

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Administrative Protest)
Under the Sales and Use Tax Law of:)
HARJAP SINGH, dba Super Stop) Account Number: SR CH 100-280367
Taxpayer) Case ID 467932
Rodeo, Contra Costa County

Type of Business: Gasoline station with mini-market

Audit period: 04/01/04 – 03/31/07

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Unreported sales	\$998,929		
Disallowed claimed sales tax prepayments	\$ 3,610		
Negligence penalty	\$ 8,689		
Finality penalty	\$ 8,543		
As determined:	\$114,691.69	\$11,469.20	
Finality penalty			11,323.07
Adjustment - Sales and Use Tax Department	- 27,805.12	- 5,561.05	
Adjusted liability	\$ 86,886.57	\$17,231.22	
Less concurred	- 864.84	00.00	
Balance, protested ¹	<u>\$ 86,021.73</u>	<u>\$17,231.22</u>	
Adjusted tax	\$ 86,886.57		
Interest	27,689.03		
Negligence penalty	8,688.66		
Finality penalty	<u>8,542.56</u>		
Total tax, interest, and penalty	\$131,806.82		
Payments	<u>-131,806.82</u>		
Balance Due	<u>\$ 00.00</u>		

¹ Taxpayer did not file a timely petition for redetermination, but filed a late appeal by letter dated October 21, 2008. The Sales and Use Tax Department acknowledged this late appeal as an administrative protest by letter dated November 3, 2008, in which the Department informed taxpayer that, even if the administrative protest resulted in a reduction of the tax due, no refund could be made of any overpayment for which a timely claim for refund was not filed (that is, within six months from the date of such overpayment or within six months from the date the determination became final, whichever period expired later). Although taxpayer has paid the entire liability, he has not filed any claims for refund, and the statute of limitations for doing so has now passed for all payments. Thus, even if this appeal results in a reduction to the tax that was due, no refund can be made.

1 A Notice of Appeals Conference was mailed to taxpayer's address of record, with a copy to his
2 representative. Although neither notice was returned by the Post Office, we received no response to
3 either notice, and no one appeared at the conference on behalf of taxpayer. After the conference, we
4 sent taxpayer a letter offering him the opportunity to provide any additional arguments and evidence in
5 writing he wished us to consider, but he did not respond.

6 UNRESOLVED ISSUES

7 **Issue 1:** Whether adjustments are warranted to the audited amount of unreported sales. We
8 recommend no adjustment.

9 Taxpayer operates a gasoline station with a mini-mart. During the audit period, taxpayer
10 posted daily sales amounts from his cash register Z-tapes to a sales journal, which he used to prepare
11 sales and use tax returns. The Sales and Use Tax Department (Department) found that the amounts
12 reported on sales and use tax returns substantially reconciled with the amounts reported on income tax
13 returns. However, the Department examined cash register Z-tapes for the second quarter 2005 (2Q05)
14 and found that recorded taxable sales exceeded reported amounts. The Department decided to
15 establish audited taxable mini-mart sales on a markup basis and to establish audited sales of gasoline
16 using the number of gallons of gasoline purchased and the average retail price of gasoline, using 2Q06
17 as a test period. For taxable mini-mart sales, the Department used costs from purchase invoices and
18 selling prices provided by taxpayer to compute markups for the various merchandise categories. It
19 used the percentages of purchases in each category, computed in a purchase segregation test, to
20 calculate a weighted average markup of 27.90 percent, which it reduced to 22.39 in the reaudit after
21 adjusting certain selling prices to reflect corrected selling prices provided by taxpayer. The
22 Department used that markup and the recorded purchases of taxable mini-mart merchandise to
23 compute audited taxable mini-mart sales of \$123,204 for 2Q06.

24 For gasoline sales, the Department computed the number of gallons sold by dividing the
25 amount of prepaid sales tax claimed by taxpayer for 2Q06 by the prepaid sales tax rate of 14.5 cents
26 per gallon. To establish the average selling price per gallon, the Department used the statewide
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1 average retail price published on the U. S. Department of Energy website, reduced by 1.76 percent.²
2 The Department computed audited taxable sales of gasoline of \$286,669 for 2Q06, resulting in audited
3 total taxable sales for the quarter of \$409,873. Comparing that amount to reported taxable sales of
4 \$307,555 for 2Q06, the Department computed an understatement of 33.27 percent. Based on its
5 review of taxpayer's reporting history, the Department concluded that reported taxable sales for 2Q04,
6 4Q06, and 1Q07 were more accurate than the amounts reported for the remainder of the audit period.
7 Accordingly, the Department applied the 33.27 percent to reported taxable sales for 3Q04 through
8 3Q06, used audited taxable sales for that period to compute average audited taxable sales per quarter of
9 \$389,848, and used that average as audited taxable sales per quarter for 2Q04, 4Q06, and 1Q07. The
10 Department compared audited and reported taxable sales to compute the understatement of \$998,929.

11 Taxpayer contends that the audited understatement of reported sales should be reduced. We
12 note that the Department's reaudit has addressed the issues raised in the meeting the Department held
13 with taxpayer after the original audit. Since taxpayer did not attend the appeals conference or respond
14 to our post-conference letter, we are not certain of taxpayer's remaining contentions. Therefore, our
15 analysis of the audit is limited to the issues we discern from our review of the audit and reaudit. In that
16 review, we noted various errors, some of which resulted in an overstatement of the amount of
17 unreported sales and some of which resulted in an understatement.³ In addition, we find that the
18 audited markup of 22.39 percent is exceptionally low for this type of business, and we conclude that
19 the audited markup is not reliable because it was based on selling prices provided by taxpayer, which
20 the Department did not verify by comparing with actual shelf prices. We are particularly concerned by
21 the audited markup for soda of 30.72 percent, which was based in part on taxpayer's claim that he
22 always sold 12-ounce cans of soda in packs of six or 12 cans, and never sold them individually. This
23 markup appears exceedingly low, given our experience that mini-marts such as those here do indeed
24 sell many sodas individually, with a markup for those individual sales higher than 31 percent. Further,
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26 ² The 1.76 percent reduction was computed based on a comparison of taxpayer's actual selling price on April 7, 2008, with
27 the average statewide selling price on the same date.

28 ³ The amount of unreported sales is overstated because the Department should have made an allowance for pilferage, and
the average amount of taxable mini-mart sales used for 2Q04, 4Q06, and 1Q07 was slightly overstated. The amount is
understated because of an error in the calculation of sales tax reimbursement in the selling price of gasoline.

1 taxpayer's sales of fountain drinks were not included in the markup analysis, and, in our experience
2 reviewing audits, we find markups on fountain drinks well over 100 percent, often ranging up to 300
3 percent. Accordingly, in addition to the specific errors noted, we find that the audited markup should
4 have been a minimum of 25 percent. If the identified errors were corrected and the audited markup
5 were increased to 25 percent, the adjustments would result in a net increase to the audited
6 understatement, which the Department has not asserted (and the statute of limitations for doing so is
7 not passed). Accordingly, we recommend no adjustment.

8 **Issue 2:** Whether adjustments are warranted to the disallowed amount of claimed sales tax
9 prepayments to fuel vendors. We recommend no further adjustment.

10 The Department compared the credits taxpayer claimed on returns for sales tax prepayments to
11 fuel vendors with the amounts reported by the vendors and found discrepancies in 2Q05, 1Q06, and
12 3Q06, which totaled \$7,567. It reduced the amount of difference to \$3,610 in the reaudit, based on
13 corrected information provided by the vendors. In the absence of evidence of other errors in the
14 amount, we recommend no further adjustment.

15 **Issue 3:** Whether taxpayer was negligent. We conclude that he was.

16 The Department imposed the negligence penalty because taxpayer failed to maintain adequate
17 records for sales and use tax purposes and because the percentage of understatement of 27.5 percent
18 was significant. Taxpayer has not specifically disputed the negligence penalty.

19 Taxpayer provided some source documents for certain portions of the audit period, but he
20 failed to maintain these source documents for the entire audit period. We find the absence of records
21 to be evidence of a lack of due care in recordkeeping, particularly since taxpayer was an experienced
22 businessperson, and another business he operated (a liquor store) had been audited previously. Also,
23 for 2Q05, the only quarter for which taxpayer provided cash register Z-tapes, recorded taxable sales of
24 \$405,979 exceeded reported amounts of \$325,061 by about 25 percent. Taxpayer's failure to report
25 taxable sales shown in his records is clear evidence of a lack of due care in reporting. Therefore, we
26 conclude that the understatement was the result of negligence, and the penalty was properly applied.

27 **Issue 4.** Whether relief of the finality penalty is warranted. We find that relief is not warranted.
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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	85.24%
Mark-up percentages developed	22.39%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None