CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: NIRVAIR CORPORATION, dba College Park Mobil Petitioner	Account Number SR EA 97-141696 Case ID 529714 Woodland Hills, Los Angeles County

Type of Business: Gas station with mini-mart

Audit period: 04/01/05 – 03/31/08

Item	Disputed Amount
Unreported sales, 2005	$458,164
Unreported gasoline sales, 2007	$331,796
Negligence penalty	$ 13,318

	Tax	Penalty
As determined	$134,390.85	$13,439.10
Post-D&R adjustment	- 579.70	- 57.95
Post-Board hearing adjustment	- 630.23	- 63.05
Proposed redetermination	$133,180.92	$13,318.10
Less concurred	- 71,959.02	00.00
Balance, protested	$ 61,221.90	$13,318.10

Proposed tax redetermination	$133,180.92
Interest through 12/31/13	73,978.89
Negligence penalty	13,318.10
Total tax, interest, and penalty	$220,477.91
Monthly interest beginning 01/01/14	$ 665.90

The Board held a hearing regarding this matter on July 18, 2013, granting petitioner 30 days to provide additional records and the Sales and Use Tax Department (Department) 30 days to respond. Based on petitioner's submissions and the Department's response, we recommend a reduction of the determined tax of $630.23, from $133,811.15 to $133,180.92, and an adjustment of the interest through December 31, 2013 to $73,978.89 (with interest continuing to accrue each month until the determined tax is paid in full), as discussed under Post Hearing Developments.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the unreported sales. We find no further adjustment is warranted other than the post-hearing adjustment.

Petitioner has operated a gasoline station with a mini-mart since October 1997. Petitioner is a corporation whose sole shareholder was Rakesh Bhakta until December 31, 2007, when he sold all his stock to Bhupinder Singh Mac. For audit, petitioner provided monthly Point of Sale reports from Mobil Oil for 2006; sales summary worksheets for the period January 1, 2006, through March 31, 2008; income statements and gasoline purchase invoices for 2006 and 2007; and federal income tax returns for 2005, 2006, and 2007. The Department found significant differences between recorded and reported taxable sales, which it used to establish an understatement of $2,853,600, which petitioner does not protest. Based on various audit tests, the Department concluded that recorded taxable sales for 2006 were substantially accurate. However, since petitioner provided almost no records for 2005 and the Department computed a negative book markup for gasoline for 2007, the Department decided to use alternate audit methods to establish audited taxable sales for the period April 1, 2005, through December 31, 2005, and for the year 2007.

For 2005, the Department established audited sales of gasoline using gallons of gasoline purchased (computed using vendors' reports of sales tax prepayments paid by petitioner) and selling prices published on GasBuddy.com for regular grade gasoline, adjusted by 102 percent (computed from petitioner's records for 2006) for higher prices for mid-grade and premium gasoline. To establish audited taxable mini-mart sales for the period April 1, 2005, through December 31, 2005, the Department used recorded taxable mini-mart sales for the corresponding period of 2006. The Department totaled audited gasoline sales and audited taxable mini-mart sales for the period April 1, 2005, through December 31, 2005, and computed that reported taxable sales for that period were understated by $458,164.

For 2007, the Department established audited gasoline sales on a markup basis, using the book markup of 5.24 percent that it had computed for 2006 and audited purchases of fuel for 2007. We found errors in the Department's computation of the book markup for 2006, and we recomputed it at 5.02 percent. Thus, we recommended that audited gasoline sales for 2007 be recomputed using

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5.02 percent. After that adjustment, the understatement of reported gasoline sales for 2007 was $339,928 at the time the hearing was held. As explained under Post Hearing Developments, we recommend a further reduction of $8,132, to $331,796.

Petitioner contends that it sold fuel for prices below the industry average selling price in the second and third quarters of 2005 in order to keep the station open while the mini-mart was under construction. Petitioner further asserts that gasoline prices remained drastically reduced during the last quarter of 2005. Petitioner also contends that the recorded gasoline sales for 2007 are correct, asserting that it inadvertently sold gasoline below cost because it had changed vendors, and it was confused by the invoices provided by the new vendor, such that it used incorrect gasoline costs when it computed the selling prices. In addition, petitioner alleges that, in anticipation of the sale of the business, it was more concerned about the volume of sales than the net profit in 2007. Further, Mr. Mac states that he was effectively forced to purchase the stock of the business on January 1, 2008, to prevent a default on Mr. Bhakta's loan (which Mr. Mac had personally guaranteed). When he made the decision to purchase the corporate stock, Mr. Mac states that he did not review the books and records but considered only the volume of gasoline purchases.

Petitioner did not provide records for 2005 (other than the federal tax return), and it has not provided documentation to show that gasoline was sold below the average industry price during the last three quarters of 2005. Accordingly, we find no adjustment of the audited selling prices for 2005 is warranted. Regarding the selling prices in 2007, petitioner has provided copies of invoices from the "new" vendor and from the vendor from whom it previously purchased gasoline, in an attempt to demonstrate that the invoices issued by the new vendor were confusing. While it is true that one vendor combined the state and federal taxes with the base price of fuel as one line item, and the previous vendor separately stated the state and federal taxes, we are not persuaded that, as a result, petitioner was unable to understand the pricing schedule and therefore inadvertently computed selling prices below cost. Petitioner has provided no convincing evidence that it sold gasoline at prices below cost in 2007 or that it established extremely low selling prices in 2007 because it intended to sell the business and wanted to increase the volume of sales. We find it was reasonable for the Department to use the book markup for 2006 to establish audited sales for all months of 2007 other than February and

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to use the markup of 1.77 percent, computed from additional documentation provided by petitioner after the Board hearing, for February 2007. Petitioner has not provided evidence sufficient to support further adjustment.

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

The Department imposed the negligence penalty because petitioner provided inadequate records and the understatement was significant. Petitioner has not offered a non-negligent explanation for the understatements established by audit, but Mr. Mac states that the business is currently struggling with the mistakes of the prior management, which have been corrected beginning with returns filed for the first quarter 2008.

The Department found that petitioner had recorded taxable sales of $2,853,600 that it did not report, and petitioner does not dispute that audit item. In addition, petitioner did not provide any records for 2005 other than the federal tax return. We find that any businessperson, even one with limited experience, should have recognized a difference of almost $3 million between recorded and reported taxable sales. We find that the substantial error and the incomplete records are clear evidence of negligence, even though petitioner had not been audited previously. Further, while it is true that the Department found the reported sales for the first quarter 2008 to be substantially correct, that improved reporting does not alter the fact that, during the audit period, petitioner was negligent. We conclude that the penalty was properly imposed.

POST HEARING DEVELOPMENTS

Petitioner argues that the selling prices used to compute audited gasoline sales for 2005 and the markup used to compute audited gasoline sales for 2007 are too high, that the amount of interest is overstated, and that the negligence penalty should be deleted. As support, petitioner provided several exhibits, both at and after the Board hearing.

The Department explained that it used selling prices published in GasBuddy.com to establish audited sales of gasoline for 2005. Although petitioner asserts that its selling prices were lower than average for 2005, it has provided no documentation to support that assertion. Also, as noted by the Department, selling prices published in GasBuddy.com were used to verify recorded gasoline sales for 2006, which the Department concluded were substantially accurate. Since the evidence shows that

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petitioner's selling prices for gasoline were consistent with industry average selling prices for 2006, and petitioner has not documented that its selling prices were lower than average in 2005, we recommend no adjustment to audited sales of gasoline for 2005.

For 2007, the Department used petitioner's book markup for 2006 to compute audited gasoline sales. We find that approach to be reasonable, as explained under Issue 1, above. However, for the month of February only, petitioner provided screen shots from GasBuddy.com and evidence of its recorded costs of gasoline to show that the markup was 1.77 percent. Petitioner has provided no evidence for any other month of 2007 to show that its markup was lower than the book markup for 2006. Accordingly, we recommend that the audited markup be reduced to 1.77 percent for February 2007 and that the book markup for 2006, 5.02 percent, be used as the audited markup for the remainder of 2007. That adjustment results in a reduction of the understatement for 2007 of $8,132, from $339,928 to $331,796.

Petitioner asserted at the Board hearing that the amount of interest through July 31, 2013, should have been $58,572.02. Using the various interest rates in effect during the period at issue, which ranged from a low of 6 percent in 2013 to a high of 11 percent in 2007, the Department has recomputed interest through July 31, 2013 of $70,649.39 ($73,978.89 through December 31, 2013, less interest of $3,329.50 for August through December 2013), after making the adjustment to the determined tax for 2007. The recomputed amount of interest is $41,867.25 less than the amount of interest through July 31, 2013, shown in the Board hearing summary ($112,516.64). We have reviewed the Department's computation of interest and have found no errors. Accordingly, we recommend that the interest be adjusted accordingly.

Petitioner continues to dispute the negligence penalty. However, as explained in the Board hearing summary, petitioner had recorded taxable sales of almost $3 million that it did not report. We find that this substantial difference between recorded and recorded taxable sales is clear evidence of negligence. Accordingly, our conclusion remains that the negligence penalty was properly applied.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

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MARKUP TABLE
(Gasoline sales for 2007)

Taxable vs. nontaxable purchases	100%
Book mark-up for 2006 applied to purchases for 2007, except February Book markup applied to purchases for February 2007	5.02% 1.77%
Self-consumption allowed in dollars	None*
Pilferage allowed in dollars	None*

* The book markup incorporates any reductions to cost of goods sold for self-consumption or pilferage.