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:

BEACH CITY MARKET, INC.

Petitioner

Account Number: SR FH 100-387902
Case ID 466431

San Diego, San Diego County

Type of Business: Delicatessen market and restaurant

Audit period: 07/01/04 – 06/30/07

Item	Disputed Amount
Unreported taxable sales	$84,731

	Tax	Penalty
As determined:	$156,645.29	$15,664.53
Adjustment - Sales and Use Tax Department	- 51,277.94	-15,664.53
Proposed redetermination	$105,367.35	$ 00.00
Less concurred	- 98,800.69	
Balance, protested	$ 6,566.66	
Proposed tax redetermination	$105,367.35	
Interest through 3/31/11	45,180.13	
Total tax and interest	$150,547.48	
Payments	- 0.60	
Balance Due	$150,546.88	
Monthly interest beginning 4/1/11	$ 614.64	

UNRESOLVED ISSUES

Issue: Whether adjustments are warranted to the amount of unreported taxable sales. We recommend no further adjustment.

Petitioner operates a delicatessen market with a restaurant and makes deliveries of food. Although it did not serve the food it delivered to its customers, petitioner used the term “catering” to describe its sales of delivered food, and, for ease of reference, we use the same terminology. The sales amounts reported on petitioner’s sales and use tax returns were based on sales reports generated by its cash register system, and the amounts reported on its income tax returns were from its Profit and Loss Statements (P&L’s), which were based on bank deposits.

During its preliminary examination, the Sales and Use Tax Department (Department) noted material differences between the amounts reported on income tax returns and those reported on sales and use tax returns. The Department compared reported total sales and total sales recorded on the P&L's for the period January 1, 2005, through June 30, 2007, to compute differences. The reported amounts of total sales exceeded amounts recorded on P&L's for five quarters and were less than recorded amounts for five quarters, with a net difference between recorded and reported total sales, excluding sales tax reimbursement, of $183,203. The Department used the percentages calculated to compute disallowed claimed deductions for exempt food sales (which deficiency petitioner does not dispute) to compute unreported taxable sales of $84,731.[1]

Petitioner disputes that it failed to report taxable sales of $84,731. It asserts that the amounts recorded on its P&L's are overstated. As support, petitioner has provided revised P&L's.[2] The amounts reported on petitioner's sales and use tax returns were based on reports generated by its cash register system, and the original P&L's examined at the time of the audit are based on bank deposits. Thus, the disputed measure of $84,731 essentially represents a difference between sales recorded on the cash register system and bank deposits. It is our understanding that the revised P&L's are based on the reports generated from the cash register system, and the amounts reconcile with the amounts reported on sales and use tax returns. Thus, the essence of petitioner's argument is that the reports generated from its cash register system, rather than the amounts deposited in the bank, should be used to establish audited sales. We note that the use of bank deposits to establish audited sales is an accepted audit method. For this business, the primary source of funds deposited in the bank is receipts from sales, and petitioner has not documented that any part of the difference between bank deposits

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[1] The Department computed audited taxable sales using audited percentages of catering and non-catering sales along with audited percentages of taxable sales in each of those categories. The Department used petitioner's records for the first six months of 2007 to compute that catering sales represented 23.86 percent of petitioner's sales, and 40.16 percent of the catering sales were taxable. It then used petitioner's sales records for September 2008 to compute that 48.16 percent of petitioner's non-catering sales were taxable. The Department used these percentages and reported total sales to compute the taxable amount of reported total sales, which exceeded reported taxable sales by $1,247,847. This is the undisputed amount characterized by the Department as disallowed claimed deductions for exempt food sales.

[2] Petitioner also argued that the Department should make adjustments for the periods during which reported total sales exceeded the amounts recorded on the P&L's (reflecting over-reporting of total sales on sales and use tax returns), noting that the Internal Revenue Service had audited and approved petitioner's income tax return for 2005, which reflected total sales less than petitioner reported on sales and use tax returns. Since the Department had in fact already made this adjustment in the audit, the argument is moot.

and reported total sales represents funds from non-sales sources, such as loans or transfers from petitioner's personal bank account. We therefore find it was appropriate for the Department to use petitioner's P&L's, which were based on bank deposits, to establish audited sales.

In the absence of a clear explanation of its basis for revising the P&L's, supported by specific documentation, we find there is no basis to use the revised P&L's, based on the cash register reports, in lieu of the original P&L's. Further, the Department accepted that petitioner reported more tax than was due for five quarters and included that overreporting in its calculation of the deficiency. Since we find it improbable that petitioner reported more sales than it made for five quarters, we believe this approach may have granted petitioner an unwarranted benefit. We believe it is much more likely that petitioner's bank deposits did not represent all of its sales because some cash proceeds were not deposited in the bank. We find there is no basis for adjustment of the understatement of reported taxable sales.

RESOLVED ISSUE

The Department imposed a negligence penalty in the audit, which it eliminated in the reaudit, primarily because there were significant reductions in the reaudit. We concur, and we recommend that the negligence penalty be deleted.

OTHER DEVELOPMENTS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III