

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 MORDEHAY RABINOWIZ, dba T. O. Catering) Account Number SR AC 13-875980
 6 Petitioner) Case ID 489446
 7 _____) Van Nuys, Los Angeles County

8 Type of Business: Catering truck
 9 Liability period: 07/01/03 – 06/30/08

10 <u>Item</u>	<u>Disputed Amount</u>	
11 Unreported taxable sales	\$	490,950
12 Unclaimed exempt sales of food	\$	- 126,326
13 Disallowed claimed sales tax included	\$	267
14 Fraud penalty	\$	6,621
	<u>Tax</u>	<u>Penalty</u>
15 As determined	\$32,820.68	\$8,205.20
16 Pre-D&R adjustment	- 1,221.97	- 305.53
17 Post-D&R adjustment	- 5,113.86	- 1,278.45
18 Proposed redetermination, protested	<u>\$26,484.85</u>	<u>\$6,621.22</u>
19 Less concurred	<u>- 94.02</u>	
20 Balance, protested	<u>\$26,390.83</u>	
21 Proposed tax redetermination	\$26,484.85	
22 Interest through 10/31/12	13,695.92	
23 Fraud penalty	<u>6,621.22</u>	
24 Total tax, interest, and penalty	<u>\$46,801.99</u>	
25 Monthly interest beginning 11/01/12	<u>\$ 132.42</u>	

26 This matter was scheduled for Board hearing in July 2012, but was postponed at petitioner's
 27 request to allow additional time to prepare for the hearing.

28 UNRESOLVED ISSUES

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

31 Petitioner operated a catering truck, selling hot and cold food, from July 1, 1991, through
 32 December 3, 2009. The average annual sales of \$3,590 reported on his sales and use tax returns was

1 substantially less than the average annual sales of \$94,034 reported on his income tax returns. The
2 Statewide Compliance and Outreach Program of the Sales and Use Tax Department (Department)
3 instructed petitioner to amend his sales and use tax returns and to provide records, but petitioner did
4 not respond.

5 The Department computed book markups ranging from 107.47 percent to 143.9 percent, using
6 the gross receipts and cost of goods sold reported on the available federal tax returns. The Department
7 considered those markups lower than expected for a catering truck, and it estimated a markup of
8 150 percent. The Department used the cost of goods sold reported on petitioner's federal tax returns
9 and the estimated markup of 150 percent to compute total sales. As recommended in the D&R, the
10 Department has reduced the cost of goods sold reported on the federal tax returns by estimated
11 amounts of the cost of self consumed merchandise at 2 percent (this is petitioner's figure, and he
12 concurs), and shrinkage at 1 percent. After those adjustments, the Department has established an
13 understatement of \$490,950. (This understatement is divided into two audit items, one of which is the
14 \$450,338 difference between amounts reported on income tax returns and on sales and use tax returns,
15 and the other of which is the remaining \$40,612 difference between the amount reported on income tax
16 returns and the amount established by markup.)

17 Petitioner claims that the shrinkage allowance should be increased to 2 percent, but he has
18 provided no records or supporting evidence, and he asserts that a markup of 150 percent is too high,
19 but has provided no records to support a lower markup. We believe that the 150 percent markup
20 estimated by the Department is reasonable, and in the absence of any evidence to support further
21 adjustments, we find none are warranted.

22 We note that petitioner also contends that the amounts of gross receipts reported on his federal
23 tax returns were excessive because they were based on bank deposits, and he claims the amounts
24 deposited included customer paychecks that he cashed. Petitioner states that approximately \$20,000 to
25 \$30,000 per year in cashed paychecks was inadvertently reported as gross receipts on his federal tax
26 returns. Petitioner apparently makes this argument because of the way the Department divided up
27 audited sales into two categories, which, on its face, makes it appear that the audited deficiency is
28 based on amounts reported on income tax returns. In fact, the total audited sales is based on the

1 Department's markup analysis. As such, even if petitioner had included paychecks in his income
2 reported for income tax purposes, the only impact here would be to decrease the audited difference
3 between amounts reported for income tax and sales tax purposes and increase the audited difference
4 between sales reported for income tax purposes and sales established on a markup basis, with no net
5 difference in the total understatement.

6 We note also that petitioner provided no records to support the amounts of sales reported and
7 has not provided complete bank statements with related bank deposit information for all deposits, so
8 that the bank deposits could be reconciled to the amounts reported on federal tax returns. Petitioner
9 provided a statement from one of its suppliers in which the supplier states that it accepted payroll
10 checks, which had been cashed by petitioner, as payment toward supplies purchased by petitioner.
11 This statement is not evidence that any such checks were deposited into petitioner's bank account, and
12 is only evidence that petitioner cashed checks for customers and then used the checks to purchase
13 supplies, which for our purposes is essentially the same as paying for supplies with cash. No evidence
14 has been provided in support of petitioner's assertion that he deposited his customers' paychecks into
15 his bank account. Thus, we find that petitioner has not shown that amounts reported for income tax
16 purposes included deposited paychecks of his customers, and in any event, since we find no further
17 adjustment is warranted to the markup analysis, we find no further adjustments are warranted to the
18 total audited understatement.

19 **Issue 2:** Whether adjustments are warranted to the allowance for exempt sales of food. We
20 find no further adjustment is warranted.

21 The Department estimated that 25 percent of petitioner's sales were exempt sales of food.
22 Petitioner contends that most of his sales were cold food items and asserts that the exempt sales of food
23 represented at least 50 percent of total sales. As support, petitioner has provided what he characterizes
24 as a menu, lists of food ingredients purchased on three separate dates, and statements from customers.
25 The item petitioner provided as a menu is actually a spreadsheet that lists food items without
26 corresponding sales prices, and it does not appear to be an actual, complete menu. Further, petitioner's
27 list of ingredients purchased includes items such as tortillas, eggs, and cheese, which could easily have
28 been used to prepare hot foods. In addition, we find the statements from customers may not be

1 representative of petitioner's customer base. Accordingly, we find that the evidence does not support
2 an increase in the estimated percentage of exempt food sales.

3 **Issue 3:** Whether adjustments are warranted to the disallowed deduction for sales tax included
4 in reported total sales. We find no adjustment is warranted.

5 Petitioner claimed a deduction for sales tax included of \$267 on his return for FYE 2006. The
6 Department disallowed the claimed deduction because petitioner provided no records. Although
7 petitioner disputes the entire liability, he has not stated any specific contention regarding the
8 disallowance of the claimed sales tax included deduction, nor has he provided records or any evidence
9 that he had posted a sign on his premises or otherwise notified his customers that sales tax was
10 included in the selling prices. Accordingly, we find no adjustment is warranted.

11 **Issue 4:** Whether the Department has established fraud by clear and convincing evidence. We
12 find the Department has met its burden of proof.¹

13 The Department imposed the fraud penalty because it concluded that petitioner intentionally
14 understated the reported amounts of taxable sales. Petitioner disputes the penalty on the basis that the
15 Department has not met its burden of proving fraud by clear and convincing evidence.

16 Petitioner consistently reported total sales that averaged only \$15 per day, which is
17 unrealistically low, and his average annual amount of sales reported of \$3,950 is less than 10 percent
18 of the \$42,133 average annual cost of goods sold reported on his federal tax returns. Overall, the
19 understatement of reported taxable measure of \$366,191 represents an understatement of more than
20 2,000 percent when compared to reported taxable sales of \$18,133. Petitioner provided no records to
21 support his reported sales. We find that the complete absence of records and the consistent, substantial
22 understatement of reported taxable sales, which cannot be explained satisfactorily as due to negligence
23 or honest mistake, are clear and convincing evidence of fraud.

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27 ¹ Without regard to whether the finding of fraud is upheld, the Notice of Determination was timely issued for the period
28 July 1, 2005, through June 30, 2008, under the 3-year statute of limitations. (Rev. and Tax. Code § 6487, subd. (a).)
Absent a finding of fraud, the determination would not have been timely for the period July 1, 2003, through June 30, 2005.

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28**MARKUP TABLE**

Percentage of taxable vs. nontaxable purchases	Unknown*
Mark-up percentage estimated	150%
Self-consumption allowed in dollars	\$3,369 for the years 2004, 2005, 2006, and 2007
Self-consumption allowed as a percent of taxable purchases	2%
Pilferage allowed in dollars	\$1,652 for the years 2004, 2005, 2006, and 2007
Pilferage allowed as a percent of taxable purchases	1%

* In this examination, the Department computed total sales on a markup basis and then estimated the exempt sales of food at 25 percent of total sales.