

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:)
 5 TRI MINH PHAN, dba River City Catering) Account Number SR KH 97-953913
 6 Petitioner) Case ID 539025
) Sacramento, Sacramento County

7 Type of Business: Catering truck

8 Liability period: 04/01/07 - 12/31/09

9 Item Disputed Amount

10 Unreported taxable sales \$125,132

11 Negligence penalty \$ 1,002

12 Tax as determined and protested \$10,024.65

13 Interest through 12/31/12 3,081.28

14 Negligence penalty 1,002.49

15 Total tax, interest, and penalty \$14,108.42

16 Monthly interest beginning 01/01/13 \$ 50.12

17 UNRESOLVED ISSUES

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

20 Petitioner operated a catering truck selling hot and cold food from December 2001 through
 21 December 2011. In December 2009, a Statewide Compliance and Outreach Program specialist
 22 interviewed petitioner and examined his menu. Since most of the items on petitioner's menu were hot
 23 food items or carbonated beverages, the specialist concluded that most of petitioner's sales were
 24 taxable sales, although petitioner consistently claimed 42 percent to 45 percent of his reported total
 25 sales as exempt sales of food products on his sales and use tax returns.

26 Petitioner provided federal income tax returns and a handwritten monthly sales summary for
 27 nine months in 2009 for examination, but provided no source documents to support the recorded and
 28 reported amounts. The Sales and Use Tax Department (Department) obtained a summary of
 petitioner's purchases from his known vendor, a catering truck commissary, and found that his
 commissary purchases of \$76,849 for 2007 and 2008, combined, exceeded reported total sales of

1 \$75,972 for the same two-year period. Based on that discrepancy, the Department concluded that
2 petitioner likely underreported his total sales. The Department considered using the markup method to
3 establish taxable sales, but concluded that there was insufficient information to do so, because
4 petitioner provided no purchase invoices and did not provide information regarding his purchases from
5 grocery stores. Therefore, the Department decided to compute petitioner's taxable sales using an
6 estimate of \$300 taxable sales per day. Then, based on its examination of the monthly sales summaries
7 for nine months that had been provided by petitioner, the Department estimated that petitioner operated
8 229 days per year. The Department's computed taxable sales exceeded reported amounts by
9 \$125,132.¹

10 Petitioner asserts that his taxable sales were accurately reported for the liability period. To
11 support his contention that his average daily taxable sales were much lower than \$300, petitioner
12 submitted a sales summary and supporting sales slips for the year 2010, which show average daily total
13 sales of \$167, average daily taxable sales of \$103, and an average ratio for exempt sales of 39 percent.
14 At the appeals conference, petitioner provided a list of 12 stops along his route, and claims that his
15 sales were reduced when two of the auto dealerships on his route closed in 2007.

16 Petitioner reported total sales averaging \$158 per day for the liability period, and his
17 documented purchases from the commissary alone exceed his reported total sales for the same period.
18 Thus, it is virtually certain that reported sales were understated, and the sales summary petitioner
19 provided for the year 2010 shows recorded sales that are relatively consistent with his understated
20 reported sales for the liability period. For that reason alone, we find the sales summary to be
21 unreliable. Further, the summary is not supported by reliable detailed documentation such as
22 prenumbered sales slips. Regarding the route information provided at the appeals conference, we find
23 that there is insufficient information to determine whether the route is complete, and by the time of the
24 conference in May 2012, an observation test of petitioner's sales no longer was possible because
25 petitioner closed his business in December 2011. Based on audited sales less estimated operating

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27 ¹ As explained in the D&R, the Department segregated the understatement into an overstatement of claimed exempt food
28 sales and an understatement of reported taxable sales. However, that segregation of the understatement into separate
categories does not impact our analysis.

1 expenses, the Department estimates that petitioner earned net income of \$22,256 per year. We find
2 that amount of net income is reasonable and indicates that the computed sales are not overstated. In
3 sum, we find that the audit method is reasonable, petitioner has not shown any basis for adjustment,
4 and the net income analysis supports the audit results. We therefore conclude no adjustments are
5 warranted.

6 **Issue 2:** Whether petitioner was negligent. We conclude that he was.

7 The Department imposed the penalty because petitioner failed to provide records, and the
8 understatement was substantial. Petitioner disputes the penalty on the basis that the understatement, if
9 any, was minor, and that he did his best to report his sales accurately. Petitioner claims that he failed
10 to understand the recordkeeping requirements described in the publications provided to him because he
11 cannot read English.

12 Petitioner started this business in 2001. For this audit period commencing in 2007, several
13 years after the business began, petitioner reported total sales that were less than his costs. We believe
14 that any businessperson, even one without several prior years of experience running the business,
15 would have realized that total sales are necessarily understated when they are less than costs. Further,
16 the understatement of \$125,132 is substantial and represents an error ratio of 224 percent in
17 comparison to reported taxable sales of \$55,887. Nor did petitioner provide any sales records for
18 periods prior to January 1, 2009, other than his federal tax returns, and the sales records he did provide
19 were limited to a one-page sales summary for nine months, with no source documents. We find that
20 the lack of reliable records, the evidence of purchases in excess of reported sales, and the magnitude of
21 the reporting errors are strong evidence of negligence, even though petitioner had not been audited
22 previously. While it is unfortunate that petitioner was not provided publications in a language he could
23 read,² we do not believe any lack of advice from the Department is a reasonable explanation for
24 petitioner's failures. We conclude that the penalty was properly imposed.

25 Summary prepared by Lisa Burke, Business Taxes Specialist III

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27 ² We are not aware whether petitioner conveyed this information to the Department when he received the English version of
28 the publications and, if not, in the absence of evidence showing that the Department knew he could not read English, it is
difficult to fault the Department's failure to provide him translated versions.