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:	
SUNBURST MAINTENANCE CO., INC., dba Pacific Sanitary Supply	Account Number: SR AP 16-660624 Case ID 421808
Petitioner	San Gabriel, Los Angeles County

Type of Business: Retailer of janitorial supplies

Audit period: 04/01/03 – 03/31/06

Item	Disputed Amount
Unreported sales	$1,208,534
Negligence penalty	$ 10,115

	Tax	Penalty
As determined	$124,199.37	$12,419.91
Post-D&R adjustment	- 23,044.37	- 2,304.44
Proposed redetermination	$101,155.00	$10,115.47
Less concurred	- 1,450.85	00.00
Balance, protested	$ 99,704.15	$10,155.47

Proposed tax redetermination	$101,155.00
Interest through 05/31/12	63,604.61
Negligence penalty	10,115.47
Total tax, interest, and penalty	$174,875.08
Monthly interest beginning 06/01/12	$ 590.07

This matter was scheduled for Board hearing on October 27, 2011, and again on January 31, 2012, but was postponed each time at petitioner's request, first because of a scheduling conflict and then to allow additional time to prepare for the hearing. This matter was then scheduled for Board hearing in April 2012, but petitioner waived its hearing, and this matter is thus scheduled for decision on the nonappearance calendar.

UNRESOLVED ISSUES

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

Petitioner has sold janitorial and cleaning supplies since 1977. For audit, petitioner provided federal income tax returns, profit and loss statements, a summary of its sales by customer, bank statements, copies of sales invoices, and purchase invoices. The Sales and Use Tax Department (Department) found that petitioner's reported total sales were less than the sales recorded on its summary of sales by customer, the amounts of gross receipts reported on federal tax returns, and the amounts deposited in its bank account. The Department also computed book markups of 8.97 percent and 10.22 percent for 2004 and 2005, respectively, which it considered low for the industry, and it decided to establish total sales on a markup basis.

To establish the audited markup, the Department conducted a shelf test, from which it computed an average markup of 43.77 percent. That markup has since been reduced to 36.06 percent, after petitioner provided two shelf tests (one before and one after the appeals conference), which the Department combined with its test. To establish the audited cost of goods sold, the Department used information from vendors regarding the amounts sold to petitioner, as well as a review of petitioner's cancelled checks and credit card statements. The Department found that petitioner's recorded purchases from the vendors who provided data were understated by 5.73 percent, and it applied that percentage of understatement to the amounts of recorded purchases from vendors who did not provide data to compute additional unrecorded purchases of $48,570. The Department then made an adjustment of 1 percent for pilferage. The D&R recommended that audited purchases be reduced by $36,456, based on the Department's review of additional documentation provided by petitioner after the conference, and by the additional unrecorded purchases of $48,570. Petitioner contends that the amount of audited taxable sales remains overstated because the audited amount of purchases and the audited average markup are excessive.

We find that petitioner has not documented any further reductions to the audited amount of purchases. With respect to the markup, petitioner computed a markup of 35.09 percent in its most recent shelf test, which was combined with petitioner's previously provided shelf test and the Department's to compute the markup of 36.06 percent used in the reaudit. We find petitioner has not provided evidence to support further reduction.

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

The Department imposed the negligence penalty because it found petitioner's records were incomplete, inaccurate, and conflicting, and the understatement was significant. Petitioner disputes the penalty on the basis that the audited understatement is excessive.

Petitioner's recorded sales, reported gross receipts on federal tax returns, and bank deposits all substantially exceed petitioner's reported total sales. Petitioner did not maintain summaries of purchases or a complete set of purchase invoices. Thus, despite having been audited before, petitioner did not exercise due care in recordkeeping. The audited understatement of reported taxable sales of $1,208,534 is substantial and represents an understatement of 40.8 percent in comparison to reported taxable sales of $2,962,092. We find that the inadequate records and substantial understatement are evidence of negligence, and that the penalty was properly applied.

OTHER MATTERS

None.

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