

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for)
Redetermination and Claim for Refund)
Under the Sales and Use Tax Law of:)
)
FRED'S LIQUOR, INC.) Account Number: SR EA 24-713809
) Case ID's 402953 and 495047
)
Petitioner/Claimant) San Clemente, Orange County

Type of Business: Liquor store

Audit period: 07/01/03 – 06/30/06

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Unreported cigarette rebates	\$ 94,229		
Claimed refund of tax paid on returns	\$ 8,361		
As determined:		\$19,909.72	\$1,990.98
Adjustment - Sales and Use Tax Department		-10,523.16	<u>- 1,990.98</u>
- Appeals Division		<u>- 2,083.77</u>	<u>00.00</u>
Proposed redetermination, protested		<u>\$7,302.79</u>	
Proposed tax redetermination		\$7,302.79	
Interest		<u>1,373.78</u>	
Total tax and interest		\$8,676.57	
Payments		<u>-18,143.43</u>	
Overpayment		<u>-\$9,466.86¹</u>	

This matter was scheduled for Board hearing on June 18, 2010, but petitioner/claimant (hereafter petitioner) did not respond to the Notice of Hearing. Accordingly, the Board Proceedings Division (BPD) informed petitioner that this matter will be presented to the Board for decision without oral hearing. Subsequently, petitioner contacted BPD to request an oral hearing before the Board.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the audited amount of additional gross receipts from cigarette rebates. We recommend no further adjustment.

¹ Of this overpayment a refund of \$8,756.87, plus credit interest, was issued in November 2007, and an overpayment of \$585.53 has been applied to an underpayment for the third quarter 2009.

1 Petitioner operates a liquor store. During the audit, the Sales and Use Tax Department
2 (Department) found that petitioner recorded cigarette rebates as “other income.” The Department
3 regarded all amounts recorded as other income as receipts from cigarette rebates which were subject to
4 tax. At the appeals conference, petitioner contended that lottery sales and other types of nontaxable
5 income were also recorded as other income. Petitioner provided records for the fiscal year ending
6 (FYE) June 30, 2006, which showed that the other income account also included lottery receipts. We
7 recommended a reaudit to delete lottery sales and any other nontaxable receipts petitioner could
8 establish were included in other income. In addition to the adjustments petitioner seeks for nontaxable
9 receipts recorded as other income, petitioner contends that the cigarette rebates should not be
10 considered part of its gross receipts or, alternatively, that it accurately included the cigarette rebates in
11 the amounts of total sales reported on its sales and use tax returns.

12 Petitioner has not provided evidence that any of the payments received from cigarette
13 manufacturers were nontaxable display allowances paid by the manufacturer *without* the requirement
14 that petitioner reduce its prices, and the audit comments indicate that the petitioner did reduce the price
15 of the cigarettes by an amount equal to the rebates. We find that the rebates were buy-down rebates
16 which were part of petitioner’s taxable gross receipts. Regarding petitioner’s alternative contention
17 that it correctly reported the cigarette rebates, petitioner explained to the Department that the amounts
18 reported on its returns were based on the amounts recorded on the cash register tapes. Since petitioner
19 reduced the selling price of its cigarettes by an amount equal to the rebate, the amount charged to the
20 customer (and recorded on the cash register receipt) would not include the rebate amount. We note
21 also that for FYE 2004 and 2005, the amount of reported taxable sales was \$1.00 greater than recorded
22 taxable sales, and for FYE 2006 the reported taxable sales was \$5,131.00 less than recorded taxable
23 sales. Thus, since the rebate amounts were recorded as other income and were not included in
24 petitioner’s recorded taxable sales and since petitioner did not report taxable sales in an amount greater
25 than its recorded taxable sales, petitioner’s records show that the cigarette rebates were *not* reported as
26 taxable sales.

27 During the reaudit we recommended, petitioner did not provide detailed records to show what
28 types of receipts were included in other income for FYE 2004 or 2005 similar to those it had provided

1 at the conference for FYE 2006. Based on this lack of documentation for FYE 2004 and 2005, the
2 Department reduced the audited amount of cigarette rebates by \$7,555 for FYE 2006, but made no
3 adjustment for the remainder of the audit period, resulting in reducing taxable cigarette rebates from
4 \$121,116 to \$113,561. We thereafter asked the Department to again review this issue to determine if
5 further adjustments were warranted based on treating the information petitioner provided for FYE
6 2006 as representative of the remainder of the audit period.

7 Upon further review, the Department concluded that, since the other income account for FYE
8 2006 included income other than cigarette rebates in FYE 2006, it is reasonable to assume that
9 petitioner had recorded similar nontaxable income in the other income account during the first two
10 years of the audit period. Thus, since petitioner established that 22.20 percent of other income
11 recorded for FYE 2006 was nontaxable, the Department used that same percentage to calculate that an
12 additional adjustment measured by \$19,332 was warranted for FYE 2004 and 2004, further reducing
13 the measure of tax for cigarette rebates for the audit period from \$113,561 to \$94,229. The
14 Department concluded, and we agree, that no further adjustments are warranted.

15 **Issue 2:** Whether the claim for refund should be granted. We recommend that the claim be
16 denied.

17 The audit included an understatement of reported taxable sales established on a markup basis.
18 In the reaudit, the Department deleted that understatement, based on additional information provided
19 by petitioner. Petitioner contends that the revised markup analysis conducted during the reaudit shows
20 that it overpaid sales tax with its sales and use tax returns (the claim was not filed with respect to
21 payments made towards the determination). On that basis, petitioner claims a refund of \$8,361.

22 It is not entirely clear when the claim for refund was filed. The first document of which we are
23 aware that could constitute a claim for refund is an undated schedule in the audit workpapers that
24 appears to have been submitted by petitioner some time during the latter part of the third quarter 2007.
25 The first document of which we are aware that claims a refund in the amount of \$8,361 is a
26 memorandum from petitioner dated November 13, 2008. Giving petitioner the benefit of the doubt and
27 assuming that the claim represented by the undated schedule is an adequate precursor to the current
28 argument, the claim for refund would be timely for periods beginning July 1, 2004. Thus, we find that

1 Department also concluded that the remaining understatement as a result of petitioner's failure to
2 report cigarette rebates as gross receipts was the result of misunderstanding rather than negligence.
3 Accordingly, in the reaudit, the Department also deleted the negligence penalty.

4 **OTHER DEVELOPMENTS**

5 None.

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7 Summary prepared by Rey Obligacion, Retired Annuitant
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