

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 MAISA, INC., dba El Toro Market 6) Account Number: SR EH 100-391505
 6) Case ID 485794
 7 Petitioner) San Jacinto, Riverside County

8 Type of Business: Grocery store

9 Audit period: 7/1/04 – 3/31/08

10	<u>Item</u>	<u>Disputed Amount</u>		
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11	Unreported taxable sales	\$470,933		
12	Negligence penalty	\$ 11,693		

		<u>Tax</u>	<u>Penalty</u>
13	As determined	\$117,272.14	\$11,727.21
14	Adjustment - Post Board Hearing	- 346.67	- 34.67
	Proposed redetermination	\$116,925.47	\$11,692.54
15	Less concurred	- 80,428.16	0.00
	Balance, protested	<u>\$ 36,497.31</u>	<u>\$11,692.54</u>
16	Proposed tax redetermination	\$116,925.47	
17	Interest through 1/31/12	54,328.96	
18	Negligence penalty	11,692.54	
	Total tax, interest, and penalty	<u>\$182,946.97</u>	
19	Monthly interest beginning 2/1/12	<u>\$682.07</u>	

21 The Board held the hearing in this appeal on August 23, 2011, to consider the disputed measure
 22 of tax of \$491,417 and the imposition of the negligence penalty. At the hearing, the Sales and Use Tax
 23 Department (Department) agreed to use the vendor survey information for the period January 1, 2006,
 24 through June 30, 2007, which would result in a reduction to the deficiency, but asserted an offset
 25 against that reduction based on weekly purchases of \$800 of other tobacco products that were not
 26 accounted for in the vendor survey. The Board ordered petitioner be given 30 days to challenge the
 27 Department's proposal to include weekly purchases of \$800 and the Department 30 days to respond.

UNRESOLVED ISSUES

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2 **Issue 1:** Whether adjustments are warranted to the audited understatement of reported taxable
3 sales. We recommend that the measure of deficiency be reduced by \$4,579, to \$1,464,853.

4 Petitioner operated a grocery store with a liquor department until June 30, 2008, when its
5 seller's permit was closed because the business was transferred, for no consideration, to another
6 corporation set up by the same family, Reem-J Inc. (SR EH 101-097390). To establish audited
7 purchases of taxable merchandise, the Department contacted petitioner's known vendors. Since the
8 information provided by vendors was most complete for 2006, the Department used 2006 as a test
9 period, compiling total purchases of \$760,867, \$734,684 of which was for taxable merchandise.
10 After the audit was completed, petitioner provided a purchase summary, prepared by its bookkeeper,
11 summarizing recorded merchandise purchases from the same vendors the Department had contacted,
12 without providing any source documents in support. Although petitioner scheduled *total* merchandise
13 purchases of \$766,846 for 2006 from those vendors, it arbitrarily adjusted that figure down to
14 \$734,684, which was the amount of *taxable* purchases the Department had compiled. In the revised
15 audit, the Department used the total merchandise purchases of \$766,846 compiled in petitioner's
16 summary. The Department computed taxable purchases of \$728,955, and compared that figure to the
17 \$430,998 amount of taxable purchases recorded in the profit and loss statements to compute an
18 understatement in recorded taxable purchases of 69.13 percent, which it applied to purchases of taxable
19 merchandise recorded on the profit and loss statements for the remainder of the audit period to
20 compute audited taxable purchases for the audit period.

21 To establish the audited cost of taxable merchandise sold, the Department reduced audited
22 purchases of taxable merchandise by one percent for self-consumed merchandise and one percent for
23 pilferage. The Department conducted shelf tests, using costs from purchase invoices and posted selling
24 prices or prices provided orally by the store manager, to compute a weighted average markup for
25 taxable sales of 21.40 percent, which it applied to audited cost of taxable merchandise sold to establish
26 audited taxable sales, which exceeded reported taxable sales by \$1,469,432.

27 Petitioner contended that the audited understatement of reported taxable sales is excessive
28 because: 1) the audited purchases of taxable merchandise are excessive; 2) the purchase segregation

1 test of 2006 is inaccurate and not representative of the entire audit period; 3) the audited markup is
2 excessive because the selling prices used in the shelf tests for beer and tobacco products are incorrect;
3 and 4) an allowance should be made for losses related to bad debts on taxable sales. Petitioner has not
4 submitted documentation to show that the markup used is incorrect, or that an allowance for bad debts
5 is warranted. Addressing its arguments regarding purchases, the Department performed a reaudit to
6 recalculated the deficiency using the vendor survey information from January 1, 2006, through June
7 30, 2007, as agreed during the Board hearing. This reduced the measure of tax due, but the
8 Department offset most of that reduction in the reaudit by based on additional purchases of \$800 per
9 week of other tobacco products. The net result of the reaudit is a reduction in the measure of tax due
10 of \$4,579, from \$1,469,432 to \$1,464,853.

11 The Department's offset for other tobacco products purchases is based on a single invoice in
12 the amount of \$800 from Cig & Tobacco Wholesale (C&T) that was obtained by the Investigations
13 and Special Operations Division (ISOD) during a compliance inspection of petitioner's premises on
14 January 4, 2007.¹ Petitioner contends the existence of the single C&T invoice is not sufficient to
15 project weekly taxable purchases of \$800 to petitioner. Petitioner argues that it is a meat market
16 selling cigarettes, soda, and beer, and that the other tobacco products described on the C&T invoice are
17 not representative of the products it routinely sold. It notes that these other tobacco products were also
18 sold by Sunset/Trepcos, a vendor who was included in the vendor survey, and shows C&T was not the
19 exclusive supplier of other tobacco products on a weekly basis.

20 Petitioner's statements (including its reference to Sunset/Trepcos as a vendor of other tobacco
21 products) shows that petitioner did sell other tobacco products as a routine part of its business.
22 Whether or not petitioner purchased all such other tobacco products from C&T, or from C&T and from
23 other vendors, we conclude that the C&T invoice is representative of petitioner's purchases of other
24 tobacco products through the audit period, consistent with the statement of petitioner's president,
25 Jamal Rahman, petitioner's president during the ISOD inspection. Since petitioner does not contend it
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28 ¹ The measure for other tobacco products is \$183,035, so the reaudited understatement *without* any additional purchases of other tobacco products would be \$1,281,818, a \$187,614 reduction to the measure of deficiency.

1 purchased the subject tobacco products from Sunset/Trepcos, it is irrelevant that Sunset/Trepcos might
2 sell such products. We note also that, while petitioner disputes the Department's allegation regarding
3 the shelf life of Copenhagen, even if petitioner were correct, this would not mean that petitioner did
4 not purchase these other tobacco products on a weekly basis. Based on the available facts, we
5 conclude that the Department properly included weekly purchases of \$800 of other tobacco products in
6 its reaudit computations. Accordingly, we recommend that the measure of tax due be reduced to
7 \$1,464,853, in accordance with the Department's reaudit.

8 We note that in its post-hearing submissions, petitioner disputes the 90 percent taxable ratio of
9 the Sunset/Trepcos purchases used in the audit. However, in its reaudit, the Department used the
10 purchase amounts from the vendor survey compiled by petitioner, which includes *petitioner's*
11 segregation of the Sunset/Trepcos purchases between taxable and nontaxable. Since the reaudit
12 adjustments are already based on petitioner's own computations of the taxable purchase ratio for
13 Sunset/Trepcos purchases, this issue is moot.

14 **Issue 2:** Whether petitioner was negligent. We conclude that it was.

15 The Department imposed the negligence penalty because it found that petitioner's records were
16 inadequate and because the understatement was substantial. Petitioner does not believe it was
17 negligent and disputes the penalty because this was its first audit and it relied on its outside bookkeeper
18 to maintain records and properly report tax due. In its post-hearing submissions, petitioner also states
19 that the brother of petitioner's principal co-operated with the audit staff and the permit is now closed.

20 Petitioner's records were inadequate and incomplete. The amounts of purchases recorded in
21 the profit and loss statements were supported by fragmented source documents. Petitioner's
22 understatement of taxable sales is \$1,464,853 represents an error rate of 76.35 percent compared to
23 total reported taxable sales of \$1,918,602. Indeed, petitioner itself concedes that it understated taxable
24 sales by \$993,920, which represents an error rate of 51.80 percent, and concedes further that its
25 reported taxable sales were less than its purchases of taxable merchandise for resale.

26 Notwithstanding that this was petitioner's first audit, these facts clearly support imposition of the
27 negligence penalty.

28 Summary prepared by Pete Lee, Business Taxes Specialist II

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	64%
Mark-up percentage developed	21.40%
Self-consumption allowed in dollars	\$22,454 for 7/1/04 – 6/30/07
Self-consumption allowed as a percent of taxable purchases	1%
Pilferage allowed in dollars	\$22,230
Pilferage allowed as a percent of total purchases	1%