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:

HARDIAL S. & DAVINDER K. PANNU, dba Willow Glen Way Market

Petitioner

Account Number: SR GH 97-890969
Case ID 390331

San Jose, Santa Clara County

Type of Business: Convenience stores

Audit period: 04/01/03 – 03/31/06

Item	Disputed Amount
Unreported taxable sales	$688,539
Negligence penalty	$ 5,716

	Tax	Penalty
As determined and protested:	$57,160.94	$5,716.14
Proposed tax redetermination	$57,160.94	
Interest through 1/31/09	23,132.19	
10% penalty for negligence	5,716.14	
Total tax, interest, and penalty	$86,009.27	
Monthly interest beginning 2/1/09	$381.07	

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the audited amount of unreported taxable sales. We recommend no adjustment.

Petitioner operated two convenience stores during the audit period, one of which it sold in 2005. The Sales and Use Tax Department (Department) conducted a purchase segregation test, using purchase invoices for the first quarter 2005, and calculated that 77.19 percent of petitioner's purchases represented taxable merchandise. However, the percentage of petitioner's reported taxable to total sales was only 24.3 percent, which indicated that reported taxable sales were substantially understated.

The Department established audited taxable sales on a markup basis. To establish the audited cost of taxable sales, the Department applied the 77.19 percent to the recorded cost of goods sold, and reduced that figure by an estimated cost of self-consumed taxable merchandise of $120 per month and by an estimated amount of pilferage, calculated at 1 percent. The Department then conducted shelf tests to establish the audited markups for various product categories, using costs from purchase invoices in February, April, and June 2006, and selling prices provided June 30, 2006, by petitioner's son, who worked at the San Jose store. The Department used those markups and the percentages of purchases in each category that were calculated in the purchase segregation test to calculate a weighted markup for taxable sales of 36.58 percent.

Petitioner contends that its records should be the source of audited taxable sales, and that it is inappropriate to use the markup method. Petitioner also contends that the audited percentage of taxable to total merchandise purchases of 77.19 percent and the audited markup of 36.58 percent are excessive.

We find that the Department was certainly justified in its decision to utilize the markup method. Petitioner did not provide cash register tapes or a sales journal and could not explain the significant disparity between the percentage of reported taxable to total sales of 24.3 percent and the percentage of taxable to total merchandise purchases of 77.19 percent. Petitioner states that it can now produce books and records that were not available at the time of the audit. However, even if petitioner could now produce its cash register tapes and sales journals, we would question the accuracy of those records if they reflected a ratio of taxable to total sales of 24.3 percent. Since 77.19 percent of the products petitioner purchased were taxable, we cannot imagine a situation in which only 24 percent of its sales would be taxable. Therefore, it was appropriate to use the markup method.

Petitioner has provided no documentation to support its contentions that the audited percentage of taxable to total merchandise purchases and the audited markup are excessive. Petitioner has neither identified any specific errors in the purchase segregation test or shelf tests nor conducted similar tests for different periods. With respect to the markup, petitioner asserts that the actual markup is in the range of 25 to 35 percent, but has provided no supporting evidence. Also, we note that the audited markup of 36.58 percent is only slightly outside the range of 25 to 35 percent. In the absence of documentation, we conclude that no adjustments are warranted to the audited percentage of taxable to total merchandise purchases or the audited markup.

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

The Department imposed the negligence penalty because the audited understatement of \$688,539 is significant and represented 186 percent (\$688,539 ÷ \$370,837) of reported taxable sales, and because there was a broad discrepancy between the percentage of taxable to total merchandise purchases and the percentage of reported taxable to total sales. Petitioner disputes the negligence penalty on the basis that the tax is not due.

We reject petitioner's contention. We have concluded that no adjustments are warranted to the audited amount of unreported taxable sales, and thus find that the tax is due. We also find that petitioner was negligent. We are particularly persuaded by the fact that 77 percent of petitioner's purchases were taxable merchandise but petitioner reported only 24 percent of its sales as taxable. A reasonably prudent businessperson should have recognized that discrepancy. Based on the Department's audit, which we find was conducted properly, petitioner reported only 35 percent of its taxable sales. This is a substantial error, even considering that this was petitioner's first audit. We find that petitioner was negligent, and the penalty was properly applied.

OTHER DEVELOPMENTS

None.

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

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	77.19%
Mark-up percentages developed	36.58%
Self-consumption allowed in dollars	$1,440 per year
Self-consumption allowed as a percent of total purchases	0.42%
Pilferage allowed in dollars	$10,648 for years 2003, 2004, & 2005
Pilferage allowed as a percent of total purchases	1%