

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 SANTONA ENTERPRISES, INC.,) Account Number: SR EH 100-657452
 dba J & J Market Liquor) Case ID 513819
 6 Petitioner) Redlands, San Bernardino County

7
8 Type of Business: Liquor store

9 Audit period: 11/1/05 – 9/30/08

10 Item Disputed Amount

11 Understated taxable sales \$472,119

12 Relief of interest \$ 7,752

13 As determined: \$44,206.21

14 Adjustment - Appeals Division - 645.52

15 Proposed redetermination \$43,560.69

16 Less concurred (diff. b/w reported and recorded) - 6,971.44

17 Balance, protested \$36,589.25

18 Proposed tax redetermination \$43,560.69

19 Interest through 3/31/09 8,431.12

20 Total tax and interest \$51,991.81

21 Payments -45,000.00

22 Balance due \$ 6,991.8123 **UNRESOLVED ISSUES**

24 **Issue 1:** Whether additional adjustments are warranted to the audited understatement of taxable
 25 sales. We conclude no further adjustments are warranted.

26 Petitioner operated one store for the entire audit period and a second store during 18 months of
 27 the audit period. Petitioner reported total sales of \$1,613,921, claimed deductions of \$1,184,650 for
 28 nontaxable food sales, and reported taxable sales of \$429,371 for the audit period. Upon audit, the
 Sales and Use Tax Department (Department) noted that petitioner did not record monthly merchandise
 purchases in its books and records. The Department scheduled purchase invoices provided by
 petitioner for December 2008 and January 2009, and later for 2006 and 2007, and computed a taxable
 merchandise purchase ratio of 80.73 percent. It applied that percentage to the total merchandise

1 purchases recorded on the 2006 and 2007 federal income tax returns to compute the cost of taxable
2 merchandise purchases for those years, and, comparing those purchases to recorded taxable
3 merchandise sales, computed negative book markups.

4 Since the negative book markups indicate that recorded taxable sales were understated, the
5 Department established taxable sales using the markup method. It adjusted purchases of taxable
6 merchandise for inventory fluctuations and for 1 percent pilferage to compute the cost of taxable goods
7 sold. A shelf test based on purchase invoices from December 2008 and January 2009 and posted
8 selling prices on February 3, 2009 (or prices petitioner provided orally where the prices were not
9 posted), resulted in a weighted taxable markup of 40.18 percent. The Department applied that markup
10 to the audited cost of taxable merchandise sold to establish audited taxable sales, compared those
11 amounts to recorded taxable sales, and computed understated taxable sales representing error rates of
12 157.93 percent for 2006 and 72.84 percent for 2007. It applied the 72.84 percent error rate to recorded
13 taxable sales for the period January 1 to September 30, 2008, to establish the taxable sales
14 understatement for that period. In sum, the Department computed the taxable sales understatement to
15 be \$501,871. The Department later concluded (after the appeals conference) that petitioner was
16 entitled to an adjustment for self-consumption of three percent, with the reduction to taxable sales
17 partially offset by the tax on the self-consumption: understated taxable sales were reduced by \$29,752
18 to \$472,119, and tax measured by \$21,423 was established for self-consumption, for a net reduction in
19 taxable measure of \$8,329.

20 On appeal, petitioner contends that: (1) the merchandise purchases recorded on its federal
21 returns are overstated because they include purchases of non-merchandise items such as lottery tickets;
22 (2) the audited taxable merchandise purchase ratio of 80.73 percent is overstated; and (3) the audited
23 weighted taxable markup of 40.18 percent is too high because the 35.21 percent markup computed by
24 the Department for beer is too high and should be approximately 15 percent.

25 The Department established the audited amounts based on petitioner's own records. Given that
26 petitioner did not record monthly merchandise purchases in its books and records, we find that the cost
27 of goods sold based on the federal returns represents the most accurate recording of petitioner's
28 purchases. Petitioner has provided no documentation to show that those reported amounts included

1 non-merchandise purchases or were otherwise overstated. We note that the 80.73-percent audited
2 taxable merchandise purchase ratio is based on purchase invoices for 26 months. While the purchase
3 invoices provided for 2006 and 2007 total substantially less than the purchases petitioner reported on
4 its federal returns for those years, the Department computed the audited taxable merchandise purchase
5 ratio using the only documentation provided by petitioner. With respect to the markup, petitioner has
6 provided no evidence to show that the 35.21-percent audited markup on beer products should be
7 reduced to 15 percent. We conclude that petitioner has not provided the required documentation to
8 support adjustments to the audited amounts. Accordingly, we recommend no further adjustments.

9 **Issue 2:** Whether petitioner is entitled to relief from some or all of the interest that has accrued
10 on the audit. We conclude that relief from interest is not warranted.

11 Interest may be relieved where failure to pay tax is due in whole or part to an unreasonable
12 error or delay by an employee of the Board acting in his or her official capacity, but only if no
13 significant aspect of the error or delay is attributable to an act, or failure to act, by taxpayer. (Rev. &
14 Tax. Code § 6593.5 subs. (a)(1), (b).) Petitioner contends that the Department took too long to
15 complete the audit. The Audit Assignment Contact History report shows that the Department
16 commenced the audit on November 14, 2008; that the Department made additional requests for records
17 on December 19, 2008, and January 23, 2009; and that the Department provided petitioner with a copy
18 of the audit work papers on February 26, 2009. We do not consider the period of time for the
19 Department to complete the audit and provide petitioner with the audit results (about three and one-
20 half months) to be in any way unreasonable. We note further that it took petitioner two months to
21 provide the purchase invoices that the Department had requested. We find that there is no basis for
22 relief of interest.

23 **OTHER DEVELOPMENTS**

24 None.

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26 Summary prepared by Pete Lee, Business Taxes Specialist II
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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	80.73% taxable 19.24% non-taxable
Mark-up percentages developed	40.18%
Self-consumption allowed in dollars	\$9,536 (2006) \$7,778 (2007)
Self-consumption allowed as a percent of total purchases	3% of taxable COGS
Pilferage allowed in dollars	\$3,083 (2006) \$2,515 (2007)
Pilferage allowed as a percent of total purchases	1% of taxable COGS