

## 1 CALIFORNIA STATE BOARD OF EQUALIZATION

## 2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Administrative Protest and )  
 4 Claim for Refund Under the Sales and Use Tax )  
 Law of: )  
 5 KATHERINE E. LETT, dba News City ) Account Number SR CH 100-583160  
 Case ID's 576171, 654996  
 6 Taxpayer ) Oakland, Alameda County

7 Type of Business: Cigarette and tobacco store

8 Audit period: 07/01/07 – 09/30/10

9 <u>Item</u>	<u>Disputed Amount</u>
10 Unreported taxable sales	\$762,785
11 Unreported taxable cigarette rebates	\$ 27,334
12 Negligence penalty	\$ 7,397

	<u>Tax</u>	<u>Penalties</u>
13 As determined	\$73,972.47	\$ 7,397.25
14 Finality penalty		7,397.25
15 Less concurred	- 1,149.05	- 00.00
Balance, protested	<u>\$72,823.42</u>	<u>\$14,794.50</u>
16 Tax, as determined	\$73,972.47	
17 Interest through 11/30/13	19,392.02	
Negligence penalty	7,397.25	
18 Finality penalty	<u>7,397.25</u>	
Total tax, interest, and penalties	\$108,158.99	
19 Less payments	- 30,000.00	
20 Balance Due	<u>\$78,158.99</u>	

21 Monthly interest beginning 12/01/13 \$ 219.86

22 This matter was scheduled for Board hearing in September 2013, but was postponed at  
 23 taxpayer's request due to illness.

## 24 UNRESOLVED ISSUES

25 **Issue 1:** Whether adjustments are warranted to the amount of unreported taxable sales. We  
 26 find no adjustment is warranted.

27 Taxpayer made retail sales of cigarettes and tobacco products, with some sales of carbonated  
 28 beverages and snack food items, from June 2005 until she sold the business in September 2010. For

1 audit, taxpayer provided bank statements for the audit period, purchase invoices and daily sales  
2 journals for the period January 1, 2008, through September 30, 2010, and federal income tax returns  
3 for 2007 and 2008. The Sales and Use Tax Department (Department) noted that the gross receipts  
4 reported on the federal income tax returns exceeded total sales reported on taxpayer's sales and use tax  
5 returns by \$12,459 in 2007 and \$10,248 in 2008. Based on its analysis of bank statements, the  
6 Department also noted that taxpayer received cigarette rebates totaling \$27,331 during the audit period,  
7 which indicated to the Department that taxpayer's volume of sales was greater than her reported  
8 amounts. Further, the Department computed that taxpayer's reported total sales of \$268,256 for the  
9 audit period equated to average daily sales of \$230, equivalent to sales of sixty packs or six cartons of  
10 cigarettes per day, which did not seem sufficient to support the business. The Department obtained  
11 taxpayer's merchandise purchase information from her primary supplier, Pitco, and found that  
12 taxpayer's total merchandise purchases of \$879,249 for the audit period exceeded her reported total  
13 sales by \$610,993. Thus, the Department concluded that taxpayer's reported total sales and reported  
14 taxable sales were substantially understated.

15 The Department performed a purchase segregation test, using the purchase information  
16 obtained from Pitco, and found that 98.78 percent of the total merchandise purchases were purchases  
17 of taxable merchandise. The Department then compared selling prices provided by taxpayer in a  
18 handwritten price list with costs from available purchase invoices for the last quarter of the audit  
19 period, and computed a weighted average markup for taxable merchandise of 19.01 percent. To  
20 compute the cost of taxable merchandise sold, the Department reduced the merchandise purchases  
21 obtained from Pitco by \$12,467 for self consumption and by 1 percent for pilferage, and multiplied by  
22 the taxable merchandise purchase ratio of 98.78 percent. The Department then added the weighted  
23 average markup of 19.01 percent to the cost of taxable merchandise sold to establish audited taxable  
24 sales of \$1,008,632 for the audit period, which exceeded reported taxable sales by \$762,785.

25 Taxpayer contends that the purchase information obtained from Pitco includes purchases made  
26 by others. Taxpayer asserts that her Pitco membership card was lost by her store manager and the  
27 store manager also admitted to her that her Pitco membership card was loaned to others.

28 We find that taxpayer has not provided any evidence showing that the purchase information

1 from Pitco included purchases made by others, or otherwise did not accurately represent taxpayer's  
2 purchases. Thus, we are not persuaded by taxpayer's assertions that the purchase information from  
3 Pitco is inaccurate, and conclude that no other adjustments are warranted.

4 **Issue 2:** Whether any adjustments are warranted to the amount of unreported taxable cigarette  
5 rebates. We conclude that no adjustments are warranted.

6 The Department used taxpayer's bank statements to schedule payments from a cigarette  
7 manufacturer totaling \$27,334 for the audit period. Since taxpayer provided no contracts regarding  
8 these rebates, the Department concluded that taxpayer received the rebates in exchange for making a  
9 specific reduction to her cigarette selling prices, and therefore the rebates represented additional gross  
10 receipts subject to tax.

11 Taxpayer contends that some of the cigarette rebates were paid to her for cigarette purchases  
12 made by other parties from Pitco. However, since taxpayer has not provided any evidence to establish  
13 that the rebates should not be considered part of her gross receipts from sales of cigarettes, we  
14 recommend no adjustment to the amount of unreported taxable cigarette rebates.

15 **Issue 3:** Whether taxpayer was negligent. We conclude that she was.

16 The Department imposed the negligence penalty because taxpayer failed to maintain any source  
17 documents of her sales, such as cash register tapes, to support the amounts recorded in her daily sales  
18 journals, and materially understated her recorded purchases. The Department also imposed the penalty  
19 because the understatement is large relative to reported taxable sales.

20 Taxpayer claims that she continued to keep the same records as her predecessor, basing her  
21 recorded sales on a tally of the number of packs of cigarettes she sold each day. Therefore, taxpayer  
22 argues that she was inexperienced, but not negligent.

23 A comparison of unreported taxable sales of \$762,785 with reported taxable sales of \$245,848  
24 shows an error rate of 310 percent, which is strong evidence of negligence in reporting. Although  
25 taxpayer claims that her daily sales journals were based on tallies of the number of packs of cigarettes  
26 she sold each day, taxpayer did not maintain any of these tally sheets. Furthermore, purchases  
27 obtained from taxpayer's vendor, Pitco, exceeded total sales by \$610,993 for the audit period. Even  
28

1 though this was taxpayer's first audit, we find that taxpayer was negligent in both reporting and  
2 recordkeeping.

3 **OTHER MATTERS**

4 A penalty of 10 percent of the unpaid tax at the time the determination became final was added  
5 to taxpayer's liability. During the appeals conference, we told taxpayer that she could file a request for  
6 relief of the finality penalty, and we also gave taxpayer a copy of form BOE-735, "Request for Relief  
7 from Penalty, Collection Cost Recovery Fee, and/or Interest." However, taxpayer has not filed a  
8 request for relief of the finality penalty. Therefore, we have no basis upon which to grant relief.

9 Taxpayer made a payment of \$30,000.00 on October 25, 2011, and, on October 23, 2012,  
10 taxpayer filed a claim for refund with respect to this payment (Case ID 654996). However, since the  
11 statute of limitations for filing a timely claim for refund had already expired prior to the filing of the  
12 claim, we recommend that the claim for refund be denied.

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14 Summary prepared by Lisa Burke, Business Taxes Specialist III