

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 FIRST PETROL, CORP.) Account Number SR CH 100-327421
 6 Petitioner) Case ID 522898
 7 _____) Livermore, Alameda County

8 Type of Business: Gas station and mini-mart

9 Audit period: 10/01/05 – 09/30/08

10 Item Disputed Amount

11 Disallowed claimed exempt food sales \$359,136

Tax

Penalty

12 As determined

\$35,024.86

\$3,502.53

13 Post-D&R adjustment

- 3,600.35

- 3,502.53

14 Proposed redetermination

\$31,424.51

\$ 00.00

15 Proposed tax redetermination

\$31,424.51

16 Interest through 10/31/13

15,424.19

17 Total tax and interest

\$46,848.70

18 Payments

- 156.84

19 Balance Due

\$46,691.86

20 Monthly interest beginning 11/01/13

\$ 156.34

21 This matter was scheduled for Board hearing in October 2012, but was postponed at
 22 petitioner's request due to a scheduling conflict. It was rescheduled for Board hearing in February
 23 2013, but was deferred for settlement consideration.

24 **UNRESOLVED ISSUE**

25 **Issue:** Whether additional adjustments to the measure for disallowed claimed exempt sales of
 26 food products are warranted. We find that no additional adjustments are warranted.

27 Petitioner has operated a gasoline station with a mini-mart since January 1, 2004. The Sales
 28 and Use Department (Department) found no material difference between petitioner's recorded and
 reported taxable sales, but found that petitioner's reported total sales exceeded its recorded total sales
 by \$78,427. Since petitioner was unable to explain the discrepancy, the Department accepted that the

1 larger amount, petitioner's reported total sales, was accurate. The Department also accepted that
2 petitioner's recorded taxable gasoline sales were accurate based on an analysis using the numbers of
3 gallons of gasoline petitioner purchased and average gasoline selling prices for the San Francisco Bay
4 Area published by the U. S. Department of Energy. The Department then segregated petitioner's
5 purchases of mini-mart merchandise for the first quarter of 2009 (1Q09) and found that 84 percent of
6 the purchases were purchases of taxable merchandise and 16 percent were purchases of exempt food
7 items. Since petitioner had recorded 63 percent of its mini-mart sales as taxable sales and 37 percent
8 as exempt food sales, the Department concluded that petitioner had understated its reported taxable
9 sales and overstated its claimed exempt food sales in its records.

10 The Department intended to perform a shelf test to establish petitioner's average markup for
11 food, but when it attempted to do so, it found that the mini-mart was half empty. While the
12 Department expected a markup for exempt food sales in petitioner's area to be in the range of
13 30 percent to 50 percent, it decided to give petitioner the benefit of the doubt, and use a 70 percent
14 markup to compute petitioner's exempt food sales. The Department added the 70 percent markup to
15 audited food purchases of \$8,423 for 1Q09 to compute audited exempt food sales of \$14,319, which
16 were \$17,160 lower than petitioner's claimed exempt food sales of \$31,479 for 1Q09. After
17 computing an error rate of 54.51 percent ($\$17,160 \div \$31,479$), the Department multiplied petitioner's
18 claimed exempt food sales of \$734,279 for the audit period by 54.51 percent to establish disallowed
19 claimed exempt food sales of \$400,283 for the audit period.

20 In preparing this summary, we noticed that, while phone card purchases of \$1,356 were
21 included in the purchase segregation test for 1Q09, the Department did not include those purchases in
22 its computation of exempt sales. Instead, the Department only marked up purchases of food for
23 comparison with petitioner's claimed exempt food sales for 1Q09. Since petitioner did not claim any
24 deductions for nontaxable or exempt sales other than its exempt sales of food, we find it likely that
25 petitioner's claimed deduction for exempt food sales included its nontaxable sales of phone cards.
26 Therefore, based on our experience in reviewing other audits, we estimate a markup of 30 percent for
27 petitioner's sales of phone cards, and recommend that phone card sales of \$1,763 ($\$1,356 \times 1.30$) be
28 added to audited exempt food sales of \$14,319 for comparison with petitioner's claimed exempt food

1 sales of \$31,479 for 1Q09. The Department calculated that including the phone card sales in audited
2 exempt sales reduces the percentage of error to 48.91 percent, which results in a reduction of \$41,147
3 to the deficiency measure, from \$400,283 to \$359,136.

4 Petitioner contends that the purchase segregation test does not accurately represent its
5 purchases during the audit period because the test period (1Q09) was outside of the audit period.
6 Petitioner alleges that, while all of its purchase invoices for the audit period were available at the time
7 of the audit, the Department ignored those records, and now, a complete set no longer is available.
8 However, after the appeals conference, petitioner was able to provide some purchase invoices from
9 which the Department tested purchases for the year 2007 and calculated a taxable merchandise
10 purchase ratio of 87 percent.

11 Since the taxable merchandise purchase ratio of 87 percent shown in the purchase invoices that
12 petitioner provided for 2007 is consistent with the taxable merchandise purchase ratio of 84 percent
13 shown in the purchase segregation test for 1Q09, we find that the purchase segregation test for 1Q09
14 fairly represents petitioner's purchases during the audit period. Thus, we reject petitioner's assertion
15 that the segregation test was not representative of its operations during the audit period, and we
16 recommend no additional adjustments.

17 **RESOLVED ISSUE**

18 The Department imposed a negligence penalty because it concluded that petitioner's records
19 were inadequate and that the overstatement of claimed exempt sales was substantial. However, we
20 find that the error ratio is not exorbitant, and petitioner provided substantially complete summary
21 records of its sales. Thus, we find that the evidence does not support a finding of negligence,
22 particularly since this was petitioner's first audit. Accordingly, we recommend that the negligence
23 penalty be deleted.

24 **OTHER MATTERS**

25 None.

26
27 Summary prepared by Lisa Burke, Business Taxes Specialist III
28

**MARKUP TABLE
FOOD AND PHONE CARDS**

Percentage of taxable vs. nontaxable purchases	84.11%
Mark-up percentage (estimated)	Food 70.00% Phone cards 30.00%
No self-consumption of food or phone cards*	
No shrinkage of food or phone cards*	

* Reducing purchases of food or phone cards to allow for self-consumption or shrinkage would result in a reduction to audited nontaxable sales and an increase to audited taxable sales. Therefore, no allowances were given in the audit.