

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION PETITION FOR REHEARING SUMMARY

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
FRANGI'S RESTAURANT, INC.,) Account Number: SR AS 99-747878
dba The Terrace) Case ID 433581
Petitioner) Venice, Los Angeles County

Type of Business: Restaurant with bar
Audit period: 01/01/98 – 09/30/06

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Unreported taxable sales	\$2,149,880		
Penalties	\$ 334,779		
As determined		\$1,421,188.90	\$551,210.12
Adjustment - Appeals Division		- 561,968.03	- 227,359.63
		<u>- 92,768.78</u>	<u>- 52,789.51</u>
Proposed redetermination		\$ 766,452.09	\$271,060.98
Less concurred		- 589,415.37	<u>00.00</u>
Balance, protested		<u>\$ 177,036.72</u>	<u>\$271,060.98</u>
Proposed tax redetermination		\$ 766,452.09	
Interest through 08/31/12		603,491.35	
Fraud penalty		191,613.21	
Amnesty double fraud penalty		79,447.77	
Amnesty interest penalty		<u>63,718.23</u>	
Total tax, interest, and penalty		\$1,704,722.65	
Payments		<u>60,000.00</u>	
Balance Due		<u>\$1,644,722.65</u>	
Monthly interest beginning 09/01/12		<u>\$ 3,532.26</u>	

The Board heard this matter on January 31, 2012. The Board ordered no further adjustments to unreported taxable sales, upheld the fraud penalty, and denied relief of the amnesty penalties. By letter dated March 12, 2012, petitioner filed a timely petition for rehearing.

UNRESOLVED ISSUE

Issue: Whether the petition for rehearing should be granted. We recommend that it be denied.

1 Upon review of the petition for hearing, we found it confusing and that it did not in any way
2 support granting of a rehearing. Rather than making our recommendation solely on the petition, by
3 letter dated March 16, 2012, we provided petitioner a detailed discussion of our concerns, along with
4 guidance as to the information we sought to help us consider the petition. Petitioner responded by
5 letter dated April 4, 2012.

6 Regarding the amount of the liability, petitioner points out that the assessed liability was based
7 on a measure of \$17,290,156, which measure was thereafter reduced to \$10,935,757, and then to
8 \$10,453,263. Petitioner's representative then notes that during the hearing, he indicated that this
9 measure should be further reduced to about \$7,100,000, but "failed to expand upon my thoughts and
10 the facts to support this contention." Petitioner goes on to state that, during the hearing, "Mr. Scott
11 Lambert [the representative of the Sales and Use Tax Department (Department)] testified that the
12 understatement was actually only \$9.3 million, which is \$1,153,267 less than the staffs' final
13 calculation of taxes underreported." Petitioner derives from this that it is "highly improper" to hold
14 petitioner liable for an estimated liability when there are "credible" records available (without
15 identifying such records, but presumably meaning income tax returns).

16 Petitioner is confused as to the amount of the understatement asserted by the Department and
17 upheld by the Board. In preparing for the originally scheduled Board hearing (October 2011), the
18 Department concluded that an additional adjustment was appropriate, and reduced understated sales to
19 \$9,320,695, as clearly explained in the Board Hearing Summary. This is the measure of tax referenced
20 by Mr. Lambert during the hearing, and already includes adjustments very favorable to petitioner.
21 Petitioner has provided no additional evidence or argument to support further adjustment, or a
22 rehearing, for this issue.

23 Petitioner contends that the Department should not have relied on the finding of fraud to project
24 the liability for the period 1998 through 2002. Petitioner contends that, instead, the Department should
25 have used the income tax returns showing an understatement of over \$7 million (for the audit period),
26 which petitioner contends that the Department never challenged. Petitioner is mistaken. By the very
27 nature of the determination, where the Department did not accept the amounts reported on income tax
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1 returns as being complete, the Department necessarily challenged the accuracy of the income tax
2 returns.

3 Petitioner's own income tax returns, which were among the limited records available for audit,
4 establish a conceded understatement of over \$7 million dollars. Petitioner has failed to provide a
5 sufficient explanation for reporting more than \$7 million in sales on its income tax returns that it failed
6 to report on its sales and use tax returns. This degree of obvious understatement is alone sufficient
7 evidence of fraud. Having established fraud for the period 1998 through 2002 based on petitioner's
8 own records, we find that it was entirely appropriate for the Department to use the best available
9 method of computing the actual deficiency for the entire period open for assessment, including for the
10 period 1998 through 2002.

11 Petitioner's reliance on Audit Manual section 0509.70 is misplaced. That section indicates that
12 the fraud penalty should not generally be asserted for periods outside the otherwise applicable statute
13 of limitations in the absence of records of actual tax liability. That is, the Department should not
14 assume fraud for periods otherwise barred by the statute of limitations based on proof of fraud during
15 the open periods. Here, the Department did not assume fraud based on evidence during the otherwise
16 open periods. Rather, the Department established fraud based on actual records back to 1998. We
17 conclude that petitioner has not shown that any further adjustment, or a rehearing, is warranted on this
18 issue.

19 Petitioner notes that Mr. Lambert stated during the Board hearing the amounts provided by
20 petitioner for the fourth quarter 2010 showed a credit card to cash ratio of 65 percent (after deducting
21 tax and tips from credit card sales). Since the Department used the industry standard 70 percent,
22 Mr. Lambert had asserted that this was favorable to petitioner (for the computation here, the higher the
23 credit card to cash ratio, the lower the total taxable sales and thus the lower the deficiency). Petitioner
24 objects that Mr. Lambert's analysis is incorrect and that the fourth quarter 2010 figures actually
25 indicate a 76.12 percent ratio. However, it is petitioner who is mistaken.

26 Petitioner's current computations compare credit card sales *including tax and tips* to total sales
27 *excluding tax and tips*. That is, petitioner performs an apples-to-oranges comparison. As explained in
28 the D&R, the Department performed the computation correctly, deducting tax and tips from credit card

1 sales and then comparing that amount to reported taxable sales (which was also net of tax and tips) to
2 compute a ratio of 65.43 percent. This ratio is based on the amounts petitioner itself provided, and the
3 Department actually used a higher ratio to petitioner's benefit. Regarding petitioner's current
4 computation, it is based on total sales of \$595,361.91, which is more than the reported taxable sales of
5 \$542,526. (If the amount used by petitioner is actually correct, that apparently means it underreported
6 taxable sales for the fourth quarter 2010.) Additionally, it uses credit card sales of \$453,160.60, while
7 the D&R indicates that the prior amount provided by petitioner was \$443,112.73. In any event, these
8 figures do not result in numbers more favorable to petitioner.

9 Assuming the deductions of tax and tips used in the Department's computations remain
10 applicable,¹ using petitioner's most recent numbers results in a taxable credit card sales ratio of 61.3
11 percent. Indeed, even if we use the same higher credit card sales figure with the same favorable
12 assumption regarding the tax and tips included and compare that amount to the lower reported taxable
13 sales, the resulting ratio is 67.3 percent. Thus, without trying to identify the reason for the discrepancy
14 in the amounts, and using only the most favorable of the newest amounts along with the most favorable
15 assumptions, the resulting ratio remains less than the 70 percent ratio used by the Department. We
16 therefore conclude that petitioner has not shown that any further adjustment, or a rehearing, is
17 warranted for this issue.

18 Finally, petitioner seeks relief of the amnesty penalties, and contends that those penalties were
19 imposed for periods through the second quarter 2006. The amnesty penalties have been imposed only
20 with respect to the period through 2002 as required by statute, and no more.² Petitioner asserts that it
21 did not benefit from the bookkeeper's alleged actions (that is, presumably in failing to include all
22 taxable sales on the sales and use tax returns). However, we are not aware of any allegation of
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25 ¹ We note that this assumption provides the most favorable result for petitioner, but it is not correct. Even if the entire
26 increase in credit card sales were for taxable sales which were charged without tips, the amount of tax included would have
27 to be greater than the amount computed by the Department based on a smaller total credit card sales amount. That is, if we
28 performed the proper calculation, the amount of tax included would increase, and the net credit card sales would decrease,
resulting in a lower taxable credit card sales ratio.

² For example, the fraud penalty for the entire audit period, through September 30, 2006, is \$191,613.21. Thus, if the
amnesty double fraud penalty were imposed for the entire period as petitioner asserts, the amnesty double fraud penalty
would be \$191,613.21. However, the actual penalty is \$79,447.77, which is equal to the fraud penalty incurred through
December 31, 2002.

1 embezzlement by the bookkeeper. As such, if errors were made in reporting tax, those errors
2 necessarily benefited petitioner since it was able to retain funds that were properly due to the state.
3 Furthermore, petitioner has explained that such proceeds resulting from unreported sales were used to
4 remodel the business and not for personal gain. Such remodeling *was* for personal gain, of the
5 petitioner before us (the corporation operating the business) and, while not relevant here, ultimately to
6 the owner of the shares of that corporation. In any event, as relates to whether the amnesty penalties
7 should be relieved, we observe, again, that petitioner reported far more sales on its income tax returns
8 than on its sales and use tax returns, and surely would have discovered that discrepancy (if it did not
9 already know) by merely looking at its records. We conclude that there is no basis for relief of the
10 amnesty penalties.

11 In sum, we conclude that the Board correctly decided this appeal, and that petitioner has
12 provided no basis for a rehearing. Accordingly, we recommend that the petition for rehearing be
13 denied.

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15 Summary prepared by David H. Levine, Tax Counsel IV
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