

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 SUNBURST MAINTENANCE CO., INC.,) Account Number: SR AP 16-660624
 dba Pacific Sanitary Supply) Case ID 421808
 6 Petitioner) San Gabriel, Los Angeles County

7 _____
 8 Type of Business: Retailer of janitorial supplies

9 Audit period: 04/01/03 – 03/31/06

10 Item Disputed Amount

11 Unreported sales \$1,208,534
 12 Negligence penalty \$ 10,115

	<u>Tax</u>	<u>Penalty</u>
13 As determined	\$124,199.37	\$12,419.91
14 Adjustment - Appeals Division	- 23,044.37	- 2,304.44
14 Proposed redetermination	\$101,155.00	\$10,115.47
15 Less concurred	- 1,450.85	00.00
15 Balance, protested	<u>\$ 99,704.15</u>	<u>\$10,155.47</u>
16 Proposed tax redetermination	\$101,155.00	
17 Interest through 02/29/12	61,834.40	
17 Negligence penalty	<u>10,115.47</u>	
18 Total tax, interest, and penalty	<u>\$173,104.87</u>	

19 Monthly interest beginning

20 This matter was scheduled for Board hearing in October 2011, but was postponed at
 21 petitioner's request because of a scheduling conflict.

22 **UNRESOLVED ISSUES**

23 **Issue 1:** Whether adjustments are warranted to the amount of unreported sales. We find no
 24 further adjustment is warranted.

25 Petitioner has sold janitorial and cleaning supplies since 1977. For audit, petitioner provided
 26 federal income tax returns, profit and loss statements, a summary of its sales by customer, bank
 27 statements, copies of sales invoices, and purchase invoices. The Sales and use Tax Department
 28 (Department) found that petitioner's reported total sales were less than the sales recorded on its

1 summary of sales by customer, the amounts of gross receipts reported on federal tax returns, and the
2 amounts deposited in its bank account. The Department also computed book markups of 8.97 percent
3 and 10.22 percent for 2004 and 2005, respectively, which it considered low for the industry, and it
4 decided to establish total sales on a markup basis.

5 To establish the audited markup, the Department conducted a shelf test, from which it
6 computed an average markup of 43.77 percent. That markup has since been reduced to 36.06 percent,
7 after petitioner provided two shelf tests (one before and one after the appeals conference), which the
8 Department combined with its test. To establish the audited cost of goods sold, the Department used
9 information from vendors regarding the amounts sold to petitioner, as well as a review of petitioner's
10 cancelled checks and credit card statements. The Department found that petitioner's recorded
11 purchases from the vendors who provided data were understated by 5.73 percent, and it applied that
12 percentage of understatement to the amounts of recorded purchases from vendors who did not provide
13 data to compute additional unrecorded purchases of \$48,570. The Department then made an
14 adjustment of 1 percent for pilferage. The D&R recommended that audited purchases be reduced by
15 \$36,456, based on the Department's review of additional documentation provided by petitioner after
16 the conference, and by the additional unrecorded purchases of \$48,570. Petitioner contends that the
17 amount of audited taxable sales remains overstated because the audited amount of purchases and the
18 audited average markup are excessive.

19 We find that petitioner has not documented any further reductions to the audited amount of
20 purchases. With respect to the markup, petitioner computed a markup of 35.09 percent in its most
21 recent shelf test, which was combined with petitioner's previously provided shelf test and the
22 Department's to compute the markup of 36.06 percent used in the reaudit. We find petitioner has not
23 provided evidence to support further reduction.

24 **Issue 2:** Whether petitioner was negligent. We find that it was.

25 The Department imposed the negligence penalty because it found petitioner's records were
26 incomplete, inaccurate, and conflicting, and the understatement was significant. Petitioner disputes the
27 penalty on the basis that the audited understatement is excessive.

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100% taxable
Mark-up percentage developed	36.06%
Self-consumption allowed in dollars	None*
Pilferage allowed in dollars	\$28,322 for the period 4/1/03-12/31/05
Pilferage allowed as a percent of taxable purchases	1%

* No adjustment was made for the cost of self-consumed merchandise because petitioner stated that it used little or none of the merchandise in inventory.