CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
L&S RESTAURANT, INC. dba Luisa & Son Bake & Deli	)	Account Number: SR AA 100-215083 Case ID 425516
Petitioner	)	Artesia, Los Angeles County

Type of Business:	Bakery and hot fast food		
Audit Period:	10/1/03 – 9/30/06		
Items	Disputed Amounts		
Unreported sales	$92,371		
Negligence penalty	$762		
		Tax	Penalty
As determined and protested		$7,620.71	$762.07
Proposed tax redetermination		$ 7,620.71	
Interest through 2/28/10		3,604.12	
Penalty		762.07	
Total tax, interest, and penalty		$11,986.90	
Monthly interest beginning 3/1/10		$ 44.45	

This matter was previously scheduled for Board hearing on September 23, 2009, but was postponed at petitioner’s request because its representative had a scheduling conflict.

UNRESOLVED ISSUES

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

Petitioner operates a Filipino bakery and delicatessen with tables and chairs for its customers. This was petitioner’s first audit. Petitioner only provided purchase invoices, general ledgers, sales tax worksheets, and federal income tax returns (FITR’s) for audit. The Sales and Use Tax Department (Department) considered the records inadequate because they did not include a sales journal or cash register tapes to support the amounts on the sales tax worksheets.

The Department found that the gross receipts on the FITR's for the years 2004 and 2005 exceeded the sales reported to the Board by $132,808. The Department noted that the FITR's disclosed achieved markups of 154.36 percent, and 160.01 percent for the years 2004 and 2005, respectively, which the Department considered reasonable for this type of business. Also, the Department found that the bank deposits exceeded the gross receipts reported on the FITR's by just over $10,000 for the two years. Since the achieved markups computed using the FITR's appeared reasonable, and the bank deposits marginally exceeded the gross receipts reported on the FITR's, the Department concluded that the gross receipts reported on the FITR's were substantially accurate.

Using petitioner's sales tax worksheets, the Department computed an average taxable ratio (sales tax included) of 74.11 percent for 2004, and 70.44 percent for 2005. The Department applied these ratios to the gross receipts on the FITR's for the respective years to establish audited taxable sales, including sales tax reimbursement. Sales tax reimbursement was then removed to compute audited taxable sales. Upon comparison to reported taxable sales, the Department found that petitioner had underreported its taxable sales by 43.41 percent for 2004 and 20.05 percent for 2005. The Department applied the 43.41 percent of error to reported taxable sales for periods prior to 2004, and the 20.05 percent of error to reported taxable sales for periods after 2005. In total, the Department computed an understatement of reported taxable sales by $92,371, or 31.24 percent.

Petitioner contends that the gross receipts reported on the FITR's include nontaxable loans, but it has not provided any loan contracts or other documentary evidence of the loans to support this contention. The only supporting documents provided by petitioner, after the conference, were copies of amended FITR's for the years 2004 and 2005, incomplete cash register tapes, and various monthly bank statements.

The amended returns submitted by petitioner disclose achieved markups of 67 percent and 77 percent for the years 2004 and 2005, respectively. Since we would expect the markup to be over 100 percent for this type of business, we do not accept the gross receipts on the amended FITR's as accurate amounts.

We note that there are deposits in the bank that are even amounts, and it is possible that those deposits represent loan proceeds. However, we have not examined that possibility further because bank deposits were not used to compute the audit liability. Therefore, even if some of the funds deposited in the bank represented funds from sources other than sales, an adjustment to the measure of tax would not be warranted. The audit liability was computed based on the gross receipts that were reported on the FITR's, and petitioner has not provided a sales journal, sales summaries, or other documentary evidence to show that the gross receipts on the FITR's include loan proceeds. Accordingly, there is no basis upon which to recommend any reduction to the measure of tax.

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

The Department imposed the penalty because petitioner did not provide adequate books and records for audit, and the understatement of reported taxable sales was significant. Petitioner's records were fragmented and not consistent, and there were no sales journals. We find that the records were incomplete and disorganized and were not adequate for sales and use tax purposes. Petitioner's unreported taxable sales of $92,371 represent an underreporting of 31.24 percent. This level of error and the lack of reliable, complete records indicate a standard of care well below that of a reasonable businessperson. Accordingly, we conclude that petitioner was negligent, and that the penalty was properly imposed.

OTHER DEVELOPMENTS

None.

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