

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for)
 4 Redetermination and Claim for Refund)
 4 Under the Sales and Use Tax Law of:) Account Number SR EH 100-572184
 5) Case ID's 571356, 571408
 6 STEPHEN ANTHONY FERNANDO and)
 6 VIVINA BRIDGET FERNANDO,)
 7 dba City Liquor and Market)
 8 Petitioner/Claimant) Fontana, Riverside County

9 Type of Business: Liquor store

10 Audit period: 04/01/08 – 10/18/10

11 Claim period: 05/10/05 – 10/18/10

	<u>Disputed Amount</u>	
<u>Item</u>	(04/01/08-10/18/10)	(07/01/05-03/31/08) ¹
12 Unreported taxable sales	\$97,158	\$218,262
13 Unreported cost of self-consumed taxable merchandise	\$2,798	\$0.00
14 Claim for Refund	\$100,000 (tax)	
15 Tax, as determined	\$13,872.41	\$20,178.87
16 Pre-D&R adjustments	4,948.39	0.00
16 Post-D&R adjustments	- 9,235.87	- 1,927.03
17 Post-Board hearing adjustments	<u>0.00</u>	<u>- 963.33</u>
17 Proposed tax redetermination	\$9,584.93	\$17,288.51
18 Less concurred	<u>- 1,245.00</u>	<u>- 372.93</u>
18 Balance protested	<u>\$8,339.93</u>	<u>\$16,915.58</u>
19 Proposed tax redetermination	\$9,584.93	\$17,288.51
20 Interest through 02/17/11	920.62	6,110.57
20 Finality penalty (prior audit)	<u>0.00</u>	<u>1,728.86</u>
21 Total tax, and interest	\$10,505.55	\$25,127.94
22 Payments	<u>- 14,509.47</u>	<u>- 26,218.41</u>
22 Overpayments	\$-4,003.92	\$- 1,090.47
23 Amount previously refunded	4,203.41	0.00
23 Amount applied to returns	<u>0.00</u>	<u>116.47²</u>
24 Balance	<u>\$ 199.49</u>	<u>\$- 974.00</u>

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 26 ¹ In order to avoid the passing of the statute of limitations for periods before January 1, 2006, the Sales and Use Tax
 27 Department issued two Notices of Determination for the prior audit period, for the periods July 1, 2005, through
 28 December 31, 2005, and January 1, 2006, through March 31, 2008. The petitions for those periods were assigned case ID's
 468671 and 489812, respectively.

² The Department applied \$116.47 of the overpayment to petitioner's returns as follows: \$6.60 to 2Q09, \$36.56 to 3Q09,
 \$16.00 to 4Q09, \$16.04 to 1Q10, \$20.28 to 2Q10, \$12.84 to 3Q10, and \$8.15 to 4Q10.

1 Petitioner operated a liquor store with sales of alcoholic beverages, carbonated beverages,
2 cigarettes, miscellaneous taxable merchandise, food, and lottery from May 10, 2005 through
3 October 18, 2010, when petitioner sold the business. For the current audit, petitioner provided sales
4 and use tax returns, federal income tax returns for 2008 and 2009, merchandise purchase invoices,
5 monthly purchases worksheets, and monthly sales worksheets. The Department found the book
6 markups on taxable sales were inconsistent throughout the audit period ranging from a low of – 8.46
7 percent in 2008 to a high of 171.61 percent in 2010. Moreover, the Department found recorded taxable
8 purchases in 2010 were substantially less than recorded taxable purchases in the other years. As a
9 result, the Department established audited taxable sales using the markup method. Using taxable and
10 non-taxable purchases recorded in petitioner’s purchases worksheets, the Department found that
11 taxable purchases represented 91.24 percent of total purchases. It applied that ratio to cost of goods
12 sold reported on petitioner’s federal income tax returns and reduced that amount by 1 percent for
13 shrinkage and 1 percent for the cost of self-consumed merchandise to establish audited costs of taxable
14 merchandise sold. Because petitioner sold the business before the audit began, and the Department
15 could not conduct a shelf test, the Department used the audited markups for each category of taxable
16 merchandise from petitioner’s prior audit along with the purchase ratios computed using petitioner’s
17 purchases worksheets, to compute the audited weighted average markup of 26.58 percent. Using that
18 markup and the audited costs of taxable merchandise sold, the Department established audited taxable
19 sales for the period January 1, 2008, through October 18, 2010. The Department calculated error ratios
20 for each year, and then used those error ratios to compute unreported taxable sales of \$144,348 for the
21 audit period. Subsequently, the Department discovered total merchandise purchases recorded in
22 petitioner’s worksheets exceeded total merchandise purchases reported on petitioner’s federal income
23 tax returns. In a pre-conference reaudit, the Department established audited taxable sales using
24 purchases from monthly purchases worksheets, which resulted in an increase in unreported taxable
25 sales to \$205,258 for the audit period.

26 Petitioner contends that the Department should not have adjusted merchandise purchases for
27 inventory fluctuations reported on the federal income tax returns because those adjustments resulted in
28 an increase to the amount of unreported taxable sales. Moreover, petitioner argues that in the prior

1 audit, the Department rejected petitioner's inventory fluctuations because petitioner failed to provide
2 documentary evidence to support any inventories, and contends the Department should be consistent in
3 the current audit. Further, petitioner contends the markup is overstated, and that the Department added
4 the markup to audited total purchases instead of taxable merchandise purchases. Additionally,
5 petitioner contends a 25 percent allowance for pilferage should be made. After the appeals conference,
6 the Department recommended increasing the allowance for pilferage to 2 percent. In the absence of
7 any documentary evidence to support petitioner's contentions that the markup is overstated and that a
8 greater allowance for pilferage should be made, we reject these arguments and conclude no further
9 adjustments are warranted. Based on our review of the audit, we find the Department added the
10 markup to audited taxable merchandise purchases, not total purchases, and we conclude no adjustment
11 is warranted for this contention. However, we find the Department had no basis to use the unsupported
12 inventory adjustments reported on petitioner's federal income tax returns, and we recommend using
13 purchases recorded in petitioner's worksheets, further reducing unreported taxable sales to \$97,158 for
14 the audit period, and that adjustment has been made in the post D&R reaudit. We find no further
15 adjustments are warranted to the liability for the period April 1, 2008, through October 18, 2010.

16 For the prior audit, petitioner contends the audited merchandise purchases were overstated.
17 The Department recommended reducing audited taxable merchandise purchases by an additional
18 \$10,000, from \$20,000 to \$30,000 to account for obsolete merchandise. It also recommended that the
19 unsupported inventory fluctuations reported on the federal income tax returns be used to establish the
20 audited cost of goods sold. We concur with the Department's recommendation regarding an
21 adjustment for obsolete merchandise. However, we have rejected the Department's recommendation
22 to further reduce audited taxable merchandise purchases using the unsupported inventory fluctuations
23 reported on the federal income tax returns during the prior audit period. In reaching that conclusion,
24 we primarily rely on Audit Manual section 0407.10, which recommends accepting merchandise
25 purchases as the cost of goods sold when any inventories cannot be checked for accuracy. The
26 Department's audit of period July 1, 2005, through March 31, 2008, was conducted in accordance with
27 the audit manual, and we find there is no basis for revising that audit approach. Moreover, we find
28 that, if the inventories reported on federal returns were used to compute the cost of goods sold in the

1 prior audit, it would be necessary to utilize the same audit approach in the audit of the period April 1,
2 2008, through October 18, 2010 in order to be consistent, which, as discussed previously, would result
3 in an increase to the understatement for that period. Accordingly, we do not recommend any further
4 adjustments to the cost of goods sold for the prior audit period.

5 **Issue 2:** Whether additional reductions to the amount of unreported cost of self-consumed
6 taxable merchandise are warranted. We find no additional adjustments are warranted.

7 For the current audit, the Department reduced the audited cost of taxable goods sold by 1
8 percent to allow for the cost of self-consumed merchandise, and included a separate measure of tax for
9 this amount. As a result of post-D&R reductions to the audited cost of goods sold, the measure of tax
10 for unreported cost of self-consumed taxable merchandise also has been reduced. Petitioner contends
11 that it did not consume any taxable merchandise.³

12 We first note that reduction of the audited cost of taxable merchandise consumed, as petitioner
13 suggests, would increase the audited understatement of reported taxable measure because it would
14 increase the cost of taxable goods sold to which the markup would be added to compute audited
15 taxable sales. Further, we find, based on our experience reviewing audits, that self-consumption of
16 merchandise is a common practice, particularly when the business owners are directly involved in the
17 operation of the business and spend long hours at the store. Moreover, we find the estimate of
18 1 percent reasonable. Thus, we conclude no further adjustments are warranted to the audited cost of
19 self-consumed taxable merchandise.

20 **Issue 3:** Whether petitioner is entitled to a refund. We conclude that petitioner has overpaid
21 the determinations by \$774.51 and has not documented any additional overpayment made on returns.

22 Petitioner filed a claim for refund for \$100,000 representing all sales tax it paid during the
23 period petitioner held a seller's permit. The \$100,000 was petitioner's approximation of the total sales
24 tax petitioner paid with its returns, and the total sales tax collected by the Board and applied to
25 petitioner's audit determinations.

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27 ³ Petitioner also argues that, since the partners spent most of their time at the business the Department's adjustment implies
28 that petitioner illegally consumed alcoholic beverages at the business. There is nothing in the audit workpapers or
comments that establishes such an implication, and we will not address this argument further.

1 The two determinations were paid in full, on February 17, 2011, from the voluntary payment of
2 \$51,000 received through a third-party escrow. We find the claim for refund was timely filed with
3 respect to the payments made against the determinations because it was filed within six months from
4 the date of payments. (Rev. & Tax. Code, § 6902, subd. (a)(1).) With respect to the sales taxes paid
5 with its returns, the claim for refund was timely only with respect to returns filed for the period
6 January 1, 2008, through October 18, 2010.

7 We note that our analysis of the timeliness of the claim has been revised since the D&R was
8 prepared. In preparing this summary, we found the payments applied to the determinations were
9 incorrectly applied effective October 18, 2010, because they were improperly regarded as payments
10 related to a security deposit, which is applied at the date of close out even if the payment is made later.
11 In addition, in the D&R we had considered the payment from escrow to be an involuntary payment,
12 such that the statute of limitations for filing a claim for refund was three years from the date of
13 payment. As a result, we had concluded that the claim for refund was timely for the payment applied
14 October 18, 2010, even though the claim was filed more than six months after that date.

15 Upon further consideration, since the payment of \$51,000.00 was applied to the two
16 determinations from funds acquired through a third-party escrow and was not related to a security
17 deposit, we find the payment should have been applied to each liability on the date the payment was
18 actually made, which was February 17, 2011. (Compliance Policy and Procedures Manual,
19 § 0410.08). Moreover, a payment from escrow is not considered an involuntary payment. As a result,
20 the six-month statute of limitations for filing a claim for refund applies, and the claim was filed within
21 that six-month period.

22 The Department has corrected the effective date of the payments applied to each determination,
23 which resulted in an increase of the interest totaling \$199.49 for the determination covering the period
24 April 1, 2008, through October 18, 2010. For the prior audit, the Department also made the adjustment
25 of \$10,000.00 to the measure of tax, recommended in the D&R, and reduced the tax, interest, and
26 penalty which resulted in a total decrease of \$1,090.47 for the determination covering the period July
27 1, 2005, through March 31, 2008. Of that amount, the Department has applied \$116.47 to amounts due
28 for several returns reducing the remaining overpayment for this period to \$974.00. Thus, the net effect

1 of all the adjustments is a net overpayment on the two determinations of \$774.51 (\$199.49 - \$974.00).
2 We recommend a refund of \$774.51.

3 With respect to petitioner's claimed overpayments on returns, and its request of a refund of all
4 taxes paid during the period of operations, petitioner has not documented any such overpayments. In
5 fact, the Department has established by audit that the amounts paid on returns were understated.
6 Accordingly, we find there were no overpayments on returns. Accordingly, we find there is no
7 overpayment in excess of the overpayment of \$774.51

8 **OTHER MATTERS**

9 Throughout the appeals process, petitioner has submitted several letters expressing its dismay
10 and frustration with governmental agencies and other entities, including Board staff. Based on
11 petitioner's letters, it is apparent petitioner lost its home, business, and all other assets. We certainly
12 empathize with petitioner's difficulties. Unfortunately, though, none of the petitioner's numerous
13 letters include any arguments or evidence that support further adjustments.

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15 Summary prepared by Ted Matthies, Business Taxes Specialist III
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MARKUP TABLE
(Current Audit)
Liquor Store

Percentage of taxable vs. nontaxable purchases	91.24%
Mark-up percentage developed	26.58%
Self-consumption allowed in dollars	\$2,798.00
Self-consumption allowed as a percent of taxable purchases	1.00%
Pilferage allowed in dollars	\$5,596.00
Pilferage allowed as a percent of taxable purchases	2.00%