STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
EDWARDS, INC., dba Fandangos	Account Number: SR KH 100-352698 Case ID 522933
Petitioner	Rancho Cordova, Sacramento County

Type of Business: Nightclub with bar

Audit period: 10/01/05 – 12/31/08

Item	Disputed Amount
Unreported taxable sales	$763,563
Negligence penalty	$ 5,918

	Tax	Penalty
As determined	$62,945.10	$6,294.53
Adjustment – Sales and Use Tax Department	- $3,768.92	- $376.90
Proposed redetermination, protested	$59,176.18	$5,917.63

Proposed tax redetermination	$59,176.18
Interest through 03/31/12	24,022.54
Negligence penalty	5,917.63
Total tax, interest, and penalty	$89,116.35
Monthly interest beginning 04/01/12	$345.19

This matter was scheduled for Board hearing on January 11, 2012, but petitioner did not respond to the Notice of Hearing, and the matter was thus scheduled for decision on the nonappearance calendar. However, petitioner subsequently requested that the matter be scheduled for hearing.

UNRESOLVED ISSUES

Issue 1: Whether further adjustments are warranted to unreported taxable sales. We conclude no further adjustments are warranted.

Petitioner operated a nightclub from February 1, 2005, through December 31, 2008, at which time the business closed. For audit, petitioner provided only the federal income tax returns for 2005, 2006, and 2007, bank statements for the audit period, and incomplete purchase journals. No source documents, such as cash register receipts or purchase invoices, were provided. Due to the lack of records and the fact that the business was closed prior to the start of the audit, the Sales and Use Tax Department (Department) used an analysis of bank deposits to establish audited sales.

For the audit period, with the exception of the year 2007 and fourth quarter 2008 (4Q08), the Department examined bank statements and removed any deposits not related to sales, such as deposits from loans, to compute audited total sales. For 2007, the Department considered the amount of gross receipts reported on petitioner's federal tax return to be audited total sales because the amount on the federal return exceeded the amount deposited in the bank, and the Department found it improbable that petitioner would have reported an excessive amount of sales on its federal return. The Department reduced audited total sales by 25 percent to account for nontaxable admission charges, based on discussion with petitioner, and adjusted the remainder for sales tax reimbursement included to arrive at audited taxable sales. Audited taxable sales exceeded reported taxable sales for the period October 1, 2005, through September 30, 2008, by $725,717, an error ratio of 580.99 percent. The error ratio was applied to 4Q08 reported taxable sales to compute unreported taxable sales for 4Q08 of $37,846, for audited unreported taxable sales for the audit period of $763,563. Petitioner contends that the Department should have supported its audit findings using a second audit method and that it failed to account for all of the loans that were included in bank deposits.

We find that the Department used a reasonable audit method which was necessitated by petitioner's own failure to maintain adequate records to support any other audit method. Since petitioner has not provided any documentation to support additional adjustments, we conclude that no further adjustments are warranted.

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

The Department imposed the negligence penalty because the records were inadequate, and the amount of understatement was substantial. Petitioner disputes the penalty, but has provided no specific contentions.

Although this was petitioner's first audit, we find the severe lack of records to be evidence of a lack of due care in recordkeeping. Further, we note that the understatement of $763,563 is substantial, represeenting an understatement of 581 percent. We find that any businessperson, even one with limited experience, should be aware that he or she should maintain complete records of the business's sales and should recognize that its bank deposits exceed reported sales by about 600 percent. Thus, even though petitioner had not been audited previously, we find there is ample evidence of negligence, and the penalty was properly applied.

OTHER MATTERS

None.

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