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:	
LAFI FALETOESE, dba the Polynesian Luau	Account Number SR BH 100-785216 Case ID 486189
Petitioner	Daly City, San Mateo County

Type of Business: Polynesian specialty store

Audit period: 01/01/06 – 03/31/08

Item	Disputed Amount
Unreported taxable sales	$48,614

	Tax	Penalty
As determined	$6,216.44	$621.66
Post-D&R adjustment	- 2,205.73	- 621.66
Proposed redetermination, protested	$4,010.71	$ 00.00
Proposed tax redetermination	$4,010.71	
Interest through 05/31/12	1,718.44	
Total tax and interest	$5,729.15	
Monthly interest beginning 06/01/12	$ 23.40	

UNRESOLVED ISSUE

Issue: Whether adjustments are warranted to the amount of unreported taxable sales. We find no further adjustment is warranted.

Petitioner operated a Polynesian specialty store selling hot and cold food to-go, crafts, fabrics, clothing, and other merchandise from January 1, 2006, through February 28, 2011, when the business was sold. Petitioner provided incomplete records for audit. Using total sales and cost of goods sold figures recorded on petitioner's income statements, the Sales and Use Tax Department (Department) computed book markups of 111 percent for 2006 and 96 percent for 2007, which it considered lower than expected.

The Department established audited taxable sales other than food and beverage sales on a markup basis and computed taxable food and beverage sales based on recorded figures for the months that sales journal were available. The Department established the audited merchandise purchases using the monthly average of $12,712 that it had computed in a three-month purchase segregation test, and added $10,000 to the cost of goods sold to account for a reduction in inventory of that amount. It then applied the 41.95 percent ratio from a purchase segregation test to compute purchases of taxable merchandise other than food and beverages, and added the audited markup of 137.36 percent, established in a shelf test. To determine audited taxable food and beverage sales, the Department computed an average monthly amount, based on petitioner's records for the period January 2008 through May 2008. After the appeals conference, the Department agreed to expand the test period for computing the monthly average to include the period September 2007 through December 2007, and for the sales established by markup, to remove the $10,000 inventory adjustment and to allow an adjustment of 1 percent for pilferage.

Petitioner contends that the amount of unreported taxable sales is excessive because the test period used to compute the monthly average taxable food and beverage sales should exclude the post-audit period months of April and May 2008, the pilferage allowance should be increased to 2 percent, and there should be an adjustment for tax-paid purchases resold.

Petitioner's only contention with respect to the use of April and May 2008 in the test is that they were after the audit period, but this is not a sufficient basis for excluding those months, particularly in an audit such as this one where insufficient records were provided. Since petitioner has not shown that sales during these months were not representative of sales during the audit period, and since we find that including the additional two months, which were immediately after the audit period, provides a more comprehensive sample of petitioner's recorded taxable food and beverage sales, we find no basis for removing those months from the test. Nor has petitioner provided any documentation to support an allowance for pilferage greater than the standard 1 percent provided in the Audit Manual, and we find that no increase of the allowance is warranted. With respect to an allowance for tax-paid purchases resold, we recommended a reaudit in the D&R, and the Department computed tax-paid purchases resold of $77 for the three-month test period and incorporated that adjustment into the computation of the audited percentage of error. We find that the adjustment is based on the available records, and no further adjustment is warranted.

RESOLVED ISSUE

The Department imposed a negligence penalty because it concluded that the records provided for audit were inadequate and the understatement of $75,350 was substantial. Petitioner disputed the penalty on the basis that the amount of understatement did not represent negligence and that she attempted to maintain complete records. After the adjustments in the post-D&R reaudit, the amount of unreported taxable sales had been reduced to $48,614, which represents about 11 percent of reported taxable sales of $434,098. We find that percentage of error material, but not exorbitant. Also, while we are troubled by petitioner's failure to maintain complete records, we note that petitioner had not been audited previously, and we believe she made an effort to report correctly. Accordingly, we find that the understatement was not the result of negligence and recommend that the penalty be deleted.

OTHER MATTERS

None.

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

MARKUP TABLE

Percentage of purchases other than food	41.95%
Mark-up percentage developed	137.36%
Self-consumption allowed in dollars	0*
Pilferage allowed in dollars for the three-month test period	$1,440
Pilferage allowed as a percent of taxable purchases	1%

* Petitioner stated at the conference that there was no self-consumption of taxable merchandise (only of food, the sale of which was exempt).