (specifically, we recommended that the understatement previously computed for 4Q11 be deleted from the computation, and that audited taxable sales of $588,397[4] be divided by 6.52 quarters to compute a quarterly average amount of audited taxable sales of $90,245 for each of the quarters (3Q10, 4Q10, 1Q11, and 2Q11). The effect of these adjustments was a reduction to the audited understatement, from $658,791 to $578,599.[5]

Petitioner contends that his recorded purchases are overstated, arguing that some of the taxable merchandise purchases from Pitco were made by someone else using his account number. As support, petitioner provided 14 cash register receipts from Pitco, six of which were dated during the 3Q09 test period. Those six purchase receipts show the purchasers as Asma Shagera, Haggag A. Mohsin, or cash (no purchaser identified). Petitioner asserts that these receipts represent purchases by individuals he does not know, stating that someone must have heard his account number when he gave it orally to the cashier and then used it without his authority to make purchases. Petitioner also notes that two of the receipts are from the Pitco located in Brisbane, California, where he states he does not shop.

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[4] The $588,397 represents audited taxable sales computed for the period April 1, 2009, through June 30, 2010, and for 3Q11, plus reported taxable sales for the partial 4Q11.

[5] We recommended a reduction of $80,189 in the D&R, but there was a minor $3 difference when the Department made the adjustments.

We first note that these receipts were in petitioner's records. It seems unlikely that he would have had the receipts if the purchases had not been made on his behalf for this business. Further, we have researched Board computer records for Asma Shagera and Haggag A. Moshin. We have not been able to locate Asma Shagera in our computer records, but Mr. Moshin applied for a seller's permit under account number SR CH 101-292419, as a partner with petitioner, to operate this business starting August 1, 2009. Petitioner later came into the office to state he had never authorized anyone as a partner, and the permit was closed and shown as "did not operate." Regardless of the outcome of that permit application, the evidence shows that petitioner knows Mr. Moshin. Since it is clear that petitioner knew at least one of the two individuals whose names were on the receipts, we reject his assertion that the purchases were unauthorized. Regarding petitioner's assertion that he did not shop at the Brisbane location of Pitco, we note that the Brisbane location is 20.2 miles from petitioner's business location, and we do not consider that an unreasonable distance to drive to make purchases for the business. In short, we find it more likely than not that all of the receipts in petitioner's records represented authorized purchases for the business. Accordingly, we find that no adjustment is warranted to the audited amount of purchases of taxable merchandise.

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

The Department imposed the negligence penalty because petitioner's records were incomplete, his recorded purchases of taxable merchandise were greater than reported taxable sales for 3Q09, and the understatement was large. Petitioner disputes the penalty on the basis that he was not negligent and requests leniency since the business had not been audited previously.

Petitioner provided unusually limited records for audit. In addition, the understatement of reported taxable sales of $578,599 is substantial and represents an error rate of 156 percent when compared to reported taxable sales of $370,778. We find the clearly inadequate records and substantial understatement are evidence of negligence. Further, we find that any business person, even one with limited experience, should have recognized that his recorded purchases of taxable merchandise far exceeded his reported sales.[6] We find that petitioner's bookkeeping and reporting errors (the absence of records, the magnitude of the understatement, and reported taxable sales that were less than purchases of taxable merchandise) cannot be attributed to its bona fide and reasonable belief that his bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Under such circumstances, the imposition of a negligence penalty in a first-time audit is appropriate. (*Cf. Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

OTHER MATTERS

None.

Summary prepared by Gary A. Lomazzi, Business Taxes Specialist II

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[6] Moreover, petitioner has business experience. Before this audit period, he was operating four other similar businesses, either as a partner or a sole proprietor.