

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 EMAD KAMAL SWEIDAN,)
6 dba Jerusalem Cafe)

7 Petitioner)

Account Number SR KH 101-268111
Case ID 710620

Carmichael, Sacramento County

8 Type of Business: Hookah lounge

9 Audit period: 07/01/09 – 06/30/12

10 Item Disputed Amount
11 Unreported taxable sales \$110,119

	<u>Tax</u>	<u>Penalty</u>
12 As determined	\$10,938.46	\$1,093.85
13 Pre-D&R adjustment	<u>- 1,711.01</u>	<u>-1,093.85</u>
14 Proposed redetermination, protested	<u>\$ 9,227.45</u>	<u>\$ 00.00</u>
15 Proposed tax redetermination	\$ 9,227.45	
Interest through 10/31/16	<u>3,198.92</u>	
16 Total tax and interest, balance	<u>\$12,426.37</u>	
Monthly interest beginning 11/01/16	<u>\$ 46.14</u>	

17 This matter was scheduled for Board hearing in December 2015, but it was postponed for
18 settlement consideration.19 **UNRESOLVED ISSUE**20 **Issue:** Whether additional adjustments to the amount of unreported taxable sales are warranted.

21 We conclude that no additional adjustments are warranted.

22 Petitioner operated a hookah lounge, selling hookah tobacco and alcoholic beverages, from July
23 2009 through September 2012, when he closed the business. During the first year of the audit period,
24 petitioner also sold food. Additionally, petitioner leased out the premises for parties that were catered
25 by unrelated third parties. For audit, petitioner provided his federal income tax returns (FITR's),
26 monthly sales summaries, and bank statements. The Business Tax and Fee Department (Department),
27 formerly the Sales and Use Tax Department, compared the gross receipts with the costs of goods sold
28 reported on the FITR's, and computed book markups of 199.42 percent for 2010 and 181.00 percent

1 for 2011, which were significantly lower than expected. The Department decided to prepare a bank
2 deposit analysis to establish audited sales.

3 The Department examined petitioner's bank statements, and compiled bank deposits of
4 \$347,787 for the audit period. Initially, the Department subtracted loans and other deposits not related
5 to sales of \$18,266 to establish total deposits from business activity of \$329,521. However, based on
6 petitioner's contention that additional loans from his family members should be excluded from the
7 bank deposits, the Department compared the cash withdrawals shown in the bank statements provided
8 by petitioner's family members with the cash deposits shown in the bank statements for petitioner's
9 business bank account, and increased the amount of loans and other deposits not related to sales to
10 \$19,266. After petitioner explained that he did not charge sales tax reimbursement on his recorded
11 event fees of \$55,447 because the event fees were for reservations and for renting the facility, the
12 Department subtracted \$55,447 to compute bank deposits from taxable sales (other than event fees),
13 and then made adjustments to exclude the sales tax reimbursement.

14 The Department found that the recorded event fees included cover charges, which the
15 Department determined were not subject to tax, and room rentals and reservation fees, which the
16 Department concluded were taxable. Since petitioner did not segregate the event fees into various
17 categories in his records, the Department estimated that 50 percent of the recorded event fees were
18 nontaxable cover charges, and the remaining 50 percent, \$27,724, was subject to tax. Adding \$27,724
19 to audited bank deposits from taxable sales (other than event fees) of \$251,937 resulted in audited
20 taxable sales of \$279,661. However, in the D&R, we concluded that the recorded event fees included
21 nontaxable room rentals of \$19,500, and recommended that audited taxable sales be reduced
22 accordingly. A comparison of audited taxable sales of \$260,161 (\$279,661 - \$19,500) with petitioner's
23 reported taxable sales shows unreported taxable sales of \$110,119 in the post-D&R reaudit.

24 Petitioner contends that there are additional loans from family members that should be
25 deducted from the bank deposits in calculating audited taxable sales. In support, petitioner provided
26 signed statements from his mother and his brother-in-law stating that they made loans to petitioner,
27 together with their bank statements showing total cash withdrawals of \$25,740. Petitioner also
28 contends that the remaining recorded event fees of \$8,224 should be deducted from audited taxable

1 sales, because none of the recorded event fees were related to his taxable sales of hookah tobacco,
2 alcoholic beverages, and food.

3 In considering petitioner's contention that additional loans from family members should be
4 deducted from his bank deposits, we reviewed the bank statements provided by petitioner's family
5 members, and found that the amounts of most of the withdrawals ranged from \$200 to \$400. We find
6 that the documentation is insufficient to show that the cash from these withdrawals was loaned to
7 petitioner and included in his regular deposits of cash and checks. We note that, before a reduction to
8 the bank deposits used to establish audited taxable sales would be warranted, petitioner would need to
9 show that the cash loans were actually deposited into the business bank account instead of being used
10 to make cash purchases for the business. We note that three cash withdrawals of larger amounts
11 (\$2,200, \$1,000, and \$3,000) were shown in the bank statements from one of the family members, but
12 only the withdrawal of \$1,000 could be traced as a deposit in petitioner's bank statements. We find
13 that it was appropriate to accept the deposit of \$1,000 as a loan and deduct that amount in calculating
14 audited taxable sales, but we find that no further deduction to allow for loans is warranted.

15 According to petitioner, recorded event fees of \$55,447 include cover charges, room rentals,
16 and reservation fees to reserve a VIP table. Based on the Department's estimate that half of the
17 recorded event fees represent nontaxable cover charges, \$27,723 has been presumed to be nontaxable.
18 Based on signed contracts for room rentals provided by petitioner stating that the event planners (not
19 petitioner) were responsible for all supplies, food, and beverages for the events held in petitioner's
20 facilities, we found that the room rentals totaling \$19,500 were not subject to tax. However, no
21 evidence has been provided indicating that the reservation fees to reserve a VIP table were not related
22 to petitioner's taxable sales of hookah tobacco, alcoholic beverages, and food. Thus, we find that the
23 remaining recorded event fees of \$8,224 represent reservation fees, which are subject to tax. We
24 conclude that no additional adjustments are warranted.

25 **RESOLVED ISSUE**

26 The Department imposed the negligence penalty because it found that petitioner's records were
27 inadequate for sales and use tax purposes. However, based on copies of police reports that petitioner
28 provided after the appeals conference, the Department concluded that petitioner's records might have

1 been stolen. Moreover, the Department found that petitioner was very cooperative during the audit and
2 seemed to have provided all of his available records. Given that this was petitioner's first audit, and he
3 therefore is entitled to leniency, the Department recommended that the negligence penalty be deleted.

4 **OTHER MATTERS**

5 None.

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