

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Administrative Protest and)
 4 Claim for Refund Under the Sales and Use Tax)
 4 Law of:)
 5) Account Number: SR FH 101-022902
 5 CAFÉ 976, LLC) Case ID's 479006, 504670
 6 dba Café 976, The Beach House)
 6) San Diego, San Diego County
 7 Taxpayer/Claimant)

8 Type of Business: Restaurant

9 Liability period: 10/1/99 – 12/31/02

10 Item Disputed Amount

11 Disallowed claimed food sales \$302,628

12 Penalties \$7,228

	<u>Tax</u>	<u>Penalties</u>
13		
14 As determined	\$52,287.42	\$10,457.52
14 Finality penalty		+5,228.76
15 Amnesty interest penalty		+8,691.39
16 Pre-D&R adjustment	-29,399.92	-12,572.35
16 Post-D&R adjustment	<u>0.00</u>	<u>-4,577.52</u>
17 Proposed liability	\$22,887.50	\$7,227.80
17 Credit concurred in	<u>+295.93</u>	<u>0.00</u>
18 Balance, protested	<u>\$23,183.43</u>	<u>\$7,227.80</u>
19 Tax, as adjusted	\$22,887.50	
20 Interest	14,016.78	
20 Finality penalty	2,288.76	
21 Amnesty double finality penalty	2,288.76	
21 Amnesty interest penalty	<u>2,650.28</u>	
22 Total tax, interest, and penalty	\$44,132.08	
22 Payments	<u>-44,132.08</u>	
23 Balance Due	<u>\$ 0.00</u>	

24 **BACKGROUND**

25 At the time of the audit, the Sales and Use Tax Department (Department) thought the business
 26 was owned by taxpayer's predecessor, Café Pacific Beach, Inc. (SR FH 99-551925). It issued a Notice
 27 of Determination on May 5, 2004, to that predecessor, and it filed a timely appeal. Prior to its
 28

1 scheduled Board hearing, the predecessor provided documentation supporting that it was not the owner
2 of the business during the audit period. Taxpayer, a limited liability company consisting of managing
3 member Toro Group, Inc. (whose sole corporate officer is Timothy O'Reilly, who was also the
4 predecessor's sole corporate officer) and Ms. Anne Lenore Dierickx, took over the restaurant
5 operations in October 1999 without informing the Board. The Department deleted the determination
6 issued to the predecessor and issued a Notice of Determination to taxpayer on November 14, 2008.
7 After that determination was final, taxpayer submitted a February 6, 2009 letter protesting the
8 determination, which the Department accepted as an administrative protest.

9 Taxpayer made a timely claim for refund for the \$118,840.73 captured on February 17, 2009,
10 as a result of a bank levy. The Department applied \$52,287.42 of those funds to this determined
11 liability and refunded the \$66,553.31 overpayment to taxpayer on February 24, 2009. Subsequently,
12 the determined liability was further reduced to \$44,132.08 resulting in an additional overpayment of
13 \$8,155.34. The Department applied \$3,577.84 of the additional overpayment to an outstanding
14 liability of taxpayer for the third quarter 2009 and refunded the \$4,577.50 difference to taxpayer on
15 April 10, 2012. Since, as explained below, we conclude no further adjustments are warranted and thus
16 there is no remaining overpayment, we recommend that the claim for refund as to the amounts applied
17 to the liability at issue here be denied.

18 UNRESOLVED ISSUES

19 **Issue 1:** Whether adjustments are warranted to the disallowed claimed exempt food sales. We
20 conclude that no further adjustments are warranted.

21 Taxpayer used cash register tapes to report its taxable sales during the audit period October 1,
22 1999, through December 31, 2002. The Department accepted reported total sales as substantially
23 accurate, but observed that taxpayer's employees did not add sales tax reimbursement to taxable sales
24 of cold food and beverages consumed on the premises. Taxpayer, after being informed of the proper
25 application of tax to those types of sales, conducted a one-week test of its sales during May 2003 and
26 determined a taxable sales ratio of 61.59 percent, but indicated it did not believe that result was
27 representative of the taxable sales ratio throughout the audit period. To give taxpayer the benefit of
28 doubt, the Department decided to use instead the lower 55.62 percent taxable sales ratio based on

1 taxable and total sales taxpayer reported on its first quarter 2003 tax return, resulting in an
2 understatement of taxable sales (that is, disallowed claimed exempt sales) of \$709,920 for the audit
3 period. Later, the Department concluded that the determination was not timely for the period
4 October 1, 1999, through June 30, 2001, and prepared a reaudit to delete the liability for this period,
5 reducing the understatement to \$302,628 for the liability period of July 1, 2001, through December 31,
6 2002.

7 Taxpayer contends that the 55.62 percent taxable sales ratio used by the Department is not
8 representative of the audit period. Taxpayer alleges that during the audit period, more seating was
9 added to the restaurant and more hot food items were added to its menu, so that the taxable sales ratio
10 was lower at the beginning of the audit period and only increased to the 55.62 percent by the end of the
11 audit period. We conclude that taxpayer has not established that there was any significant increase in
12 the seating or hot food items before the first quarter 2003, during which the 55.62 percent taxable sales
13 ratio was established. We note also that it is not entirely clear that taxpayer had corrected all its
14 reporting problems during the first quarter 2003, and we believe that the Department's acceptance and
15 use of the ratio based on taxpayer's return for that quarter was conservative. Finally, we note that the
16 first seven quarters of the audit period have been deleted, so the liability period extends only to the six
17 quarters immediately prior to the first quarter 2003 from which the audited sales ratio was derived. We
18 conclude that taxpayer has not shown that its average sales ratio during the six quarters of the liability
19 period was less than audited sales ratio, and conclude no adjustment is warranted for this contention.

20 **Issue 2:** Whether the Notice of Determination dated November 14, 2008, for the period July 1,
21 2001, through December 31, 2002, was timely issued. We conclude that it was.

22 Taxpayer contends the Notice of Determination was not timely issued. However, the sales and
23 use tax amnesty program adopted by the Legislature provides for a ten-year statute of limitations for
24 assessing liabilities covered by the amnesty program, provided that issuance of a determination was
25 not already barred on August 16, 2004, the date the legislation was enacted. On that date, the
26 Department could have timely issued a Notice of Determination for the third quarter 2001, but not for
27 the second quarter 2001, under the normal three-year statute of limitations. Since taxpayer filed
28 returns and there is no basis for avoiding the three-year limitation period (as would be the case if fraud

1 were involved), the second quarter 2001 and earlier was already closed as of August 16, 2004, which is
2 why the Department concluded that the determination was not timely as to that period. However, the
3 third quarter 2001 remained open on August 16, 2004, and thus remained open under the 10-year
4 limitations period of the amnesty program. Since the determination here was issued on November 14,
5 2008, well within the 10-year amnesty limitations period (which extended the period to October 31,
6 2011), we conclude the determination was timely for the remaining liability period, July 1, 2001,
7 through December 31, 2002.

8 **Issue 3:** Whether taxpayer has established a basis for relief of the finality penalty. We
9 conclude that it has not.

10 Since taxpayer failed to timely file an appeal or pay the determination, a 10 percent finality
11 penalty was imposed pursuant to Revenue and Taxation Code 6565. Taxpayer submitted a statement
12 signed under penalty of perjury requesting relief of the finality penalty on the grounds that neither it
13 nor its representatives received a copy of the determination, and that it was informed by the
14 Department that an appeals conference would automatically be scheduled.

15 The record indicates that copies of the Notice of Determination were mailed to taxpayer and
16 both of its representatives at their respective addresses of record, none of the copies were returned by
17 the post office as undeliverable, and none of the mailing addresses have changed. We find taxpayer
18 received a timely issued determination and could have timely responded to it. Further, the documents
19 mailed to taxpayer contain instructions regarding how to file a timely appeal, but do not state that an
20 appeals conference will automatically be scheduled. We conclude taxpayer has not established
21 reasonable cause for its failure to timely file an appeal or pay the determination.

22 **Issue 4:** Whether taxpayer has established a basis for relief of the amnesty penalties. We
23 conclude that it has not.

24 All of the liability at issue falls within amnesty-eligible periods. Since taxpayer failed to
25 participate in the amnesty program, the liability is subject to the penalties provided under the program,
26 which include an amnesty doubled finality penalty and an amnesty interest penalty. Taxpayer
27 submitted a statement signed under penalty of perjury requesting relief from the amnesty penalties on
28 the grounds that the determination was issued to taxpayer on November 14, 2008, more than three

1 years after the March 31, 2005 deadline to file for amnesty, and that it was never notified of the
2 amnesty program.

3 A Notice of Determination for the liability at issue here was first issued to taxpayer's
4 predecessor, who filed a timely appeal. All taxpayers under appeal were offered the opportunity to
5 participate in the amnesty program, and the predecessor was provided an application to participate in
6 tax amnesty. Mr. O'Reilly was the sole corporate officer of both the predecessor and Toro Group, Inc.,
7 the managing member of taxpayer. He was actively involved in the audit of the business. The audit
8 was completed and the audit results were discussed with Mr. O'Reilly in late 2003. Based on
9 statements by Ms. Dierickx at the appeals conference, it appears that she would have also received
10 copies of the amnesty application (she indicated that she received copies of documentation the business
11 received from governmental agencies). Accordingly, we find that taxpayer's two members were aware
12 that taxpayer was the person who was liable for any tax due, were aware that tax was due, and were
13 aware of the amnesty program. Accordingly, we conclude that taxpayer had the knowledge and
14 opportunity to participate in the amnesty program, and that relief is not warranted.

15 **RESOLVED ISSUE**

16 The Department imposed the negligence penalty because taxpayer failed to maintain guest
17 checks in support of its claimed exempt food sales, and the understatement was large in relation to the
18 reported measure. We concluded that taxpayer's understatement was primarily caused by its
19 misunderstanding of the law. Since this was taxpayer's first audit, we conclude that taxpayer was not
20 negligent, and recommend that the negligence penalty be deleted, which also results in the deletion of
21 the amnesty double negligence penalty.

22 **OTHER MATTERS**

23 None.

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25 Summary prepared by Pete Lee, Business Taxes Specialist II
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