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:	
LONA MARIE LEE, dba Wardlow Station	Account Number: SR AA 97-492778 Case ID 390217
Petitioner	Long Beach, Los Angeles

Type of Business: Cocktail lounge with food sales

Audit Period: 1/1/03 – 12/31/05

Item	Measure in Dispute
Unreported sales	$477,566[1]

	Tax
As determined, protested	$40,566.34
Adjustment - Sales and Use Tax Department	- 867.92
- Appeals Division	+ 490.88
Proposed tax redetermination	$40,189.30
Less concurred	- 790.02
Balance, protested	$39,399.28
Proposed redetermination	$40,189.30
Interest to 6/30/11	23,818.84
Total tax and interest	$64,008.14
Payments	-1,423.68
Balance due	$62,584.46
Monthly interest beginning 7/1/11	$193.83

This matter was previously scheduled for Board hearing on February 24, 2010, but petitioner did not respond to the Notice of Hearing, and thus, the Board Proceedings Division informed petitioner that this matter would be presented to the Board for decision without oral hearing. Subsequently, petitioner contacted the Board Proceedings Division and indicated that she would like a Board hearing, and the matter was rescheduled for June 18, 2010. The Board hearing was then deferred so that the Appeals Division could issue a Supplemental Decision and Recommendation.

[1] Petitioner disputes some unspecified portion of this audit item, so we treat the entire amount of this audit item as disputed.

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

UNRESOLVED ISSUE

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

Petitioner has operated a cocktail lounge since November 1, 1998. Sales based on the cash register are recorded in the sales journal, which is used to prepare the sales and use tax returns. The Sales and Use Tax Department (Department) found that petitioner's markup, based on a comparison of gross receipts and cost of good sold reported on the 2003 federal income tax return (FITR), was 91.09 percent, which appeared low (the Department expected a markup greater than 200 percent). The Department decided to compute petitioner's sales using the markup method. However, since petitioner provided information regarding cost of goods sold for the year 2003 only, the Department used that year as a test period and applied the percentage of error to the remainder of the audit period.

The Department found that the $155,321 cost of merchandise petitioner recorded on her 2003 FITR represented only beverage purchases and did not include food costs. The Department segregated petitioner's purchases for the month of December 2005 and applied the computed percentages to recorded beverage purchases to establish audited purchases of beer and of liquor and wine. To establish the audited cost of goods sold for 2003, the Department reduced purchases of beer by allowances for bottle breakage (1 percent), self-consumption (2 percent), pilferage (2 percent) and the cost of beer kegs donated to various charity events, and it reduced liquor and wine purchases for self-consumption (2 percent) and pilferage (2 percent). The tables used by the Department to compute audited sales of draft beer, liquor and wine incorporated allowances for spillage of 10 percent, 12 percent, and 6 percent, respectively. The Department then prepared shelf tests to compute weighted average markups of 188.71 percent for beer and 283.33 percent for liquor and wine, which were applied to the audited cost of goods sold in each category, resulting in audited taxable beverage sales of $437,303 for 2003. Since the recorded cost of goods sold did not include food purchases, the Department computed food sales using the percentage of recorded food sales to beverage sales for February 2006. The Department established audited taxable sales of beverages and food of $501,322 for the year 2003, which exceeded reported taxable sales of $328,403 by 52.65 percent. The

Department applied that percentage to reported taxable sales to establish the understatement for the period January 1, 2003, through September 30, 2005.[2]

Petitioner contends that adjustments are warranted to the amount of audited taxable sales because the selling prices used in the audit to compute the markups were excessive. Petitioner asserts that she increased her selling prices on December 1, 2005, and that the selling prices listed on the Bar Fact Sheet and the price list, which she provided on February 7, 2006, represent the higher selling prices after the price increase. Petitioner also contends that selling prices should be adjusted to account for lower happy hour selling prices, and that only 25 to 27 percent of sales occurred at higher entertainment selling prices, not 37.5 percent as used by the Department.

Petitioner's assertions conflict with information provided on the Bar Fact Sheet at the time of the audit. Further, we find that the audited markups are well within the range of markups expected for this type of business, and petitioner has not provided documentation to support any adjustments.

Petitioner has also contended that the audited amounts of cost of goods sold were excessive because they included merchandise purchases she paid for but never received (which she asserts were unauthorized purchases made by an employee of Southern Wine & Spirits using petitioner's account). Based on additional information submitted by petitioner, we recommend in the SD&R that petitioner's cost of goods sold for 2003 be reduced by $1,345 for purchases that were not made by petitioner, which was the full amount of unauthorized purchases petitioner claimed. Since the percentage of error calculated for 2003 was applied to reported taxable sales to establish the understatement for the audit period, this adjustment for unauthorized purchases made in 2003 was also incorporated into the calculation of the deficiency for 2004 and 2005. Petitioner has not provided documentation to support a greater adjustment.

Finally, petitioner states that she disputes any oral assertions made by the auditor because she had a difficult time understanding the auditor and, therefore, understanding his questions. Since

---

[2] Since reported taxable sales for the fourth quarter 2005 increased from the $82,460 average for prior quarters to $105,989, the Department concluded that the reported amount for that quarter was substantially accurate. However, we note that the average amount of audited taxable sales for the prior quarters was $125,326 per quarter, and we find that the Department's acceptance of recorded taxable sales for this quarter may have granted petitioner an unintended benefit.

petitioner has not provided any details regarding communication issues and it appears that her written answers on the Bar Fact Sheet were in response to written questions (rather than the auditor's oral explanation), we find that there is no evidence of errors in the audit related to petitioner's inability to understand the auditor.

OTHER DEVELOPMENTS

None.

Summary prepared by Thea Etheridge, Business Taxes Specialist II