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:	
VINI FALETOESE and LAFI LIZ FALETOESE, dba Lafi's Polynesian Luau	Account Number SR BH 97-822314 Case ID 486167
Petitioner	Daly City, San Mateo County

Type of Business: Polynesian specialty store

Audit period: 07/01/04 – 12/31/05

Item	Disputed Amount
Disallowed claimed exempt food sales	$7,733
Negligence penalty	$ 598

	Tax	Penalty
As determined	$6,620.89	$662.09
Post-D&R adjustment	- 638.06	- 63.80
Proposed redetermination	$5,982.83	$598.29
Less concurred	- 5,344.86	00.00
Balance, protested	$ 637.97	$598.29

Proposed tax redetermination	$5,982.83
Interest through 05/31/12	3,264.49
Negligence penalty	598.29
Total tax, interest, and penalty	$9,845.61
Payments	- 1,000.01
Balance Due	$8,845.60
Monthly interest beginning 06/01/12	$ 29.07

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the disallowed claimed exempt food sales. We find no further adjustment is warranted.

Petitioner, a husband and wife co-ownership, operated a Polynesian specialty store selling hot food and cold food to-go, crafts, fabrics, clothing, and other taxable merchandise. Originally, Mr. Faletoese operated this business as a sole proprietorship, under seller's permit SR BH 97-814986, which was closed out in March 2001. Ms. Faletoese then obtained seller's permit SR BH 100-785216 when she began to operate the business as a sole proprietorship in January 2006. When she applied for that permit, Ms. Faletoese informed the Sales and Use Tax Department (Department) that the business had been operating for several years as a husband and wife co-ownership, and stated that she believed her husband had been filing sales and use tax returns. The Department explained that no returns had been filed, and it opened the permit at issue here, with an effective start date of July 6, 2001 and close-out date of December 31, 2005. The Department instructed petitioner to file returns for the delinquent periods, which it did.

Petitioner provided limited records, and Ms. Faletoese explained that all amounts reported on the returns for the audit period were estimates because she had relied on her husband to file returns and maintain records, which he had not done. Using the gross receipts and cost of goods sold reported on petitioner's federal income tax returns, the Department computed book markups of 64 percent for 2004 and 34 percent for 2005, which appeared low, since the Department expected the markup to be closer to 100 percent. Also, the Department found that the bank deposits for the last six months of 2005 totaled $87,956, which exceeded reported total sales of $67,615 by $20,341. Nevertheless, the Department decided to accept reported total sales as substantially accurate. The Department then estimated that exempt food sales represented about 10 percent of petitioner's total sales. That percentage was about twice the percentage of exempt food purchases (5.28 percent) computed in the purchase segregation performed in the audit of the related account for the subsequent period.

Petitioner contends that the ratio of exempt food sales to total sales should be increased from 10 percent to 20 percent, arguing that it made sales of bulk food that were not reflected in the estimate of 10 percent. As support, petitioner has provided photographs of the store merchandise displays and a price list for bulk food items. In response, the Department states that the photographs and price list do not relate to the operation of the business during the audit period. Nevertheless, the Department has recommended an increase in the percentage of exempt food sales to total sales from 10 percent to 15 percent. We concur, and that adjustment has been made by the Department.

Petitioner did not maintain sales invoices, cash register tapes, or a sales journal to support its claimed sales of exempt food. The Department states there was no bulk food on display when it performed the audit. Also, the photographs provided by petitioner were taken in early 2009, after the audit periods of both petitioner and the related account. Similarly, the price list for bulk foods shows prices in effect after the audit period. Therefore, we find that neither the photographs nor the price list offer evidence that petitioner sold bulk food during the audit period. Further, the photographs show that the substantial majority of merchandise sold in the store was taxable. In addition, the majority of prepared food sold is hot food. Accordingly, we find the evidence does not support any further increase in the percentage of exempt food sales.

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

The Department imposed the negligence penalty because petitioner's records were inadequate and the understatement was substantial. Petitioner protests the penalty on the basis that the amount of liability does not represent negligence, petitioner filed the delinquent returns as soon as Ms. Faletoese became aware of them, and the application of tax to food products was not clear to petitioner. Also, Ms. Faletoese states she relied on her husband to file returns and was unaware he was not doing so.

The disallowed amount of claimed exempt food sales of $72,591 represents 78.19 percent of the claimed amount ($95,720) and 44.84 percent of reported taxable sales ($8,952). Also, petitioner did not maintain a sales journal, purchase journal, or cash register tapes. In addition, the purchase invoices and bank statements were not complete. Further, petitioner did not file timely returns, and, when returns were filed, the reported amounts were estimated. We find that any business person should have been aware that it was necessary to file returns, reporting sales based on records. Moreover, Mr. Faletoese had been operating the business as a sole proprietorship and thus had experience with the reporting process. Further, we conclude that the severely limited records, the estimated reported amounts, and the substantial understatement are all strong evidence of negligence. Thus, although petitioner had not been audited previously, we find the penalty was properly applied.

OTHER MATTERS

None.

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