

## 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 FRANGI'S RESTAURANT, INC., )  
6 dba The Terrace )Account Number: SR AS 99-747878  
Case ID 433581

7 Petitioner )

Venice, Los Angeles County

8 Type of Business: Restaurant with bar

9 Audit period: 01/01/98 – 09/30/06

10 Item Disputed Amount11 Unreported taxable sales \$2,149,880  
12 Penalties \$ 334,779TaxPenalty

13 As determined \$1,421,188.90 \$551,210.12

14 Adjustment - Appeals Division - 561,968.03 - 227,359.63

- 92,768.78 - 52,789.51

15 Proposed redetermination \$ 766,452.09 \$271,060.98

Less concurred - 589,415.37 00.00

16 Balance, protested \$ 177,036.72 \$271,060.98

17 Proposed tax redetermination \$ 766,452.09

Interest through 10/31/11 564,636.49

18 Fraud penalty 191,613.21

19 Amnesty double fraud penalty 79,447.77

Amnesty interest penalty 63,718.23

20 Total tax, interest, and penalty \$1,665,867.79

Payments 60,000.0021 Balance Due \$1,605,867.7922 Monthly interest beginning 11/01/11 \$ 3,532.2623 **UNRESOLVED ISSUES**24 **Issue 1:** Whether further reductions are warranted to the amount of unreported taxable sales.

25 We find no further adjustments are warranted.

26 Petitioner operates a restaurant with a bar. The only records petitioner provided for audit were  
27 summary pages of bank statements for 2004 and 2005, and sales and use tax returns and federal  
28 income tax returns for the years 2003, 2004, and 2005.

1 The Sales and Use Tax Department (Department) found that the cost of goods sold reported on  
2 federal returns for 2003, 2004, and 2005, substantially exceeded the amounts of total sales reported on  
3 petitioner's sales and use tax returns for those years, and the gross receipts of \$4,089,037 reported on  
4 the federal returns exceeded total sales of \$574,051 reported on sales and use tax returns by  
5 \$3,514,986, an understatement of more than 600 percent. Petitioner's California income tax returns for  
6 the years 1998 through 2002 reflected gross receipts of \$4,504,502 compared to total sales of \$848,673  
7 reported for sales tax purposes for those years, an understatement of more than 400 percent. The total  
8 difference between sales reported for income tax purposes and sales reported for sales tax purposes is  
9 \$7,170,815, which petitioner concedes represents unreported taxable sales.

10 The Department then compared the bank statements for 2004 and 2005 and found that the  
11 amounts deposited significantly exceeded the amounts of gross receipts reported on petitioner's federal  
12 returns. The Department decided to use bank deposits to establish audited sales, which resulted in an  
13 understatement of \$17,290,156. Based on adjustments conceded by the Department and as  
14 recommended in the D&R, the understatement of reported taxable sales has been reduced to  
15 \$10,453,263. Petitioner disputes \$3,282,448 of this asserted understatement, which is the amount in  
16 excess of the \$7,170,815 understatement it concedes. Petitioner asserts that the Department incorrectly  
17 computed sales using the bank deposit information, the bank deposits include amounts not attributable  
18 to taxable sales, and the amount of sales computed using bank deposits should be adjusted to reflect  
19 tips of 19 percent (the asserted understatement is based on tips of 16.58 percent).

20 In the virtual absence of records, we find it was appropriate for the Department to establish  
21 audited sales based on bank deposits. Also, with the exception of our recommendation in the D&R to  
22 increase the adjustment for tips included in bank deposits, we find that the Department's assumptions  
23 and estimates were reasonable and that its computations were accurate. In that regard, we note that the  
24 Department used an estimated percentage of 70 percent credit card sales to total sales. Based on  
25 records provided by petitioner after the conference, we computed a percentage of 65.43 percent credit  
26 card sales to total sales for the fourth quarter 2010 (using 65.43 percent rather than 70 percent would  
27 have increased the audited understatement). We find petitioner has not shown that the Department  
28 incorrectly computed sales using the bank deposits. Regarding petitioner's assertion that the amounts

1 deposited in the bank included amounts not attributable to taxable sales, we find that the Department  
2 has made adjustments for all such deposits for which petitioner provided documentation. With respect  
3 to petitioner's claim that an adjustment should be made for tips of 19 percent, we find that petitioner  
4 has made errors in its calculation of the percentage, as detailed in the D&R, which based its  
5 recommendation of 16.58 percent on the same information relied on by petitioner. We find no further  
6 adjustments are warranted.

7 **Issue 2:** Whether the Department has established fraud by clear and convincing evidence.<sup>1</sup> We  
8 find that it has.

9 The Department imposed the fraud penalty because it found that petitioner had knowledge of  
10 the proper application of tax and because of the substantial understatement, the virtual absence of  
11 records, and the substantial discrepancies found in the available records that could not be explained  
12 satisfactorily as being the result of negligence. Petitioner contends that the sales and use tax returns  
13 were prepared by an in-house bookkeeper and that it had no knowledge of the substantial  
14 understatements in reported taxable sales.

15 We find that petitioner was knowledgeable regarding the application of the sales tax to its sales  
16 because it regularly filed sales and use tax returns, and it charged sales tax reimbursement on its sales  
17 of tangible personal property. Further, petitioner has conceded that the difference of \$7,170,815  
18 between amounts reported for income tax purposes and those reported for sales tax purposes for the  
19 years 1998 through 2005 represented taxable sales. In other words, petitioner concedes that it knew it  
20 had made sales in excess of \$7 million that it had not reported on its sales and use tax returns. That  
21 difference alone represents an understatement of more than 500 percent in comparison to the amount  
22 reported for those eight years of \$1,422,724, and the understatements occurred consistently throughout  
23 the years 1998 through 2005.

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26 <sup>1</sup> Without regard to whether the finding of fraud is upheld, since petitioner did not participate in the amnesty program, the  
27 determination is timely for the period July 1, 2001, through December 31, 2002, under the 10-year amnesty statute of  
28 limitations. (Rev. and Tax. Code § 7073, subd. (d).) The determination is also timely for the period October 1, 2004,  
through September 30, 2006, under the general 3-year statute of limitations. (Rev. & Tax. Code, § 6487, subd. (a).) The  
determination is timely for the periods January 1, 1998, through June 30, 2001, and January 1, 2003, through September 30,  
2004, only if the finding of fraud is upheld.



1 apply the percentage of error for 2002 to the years prior to 2002 and to apply the percentage of error  
2 for 2005 to the two quarters of 2006 for which understatements were computed. However, applying  
3 the percentage of error to 2001 would reduce the measure below the gross receipts petitioner reported  
4 on its 2001 state income tax return. Since there is no evidence petitioner over reported its sales on its  
5 2001 income tax return and all gross receipts were taxable, for 2001 the Department believes that the  
6 gross receipts reported for income tax purposes should be accepted as audited taxable sales for 2001.  
7 Accordingly, applying the 2002 error to 1998 through 2000, using gross receipts reported for income  
8 tax purposes in 2001 as audited taxable sales, and applying the 2005 error to the first two quarters of  
9 2006, the Department now recommends that the amount of unreported taxable sales be reduced by  
10 \$1,132,568, from \$10,453,263 to \$9,320.695. We agree, and we recommend the additional  
11 adjustment.

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