

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 CARLOS MARTIN ESCOBAR, dba Jersey Deli) Account Number: SR EH 97-677318
 6 Petitioner) Case ID 473069
 7 _____) Rancho Cucamonga, San Bernardino County

8 Type of Business: Caterer
 9 Audit period: 01/01/04 – 06/30/07

<u>Item</u>	<u>Disputed Amount</u>
11 Disallowed claimed exempt sales of food	\$483,808
12 Unreported sales	\$ 61,708
13 Tax as determined and proposed to be redetermined:	\$49,079.94
14 Less concurred	<u>- 6,802.41</u>
15 Balance, protested	<u>\$42,277.53</u>
16 Proposed tax redetermination	\$49,079.94
Interest through 02/29/12	<u>22,059.63</u>
17 Total tax and interest	<u>\$71,139.57</u>
Monthly interest beginning 03/01/12	<u>\$ 286.30</u>

18 This matter was scheduled for Board hearing in June 2011 but was deferred for further review,
 19 at the request of the Sales and Use Tax Department (Department).

UNRESOLVED ISSUES

21 **Issue 1:** Whether adjustments are warranted to the amount of disallowed claimed exempt sales
 22 of food. We recommend no adjustment.

23 Until July 1, 2005, petitioner operated a deli inside a commercial center. The business then
 24 moved onto the campus of a private school, Universal Technical Institute (Uni-Tech), where petitioner
 25 rented the school cafeteria.¹ When petitioner operated in the commercial center, he claimed all his

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 27 ¹ The business was closed when petitioner was evicted by the school in November 2008, and petitioner filed bankruptcy in
 28 December 2008.

1 sales as nontaxable sales for resale to lunch trucks or exempt sales of cold food to go. For the period
2 that petitioner operated at Uni-Tech, he reported tax on his sales to employees and visitors of the
3 school and on sales of carbonated beverages, and he claimed his sales of meals to students at the
4 cafeteria as exempt.

5 The Department concluded that, prior to the move to Uni-Tech, all of petitioner's sales were
6 nontaxable. With respect to the cafeteria sales at Uni-Tech, the Department found that the meals sold
7 by petitioner to students did not qualify for the exemption for sales of meals by schools to their
8 students.² The Department therefore disallowed all claimed exempt sales of food for the period that
9 petitioner operated in the cafeteria at Uni-Tech. The Department further concluded that none of
10 petitioner's sales were exempt sales of cold food to go because more than 80 percent of his sales were
11 food products, and more than 80 percent of his sales of food were subject to tax (known as the 80/80
12 rule), and petitioner had not separately accounted for the sales of cold food sold to go in a form
13 suitable for consumption on its premises. The Department re-examined the application of the 80/80
14 rule after this matter was deferred from the previously-scheduled Board hearing. The Department
15 concluded, based on its observation of the business location and petitioner's estimates of his sales, that
16 approximately 10 percent of petitioner's sales of food were sales of cold food to go, while 90 percent
17 of his food sales were taxable because they were sales of hot food or were sales of cold food consumed
18 at facilities provided. Thus, the Department's conclusion remains that all of petitioner's sales of food
19 are subject to tax.

20 Petitioner does not dispute the application of sales tax to meals he sold to students. Instead, he
21 contends that he should not be held liable for the sales tax on those sales because, on the advice of
22 school personnel, he had not collected reimbursement for the sales tax due on sales of meals to
23 students. Alternatively, petitioner contends that, if he is held liable for tax on the sales of meals to
24 students, an allowance should be made for sales of cold food sold to go.

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26 ² Revenue and Taxation Code section 6363 exempts sales of meals to students by schools and some other entities.
27 Petitioner does not qualify as a school or one of the other entities listed in the exemption. California Code of Regulations,
28 title 18, section 1603, subdivision (j)(2)(D), was added to expand the exemption to sales by caterers at schools that met
specified conditions for which the Board concluded the school should be regarded as furnishing the meals. The
circumstances here do not satisfy those conditions such that petitioner's sales are treated as exempt sales by the school.

1 The only basis for relief of tax otherwise due based on reasonable reliance arises when that
2 advice was issued by the Board under specified circumstances. (Rev. & Tax. Code, § 6596.) There is
3 no assertion that petitioner relied on any advice from the Board, and his apparent reliance on incorrect
4 advice from school personnel does not provide any basis for the Board to grant relief of the tax due.

5 Regarding petitioner's alternative contention that an allowance should be made for exempt
6 sales of cold food to go, since over 80 percent of his sales were sales of food and over 80 percent of
7 those sales of food were subject to tax, his sales of cold food to go were subject to the 80/80 rule,
8 which means that tax applies to such sales unless petitioner maintained a separate accounting of his
9 sales of cold food to go. (Rev. & Tax. Code, §§ 6359, subd. (d)(6) & (f); Cal. Code Regs., tit. 18, §
10 1602, subd. (c)(1)(A).) Since petitioner did not maintain such a separate accounting of his sales of
11 cold food to go, we find that no adjustment is warranted for exempt sales of cold food to go.

12 **Issue 2:** Whether adjustments are warranted to the understatement of reported taxable sales
13 established on a markup basis. We recommend no adjustment.

14 For the period January 1, 2004, through December 31, 2006, the Department computed book
15 markups ranging from 105 percent to 146 percent, which it considered reasonable for this business.
16 For the period January 1, 2007, through June 30, 2007, however, the Department computed a book
17 markup of 70.62 percent, and it considered that lower-than-expected markup to be evidence that
18 recorded total sales were understated for that six-month period. Also, based on discussions with
19 petitioner, the Department concluded that petitioner had voided valid sales transactions and withdrawn
20 cash of approximately \$200 per day during that period to pay a business credit line. Accordingly, the
21 Department decided to establish audited total sales on a markup basis for the period January 1, 2007,
22 through June 30, 2007, using the book markup of 105.13 percent for the year 2006 and the audited cost
23 of goods sold. The Department has computed an understatement of reported taxable sales of \$61,706
24 for those six months. Petitioner contends that all sales were properly reported, and asserts that the
25 understatement established on a markup basis should be deleted.

26 In general, we would expect a markup of at least 100 percent for this business, and, in fact, the
27 available evidence supports a finding that petitioner's book markups were greater than 100 percent.
28 Further, we conclude it was reasonable for the Department to use the book markup for 2006 as the

1 audited markup for the first six months of 2007. Moreover, petitioner has not provided a plausible
2 explanation why the markup would decrease from 105 percent in 2006 to 70 percent in 2007. For all
3 these reasons, we recommend no adjustment to the audited understatement of reported taxable sales
4 established on a markup basis.

5 **OTHER DEVELOPMENTS**

6 None.

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8 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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28**MARKUP TABLE****January 1, 2007, through June 30, 2007***

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentages developed	105.13%
Self-consumption allowed in dollars	\$1,993 for the first six months of 2007
Self-consumption allowed as a percent of total purchases	0.98%
Pilferage allowed in dollars	\$2,428 for the first six months of 2007
Pilferage allowed as a percent of total purchases	2%

* The period January 1, through June 30, 2007, was the only period for which the Department established unreported sales on a markup basis.