

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:)
TOM YOUNG CHUNG, dba) Account Number: SR AA 14-763932
Chung's Mobil Service) Case ID 470308
Petitioner) Long Beach, Los Angeles County

Type of Business: Gasoline station with mini-mart

Audit period: 01/01/05 – 12/31/07

<u>Item</u>	<u>Disputed Amount</u>		
Unreported sales of gasoline	\$2,759,073		
Negligence penalty	\$ 22,762		
		<u>Tax</u>	<u>Penalty</u>
As determined:		\$245,103.36	\$24,510.34
Adjustment - Sales and Use Tax Department		- 17,479.75	- 1,747.98
Proposed redetermination, protested		<u>\$227,623.61</u>	<u>\$22,762.36</u>
Proposed tax redetermination		\$227,623.61	
Interest through 3/31/11		81,430.79	
Negligence penalty		<u>22,762.36</u>	
Total tax, interest, and penalty		\$331,816.76	
Payments		- 11,049.91	
Balance Due		<u>\$320,766.85</u>	
Monthly interest beginning 4/1/11		<u>\$ 1,263.35</u>	

This matter was previously scheduled for Board hearing on October 21, 2010, but was postponed at petitioner's request because of a scheduling conflict.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the unreported sales of gasoline. We recommend no further adjustment.

Petitioner operated a Mobil service station with a minimart and some automobile repair services. Early in 2007, petitioner began operating a car wash on the premises, and he offered discounted gasoline prices to customers who purchased a car wash. The sales amounts reported on

1 petitioner's sales and use tax returns were based on amounts recorded in quarterly reports from his
2 cash register system, which were not supported by source documents.

3 In its preliminary examination, the Department computed negative book markups for gasoline
4 (in other words, according to the books, petitioner was selling gasoline at a loss), with overall book
5 markups of five to six percent. To establish audited sales of gasoline, the Department used the audited
6 number of gallons of gasoline sold (computed using the claimed credits for prepaid sales tax and the
7 rates of sales tax prepaid to vendors) and the average prices for gasoline from the U.S. Department of
8 Energy website (average market prices), reduced by 8.44 cents per gallon for gasoline sold without a
9 car wash and by 22.31 cents per gallon for sales of gasoline with a car wash, based on the
10 Department's observation of petitioner's posted prices for two days in 2008. To establish the number
11 of gallons sold with a car wash, the Department used total recorded car wash sales, an average price of
12 \$4.00 per car wash, and an estimate of 15 gallons of gasoline sold with each car wash. Petitioner
13 asserted the audited selling prices of gasoline were excessive. In addition, petitioner stated that the
14 number of gallons of gasoline sold with car washes was higher in 2007 because the car wash prices
15 were lower when the car wash was first opened.

16 In a reaudit, the Department further reduced the audited selling prices of gasoline sold without
17 a car wash to 14 cents, 12 cents, and 10 cents per gallon below average market prices for 2005, 2006,
18 and 2007, respectively. The Department also increased its estimate of gallons of gasoline sold with a
19 car wash (only applicable for 2007), and further reduced the audited selling prices of such gasoline to
20 24.44 cents per gallon below the average market prices. To establish recorded sales of taxable mini-
21 mart merchandise and automobile parts of \$142,629 for the audit period, the Department subtracted
22 petitioner's recorded sales of gasoline from his reported total sales.¹ The Department used that
23 unverified amount as audited sales of taxable minimart merchandise and auto parts, and it compared
24 audited taxable sales, which represented audited sales of gasoline plus \$142,629, to reported amounts
25 to compute the understatement of \$2,759,073 at issue.

26 ¹ This amount of sales of taxable minimart merchandise and automobile parts, combined, appears low in comparison to
27 petitioner's claimed deductions of \$353,855 for exempt sales of food products. However, the Department believed it
28 possible that the claimed deductions for exempt sales of food products included lottery sales. Further, the Department
explained that this account had been selected for audit because of a potential significant understatement of reported gasoline
sales so that the primary focus of the audit was the verification of gasoline sales. Thus, the Department decided that further
investigation of the recorded taxable sales of minimart merchandise and automobile parts was not warranted.

1 Petitioner contends that his reported taxable sales are accurate, even though those amounts are
2 less than his recorded costs for gasoline.² He asserts that the audited selling prices are excessive
3 because, by the time the audit was conducted, his business was more profitable than it had been during
4 the audit period. In that regard, petitioner asserts that he was forced to sell gasoline at extremely low
5 prices during the audit period in order to increase the volume of his sales, in part because Exxon-Mobil
6 was threatening to terminate his franchise agreement. Petitioner explained further that the service
7 station was located in a redevelopment zone, and he believed that business would improve following
8 the redevelopment efforts. As a result, he states he was willing to accept losses in the current period in
9 anticipation of future profits, and that the gasoline prices the Department observed in 2008 were thus
10 not representative of his prices during the audit period, which were in fact 27.99 cents below the
11 average market prices, calculated as follows: 14.44 cents below average market prices (i.e., 6 cents per
12 gallon less than the 8.44 cents observed by the Department), a credit card fee of 6.26 cents per gallon,
13 and 7.29 cents per gallon to account for the statistical error possible in the weekly average market
14 price. However, although starting with 27.99 cents as a base, petitioner argues that his prices were
15 even lower during the audit period, so that his non-discounted selling prices for gasoline should be
16 established by reducing the average market prices by 34 cents, 32 cents, and 30 cents for 2005, 2006,
17 and 2007, respectively. For discounted sales with a car wash, petitioner asserts that the selling prices
18 of gasoline should be computed by reducing average market prices by 50 cents per gallon in 2007.

19 As support for his assertion that he routinely sold gasoline at sales prices lower than cost,
20 petitioner provided 24 credit card receipts with dates ranging from January 19, 2005, to December 16,
21 2007. Using the selling prices on the credit card receipts and the associated purchase costs that were
22 available (for 2006 and 2007 only), the Department computed a markup of -1.69 percent. The
23 Department also computed that the selling prices on the receipts were from 31 cents to 69 cents lower
24 than the average market prices. However, the Department found that the 24 credit card receipts were a
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27 ² To explain how he supported his family while selling gasoline at a loss, petitioner provided evidence of various loans and
28 income from sources other than sales.

1 small sample of sales, which did not represent convincing evidence that petitioner made all sales of
2 gasoline at a loss for three years.

3 After the appeals conference, the Department obtained petitioner's quarterly average prices for
4 regular unleaded gasoline from January 2006 through December 2007 from OPISnet.com, which
5 maintains prices for specific service stations. As explained in detail in the D&R, the Department used
6 the information from OPISnet.com to compute audited selling prices, which it then used to compute
7 audited gasoline sales that were slightly higher than the understatement established in the most recent
8 reaudit. The Department offers those calculations as secondary support for the findings of the reaudit.
9 Petitioner asserts that the prices provided by OPISnet.com are not reliable because a page of the
10 website states, "OPIS does not guarantee the accuracy of these prices." Petitioner also asserts that he
11 never provided selling prices to OPIS, and any information from credit card transactions might have
12 included extra charges for car washes. For these reasons, petitioner contends that the information from
13 OPISnet.com should be disregarded.

14 Petitioner asserts that his reported gasoline sales are accurate. In order for that statement to be
15 correct, he would have had to sell gasoline at prices 46 cents to 80 cents per gallon below market
16 prices. That is simply not plausible. Petitioner has not provided records to document that his prices
17 were remarkably low throughout the audit period. Instead, he asserts that the most reliable
18 documentation available, from the OPISnet.com website, should be disregarded. As evidence that he
19 sold gasoline at a loss continually for three years, petitioner has provided his franchise agreement,
20 evidence that the station was located in a redevelopment zone, and evidence he took out loans during
21 the audit. We find that the information provided by OPISnet.com, albeit not guaranteed, is
22 substantially more reliable evidence of petitioner's actual selling prices than his various descriptions of
23 business hardships during the audit period. We further reject petitioner's assertions that the
24 Department has not considered any of his explanations for the low reported amounts of gasoline sales.
25 To establish the audited selling prices, the Department made substantial reductions to the average
26 market prices, and those adjustments were only partially supported by the available records and by the
27 Department's observations during the audit. In addition, the Department substantially increased the
28 estimated number of gallons sold at a discount because it considered petitioner's claim of lower car

1 wash prices in 2007 plausible. On that issue, the D&R computes that, in order for the amount of
2 discounted sales of gasoline for 2007 to be correct, petitioner would have had to sell 248 car washes
3 per day, or 15.5 car washes per hour, 16 hours a day, for every day in 2007. We find that level of car
4 wash activity to be unlikely, and conclude that this adjustment of the Department already more than
5 reasonably takes into account petitioner's contentions. We recommend no further adjustments.

6 **Issue 2:** Whether petitioner was negligent. We conclude that he was.

7 The Department imposed the negligence penalty because petitioner failed to maintain adequate
8 records, and as result of that failure, the Department was required to use an alternative audit method to
9 establish sales of gasoline. Moreover, the Department notes that petitioner's reported taxable sales
10 were understated by about 20 percent. Petitioner protests the negligence penalty on the grounds that
11 reported taxable sales were accurate.

12 As explained above, we find petitioner has substantially understated his reported taxable sales,
13 and we therefore reject petitioner's argument that there was no negligence because reported sales were
14 accurate. Petitioner's records were sorely limited. The quarterly summary reports from the cash
15 register system were not supported by any detailed records. Petitioner did not provide daily sales
16 reports showing the number of gallons of gasoline sold and the recorded sales, by grade of gasoline,
17 although those records are commonly maintained by service station operators. Since petitioner has
18 operated this business since 1989 and has been audited twice before,³ he should have been aware of the
19 necessity to maintain complete records. In addition, there were discrepancies in the available records,
20 such as differences between amounts reported on income tax returns and on sales and use tax returns.
21 We find the lack of records and discrepancies in the available records to be evidence of a lack of due
22 care in record keeping. In addition, the understatement of almost \$3 million in reported sales of
23 gasoline, which represents a reporting error of approximately 20 percent ($\$2,759,073 \div \$13,621,336$
24 reported), is substantial, both as an absolute value and in relation to reported amounts, and is additional
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27 ³ The D&R notes that, in the most recent reaudit, through March 31, 1996, the Department found that reported amounts
28 were substantially accurate.

1 evidence of negligence. For all these reasons, we conclude that the understatement was the result of
2 negligence, and the penalty was properly applied.

3 **OTHER DEVELOPMENTS**

4 None.

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