# CALIFORNIA STATE BOARD OF EQUALIZATION

## APPEALS DIVISION SUMMARY FOR BOARD HEARING

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| In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:<br><br>LJ Corporation<br><br>Petitioner | Account Number: SR AA 100-470733<br>Case ID 478296<br><br>S. Pasadena, Los Angeles County |

Type of Business: Gasoline station with mini-mart

Audit period: 01/01/05 – 04/16/08

| Item | Disputed Amount |
|---|---|
| Unreported sales | $1,669,414 |
| Negligence penalty | $ 13,773 |

| | Tax | Penalty |
|---|---|---|
| As determined and protested: | $137,726.72 | $13,772.73 |
| Proposed tax redetermination | $137,726.72 | |
| Interest through 6/30/10 | 45,967.05 | |
| 10% penalty for negligence | 13,772.73 | |
| Total tax, interest, and penalty | $197,466.50 | |
| Payments | - 30,000.00 | |
| Balance Due | $167,466.50 | |
| Monthly interest beginning 7/1/10 | $ 628.41 | |

### UNRESOLVED ISSUES

**Issue 1:** Whether adjustments are warranted to the audited amount of unreported sales. We recommend no adjustment.

Petitioner operated a Valero gasoline station with a mini-mart from October 1, 2004, through April 16, 2008, at which time the business was sold. For the year 2006, the Sales and Use Tax Department (Department) found that recorded sales of gasoline of $3,472,550 were less than audited purchases of gasoline of $3,837,021, based on an examination of purchase invoices.,[1] and the Department thus concluded that recorded sales of gasoline were substantially understated. The Department obtained gasoline selling prices for the Los Angeles Area from the Department of Energy

[1] Petitioner did not provide the information necessary to make similar calculations for the rest of the audit period.

(DOE), and computed weighted average selling prices for each quarter, based on 75.2 percent regular gasoline, 12.5 percent mid-grade, and 12.3 percent premium. The Department accepted petitioner's argument that its gasoline selling prices were much lower than average during the audit period because it was in a price war with the MRCO station across the street, and used the selling prices at the MRCO station to compute a pricing differential compared to the DOE figures of 9.61 cents per gallon.[2] To compute the audited number of gallons of gasoline purchased, the Department used the amounts of sales tax prepayments to vendors of fuel, divided by the applicable rate of prepayment. The audited number of gallons purchased were multiplied by the applicable DOE figure reduced by 9.61 cents per gallon to compute audited sales of gasoline on a quarterly basis.

To establish audited taxable sales of mini-mart merchandise, the Department estimated that petitioner's taxable sales in the mini-mart would be at least equal to its exempt sales of food products in the mini-mart. Thus, the Department used amounts equivalent to petitioner's claimed deductions for exempt food sales each quarter as the audited amounts of taxable mini-mart sales. The Department added audited gasoline sales and audited taxable mini-mart sales and deducted reported taxable sales to compute an understatement of $1,669,414.

Petitioner contends that the audited selling prices for gasoline are excessive, arguing that the pricing differential should be increased to 25 or 30 cents per gallon. Petitioner asserts that the Department's comparison of DOE selling prices and MRCO selling prices should be expanded to include additional days. As support, petitioner has provided 21 credit card sales receipts and dated photographs showing posted selling prices at various gasoline stations.

The Department concluded that the dates and per-gallon selling prices on the 21 credit card sales receipts appear to have been typed onto the receipts after-the-fact. We have reviewed the sales receipts and agree. For example, the dates and per-gallon selling prices do not line up in the same place on each receipt, and there are differences in the fonts on the receipts. We find that petitioner altered the sales receipts in an effort to falsely represent its selling prices, and we reject the sales

[2] The Department compared the selling prices at the MRCO station with DOE selling prices for September 19 and 26, 2008, and November 7 and 11, 2008, all of which were after the audit period and after petitioner sold the business.

receipts as evidence of lower selling prices. Regarding the photographs, even if they were actually taken on the dates indicated thereon, the comparison of MRCO's selling prices to selling prices at other gasoline stations is irrelevant. The Department compared MRCO's selling prices to DOE selling prices, which represent averages of selling prices obtained from many different gasoline stations in petitioner's area. There is no basis for using a comparison between MRCO's selling prices and those at specific stations. At the appeals conference, petitioner suggested that, if the photographs were not regarded as evidence sufficient to increase the pricing differential used by the Department for this audit, then the Department should expand its test to include comparisons of MRCO's selling prices and DOE selling prices for several days.

Initially, we note that, while petitioner may have been in a pricing war with MRCO, we are not convinced that MRCO selling prices are reliable indicators of petitioner's selling prices during the audit. We find that the best information available regarding petitioner's selling prices is the Department's comparison of *petitioner's* selling prices on April 4, 2008 with DOE selling prices for the week ending April 7, 2008. Furthermore, even if petitioner had been in a price war with MRCO during the audit period, we do not believe a MRCO's current prices, or a comparison of MRCO's current prices with the current prices of other stations, is relevant to this audit period, which ended in April 2008, and is after petitioner sold the business, particularly given the volatility of gasoline selling prices. We find that the Department's test, conducted five to seven months after the audit period, is more reliable than any test that could be performed now, about two years after the end of the audit period. We find that petitioner has benefited significantly from the Department's use of a 9.61 cents per gallon pricing differential, which was computed using MRCO selling prices five to seven months after the audit period, rather than the 4.4 cents per gallon pricing differential computed using petitioner's selling prices during the audit period. In the absence of evidence of petitioner's selling prices during the audit period, we recommend no further reduction to the audited selling prices of gasoline.

At the appeals conference, the Department raised concerns about the accuracy of audited taxable mini-mart sales, which petitioner has not disputed. The Department noted that it had compiled purchases of taxable mini-mart merchandise for 2006 of $218,420, while audited taxable mini-mart sales for that year were $133,605, an amount equivalent to petitioner's claimed exempt food sales. The Department stated, if a reaudit were conducted, it would like to recompute audited taxable mini-mart sales on a markup basis. Petitioner opposed further review of the taxable mini-mart sales on the basis that it thought that issue had been settled.

Since audited taxable mini-mart sales of $133,605 for 2006 are significantly less than known purchases of taxable mini-mart merchandise of $218,420, it is virtually certain that audited taxable mini-mart sales are understated for that year. We find it probable that they are understated for the entire audit period. It is unfortunate the Department did not identify this problem at the time of the audit. However, we find it would be difficult to establish audited taxable mini-mart sales on a markup basis at this point, since the business closed so long ago. Accordingly, we do not recommend adjustments to the audited amount of taxable mini-mart sales, and the Department has not proposed an increase to the determination in accordance with Revenue and Taxation Code section 6563.

**Issue 2:** Whether petitioner was negligent. We conclude that it was.

The Department imposed the 10-percent negligence penalty because audited purchases of gasoline exceeded recorded sales for 2006, and the audited understatement is substantial. Petitioner disputes the negligence penalty on the grounds that most of the determined tax is not due. With respect to the amount of audited purchases in excess of recorded sales, petitioner states that it is possible the purchase amounts should be adjusted for vendors' discounts. However, petitioner has provided no evidence of errors in audited purchases of gasoline.

Petitioner did not maintain cash register tapes or any other source documents, other than the 21 sales receipts which we have found were altered. In addition, the amount of audited purchases of taxable merchandise for 2006 of $4,055,441 ($3,837,021 gasoline purchase + $218,420 purchases of taxable mini-mart merchandise) exceeds the cost of goods sold recorded on petitioner's income tax return of $3,349,334 by $706,107. The unrecorded merchandise purchases would be greater if we added the purchases of exempt food products (we do not know the amount of those purchases). We find that petitioner's failure to record substantial amounts of merchandise purchases and its failure to retain source documents to be strong evidence of negligence in recordkeeping. Also, as previously noted, petitioner's recorded sales of gasoline were significantly less than purchases, and we find that this discrepancy should have alerted petitioner to errors in its records. Further, the size of the understatement of reported taxable sales, that is, $1,669,414 representing 14.4 percent of reported taxable sales of $11,616,815, is additional evidence of negligence.

**OTHER DEVELOPMENTS**

None.

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