

## 1 CALIFORNIA STATE BOARD OF EQUALIZATION

## 2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination )  
 4 Under the Sales and Use Tax Law of: )  
 ) Account Number SR CH 100-831087  
 5 NOORNEEL, INC., dba Eden's Liquor and Deli ) Case ID 538911  
 )  
 6 Petitioner ) Hayward, Alameda County

7 Type of Business: Liquor store

8 Audit period: 08/08/06 – 06/30/09

9 Item Disputed Amount

10 Unreported taxable sales \$435,817

11 Unreported cigarette rebates \$ 31,642

12 Negligence penalty \$ 4,177

13 Tax as determined and protested \$41,773.66

14 Interest through 11/30/12 14,401.96

15 Negligence penalty 4,177.42

16 Total tax, interest, and penalty \$60,353.04

17 Payments - 30.04

18 Balance Due \$60,323.0019 Monthly interest beginning 12/01/12 \$ 208.72

20 A Notice of Appeals Conference was mailed to petitioner's address of record. Petitioner did  
 21 not respond to the notice or appear at the appeals conference, which was held as scheduled. After the  
 22 conference, petitioner requested that the conference be rescheduled, on the basis that there was a  
 23 medical emergency at the scheduled conference time. The Case Management Section agreed to  
 24 reschedule the conference upon receipt of evidence of the medical emergency, but petitioner did not  
 25 provide any documentation. We thereafter sent petitioner a letter offering it the opportunity to provide  
 26 any additional arguments and evidence in writing it wished us to consider, but it did not respond. The  
 27 matter was scheduled for Board hearing in August 2012, but was postponed at petitioner's request  
 28 because taxpayer had a scheduling conflict and its representative had a family emergency.

## UNRESOLVED ISSUES

29 **Issue 1:** Whether adjustments are warranted to the amount of unreported taxable sales. We  
 30 find no adjustments are warranted.

1 Petitioner operated a liquor store from August 8, 2006, through June 30, 2009. Petitioner also  
2 sold pizza until September 30, 2006, at which time the pizza business was transferred to a new  
3 corporation. For audit, petitioner provided federal income tax returns, sales and use tax returns,  
4 purchase invoices, bank statements, and selected cash register z-tapes.

5 The Sales and Use Tax Department (Department) established audited taxable sales on a markup  
6 basis. The Department used the amounts reported on federal income tax returns as a basis for audited  
7 cost of goods sold, after increasing for certain of petitioner's adjustments that the Department rejected.  
8 For 2006, since petitioner provided no evidence of the alleged sale, the Department rejected a  
9 reduction of \$18,000 for inventory that petitioner alleges it sold to a lessee. For 2007 and 2008, the  
10 Department rejected reductions for cigarette rebates of \$11,847 and \$9,953, respectively, because it  
11 concluded that the cigarette rebates represented taxable gross receipts rather than reductions to the cost  
12 of goods sold. The Department performed a purchase segregation test to compute an 88.85 percent  
13 taxable to total purchase ratio, which it applied to audited cost of goods sold to establish the audited  
14 cost of taxable goods sold, and it added the weighted average markup of 32.59 percent from its shelf  
15 test to compute taxable sales.<sup>1</sup> The Department then compared audited taxable sales by year to  
16 reported taxable sales to compute percentages of understatement in reported taxable sales of 24.32  
17 percent for 2006, 42.58 percent for 2007, 48.82 percent for 2008, and 41.09 percent overall. The  
18 Department applied those percentages of understatement to reported taxable sales by quarter (using  
19 41.09 percent for the first six months of 2009) to compute unreported taxable sales for the audit period  
20 of \$435,817.

21 Petitioner contends that the amount of unreported taxable sales is overstated because the  
22 Department performed the audit without a complete set of records. Petitioner stated that it was  
23 prepared to submit the missing records, but it has not done so. Petitioner also contends that another  
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26 <sup>1</sup> The Department made no adjustment for the cost of self-consumed merchandise because petitioner stated that no  
27 merchandise was withdrawn from inventory for use, and made no adjustment for pilferage because petitioner explained that  
28 the cost of goods sold amounts reported on federal tax returns had already been reduced by one percent for losses due to  
spoilage and theft.

1 operator leased the business for a portion of the audit period, asserting that it should not be responsible  
2 for the tax on sales made during that period.

3 We find that the markup audit method was appropriate in this case, and we find no errors in the  
4 audit computations. Petitioner has not identified any errors in the audit, nor has it provided any  
5 additional records, even though it stated it could do so. Not only has petitioner failed to provide any  
6 evidence that the business was leased to another operator for any portion of the audit period, but even  
7 if petitioner could establish that such had been the case, petitioner would be liable for the tax liabilities  
8 incurred for the quarter in which the business was transferred, plus the three subsequent quarters,  
9 because petitioner did not notify the Board of the transfer of the business. (Rev. & Tax. Code, §  
10 6071.1.) In the absence of supporting evidence, we find no adjustment is warranted.

11 **Issue 2:** Whether the cigarette rebates represent taxable gross receipts. We find that they do.

12 The Department found that petitioner received cigarette rebates from manufacturers of \$31,642  
13 during the audit period, which it concluded were taxable gross receipts. Although petitioner has  
14 disputed the entire determination, it has not raised a specific argument regarding the cigarette rebates.  
15 It is undisputed that petitioner received cigarette rebate payments from cigarette manufacturers in  
16 exchange for petitioner's specific reductions in the retail selling price of the cigarettes. Thus, the  
17 rebates were part of petitioner's taxable gross receipts.

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

19 The Department imposed a negligence penalty because petitioner's books and records were  
20 incomplete and the understatement was significant. Although petitioner has disputed the entire  
21 determination, it has not raised a specific argument regarding the negligence penalty.

22 Petitioner did not provide cash register tapes, sales journals, sales tax return worksheets,  
23 general ledgers, or profit and loss statements. We find that any businessperson, even one with limited  
24 experience, should have been aware that such records were necessary, and petitioner has not provided  
25 any reasonable explanation for its failure to maintain complete records. The total understatement of  
26 reported taxable measure of \$467,459 is substantial and represents an understatement of 44 percent in  
27 comparison to reported taxable sales of \$1,060,663. We find that the limited records and significant  
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1 understatement are evidence of negligence, and that the penalty was properly applied even though  
2 petitioner had not been audited previously.

3 **OTHER MATTERS**

4 None.

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6 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III  
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28**MARKUP TABLE**

Percentage of taxable vs. nontaxable purchases	88.85%
Mark-up percentage developed	32.59%
Self-consumption allowed in dollars	None*
Pilferage allowed in dollars	None**

\* The Department did not make an adjustment for self-consumption because petitioner stated that it did not withdraw merchandise from inventory for use.

\*\* The Department did not make an adjustment for pilferage because petitioner explained that it had reduced the recorded amounts of cost of goods sold by one percent for losses due to spoilage and theft.