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:	
HARDIP SINGH SANDHU, dba 97 Mini Mart	Account Number SR KHM 100-632634 Case ID 533270
Petitioner	Weed, Siskiyou County

Type of Business: Convenience store

Audit period: 04/01/06 – 03/31/09

Item	Disputed Amount
Unreported taxable sales	$785,044
Negligence penalty	$ 8,268

	Tax	Penalty
As determined and proposed to be redetermined	$82,677.00	$8,267.71
Less concurred	- 25,761.29	00.00
Balance, protested	$56,915.71	$8,267.71

Proposed tax redetermination	$ 82,677.00
Interest through 08/31/13	36,045.57
Negligence penalty	8,267.71
Total tax, interest, and penalty	$126,990.28
Payments	- 1,633.40
Balance Due	$125,356.88
Monthly interest beginning 09/01/13	$ 405.22

The Board held a hearing regarding this matter on January 15, 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 do not recommend adjustments, as discussed below under Post Hearing Developments.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the unreported taxable sales. We find no adjustment is warranted.

Petitioner has operated a convenience store since September 2005, and he claimed more than half of his reported sales as exempt sales of food products during the audit period. However, when the

Department visited the store in June 2009, it noted that the shelf space allotted to nontaxable merchandise represented only a small area of the store. Accordingly, the Department concluded that further investigation was warranted. For audit, petitioner provided cash register Z-tapes for eight months of the audit period and incomplete purchase invoices for the last five quarters of the audit period. No other records were provided, and petitioner had not filed federal income tax returns for 2006, 2007, or 2008 at the time of the audit.

To establish audited taxable sales, the Department listed the amounts shown on the available cash register Z-tapes for the third quarter 2008 (3Q08) and 1Q09. The Department compared the taxable sales it compiled of $147,755 for 3Q08 and $112,241 for 1Q09 to reported taxable sales for the two quarters to compute an understatement of 158.91 percent in reported amounts, which it applied to reported figures to establish an understatement of $1,142,089. Petitioner contends that the amount of understatement should be reduced to $357,045, based on taxable sales compiled from cash register Z-tapes for four additional quarters and the Department's examination of two quarters. Petitioner compiled taxable sales of $65,684 for 2Q06, $52,755 for 1Q07, $59,828 for 2Q07, and $130,659 for 2Q08, which he compared to reported taxable sales for the same respective quarters of $69,875, $60,000, $80,000, and $69,800, asserting that his reported taxable sales were overstated for 2Q06, 1Q07, and 2Q07, and were understated for 2Q08. As explanation, petitioner states that his reported taxable sales were estimates, with both over-reporting and under-reporting errors.

Based on the nature of the available records, we find it was appropriate for the Department to compute a percentage of understatement for two quarters and apply that percentage to the remainder of the audit period. We note that there were dates during those two quarters for which Z-tapes were not provided, and we therefore are not certain that the available Z-tapes were complete. Accordingly, we find that the audit results appear reasonable, if not conservative. In contrast, the taxable sales compiled by petitioner for three of the four quarters were significantly less than the taxable sales compiled by the Department for the two quarters it examined ($65,684, $52,755, and $59,828 as compared to $147,755 and $112,241). However, petitioner has offered no explanation for the apparent dramatic increase in sales from an average of less than $60,000 per quarter for 2Q06, 1Q07, and 2Q07 to an average of over $130,000 for 2Q08, 3Q08, and 1Q09. In fact, petitioner's reported taxable sales actually declined after

2Q07, indicating a decrease, rather than an increase, in business. Moreover, petitioner acknowledges that the Z-tapes used to compile taxable sales for the four quarters he reviewed are incomplete. Accordingly, we find that the information petitioner provided for the four additional quarters is not reliable and does not support any adjustment.

Issue 2: Whether petitioner was negligent. We find that he was.

The Department imposed a negligence penalty because petitioner did not provide adequate records and the understatement was substantial. Petitioner disputes the penalty, but has not expressed a specific basis for that disagreement.

Petitioner provided hardly any records, and the substantial understatement of $1,142,089 represents 159 percent of reported taxable sales of $718,701. Furthermore, petitioner has stated that reported amounts were estimates, and those estimates, for the two quarters reviewed by the Department, represented significantly less than half the amounts of taxable sales reflected on his own records (the cash register Z-tapes). We find that the sorely limited records and the considerable amount of understatement, based solely on a comparison of recorded and reported taxable sales, are clear evidence of negligence. Further, we find that any businessperson, even one with limited experience, should have recognized that sales reported to the Board should not be estimated, and should have reported taxable sales reflected in its own records. Thus, we find that the negligence penalty was properly applied, even though petitioner had not been audited previously.

POST HEARING DEVELOPMENTS

At the Board hearing, the Board directed the Department to review the Z-tapes petitioner used to compile sales for 2Q06, 1Q07, 2Q07, and 2Q08, and to compare the credit card sales on the Z-tapes with credit card deposits on the bank statements, which petitioner was to provide. Also, Chairman Horton asked the Department to consider using average monthly taxable sales in the audit calculation instead of using a percentage of error, as that audit procedure would take into account all the available Z-tapes.

Petitioner provided Z-tapes for the four quarters and bank statements for all quarters except 2Q06. The audit staff noted that the available Z-tapes were missing from one to thirteen days for each quarter, and the Z-tapes did not segregate sales between cash and credit card sales. The staff also noted that there were daily credit card batch summaries attached to the Z-tapes for May and June 2008 that appear to be generated from petitioner's credit card machine. Thus, the Department compared credit card sales to credit card deposits for those two months. The Department found that the credit card deposits shown on the bank statements of $7,377 and $7,087 for May and June, respectively, were substantially less than the credit card sales from the batch summaries of $11,156 and $11,177 for the same months. Also, the bank deposits (excluding non-sale deposits) of $13,664 and $20,989 for May and June, respectively, were considerably less than the sales shown on the Z-tapes for those months of $64,140 and $59,252. Because of these broad discrepancies, the Department concluded that it was likely petitioner maintained other bank accounts for which it did not provide bank statements. As a result, the Department concluded it could not confirm the accuracy of the additional sales compiled by petitioner for 2Q06, 1Q06, 2Q07, and 2Q08. Regarding Chairman Horton's suggestion to consider establishing audited sales using an average amount of sales from the provided Z-tapes, the Department opines that the percentage of error approach remains more appropriate in this case, since the available records indicate that monthly sales were not consistent. That inconsistency is further evidenced by the decreasing amounts of reported sales during the latter part of the audit period. We concur with the Department's findings, and we recommend no adjustment to the amount of unreported taxable sales.

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