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: GURENDERJEET SINGH SANDHU, dba Manteca Liquor and Food Petitioner	Account Number SR KH 97-957312 Case ID 515741 Manteca, San Joaquin County

Type of Business: Service station with mini-mart

Audit period: 07/01/05 – 12/31/08

Item	Disputed Amount
Unreported taxable sales of fuel	$351,766
Unreported taxable mini-mart sales	$849,535
Negligence penalty	$ 9,601

	Tax	Penalty
As determined	$158,601.01	$15,860.16
Post-D&R adjustment	- 62,589.47	- 6,259.01
Proposed redetermination, protested	$ 96,011.54	$ 9,601.15

Proposed tax redetermination	$ 96,011.54
Interest through 01/31/14	47,510.87
Negligence penalty	9,601.15
Total tax, interest, and penalty	$153,123.56
Payments	- 1,352.03
Balance Due	$151,771.53
Monthly interest beginning 02/01/14	$ 473.30

This matter was scheduled for Board hearing in November 2012, but it was deferred for settlement consideration. It was rescheduled for Board hearing in November 2013, but was postponed at petitioner's request due to a scheduling conflict.

UNRESOLVED ISSUES

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

Petitioner has operated a service station with a mini-mart since December 2001. To prepare his sales and use tax returns, petitioner used his monthly sales summaries, which were based on sales recorded on the cash register. For audit, petitioner provided federal income tax returns, sales and use tax returns, monthly sales summaries, monthly worksheets showing purchases and expenses, and purchase invoices.

The Sales and Use Tax Department (Department) found several discrepancies in petitioner's records, and it concluded that additional investigation was necessary. To establish audited sales of gasoline and diesel, the Department used the number of gallons of fuel purchased and adjusted statewide average retail selling prices. Originally, to establish the differentials between petitioner's selling prices and the statewide average prices for gasoline and diesel, the Department relied on a comparison of petitioner's selling prices, observed by the Department on April 7, 2008, and statewide average prices reported by the U. S. Department of Energy for that week. The Department found that petitioner's selling prices for gasoline were equivalent to the statewide average selling prices, and his selling prices for diesel were 4.0 cents per gallon higher than the statewide average prices. Petitioner protested the audited selling prices for gasoline.

After the appeals conference, based on information it obtained for the period October 1, 2007, through December 31, 2008, from Oil Price Information Service (OPIS), the Department computed that petitioner's selling prices averaged 9.95 cents less than the statewide prices.[1] Rather than using this computation in its audit calculations, however, the Department instead relied on additional documentation petitioner provided, consisting of cash register z-tapes for 22 days, all either a Monday or a Tuesday, from the period July 6, 2009, through September 14, 2010, which reflected that petitioner's selling prices were 14.24 cents per gallon lower than the statewide average prices. Based on this figure and on revised percentages of sales of each grade of gasoline, the Department recommended a reduction in the audited understatement of reported sales of fuel from $792,129 to $335,613.

We have significant concerns regarding the reliability of the information the Department has used to compute its recommended reduction because the 22 days were during a period from six to 21

[1] The website for OPIS states that OPIS captures station-specific retail gasoline and diesel prices for up to 120,000 service stations throughout the United States and claims that OPIS is able to provide the most comprehensive and accurate pump prices in the industry.

months after the end of the audit period, and the days, all Mondays or Tuesdays, were broadly scattered throughout that period. The reliability of fragmentary documentation of this type is questionable because there is no control to ensure that the documentation has not been selected based on the days with selling prices most favorable to the taxpayer. Had, instead, petitioner provided all of his records for a specific period, from which the Department had chosen a sample of cash register tapes to review, the computations based on that sample would have produced a more reliable result. Nevertheless, despite our concerns, we accepted the Department's recommended reduction except for its exclusion of its April 7, 2008 observation that petitioner's selling price for gasoline was identical to the statewide average price. Accordingly, with the findings for April 7, 2008 incorporated into the Department's computations, we recommend that the understatement of reported taxable sales of fuel be established at $351,762. We find that there is certainly no basis for any further reduction.

In addition to disputing the audited selling prices, petitioner contended that adjustments were warranted for bad debts. Since petitioner did not claim bad debts on his federal tax returns or provide documentation to support an adjustment for bad debts, we find no adjustment is warranted.

Issue 2: Whether adjustments are warranted to the unreported taxable sales of mini-mart merchandise. We find no further adjustment is warranted.

The Department established audited taxable mini-mart sales on a markup basis. To establish the audited cost of taxable merchandise sold, the Department used recorded mini-mart purchases and a taxable-to-total purchase ratio of 89.67 percent (based on a purchase segregation test), and allowed an adjustment of 1 percent for pilferage. The Department originally computed a weighted average markup of 24.75 percent based on a shelf test. Based on additional documentation provided by petitioner after the appeals conference, the Department recommended a reduction of the taxable-to-total purchase ratio from 89.67 percent to 89.19 percent and a reduction of the audited markup from 24.75 percent to 20.76 percent. The Department also made an adjustment for sales of otherwise taxable merchandise purchased with food stamps. As a result of the post-conference adjustments, the amount of unreported taxable mini-mart sales has been reduced from $1,186,658 to $849,535. Petitioner has not provided evidence to support further adjustments.

Issue 3: Whether petitioner was negligent. We conclude that he was.

The Department imposed the negligence penalty because the summary records petitioner maintained showed costs in excess of sales with respect to fuel sales for 2007 and with respect to taxable mini-mart sales for 2006 and 2007. The Department concluded that a prudent businessperson would notice those aberrations and take steps to correct them. Also, the Department noted that there were numerous discrepancies in petitioner's records, and the understatement is substantial. Petitioner disputes the penalty on the basis that the understatement was due to his inexperience in keeping records, rather than negligence.

Petitioner failed to maintain reliable records, and he was unable to explain several significant discrepancies in the records. Also, he failed to notice that recorded purchases exceeded costs. After the adjustments recommended in the D&R, the understatement of reported taxable sales is $1,201,301, which is a substantial amount, representing an understatement of 12.27 percent in comparison to reported taxable sales of $9,787,477. We find that the discrepancies in the records and the substantial understatement are evidence of negligence, and we find that any businessperson, even one with limited experience, should have promptly recognized that recorded costs exceeded recorded sales. Accordingly, we find that the negligence penalty was properly applied, even though petitioner had not been audited previously.

OTHER MATTERS

None.

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

MARKUP TABLE
MINI-MART

Percentage of taxable vs. nontaxable purchases	89.19%
Mark-up percentages developed	20.76% taxable MU%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	$7,273 for 2006, $7,721 for 2007
Pilferage allowed as a percent of taxable purchases	1%

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