

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 JASVIR SINGH SHAHI, dba JK Market) Account Number: SR Y CH 97-543799
 Case ID 303529
 6 Petitioner) Brentwood, Contra Costa County

7 Type of Business: Liquor store and gas station with mini-mart

8 Audit period: 4/1/01 – 12/31/03

9 Item Disputed Amount

10 Disallowed claimed exempt food sales \$1,304,159

11 Unreported cigarette rebates \$ 59,032

12 Negligence penalty \$ 10,582

13 Tax

14 Tax as determined and protested \$105,824.73¹

15 Interest through 5/31/12 83,887.28

16 Negligence penalty 10,582.48

17 Total tax, interest, and penalty \$200,294.49

18 Payments - 4,739.73

19 Balance Due \$195,554.76

20 Monthly interest beginning 6/1/12 \$589.66

21 This matter was previously scheduled for Board hearing on November 16, 2011, but was
 22 postponed at petitioner's request due to a scheduling conflict. It was rescheduled for Board hearing on
 23 January 11, 2012, but was again postponed at petitioner's request to pursue a settlement.

24 **UNRESOLVED ISSUES**

25 **Issue 1:** Whether any adjustments are warranted to the disallowed claimed exempt food sales.

26 We conclude no adjustments are warranted.

27 Petitioner operated a liquor store in Brentwood and a gas station with mini-mart in Byron.

28 During the audit period petitioner reported 40.33 percent of his grocery sales as taxable and the
 remainder as nontaxable or exempt, which the Sales and Use Tax Department (Department) regarded

¹ The determined tax is net of a concurred credit of \$5,565.55. Accordingly, petitioner actually protests tax of \$111,390.28. Petitioner has filed a claim for refund with respect to the concurred credit.

1 as unreasonable for these types of businesses, and his audited taxable grocery purchases significantly
2 exceeded his recorded taxable grocery sales in 2002.² Based on these discrepancies, the Department
3 decided to establish petitioner's taxable grocery sales by markup. The Department performed a
4 purchase segregation test which indicated that 81.55 percent of petitioner's non-fuel purchases were of
5 taxable merchandise. The Department applied this ratio for the test year of 2002 to compute a 75.67
6 percent understatement in reported taxable grocery sales for 2002 (i.e., excess claimed exempt sales),
7 which it applied to compute disallowed claimed exempt food sales of \$1,304,159 for the audit period.

8 Petitioner's only dispute with the Department's audit method is the use of a taxable purchase
9 ratio of 81.55 percent. Petitioner contends that the taxable purchase ratio should be closer to 50
10 percent. Petitioner also contends that his employees made errors by ringing up taxable sales as
11 nontaxable sales and not collecting tax reimbursement. Petitioner's ringing error contention appears to
12 be that he should not be held liable for the tax that is actually due because he did not collect sales tax
13 reimbursement from his customers.

14 The taxable purchase ratio was established from tests on petitioner's own records, and
15 petitioner has not identified any errors in the Department's computations, nor have we found any. Nor
16 has petitioner provided any documentation or his own calculations to support a lower taxable ratio.
17 Thus, we find no basis for adjustment to the taxable purchase ratio. Regarding petitioner's possible
18 failure to collect sales tax reimbursement on some taxable sales, while petitioner was entitled to collect
19 tax reimbursement from his customers, such collection is not required for sales tax to apply. The sales
20 tax is imposed directly on petitioner as the retailer without regard to whether he collected tax
21 reimbursement from his customers. Thus, this contention provides no basis for adjustment.

22 **Issue 2:** Whether rebates petitioner received from cigarette manufacturers constitute taxable
23 gross receipts. We conclude that such rebates constitute taxable gross receipts.

24 During the audit period petitioner received rebates for participating in promotional programs
25 offered by cigarette manufacturers, but did not include them in his gross receipts. The Department
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27 ² Due to a calculation error, the audit report reflects that petitioner reported 24.14 percent of grocery sales as taxable. This
28 error had no effect on the audit method since the Department would have regarded the actual reported taxable percentage of
40.33 percent as much too low for this type of business.

1 computed that petitioner received \$59,032 in taxable rebates for the audit period. Petitioner does not
2 dispute the amount, but argues that the programs he participated in were not rebate programs. He
3 asserts that the payments he received were buy-downs paid by the cigarette manufacturers to
4 compensate him for reducing the retail price of cigarettes. These are the very facts that establish the
5 rebates were taxable. Since petitioner received payments from cigarette manufacturers as
6 compensation for reducing his retail sale prices of cigarettes, the rebates were part of his taxable gross
7 receipts from those retail sales of cigarettes.³

8 **Issue 3:** Whether petitioner was negligent. We conclude he was.

9 The Department imposed the negligence penalty because the taxable merchandise sales
10 understatement was 75.67 percent, and because the Department believes a reasonably prudent business
11 person would have noticed such a large portion of taxable sales erroneously recorded as exempt sales
12 of food. Petitioner contends that his employees were from India, did not understand the correct tax
13 rate to use, and made errors that caused taxable sales to be rung up as nontaxable. He states that he did
14 not attempt to conceal any of his sales, and assumed the cash register z-tapes from which he reported
15 his sales onto the tax returns were relatively accurate. Finally, he argues that he did not profit from the
16 errors because he did not collect tax reimbursement from his customers on those sales.

17 Although this was petitioner's first audit, we find sufficient evidence of negligence to sustain
18 the penalty. Mr. Shari is an experienced business person who has gross receipts of over \$1 million per
19 month from the two locations, and the 75.67 percent taxable merchandise sales understatement is
20 strong evidence of negligence. Petitioner's own records indicate that taxable merchandise purchases
21 were over 80 percent of his total merchandise purchases, about twice the percentage of sales that
22 petitioner reported as taxable. We believe that petitioner should have realized something was amiss
23 and taken the necessary steps to correct the error, and was negligent by not doing so.

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27 ³ California Code of Regulations, title 18, section 1671.1 explains the application of tax to the type of cigarette rebates at
28 issue here, for periods commencing October 1, 2007. Since this operative date is after the audit period here, we have not
applied this regulation in our analysis, but the result would be the same if the regulation were applicable here.

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OTHER MATTERS

A portion of the determination falls within the period covered by the amnesty program but amnesty penalties will not apply because petitioner applied for amnesty and entered into an installment payment plan.

Summary prepared by Pete Lee, Business Taxes Specialist II

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	81.55% taxable 18.45% nontaxable
Mark-up percentages developed	28.12%
Self-consumption and pilferage allowed in dollars	\$18,882 for test year of 2002
Self-consumption and pilferage allowed as a percent of taxable purchases	2%

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