CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
TARUN MAITRA, ET AL., dba M & S Liquor	Account Number: SR AA 100-452872 Case ID 473027
Petitioner	Lakewood, Los Angeles County

Type of Business: Liquor store

Audit period: 10/01/04 – 07/11/07

Item	Disputed Amount
Understatement of reported taxable sales	$1,065,523
Tax-paid purchases resold	Unstated
Negligence penalty	$ 8,926

	Tax	Penalty
As determined:	$91,418.68	$9,141.91
Adjustment - Appeals Division	- 2,161.17	- 216.15
Proposed redetermination	$89,257.51	$8,925.76
Less concurred	- 1,309.82	00.00
Balance, protested	$87,947.69	$8,925.76

Proposed tax redetermination	$ 89,257.51
Interest through 10/31/11	33,500.49[1]
Negligence penalty	8,925.76
Total tax, interest, and penalty	$131,683.76
Payments	- 14,050.00
Balance Due	$117,633.76
Monthly interest beginning 11/1/11	$ 376.04

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the understatement of reported taxable sales. We find no further adjustment is warranted.

Petitioner operated a liquor store from September 1, 2004, through July 11, 2007. Petitioner provided sales journals, federal income tax returns, and incomplete purchase invoices for audit. Also,

[1] As explained below, we recommend relief of interest of $4,611.62, and this is *not* included in the amount of interest here.

petitioner provided some cash register tapes in December 2007, but it did not provide them in June 2008 when the Sales and Use Tax Department (Department) requested them for additional review.

The Department noted discrepancies between gross receipts reported on the federal returns and total sales reported on the sales and use tax returns and noted that the available purchase invoices were incomplete. The Department contacted petitioner's vendors and used the information provided in its markup-basis audit. For vendors that did not provide data regarding their sales to petitioner, the Department based audited purchases on petitioner's records. The Department reduced audited purchases of taxable merchandise by two percent for self consumption and two percent for pilferage to establish the audited cost of taxable goods sold. It then conducted a purchase segregation test to compute percentages of taxable merchandise in various categories. Since the business had been sold before the audit commenced so that the Department could not perform a shelf test, it estimated markups of 25 percent for beer, 25 percent for liquor and wine, 19 percent for cigarettes, 25 percent for carbonated drinks, and 35 percent for miscellaneous taxable merchandise, for a weighted average markup of 23 percent. The Department added the 23 percent markup to the audited cost of taxable goods sold to compute audited taxable sales of $1,442,893, which exceeded reported taxable sales of $351,071 by $1,091,822. In the D&R, we noted an error in the Department's calculation of taxable merchandise purchased from one vendor. Also, in response to a contention raised by petitioner, we recommended an adjustment for changes in inventory. After those adjustments, the audited understatement of reported taxable sales has been reduced by $26,299, from $1,091,822 to $1,065,523.

Petitioner contends that the audited amount of taxable sales is excessive, primarily because petitioner believes it could not have made that amount of sales. Petitioner asserts that the markup of 23 percent used for the audit is excessive because petitioner routinely offered special discount prices to its regular customers and because competition in the area required it to keep prices low. Further, petitioner claims that a markup of 19 percent for cigarettes is too high because petitioner participated in rebate programs which petitioner argues reduced the markup. In addition, petitioner asserts that the amounts of purchases provided by its vendors may be excessive.

Before addressing petitioner's specific contentions, we note that petitioner's purchases of taxable merchandise from Sam's Club, which was just one of petitioner's several vendors, was

$501,140 during the audit period, while petitioner reported taxable sales of $351,071 for that same period. That petitioner's purchases of taxable merchandise from just one of its several vendors significantly exceeded its reported taxable sales makes it virtually certain that petitioner substantially underreported its taxable sales. Regarding petitioner's assertion that the estimated markups are excessive, we note that it has provided no evidence to support a reduction of those markups. Further, based on our experience examining audits of liquor stores, we generally expect the weighted average markup to be in the range of 25 to 40 percent. Since the weighted average markup of 23 percent used by the Department for this audit is below that range and petitioner has submitted no evidence to impeach that markup, we find that no reduction is warranted.

With respect to petitioner's objection to the markup used for sales of cigarettes, petitioner acknowledges that the subject rebates are subject to tax, but it nevertheless believes that the rebates should reduce the audited markup for cigarettes. Petitioner is mistaken. The Department, unaware of the rebate programs at the time of the audit, estimated that petitioner's regular selling prices for cigarettes would achieve a markup of 19 percent. Since petitioner's taxable receipts from sales of cigarettes (amounts received from the purchasers plus the amounts received as rebates) were not reduced as a result of the rebates, the rebates could *not* serve to reduce the markup used by the Department for the audit.

With respect to the audited cost of taxable goods sold, petitioner has provided no evidence that the amounts provided by the vendors were incorrect, and we note that the information from the vendors specifically identifies petitioner as the purchaser and provides detailed information regarding the goods purchased and the time the purchases were made. Thus, we find no reason to conclude that the vendors' information is incorrect. We conclude that no further adjustments are warranted to the understatement of reported taxable sales.

Issue 2: Whether the audited amount of tax-paid purchases resold should be increased. We find it should not.

The information provided by Sam's Club to the Department showed purchases of taxable merchandise by petitioner of $501,140 and indicated that petitioner had paid sales tax reimbursement with respect to $8,519 of those purchases. Accordingly, the Department allowed a tax-paid purchases resold adjustment of $8,519 in the audit. Petitioner contends that the amount of tax-paid purchases resold was greater than $8,519, but it states that it has no documentation to support a greater amount. In the absence of documentation, we find no adjustment is warranted.

Issue 3: Whether petitioner was negligent. We conclude that it was.

The Department imposed the penalty because the records were inadequate and because the understatement was substantial. Petitioner disputes the penalty on the basis that this was its first business venture, and it was unaware of the records it should maintain. Petitioner further claims that it provided cash register tapes and purchase invoices to an outside bookkeeper and relied on the bookkeeper to properly prepare the records and report the accurate amount of sales and use tax.

Petitioner provided incomplete, conflicting records. The amounts of total sales reported on sales and use tax returns were less than the cost of goods sold reported on federal tax returns by $449,291 for 2005 and $511,160 for 2006. Petitioner's reported taxable sales for the audit period were significantly less than its purchases of taxable merchandise from just one of its several vendors, and represent only 17 percent of reported total sales, even though the inventory reports show that taxable merchandise represented about 91 percent of petitioner's merchandise. Petitioner's taxable understatement of $1,065,523 represents an error ratio greater than 300 percent when compared with reported taxable sales of $351,071. We believe that any reasonably prudent business person, even one with limited experience and without a prior audit, would recognize this level of discrepancies between its purchases of taxable merchandise and its reported taxable sales. We do not believe that the discrepancies here can be explained in any way other than as a result of petitioner's negligence, and therefore conclude that the negligence penalty was properly imposed.

RESOLVED ISSUE

Petitioner requested relief of interest on the basis that there was an unreasonable delay on the part of a Board employee in the processing of this audit. Petitioner originally requested relief of all interest applied to the liability, but it later amended the amount to $4,000.00, which it estimated to be the amount of interest accrued from April 1, 2008, through November 30, 2008. The Department conceded that relief of interest is warranted for the period June 1, 2008, through October 31, 2008 (the end of the month during which the Notice of Determination was issued), because, under the unusual facts of this case, there was an unreasonable delay caused by the auditor's use of an inappropriate audit method, and the audit should have been completed by the end of May 2008. The amount of interest accrued for the five months for which the Department concedes relief is $3,885. Given the Department's concession, we conclude in the D&R that there was an additional month of delay warranting relief of interest, totaling $4,611.42.

OTHER DEVELOPMENTS

None.

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

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	Unknown*
Mark-up percentages estimated	Beer, liquor, wine, and soda 25% Cigarettes 19% Misc. Taxable 35% Weighted average markup 23%
Self-consumption allowed in dollars	$24,021 for the audit period
Self-consumption allowed as a percent of taxable purchases	2%
Pilferage allowed in dollars	$23,540
Pilferage allowed as a percent of taxable purchases	2%

* For this audit, the Department did not compute a percentage of taxable to total merchandise purchased. Instead, the Department computed taxable purchases based on information provided by vendors and some purchase record provided by petitioner.