STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
SUKRITA SANAHI, dba Kinni Tobacco	)	Account Number: SR EA 100-385920 Case ID 436874
Petitioner	)	Clearfield, Utah

Type of Business: Tobacco shop

Audit period: 05/01/04 – 12/31/06

Item	Disputed Amount
Unreported sales	$138,050
Negligence penalty	$ 1,098

	Tax	Penalty
As determined:	$13,729.34	$1,372.95
Adjustments - Appeals Division	- 2,746.00	- 274.61
Proposed redetermination	$10,983.34	$1,098.34
Less concurred	284.43	00.00
Balance, protested	$10,698.91	$1,098.34

Proposed tax redetermination	$10,983.34
Interest through 3/31/10	4,300.28
10% penalty for negligence	1,098.34
Total tax, interest, and penalty	$16,381.96
Monthly interest beginning 04/01/10	$64.07

This matter was scheduled for Board hearing on December 15, 2009, but petitioner did not respond to the Notice of Hearing. Accordingly, the Board Proceedings Division informed petitioner that this matter will be presented to the Board for decision without oral hearing. Subsequently, petitioner responded and requested an oral hearing.

UNRESOLVED ISSUES

Issue 1: Whether further adjustments are warranted to the audited understatement of reported sales. We recommend no further adjustment.

Petitioner operated a tobacco store from May 1, 2004, through August 14, 2007, when the business was sold to an unrelated party. Petitioner provided limited records for audit. The Sales and

Use Tax Department (Department) established audited sales on a markup basis. Since petitioner did not maintain a purchase journal with which the Department could verify the completeness of the purchase invoices that petitioner made available for audit, the Department used information from Sam's Club to establish petitioner's purchases from that vendor. However, for petitioner's other vendor, Costco, the Department received information only for 2007, the year after the audit period. Therefore, the Department used the Costco purchase invoices petitioner had provided for the fourth quarter 2006 to compile purchases for that quarter of $6,864, which the Department regarded as average purchases per quarter from Costco for the audit period. To establish audited cost of goods sold, the Department reduced audited purchases by an estimated amount of pilferage, computed at 1 percent, and an estimated cost of self-consumed merchandise, computed at 2 percent.

Since petitioner had sold the business before the audit began, the Department was unable to conduct a shelf test. Accordingly, it estimated a markup of 25 percent based on its experience auditing similar businesses in petitioner's area. To establish audited taxable sales for 2005 and 2006 (all petitioner's sales were taxable), the Department added the estimated markup of 25 percent to audited cost of good sold. Upon comparison of audited and reported taxable sales, the Department computed error ratios of 233.7 percent for 2005 and 301.5 percent for 2006, and 267.89 percent for the two years combined. The Department applied the error ratio of 267.89 percent to reported taxable sales for the period May 1, 2004, through December 31, 2004, resulting in an audited understatement of taxable sales of $172,858 for the audit period.

Petitioner contends that the reported amounts of taxable sales were correct, and that the audited purchases from both Sam's Club and Costco were excessive, as well as the markup used by the Department. Petitioner contended that she did not begin making purchases from Costco until November 2005 and that the estimated purchases from Costco for quarters before the fourth quarter 2006 are excessive. Petitioner has provided additional purchases invoices, which she asserts should be used to establish audited purchases from Costco. Based on a comparison of the purchase invoices provided by petitioner for Costco for 2007 and the information provided by Costco for that year, we find that petitioner's purchase invoices are incomplete. Accordingly, we recommend no reduction based on this contention. However, we conclude that petitioner has established that she did not make purchases from Costco prior to November 2005, and we thus recommend in the D&R that audited purchases from Costco be deleted from the audit for the period prior to November 2005.

With respect to her contention that the audited purchases from Sam's Club were also excessive, we note that the information provided by Sam's Club was very detailed, listing invoice numbers, invoice dates, purchase amounts, and descriptions of the merchandise purchased. Petitioner has not provided any documentation to refute that information. We find that the information provided by Sam's Club is the most reliable evidence of petitioner's purchases from that vendor, and we recommend no reduction for petitioner's contention regarding purchases from Sam's Club.

With respect to petitioner's contention that the audited markup of 25 percent is excessive, we note that petitioner has provided no documentation, such as detailed cash register tapes, from which a more accurate markup could have been computed. Rather, petitioner stated that she received rebates from cigarette manufacturer Philip Morris in exchange for her agreement to reduce her selling price for the cigarettes. Although petitioner provided a 1099 form from Philip Morris for 2006 showing rebates of $6,786 paid to petitioner, she did not have copies of the contracts entered into with Philip Morris. The Department explained that it was not aware during the audit that petitioner had received rebates from a cigarette manufacturer.

Based on petitioner's description of the rebates, such amounts she received were part of her taxable gross receipts. Accordingly, this information does not support a reduction in the audited measure of tax due. We note that the audit does not include a separate measure of tax for cigarette rebates, but since petitioner apparently lowered her price to consumers by the amount received as rebates, it appears that the audited markup of 25 percent, which based on our experience is reasonable for sales by a cigarette store, is sufficient to include such amounts in petitioner's audited taxable gross receipts.

The Department made the adjustment we recommended to remove audited purchases from Costco prior to November 2005 by reaudit dated June 10, 2009, reducing the audited understatement of reported sales by $34,808, from $172,858 to $138,050. In a reaudit dated July 21, 2009, the Department reduced the audited cost of self-consumed merchandise related to this reduction in purchases by $624, from $4,294 to $3,670. We recommend no further adjustments.

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

Petitioner asserts that her reported sales were correct, there was no understatement, and she was not negligent. However, the only records petitioner provided were income tax returns and incomplete purchase invoices. We find that these records are woefully inadequate, and petitioner was negligent in recordkeeping. Furthermore, petitioner reported sales of $64,525 for the entire audit period, May 1, 2004, through December 31, 2006, while her purchases from Sam's Club, as supported by the vendor's detailed report, total $101,271 for 2005 and 2006. Thus, just looking at purchases from Sam's Club alone for a period less than the full audit period, petitioner's purchases far exceed her reported sales. Petitioner has not provided a non-negligent explanation for her failure to report an amount of sales sufficient to at least account for her merchandise purchases. Further, the audited understatement of reported taxable sales of $138,050, after the adjustments in the reaudits, represents an understatement of 214 percent when compared to reported taxable sales of $64,525. Thus, in addition to her negligence in recordkeeping, we find that petitioner was negligent in reporting her tax liability.

OTHER DEVELOPMENTS

None.

Summary prepared by Rey Obligacion, Business Taxes Specialist III, Retired

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentage (estimated)	25%
Self-consumption allowed in dollars	$2,666 for 2005 and 2006
Self-consumption allowed as a percent of total purchases	2%
Pilferage allowed in dollars	$1,333 for 2005 and 2006
Pilferage allowed as a percent of total purchases	1%