

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

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

Audit period: 4/1/01 – 12/31/03

<u>Item</u>	<u>Disputed Amount</u>
Disallowed claimed exempt food sales	\$1,304,159
Unreported cigarette rebates	\$ 59,032
Negligence penalty	\$ 10,582

	<u>Tax</u>
Tax as determined and protested	\$105,824.73 ¹
Interest through 11/30/11	80,433.55
Negligence penalty	<u>10,582.48</u>
Total tax, interest, and penalty	\$196,841.56
Payments	<u>- 4,739.73</u>
Balance Due	<u>\$192,101.83</u>
Monthly interest beginning 12/1/11	<u>\$505.43</u>

UNRESOLVED ISSUES

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

We conclude no adjustments are warranted.

Petitioner operated a liquor store in Brentwood and a gas station with mini-mart in Byron. During the audit period petitioner reported his grocery sales as 24 percent taxable and 76 percent nontaxable or exempt, which the Sales and Use Tax Department (Department) regarded as unreasonable for these types of businesses, and his audited taxable grocery purchases significantly exceeded his recorded taxable grocery sales in 2002. Based on these discrepancies, the Department decided to establish petitioner's taxable grocery sales by markup. The Department performed a

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 purchase segregation test which indicated that 81.55 percent of petitioner's non-fuel purchases were of
2 taxable merchandise. The Department applied this ratio for the test year of 2002 to compute a 75.67
3 percent understatement in reported taxable grocery sales for 2002 (i.e., excess claimed exempt sales),
4 which it applied to compute disallowed claimed exempt food sales of \$1,304,159 for the audit period.

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

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

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

21 During the audit period petitioner received rebates for participating in promotional programs
22 offered by cigarette manufacturers, but did not include them in his gross receipts. The Department
23 computed that petitioner received \$59,032 in taxable rebates for the audit period. Petitioner does not
24 dispute the amount, but argues that the programs he participated in were not rebate programs. He
25 asserts that the payments he received were buy-downs paid by the cigarette manufacturers to
26 compensate him for reducing the retail price of cigarettes.

27 Payments made by a third party towards particular retail sales constitute taxable gross receipts.
28 The rebate programs here involve three-party transactions – that is, the rebates were paid by a cigarette

1 manufacturer, not by petitioner's own cigarette vendors, and were based on a specific reduction in the
2 retail selling price of the cigarettes. Petitioner has not provided any rebate agreements to show that the
3 rebates he received are not subject to tax. We find that the rebates constitute taxable gross receipts.²

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

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

13 Although this was petitioner's first audit, we find sufficient evidence of negligence to sustain
14 the penalty. Mr. Shari is an experienced business person who has gross receipts of over \$1 million per
15 month from the two locations, and the 75.67 percent taxable merchandise sales understatement is
16 strong evidence of negligence. Petitioner's own records indicate that taxable merchandise purchases
17 were over 80 percent of his total merchandise purchases, yet petitioner reported barely 25 percent of
18 his merchandise sales as taxable. We believe that petitioner should have realized something was amiss
19 and taken the necessary steps to correct the error, and was negligent by not doing so.

20 **OTHER MATTERS**

21 A portion of the determination falls within the period covered by the amnesty program, but
22 amnesty penalties will not apply because petitioner submitted an application to participate in amnesty
23 and an installment payment plan was approved.

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25 Summary prepared by Pete Lee, Business Taxes Specialist II

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27 ² California Code of Regulations, title 18, section 1671.1 explains the application of tax to cigarette rebates of the type at
28 issue here. Although we would reach the same conclusion if this regulation were applicable (that is, that the rebates at issue
here were taxable), we have not applied this regulation in our analysis because the periods at issue here predate the October
1, 2007 operative date of the regulation.

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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%