

1 consisting of sporting events shown on flat-screen televisions, live music with dancing, and karaoke.
2 Petitioner closed its seller's permit effective October 31, 2008, after a fatal shooting incident occurred
3 in the parking lot outside the business. Upon audit, petitioner failed to provide the Sales and Use Tax
4 Department (Department) with any records supporting its reported total sales of \$43,069 for the 30-
5 month reporting period of October 1, 2005, through March 31, 2008, or for the seven-month period of
6 April 1 through October 31, 2008, for which it filed no tax returns. The Department obtained copies of
7 sales reports that petitioner had submitted to its landlord, Crosspoint Realty Services (Crosspoint). The
8 Department concluded that the average monthly sales of \$15,656 reported to Crosspoint constitute
9 evidence that the average monthly sales of \$1,436 reported on the sales and use tax returns are grossly
10 understated, but also concluded that the sales reported to Crosspoint were understated. Using
11 information obtained from petitioner, a former customer of petitioner, employees of surrounding
12 businesses, and its own research, the Department calculated that petitioner made taxable sales of
13 \$828,508, resulting in unreported sales of \$785,439.¹

14 Petitioner contends that the audited taxable sales are significantly overstated. It contends that it
15 sold the business to Derrick Langford on July 5, 2006, and provided a signed asset sale agreement in
16 support of the transaction. It also contends that its bank deposits and the sales reported to Crosspoint
17 include nontaxable revenue, and provided a revenue analysis segregating its bank deposits by source.

18 We find from the following evidence that a sale of the business did not occur in July 2006 as
19 alleged: (1) petitioner did not notify the Board, the licensing department of the City of Pinole, or the
20 landlord of any sale of the business, nor did it close out its seller's permit at the time of the alleged

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22 ¹ The Department learned from a former customer of petitioner that petitioner's average selling prices were \$8.50 for
23 cocktails and mixed drinks, \$3.38 for bottled beer, and \$5.50 for food items. Petitioner told the Department that the seating
24 capacity in the bar was 49 persons and that the bar was open five days a week (Wednesday through Sunday). However, the
25 Department also learned from employees of surrounding businesses that petitioner's business seemed to be very popular,
26 the parking lot was often filled with cars belonging to petitioner's customers, and there was little doubt that petitioner often
27 served more than 49 customers at one time. The Department also noted that the police report from the night of the shooting
28 incident indicated there were about 200 people in the parking lot outside petitioner's business when the shooting occurred.
Nevertheless, based on industry averages for similar bars and restaurants, the Department estimated that on average
petitioner sold two drinks and two food items for each of the 49 seats every day that the business was open. It computed
average daily sales of drinks of \$582 and average daily sales of food of \$539, for average daily taxable sales of \$1,121. It
concluded that petitioner was open 60 days per quarter for the period October 1, 2005, through September 30, 2008, and 19
days for the period October 1 through 26, 2008, for a total of 739 days.

1 sale; (2) there is no evidence that petitioner received proceeds from the alleged sale, including a \$5,000
2 buyer's deposit, \$20,000 at closing, and a promissory note for the balance of the purchase price as
3 provided for in the agreement petitioner provided; (3) there is no evidence that a buyer was added to
4 the lease for the premises or that the buyer applied for a temporary liquor license and a seller's permit
5 as provided for in the agreement (characterized as "resale license"); (4) petitioner reported the
6 business's sales on returns filed under its seller's permit; (5) petitioner admitted that it allowed
7 Mr. Langford to purchase resale inventory under its seller's permit; and (6) petitioner's instruction to
8 Sean Rawlins, Mr. Langford's business partner, to immediately close the business in light of the
9 cancellation of the business's insurance policy was a decision that only an owner of the business could
10 make.

11 We find that petitioner has not demonstrated that the audit computations overstate the actual
12 amounts: (1) it is not unusual that bank deposits for a business of this type are not reliable evidence of
13 sales; (2) petitioner failed to sufficiently document the source of its deposits; (3) petitioner has not
14 shown that all of its gross receipts were deposited into this single bank account; (4) the Department's
15 estimate that petitioner sold 98 drinks and 98 food items a day is conservative in light of the apparent
16 popularity of petitioner's business; and (5) the asset sale agreement listing 75 chairs and bar stools, and
17 promotional flyers that show petitioner offered a "Two Dollar Tuesday" beer special, indicate that the
18 Department's computation of audited taxable sales, based on its understanding that petitioner had only
19 49 chairs and was only open for business Wednesday through Sunday, is actually more conservative
20 than previously thought.

21 **Issue 2:** Whether petitioner was negligent. We conclude that it was.

22 The Department concluded that petitioner was negligent because it failed to maintain adequate
23 records for sales and use tax purposes and substantially understated its sales. Petitioner contends that it
24 has attempted to obtain its records from Mr. Langford and Mr. Rawlins but has been unsuccessful, and
25 thus its failure to provide records is due to circumstances beyond its control.

26 We find that petitioner's explanation, while plausible for periods after June 2006, cannot apply
27 to periods prior to July 2006 when it admittedly operated the business. The incomplete and inadequate
28 condition of petitioner's records is evidence of negligence in recordkeeping. Moreover, the

1 understated taxable sales of \$629,601 for the periods for which petitioner filed returns represent an
2 error rate of 1,462 percent when compared with reported taxable sales of \$43,069, which is strong
3 evidence of negligence in reporting, even though petitioners had not been audited previously. We
4 conclude that the negligence penalties have been properly imposed.

5 **Issue 3:** Whether petitioner has established reasonable cause to relieve the failure-to-file
6 penalty for the period April 1 through October 31, 2008. We conclude that petitioner has not.

7 The failure-to-file penalty was imposed for the period April 1 through October 31, 2008,
8 because petitioner did not file tax returns for this period. Petitioner's letter requesting relief of the
9 penalty states that the records necessary to prepare the returns were never in its possession. We note
10 that the request for relief was not signed under penalty of perjury as required for a valid request for
11 relief of the penalty, and thus we are unable to recommend relief on that basis. Furthermore,
12 we note that petitioner states it filed returns for periods prior to April 2008 based only on sales
13 information provided to it over the telephone. Thus, lack of records does not appear to be a compelling
14 reason for petitioner's failure to file returns. Accordingly, even if petitioner had signed its request for
15 relief under penalty of perjury, we would recommend that relief be denied.

16 **OTHER MATTERS**

17 None.

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19 Summary prepared by Pete Lee, Business Taxes Specialist II
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