CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
L&S RESTAURANT, INC. dba Luisa & Son Bake & Deli	Account Number: SR AA 100-215083 Case ID 425516
Petitioner	Artesia, Los Angeles County

Type of Business: Bakery and hot fast food

Audit Period: 10/1/03 – 9/30/06

Items	Disputed Amounts
Unreported sales	$92,371
Negligence penalty	$762

	Tax	Penalty
As determined and protested	$7,620.71	$762.07

Proposed tax redetermination	$ 7,620.71
Interest through 9/30/09	3,362.82
Penalty	762.07
Total tax, interest, and penalty	$11,745.60
Monthly interest beginning 10/1/09	$50.80

UNRESOLVED ISSUES

Issue 1: Whether audited unreported taxable sales are excessive. We conclude they are not.

Petitioner operates a Filipino bakery and delicatessen with tables and chairs for its customers. This was petitioner's first audit. Petitioner only provided purchase invoices, general ledgers, sales tax worksheets, and federal income tax returns (FITR's) for audit. The Sales and Use Tax Department (Department) considered the records inadequate because they did not include the sales journal or cash register tapes to support the amounts on the sales tax worksheets.

The Department found that the gross receipts on the FITR's for the years 2004 and 2005 exceeded the reported sales to the Board by $132,808, and noted that the FITR's disclosed achieved markups of 154.36 percent, and 160.01 percent for the years 2004 and 2005, respectively. The Department stated that these markups appeared reasonable for this type of business. The Department also found that the bank deposits exceeded the gross receipts on the FITR's by just over $10,000 for the two years. Since the FITR's markups appeared reasonable and the bank deposits marginally exceeded the gross receipts reported on the FITR's, the Department accepted those gross receipts. Using petitioner's sales tax worksheets, the Department computed an average taxable ratio (sales tax included) of 74.11 percent for 2004, and 70.44 percent for 2005. The Department applied these ratios to the gross receipts on the FITR's for the respective years to establish audited taxable sales, including sales tax reimbursement. Sales tax reimbursement was then removed to arrive at audited taxable sales. Upon comparison to reported taxable sales, the Department found that petitioner had underreported its taxable sales by 43.41 percent and 20.05 percent for the years 2004 and 2005, respectively. Upon projection (the 43.41 percent was applied to periods prior to 2005, and the 20.05 percent was applied to periods after 2004), the Department calculated that petitioner had underreported its taxable sales by $92,371, or by 31.24 percent.

Petitioner contends that the gross receipts on the FITR's include nontaxable loans. At the appeals conference, petitioner stated that it did not possess any loan contracts or other documentary evidence to support its contention that the gross receipts on the FITR's include loans. After the conference, petitioner submitted copies of amended FITR's for the years 2004 and 2005, incomplete cash register tapes, and various monthly bank statements to show that a portion of the deposits were from loans.

The amended returns submitted by petitioner disclose achieved markups of 67 percent and 77 percent for the years 2004 and 2005, respectively. We consider these low markups inadequate for this type of business because we would expect the markup to be over 100 percent. Therefore, we do not accept the gross receipts on the amended FITR's. Furthermore, if some of the bank deposits represent loans, an adjustment to the measure of tax would not be warranted because the bank deposits were not used to compute the audit liability. The audit liability was computed based on the gross receipts that were reported on the FITR's, and petitioner has not provided any sales summaries, copies of a sales journal, or other documentary evidence to show that the gross receipts on the FITR's include nontaxable loans. Accordingly, there is no basis upon which to recommend any reduction to the measure of tax.

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

The Department imposed the penalty because petitioner did not provide adequate books and records for audit, and petitioner underreported a significant amount of its taxable sales. Petitioner's records were fragmented and not consistent, and there were no sales journals. We find that the records were incomplete and disorganized and were not adequate for sales and use tax purposes. Petitioner's unreported taxable sales of $92,371 represent an underreporting of 31.24 percent. This level of error and the lack of reliable complete records indicate a standard of care well below that of a reasonable businessperson. Accordingly, we conclude that petitioner was negligent and that the penalty was properly imposed.

OTHER DEVELOPMENTS

None.

Summary prepared by John K. Chan, Business Taxes Specialist I