STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

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:	
NIRVAIR CORPORATION, dba College Park Mobil	Account Number SR EA 97-141696 Case ID 529714
Petitioner	Woodland Hills, Los Angeles County

Type of Business: Gas station with mini-mart

Audit period: 04/01/05 – 03/31/08

Item	Disputed Amount
Unreported sales, 2005	$458,164
Unreported gasoline sales, 2007	$339,928
Negligence penalty	$ 13,381

	Tax	Penalty
As determined	$134,390.85	$13,439.10
Post-D&R adjustment	- 579.70	- 57.95
Proposed redetermination	$133,811.15	$13,381.15
Less concurred	- 71,959.02	00.00
Balance, protested	$ 61,852.13	$13,381.15

Proposed tax redetermination	$133,811.15
Interest through 07/31/13	112,516.64
Negligence penalty	13,381.15
Total tax, interest, and penalty	$259,708.94
Monthly interest beginning 08/01/13	$ 669.06

This matter was scheduled for Board hearing in October 2012, but was deferred for settlement consideration.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the unreported sales. We find no further adjustment is warranted.

Petitioner has operated a gasoline station with a mini-mart since October 1997. Petitioner is a corporation whose sole shareholder was Rakesh Bhakta until December 31, 2007, when he sold all his

stock to Bhupinder Singh Mac. For audit, petitioner provided monthly Point of Sale reports from Mobil Oil for 2006; sales summary worksheets for the period January 1, 2006, through March 31, 2008; income statements and gasoline purchase invoices for 2006 and 2007; and federal income tax returns for 2005, 2006, and 2007. The Sales and Use Tax Department (Department) found significant differences between recorded and reported taxable sales, which it used to establish an understatement of $2,853,600, which petitioner does not protest. Based on various audit tests, the Department concluded that recorded taxable sales for 2006 were substantially accurate. However, since petitioner provided almost no records for 2005 and the Department computed a negative book markup for gasoline for 2007, the Department decided to use alternate audit methods to establish audited taxable sales for the period April 1, 2005, through December 31, 2005, and for the year 2007.

For 2005, the Department established audited sales of gasoline using gallons of gasoline purchased (computed using vendors' reports of sales tax prepayments paid by petitioner) and selling prices published on GasBuddy.com for regular grade gasoline, adjusted by 102 percent (computed from petitioner's records for 2006) for higher prices for mid-grade and premium gasoline. To establish audited taxable mini-mart sales for the period April 1, 2005, through December 31, 2005, the Department used recorded taxable mini-mart sales for the corresponding period of 2006. The Department totaled audited gasoline sales and audited taxable mini-mart sales for the period April 1, 2005, through December 31, 2005, and computed that reported taxable sales for that period were understated by $458,164.

For 2007, the Department established audited gasoline sales on a markup basis, using the book markup of 5.24 percent that it had computed for 2006 and audited purchases of fuel for 2007. We found errors in the Department's computation of the book markup for 2006, and we recomputed it at 5.02 percent. Thus, we recommended that audited gasoline sales for 2007 be recomputed using 5.02 percent. After that adjustment, the understatement of reported gasoline sales for 2007 is $339,928.

Petitioner contends that it sold fuel for prices below the industry average selling price in the second and third quarters of 2005 in order to keep the station open while the mini-mart was under construction. Petitioner further asserts that gasoline prices remained drastically reduced during the last

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quarter of 2005. Petitioner also contends that the recorded gasoline sales for 2007 are correct, asserting that it inadvertently sold gasoline below cost because it had changed vendors, and it was confused by the invoices provided by the new vendor, such that it used incorrect gasoline costs when it computed the selling prices. In addition, petitioner alleges that, in anticipation of the sale of the business, it was more concerned about the volume of sales than the net profit in 2007. Further, Mr. Mac states that he was effectively forced to purchase the stock of the business on January 1, 2008, to prevent a default on Mr. Bhakta's loan (which Mr. Mac had personally guaranteed). When he made the decision to purchase the corporate stock, Mr. Mac states that he did not review the books and records but considered only the volume of gasoline purchases.

Petitioner did not provide records for 2005 (other than the federal tax return), and it has not provided documentation to show that gasoline was sold below the average industry price during the last three quarters of 2005. Accordingly, we find no adjustment of the audited selling prices for 2005 is warranted. Regarding the selling prices in 2007, petitioner has provided copies of invoices from the "new" vendor and from the vendor from whom it previously purchased gasoline, in an attempt to demonstrate that the invoices issued by the new vendor were confusing. While it is true that one vendor combined the state and federal taxes with the base price of fuel as one line item, and the previous vendor separately stated the state and federal taxes, we are not persuaded that, as a result, petitioner was unable to understand the pricing schedule and therefore inadvertently computed selling prices below cost. Petitioner has provided no convincing evidence that it sold gasoline at prices below cost in 2007 or that it established extremely low selling prices in 2007 because it intended to sell the business and wanted to increase the volume of sales. We find it was reasonable for the Department to use the book markup for 2006 to establish audited sales for 2007, and petitioner has not provided evidence sufficient to support any adjustment.

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

The Department imposed the negligence penalty because petitioner provided inadequate records and the understatement was significant. Petitioner has not offered a non-negligent explanation for the understatements established by audit, but Mr. Mac states that the business is currently

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struggling with the mistakes of the prior management, which have been corrected beginning with returns filed for the first quarter 2008.

The Department found that petitioner had recorded taxable sales of $2,853,600 that it did not report, and petitioner does not dispute that audit item. In addition, petitioner did not provide any records for 2005 other than the federal tax return. We find that any businessperson, even one with limited experience, should have recognized a difference of almost $3 million between recorded and reported taxable sales. We find that the substantial error and the incomplete records are clear evidence of negligence, even though petitioner had not been audited previously. Further, while it is true that the Department found the reported sales for the first quarter 2008 to be substantially correct, that improved reporting does not alter the fact that, during the audit period, petitioner was negligent. We conclude that the penalty was properly imposed.

OTHER MATTERS

None.

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

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MARKUP TABLE
(Gasoline sales for 2007)

Taxable vs. nontaxable purchases	100%
Book mark-up for 2006 applied to purchases for 2007	5.02%
Self-consumption allowed in dollars	None*
Pilferage allowed in dollars	None*

* The book markup incorporates any reductions to cost of goods sold for self-consumption or pilferage.