

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 BRUCE SAM CHHUTH and BOPHA TEP,) Account Number: SR KH 97-639141
 dba JS'C Gas Minimart) Case ID's 401822 & 420939
 6 Petitioner) Turlock, Stanislaus County

7
8 Type of Business: Gas station and mini-mart9 Audit period: 4/1/03 – 11/13/06¹

10 <u>Item</u>	<u>Disputed Amount</u>
11 Underreported fuel sales	\$1,161,746
12 Underreported mini-mart sales	\$ 769,987
12 Penalties	\$ 13,948

	4/1/03 – 6/30/04		7/1/04 – 11/13/06	
	401822		420939	
	<u>Tax</u>	<u>Penalty</u>	<u>Tax</u>	<u>Penalty</u>
15 As determined:	\$53,112.61	\$5,311.27	\$96,885.95	\$9,688.58
16 Post-D&R adjustments	<u>- 5,070.98</u>	<u>- 507.11</u>	<u>- 7,241.58</u>	<u>- 724.13</u>
16 Proposed redetermination	\$48,041.63	\$4,804.16	\$89,644.37	\$8,964.45
17 Less concurred	<u>- 159.88</u>	<u>0.00</u>	<u>- -298.32</u>	<u>0.00</u>
17 Protested	<u>\$47,881.75</u>	<u>\$4,804.16</u>	<u>\$89,346.05</u>	<u>\$8,964.45</u>
18 Proposed tax redetermination	\$48,041.63		\$89,644.37	
19 Interest through 06/30/12	14,341.80		28,256.62	
19 Negligence penalty	<u>4,804.16</u>		<u>8,964.45</u>	
20 Total tax, interest, and penalty	\$67,187.59		\$126,865.44	
20 Payments	<u>-67,187.59</u>		<u>- 58,236.15</u>	
21 Balance Due	<u>\$ 00.00²</u>		<u>\$ 68,629.29</u>	
22 Monthly interest beginning 07/01/12	<u>\$0.00</u>		<u>\$157.04</u>	

23 This matter was scheduled for Board hearing in September 2011, but was deferred at the
 24 request of the Sales and Use Tax Department (Department) for further review of the audited markups.

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 27 ¹ Two Notices of Determination were issued in connection with the audit of this period so that the period covered by the first determination was not barred by the statute of limitations.

28 ² Amounts paid towards this liability in excess of the amount due have been applied to petitioner's liability under case ID 420939.

UNRESOLVED ISSUES

1
2 **Issue 1:** Whether adjustments are warranted to the audited understatement of fuel sales. We
3 conclude no further adjustments are warranted.

4 The Department found that petitioner's reported fuel sales were less than its recorded fuel
5 purchases. It decided to establish petitioner's fuel sales using the numbers of gallons purchased, which
6 were obtained from petitioner's fuel vendor, and audited selling prices. Since petitioner did not
7 provide records that would establish its selling prices, the Department used the average fuel selling
8 prices published by the United States Department of Energy (DOE), adjusted by the percentage
9 differences for lower selling prices of fuel for the Turlock area, as published by the AAA Auto Club.
10 The Department computed audited taxable sales of \$4,838,220 of gasoline and \$269,563 of diesel.
11 Upon comparison with reported fuel sales of \$3,921,724, the Department established an
12 understatement of \$1,186,059, and that amount has been reduced to \$1,161,745 after correction of two
13 errors we identified in the audit computations. A comparison of the audited gasoline sales with the
14 audited gasoline purchases for the period January 1, 2004, through November 10, 2006, yielded an
15 audited gasoline markup of 23.78 percent. A comparison of the audited diesel sales with the audited
16 diesel purchases for that same period yielded an audited diesel markup of 18.86 percent.

17 Petitioner does not contest the audited diesel markup, but contends that the 23.78 percent
18 audited gasoline markup is too high, and that the true markup was about seven percent. In support,
19 petitioner provided cash register z-tapes for April 2003, and copies of bank statements for the second
20 quarter of 2003.

21 After the Department requested that this matter be deferred (when it was previously scheduled
22 for hearing), it conducted additional review of the audited sales of gasoline. Using the cash register
23 Z-tapes for April 2003, the Department found that the lowest selling price on the Z-tapes was still
24 higher than the selling prices published by DOE. Since the Department had already used DOE selling
25 prices adjusted to reflect *lower* prices in the Turlock area, it concluded that no further adjustments
26 were warranted to the audited sales of fuel.

27 We have reviewed the cash register Z-tapes for April 2003, and we concur with the
28 Department's conclusion that the prices shown on those tapes confirm the validity of the Department's

1 audit method for sales of gasoline. The Z-tapes do not support petitioner's argument that the audited
2 markup for gasoline should be about seven percent. Further, we find that the bank statements for one
3 quarter of the audit period do not provide evidence that supports any adjustments. Therefore, we find
4 no further adjustments are warranted to the audited understatement of reported fuel sales.

5 **Issue 2:** Whether adjustments are warranted to the audited understatement of reported taxable
6 mini-mart sales. We conclude no further adjustments are warranted.

7 Petitioner sold the usual mini-mart merchandise. Based on a two-quarter purchase segregation
8 test, the Department found that 79.93 percent of petitioner's mini-mart purchases represented taxable
9 merchandise, 19.96 percent represented exempt food products, and 0.11 percent represented supplies.
10 It applied the 79.93 percent to recorded total mini-mart purchases to compute audited taxable mini-
11 mart purchases, and found that this amount was less than petitioner's reported taxable mini-mart sales
12 (i.e., petitioner had a negative book markup for its taxable mini-mart sales). It conducted a similar
13 comparison of claimed exempt sales of food and audited purchases of exempt food products and
14 computed book markups for exempt food sales between 453 and 668 percent.

15 The Department concluded that petitioner had claimed a significant portion of its taxable sales
16 as exempt sales of food products, and decided to establish taxable mini-mart sales by the markup
17 method. To establish the audited cost of taxable mini-mart sales, the Department reduced audited
18 purchases of taxable mini-mart merchandise by an estimated cost of self-consumed merchandise of
19 \$1,800 per year and by estimated losses due to pilferage, computed at one percent. Since petitioner
20 had sold the business and did not maintain any record of its selling prices, the Department used an
21 estimated markup of 45 percent, which petitioner argued was too high. As support, petitioner provided
22 verification comments from an audit of another taxpayer that showed that the average taxable markup
23 of mini-mart merchandise sold in that gas station was 28 percent. In its additional review of the
24 markup after it requested that this matter be deferred, the Department concluded that the audited
25 markup for taxable mini-mart sales should be reduced to 32 percent, based on its recent review of
26 similar businesses.

27 In our experience, the audited markup for taxable sales in mini-marts generally ranges from 25
28 to 40 percent, and we find that the Department's estimated markup of 32 percent is reasonable.

1 Further, we note that it is only 4 percent higher than the 28 percent markup in the audit of another
2 business that was provided by petitioner. In the absence of records from which petitioner's markup
3 can be computed, we find no further adjustment is warranted.

4 **Issue 3:** Whether petitioner was negligent. We conclude that it was.

5 The Department asserted the negligence penalty because the deficiency is significant and
6 petitioner was negligent in recordkeeping. Petitioner contends that it should not be penalized simply
7 because the Department was unable to perform a shelf test, and that the records provided subsequent to
8 the appeals conference show that it did maintain records.

9 The \$1,938,183 understatement of reported taxable measure computed in the most recent
10 reaudit is substantial, and it represents an error ratio of 42 percent when compared to the \$4,600,061
11 reported taxable measure. Petitioner did not record all of its cash purchases, maintain documents of
12 original entry such as cash register tapes, or segregate its sales by the various product categories. We
13 find that any businessperson, even one with limited experience, should have been aware that those
14 deficiencies rendered its records inadequate. Further, we note that the reported sales of fuel were less
15 than the recorded purchases, and we find that discrepancy should have been readily apparent. We find
16 that the substantial understatement, the large error ratio, the shortcomings in petitioner's records, and
17 the fact that recorded fuel purchases exceeded reported fuel sales are strong evidence of negligence,
18 even though petitioner had not been audited previously. We thus find that the negligence penalty was
19 properly imposed.

20 **OTHER MATTERS**

21 None.

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23 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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MARKUP TABLE**Taxable Mini-Mart sales**

Percentage of taxable vs. nontaxable purchases	79.93% taxable (mini-mart)
Mark-up percentages developed	32% based on industry average in local vicinity
Self-consumption allowed in dollars	\$1,800 per year
Self-consumption allowed as a percent of total purchases	0.58% of taxable purchases
Pilferage allowed in dollars	\$11,083
Pilferage allowed as a percent of total purchases	1% of taxable purchases