

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

Type of Business: Catering truck

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

<u>Item</u>	<u>Disputed Amount</u>
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Unreported taxable sales	\$125,132
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Negligence penalty	\$ 1,002
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Tax as determined and protested	\$10,024.65
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Interest through 11/30/13	3,632.60
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Negligence penalty	<u>1,002.49</u>
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Total tax, interest, and penalty	<u>\$14,659.74</u>
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Monthly interest beginning 12/01/13	<u>\$ 50.12</u>
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This matter was scheduled for Board hearing in December 2012, but was postponed for settlement consideration.

UNRESOLVED ISSUES

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

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

Petitioner provided federal income tax returns and a handwritten monthly sales summary for nine months in 2009 for examination, but provided no source documents to support the recorded and reported amounts. The Sales and Use Tax Department (Department) obtained a summary of

1 petitioner's purchases from his known vendor, a catering truck commissary, and found that his
2 commissary purchases of \$76,849 for 2007 and 2008, combined, exceeded reported total sales of
3 \$75,972 for the same two-year period. Based on that discrepancy, the Department concluded that
4 petitioner likely underreported his total sales. The Department considered using the markup method to
5 establish taxable sales, but concluded that there was insufficient information to do so, because
6 petitioner provided no purchase invoices and did not provide information regarding his purchases from
7 grocery stores. Therefore, the Department decided to establish audited taxable sales based on
8 estimated taxable sales of \$300 per day. Then, based on its examination of the monthly sales
9 summaries for nine months that had been provided by petitioner, the Department estimated that
10 petitioner operated 229 days per year. Audited taxable sales thus computed exceeded reported
11 amounts by \$125,132.¹

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

18 Petitioner reported total sales averaging \$158 per day for the liability period, and his
19 documented purchases from the commissary alone exceed his reported total sales for the same period.
20 Thus, it is virtually certain that reported sales were understated, and the recorded sales shown in the
21 sales summary that petitioner provided for the year 2010 are relatively consistent with his understated
22 reported sales for the liability period. For that reason alone, we find the sales summary to be
23 unreliable. Further, the summary is not supported by reliable detailed documentation such as
24 prenumbered sales slips. Regarding the route information provided at the appeals conference, we find
25 that there is insufficient information to determine whether the route is complete, and by the time of the
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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 conference in May 2012, an observation test of petitioner's sales was not possible because petitioner
2 no longer operated the business. Based on audited sales less estimated operating expenses, the
3 Department estimates that petitioner earned net income of \$34,505 per year. We find that the amount
4 of net income is reasonable and indicates that the computed sales are not overstated. In sum, we find
5 that the audit method is reasonable, petitioner has not shown any basis for adjustment, and the net
6 income analysis supports the audit results. We therefore conclude that no adjustments are warranted.

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

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

13 Petitioner started this business in 2001. For the liability period beginning in 2007, petitioner
14 reported total sales that were less than his costs. We find that a prudent businessperson, even one
15 without several years of experience running the business, would have noticed that his reported sales
16 were less than costs and taken immediate steps to correct the obvious reporting errors. A comparison
17 of unreported taxable sales of \$125,132 with reported taxable sales of \$55,887 shows a reporting error
18 rate of 224 percent, which is evidence of negligence in reporting. Petitioner did not provide any sales
19 records for periods prior to January 1, 2009, and the sales records he did provide were limited to a one-
20 page sales summary for nine months, with no source documents. We find that petitioner's failure to
21 maintain records was not due to his inability to read the English publications provided to him, and
22 instead, was due to negligence.² Given the lack of reliable records, the evidence of purchases in excess
23 of reported sales, and the magnitude of the reporting errors, we conclude that petitioner was negligent
24 and the penalty was properly imposed, even though petitioner had not been audited previously.

25 Summary prepared by Lisa Burke, Business Taxes Specialist III

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27 ² Petitioner has not indicated that he informed the Department that he was unable to read English. In the absence of
28 evidence showing that the Department knew that petitioner could not read English, it is difficult to fault the Department's
failure to provide him with translated versions of the publications.