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:	
IFEANYI OBIEKEA, dba All Star Liquor & Market	Account Number: SR AS 97-887624 Case ID 462256
Petitioner	Los Angeles, Los Angeles County

Type of Business: Liquor store

Liability period: 04/01/05 – 04/30/08

Item	Disputed Amount
Unreported sales	$74,954

	Tax	Penalty
As determined	$73,188.82	$7,318.88
Adjustment - Sales and Use Tax Department	-34,713.32	- 3,471.33
- Appeals Division	- 1,786.95	- 178.67
Proposed redetermination	$36,688.55	$3,668.88
Less concurred	- 30,504.84	- 3,668.88
Balance, protested	$ 6,183.71	$ 00.00

Proposed tax redetermination`	$36,688.55
Interest through 10/31/11	13,787.63
Negligence penalty	3,668.88
Total tax, interest, and penalty	$54,145.06
Payments	- 11,605.75
Balance Due	$42,539.31
Monthly interest beginning 11/1/11	$125.41

UNRESOLVED ISSUE

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

Petitioner operated a liquor store. When the Sales and Use Tax Department (Department) requested records to conduct an audit, petitioner provided nothing. Accordingly, rather than conducting an audit, the Department prepared a Field Billing Order (FBO) using the results of a prior audit of petitioner to establish an estimated understatement of reported taxable measure of $887,136, which consisted of additional taxable sales made in the regular course of business of $882,136 and a final sale of fixtures and equipment of $5,000.00. After the Department issued a Notice of Determination based on the FBO, petitioner provided some records, and the Department obtained some records from petitioner's suppliers. Based on those additional records, the Department prepared an adjusted FBO, in which it deleted the estimated taxable sales for the period October 1, 2007, through April 30, 2008, because it concluded that there was no evidence petitioner made sales after September 30, 2007, and deleted the final sale of fixtures and equipment based on evidence that the sale of the business was never finalized.

For the adjusted FBO, the Department computed taxable sales on a markup basis. The Department conducted a purchase segregation test, using the available purchase records for the second quarter 2006 (2Q06). When it compared the recorded purchases to information provided by petitioner's vendors, it found additional unrecorded purchases from two vendors that totaled $1,490, resulting in an understatement of 3.32 percent in recorded purchases. Using the available information for 2Q06, the Department computed that 80.86 percent of petitioner's purchases represented taxable merchandise. To compute the cost of goods sold for 2005 and 2006, the Department used the amounts recorded on petitioner's federal income tax returns, including changes in inventory, adjusted for the 3.32 percent understatement, and then multiplied by 80.86 percent and made an adjustment of 1 percent for pilferage to compute the cost of taxable goods sold.[1]

Since the business had been closed for over a year before the Department's investigation, the Department was unable to perform a shelf test. The Department added an estimated 35 percent markup to the computed cost of taxable goods sold to compute taxable sales for 2005 and 2006. It then made an adjustment for sales of taxable merchandise purchased with food stamps, estimated by applying 2 percent to the computed amount of food stamp sales. The Department computed percentages of understatement which it applied to reported taxable sales to establish the understatement on a quarterly basis for the period April 1, 2005, through June 30, 2007. It then used the average quarterly taxable sales for that period to establish taxable sales for 3Q07. Using these

[1] The Department did not make an adjustment for the cost of self-consumed taxable merchandise because petitioner stated that he paid tax reimbursement to vendors on all purchases of taxable goods for his own use.

procedures, the Department established an understatement of reported taxable sales of $466,369 in the adjusted FBO prepared before the appeals conference. In the D&R, we recommended that the adjustment for unrecorded purchases be deleted from the computation of the cost of goods sold because we found there was insufficient evidence that the purchases recorded on the federal tax returns were understated. We concluded that an increase was warranted in the allowance for petitioner's sales of taxable merchandise paid for with food stamps from 2 percent to 18.14 percent based on a comparison of purchases of carbonated beverages to the total of those purchases and purchases of exempt food products, and that the allocation of taxable sales per quarter should be revised. These findings result in a $21,660 reduction to the computed understatement of taxable sales, from $466,369 to $444,709.

Petitioner concedes that reported taxable sales were understated, and he has provided his own computation of an understatement of $369,755, disputing the $74,954 difference between his calculation of the understatement and the amount at issue here, which he contends is the result of errors in the computed cost of taxable goods sold. Specifically, petitioner asserts that the cost of goods sold reported on his federal income tax returns should not be regarded as accurate because he likely made errors in computing those figures. Instead, petitioner proposes that the Department compute taxable sales for 2Q06, compute a percentage of that figure to reported total sales, and then apply that percentage to reported total sales for the liability period, excluding 3Q07. Petitioner states this method would use purchases for 2Q06, which are known, rather than the cost of goods sold claimed on the federal tax returns, which petitioner describes as "more nebulous."

Petitioner has provided no documentation to show errors in the cost of goods sold claimed on the federal tax returns or to demonstrate that he has made any corrections to those figures. Also, we note that the book markups computed using gross receipts and cost of goods sold figures from the federal tax returns were 71 percent for 2005 and 69 percent for 2006, both of which are higher than the range of markups expected for this business (30 to 40 percent) and thus indicate that the cost of goods sold claimed on the federal tax returns were not overstated. Accordingly, we see no basis to consider a reduction of the cost of goods sold amounts used in the markup computations. In the absence of evidence of errors, we find that the federal tax returns provide the most reliable information available regarding petitioner’s cost of goods sold. Accordingly, we recommend no further adjustments

OTHER DEVELOPMENTS

None.

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

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	80.86%
Mark-up percentages estimated	35%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	$3,214 for the years 2005 and 2006
Pilferage allowed as a percent of taxable purchases	1%