

## 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 JAMSHID DARYANABARD, dba ) Account Number: SR GH 100-388588  
 6 Saffron Restaurant ) Case ID 467994  
 7 Petitioner )  
 8 ) San Jose, Santa Clara County

9 In the Matter of the Administrative Protest )  
 10 and Claim for Refund Under the Sales and )  
 11 Use Tax Law of: )  
 12 JAMSHID DARYANABARD AND TOFAN ) Account Number: SR GH 100-820442  
 13 DARYANABARD, dba Saffron Restaurant ) Case ID's 485017, 556731  
 14 Taxpayer/Claimant )  
 15 ) San Jose, Santa Clara County

16 Type of Business: Restaurant

17 Audit period: 10/01/04 – 09/30/06 (Case ID 467994)  
 18 10/01/06 – 12/31/07 (Case ID's 485017, 556731)

19	467994		485017		
	Tax	Penalty	Tax	Penalty	
20	As determined:	\$49,292.65	\$12,323.18	\$15,707.63	\$3,926.91
	Finality penalty				1,570.76
21	Adjustment - Appeals Division	- 5,659.82	- 1,414.94	- 2,745.28	- 960.82
22	Proposed redetermination, protested	<u>\$43,632.83</u>	<u>\$10,908.24</u>		
	Adjusted determination, protested			<u>\$12,962.35</u>	<u>\$4,536.85</u>
23	Proposed tax redetermination	\$43,632.83			
24	Adjusted tax			\$12,962.35	
	Interest (through 7/31/11 for 467994)	22,117.44		2,421.78	
25	Fraud penalty	<u>10,908.24</u>		3,240.61	
	Finality penalty			<u>1,296.24</u>	
26	Total tax, interest, and penalty	<u>\$76,658.51</u>		\$19,920.98	
27	Payments			- 18,337.78	
	Balance Due			<u>\$ 1,583.20</u>	
28	Monthly interest beginning 8/1/11	<u>\$ 218.16</u>			

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## UNRESOLVED ISSUES

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2       **Issue 1:** Whether adjustments are warranted to the audited amounts of unreported sales. We  
3 recommend no further adjustment, and we recommend that the claim for refund filed be denied.

4       Petitioner and taxpayer (hereafter petitioners) operated a restaurant with sales of beer and wine  
5 until September 30, 2008, when the business was sold to an unrelated party. Petitioners were unable to  
6 show how the amounts reported on their sales and use tax returns had been established. The Sales and  
7 Use Tax Department (Department) observed that petitioners recorded sales on guest checks and rang  
8 them on the cash register, and sales tax reimbursement was added to the sales price. Although  
9 petitioners recorded sales in a single-entry set of records, those books and records were not provided to  
10 the Department. Instead, petitioners provided bank statements, the federal income tax return for the  
11 sole proprietorship for 2004, and guest checks for the periods November 5, 2007, through November  
12 11, 2007, and November 15, 2007, through November 21, 2007.

13       The Department used the gross profit and cost of goods sold reported on the 2004 federal return  
14 to compute a book markup of 373 percent. Although that markup appeared reasonable on the surface,  
15 the Department found it unreliable because the average monthly recorded purchases of \$1,724  
16 appeared low for this business, based on its seating capacity and the hours of operation. The  
17 Department decided to use a ratio of credit card sales to total sales, along with recorded credit card  
18 deposits, to establish audited total sales. The Department originally used the results of its two-day  
19 observation test to compute a ratio of credit card sales to total sales of 66.25 percent. It then revised  
20 that percentage to 61.91 percent, after incorporating petitioners' guest checks for a subsequent week  
21 into the test. After the appeals conference, petitioners provided the recorded sales for September 2008,  
22 and the Department incorporated those records into the test, computing a ratio of credit card sales to  
23 total sales of 67.47 percent, which it used to compute the amounts in dispute.

24       Petitioners contend that the audited amounts of unreported taxable sales are excessive, for  
25 several reasons. First, petitioners contend that the audited ratio of credit card sales to total sales should  
26 be increased to approximately 85 percent. Also, petitioners contend that adjustments should be made  
27 to the amounts of recorded credit card deposits for transactions in which customers requested cash  
28 back from the amount charged. In addition, petitioners assert that an adjustment should be made for

1 exempt sales of cold food to go. Petitioners have provided limited documentation, as more fully  
2 explained below, and they have accounted for the lack of evidence by stating that their records were  
3 stolen on Memorial Day in 2008. They have not explained why the records were not provided before  
4 they were stolen, even though the audit was in process at least as early as November 2007.

5 With respect to the ratio of credit card sales to total sales, petitioners argue that the ratio should  
6 be 85 percent, an estimate they claim is supported by the 83.1 percent computed for the month of  
7 September 2008. Alternatively petitioners argue that the ratios computed for the three test periods  
8 should be weighted differently in the computation of the audited ratio. Specifically, petitioners assert  
9 that the ratios computed using the Department's original 2-day test, petitioner's guest checks for a  
10 subsequent week during the audit period, and the records petitioner provided for 19 days of September  
11 2008 (after the audit period) should be weighted based on the length of the period covered by the test,  
12 while the Department weighted the three ratios equally. We find that the most reliable test is the first  
13 2-day observation test, in which the Department actually observed the sales as they were recorded.  
14 The least reliable test is the 19-day test from September 2008, since those figures are supported by  
15 cash register Z-tapes only, with no source documents, such as guest checks. Also, September 2008  
16 was the last month of petitioners' operation of the restaurant, and it may not have been representative  
17 of operations during the audit periods, particularly since the average sales per day during that month  
18 was \$510, which is significantly lower than the average *credit card deposits* per day of \$833 for 2005,  
19 \$756 for 2006, and \$614 for 2007. Accordingly, we find there is no basis for weighting the ratios  
20 based on the length of the period of each test, which would give the greatest weight to the least reliable  
21 test, and we further find petitioners have offered no persuasive evidence to support their estimated ratio  
22 of 85 percent.

23 With respect to petitioners' contention that recorded credit card deposits should be adjusted for  
24 cash back to customers, petitioners have provided no documentation, such as guest checks, cash  
25 register tapes, or credit card receipts. Also, sales with cash given back to customers were not noted in  
26 any of the tests used to compute the ratio of credit card to total sales transactions. Accordingly, we  
27 recommend no adjustment.

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1           Regarding petitioners' contention that the audited amounts should be adjusted for exempt sales  
2 of cold food sold to go in a manner not suitable for immediate consumption, petitioners have provided  
3 two affidavits signed by customers indicating that, on a regular basis, the customers purchased cold  
4 food products in large quantities that they later reheated before serving. We find those affidavits self-  
5 serving and generally unpersuasive because the typed language on both affidavits is identical, and they  
6 are printed on petitioners' letterhead. Further, petitioners did not claim any exempt sales of sales of  
7 food products on their sales and use tax returns. The only other records petitioners have provided in  
8 support are monthly summaries of sales with no detailed records. Petitioners have provided no cash  
9 register tapes, guest checks, or credit card receipts prepared at the time of the alleged sales to show that  
10 they made sales of cold food products to go, whether in a form suitable for immediate consumption or  
11 not. Moreover, although petitioners state the restaurant made exempt sales of cold food on the days  
12 the Department observed the business, the auditor states that she observed sales tax reimbursement  
13 being added to each and every sale, and she observed no exempt sales of food to go.

14           We recommend no further adjustment to the audited understatements of reported sales, and that  
15 the claim for refund be denied.

16           **Issue 2:** Whether the understatements were the result of fraud.<sup>1</sup> We find the Department has  
17 shown fraud by clear and convincing evidence.

18           The Department concluded that the understatements were the result of fraud because:

- 19 1) petitioners were knowledgeable business people, with extensive experience in retail sales;  
20 2) petitioners added sales tax reimbursement to the selling price of all food sold; 3) the restaurant  
21 menus state "sales tax will be added to the price of all items served;" 4) petitioners furnished their  
22 accountant with the amounts of sales to be reported, and those amounts represented only a fraction of  
23 their credit card receipts; and 5) audited taxable sales materially exceeded reported amounts.

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26 <sup>1</sup> Without regard to whether the findings of fraud are upheld, the determination issued to the partnership is timely for the  
27 entire period under the three-year statute of limitations, and the determination issued to the sole proprietor is timely because  
28 petitioner had signed a waiver, and the determination was issued within the extended period.

1           Petitioners dispute the fraud penalties on the basis that they trusted the accountant to report the  
2 amounts correctly. Petitioners state that they provided guest checks from which the accountant  
3 developed reported amounts, but they assert that he had health issues that might have caused him to  
4 report incorrect amounts. In addition, petitioners assert that Mr. Daryanabard does not understand or  
5 speak English fluently, and neither partner has a good understanding of accounting procedures.  
6 Moreover, petitioners note that these were the first audits of the restaurant, and they allege that any  
7 errors were the result of ignorance, rather than an intent to evade the tax.

8           Petitioners were not unsophisticated, uninformed business people. Both partners had been  
9 involved in the operation of a grocery store since January 2002, and Mr. Daryanabard had operated  
10 that grocery store as a sole proprietorship from March 1988 through December 2001, during which  
11 period the grocery store was audited on three occasions. Therefore, while the restaurant had not been  
12 audited previously, petitioners had prior business experience, and Mr. Daryanabard had operated a  
13 business that had been audited several times. We therefore find petitioners had knowledge of their  
14 recordkeeping and reporting requirements. In addition, we note that petitioners were sufficiently  
15 knowledgeable to collect sales tax reimbursement on the restaurant's sales. Furthermore, petitioners  
16 were operating the business and had to know the volume of business, which in turn means that  
17 petitioners had to be aware of the substantial understatement of taxable sales. The audited  
18 understatements of \$528,883 for the sole proprietorship and \$157,119 for the partnership represent  
19 percentages of error of 225 percent and 74 percent, respectively in comparison to reported sales of  
20 \$235,021 and \$213,410. For the combined audit periods, petitioners reported sales of only \$448,431,  
21 compared to audited sales of \$1,134,433 (with respect to all of which petitioners collected sales tax  
22 reimbursement). In fact, petitioners' credit card sales alone were \$875,666, almost twice as much as  
23 petitioners reported.

24           Contrary to petitioners' unsupported assertions, we believe that the accountant reported the  
25 sales that petitioners reported to him, and we reject petitioners' attempt to shift the error to the  
26 accountant. Rather, we believe that petitioners intended to report the amounts they reported, which  
27 were less than 40 percent of their audited sales, and particularly telling, just over 50 percent of credit  
28 card sales. That is, petitioners essentially failed to report almost 50 percent of their credit card sales

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1 and failed to report any cash sales. Based on the facts here, we do not believe that petitioners could  
2 have unknowingly reported these amounts, and we conclude instead that the failure of these  
3 knowledgeable, experienced business people to report a substantial percentage of the sales on which  
4 they had collected sales tax reimbursement was the result of their intent to defraud the state. We find  
5 that clear and convincing evidence supports the assertion of fraud penalties, and we recommend that  
6 the penalties be upheld.

7 **Issue 3:** Whether relief of the finality penalty is warranted. We find relief is not warranted.

8 Since the partnership did not timely pay the determination or file a petition for redetermination,  
9 a finality penalty of \$1,296.23 was applied. The partnership has submitted a request for relief of the  
10 finality penalty based on: 1) it relied on its accountant to report timely and accurately; 2) the partners  
11 do not speak fluent English and were not familiar with State requirements; 3) it should not be further  
12 punished by this penalty; and 4) this is the first audit of the partnership.

13 We reject the partnership's argument that its failure to file a timely petition was the result of a  
14 language barrier, since its representative speaks English well and is an experienced professional who is  
15 aware of the requirements for filing a timely petition. Further, neither the fact that this was the first  
16 audit of the partnership nor the partnership's belief that it should not be further punished by this  
17 penalty represent reasonable cause for the partnership's failure to timely pay the determination or file a  
18 petition. Accordingly, we recommend that the request for relief of the finality penalty be denied.

19 **OTHER DEVELOPMENTS**

20 None.

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