

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:)
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)
GURMINDER SINGH PARMAR) Account Number: SR KH 97-972134
dba Tokay Liquors) Case ID 400369
)
)
Petitioner) Lodi, San Joaquin County

Type of Business: Liquor store

Audit Period: 4/1/03 – 3/31/06

<u>Item</u>	<u>Amount in Dispute</u>		
Unreported sales	\$755,763		
Negligence penalty	\$ 5,860		
		<u>Tax</u>	<u>Penalty</u>
As determined and protested		<u>\$58,596.09</u>	<u>\$5,859.65</u>
Proposed tax redetermination		\$58,596.09	
Interest through 4/30/09		24,181.70	
Penalty		<u>5,859.65</u>	
Total tax, interest, and penalty		\$88,637.44	
Payments		- 151.00	
Balance Due		<u>\$88,486.44</u>	
Monthly interest beginning 5/1/09		<u>\$389.63</u>	

UNRESOLVED ISSUES

Issue 1: Whether the Sales and Use Tax Department (Department) has accurately computed petitioner’s taxable sales. We conclude that it has.

During the audit, the Department noted that the gross receipts on petitioner’s federal income tax returns (FITR’s) exceeded the reported sales to the Board by \$186,366 in 2003, \$561,539 in 2004, and \$260,000 in 2005. The Department also noted that the reported taxable sales to the Board were much less than the amount of audited cost of taxable goods sold. Thus, the Department concluded that the reported taxable sales were grossly understated and decided to compute petitioner’s taxable sales on a markup basis.

1 The Department performed a shelf test using purchase invoices from August 2006 and selling
2 prices posted on the shelf, and computed taxable markups of 29.7 percent for beer, 28 percent for
3 liquor, 39.2 percent for soda, and 22 percent for cigarettes. The Department estimated the markup for
4 miscellaneous taxable merchandise at 34 percent. In sum, the Department computed a weighted
5 markup of 28.61 percent to establish taxable sales. The Department applied the 28.61 percent
6 weighted markup to the audited cost of taxable goods sold (adjusted by 2 percent for pilferage and
7 \$150 per month for self-consumed merchandise) and calculated that petitioner had underreported his
8 taxable sales by \$755,763, or by 86.8 percent.

9 Petitioner contends that: (a) the pilferage allowance should be increased to 10 percent; (b) the
10 weighted markup of 28.61 percent is excessive; (c) additional adjustments should be provided for
11 increase in inventory; and (d) the sales reported by petitioner's predecessor should be taken into
12 consideration in this audit. Petitioner argues that the audit incorrectly compares selling prices from
13 2007 to costs from 2004, 2005, and 2006, and that the audit fails to account for inflation. Subsequent
14 to the appeals conference, petitioner provided a list of costs and selling prices for 5 beer products, 5
15 liquor products, and 1 soda product, without supporting documentation.

16 When a taxpayer claims theft of more than 1 percent, the taxpayer must substantiate the amount
17 of theft by providing documentation such as police reports, reports from regularly employed security
18 guards, private detective agencies, or similar service firms, and insurance claims. (Audit Manual
19 § 0407.10.) The Department applied a 2 percent allowance for theft, which we believe is reasonable
20 because petitioner's business is located in a bad neighborhood. However, petitioner has not provided
21 any documentation such as police reports to support a larger allowance for theft, and we therefore
22 conclude that petitioner has not established a basis for increasing that allowance.

23 The Department computed the markups by comparing selling prices that were in effect on
24 September 1, 2006, to costs that were in effect in August 2006. We find that the Department's method
25 of computing the markups is correct because the Department compared costs and selling prices that
26 were in effect at the same point in time. Petitioner has not provided any documentation, such as
27 purchase invoices and cash register tapes, to support the costs and selling prices in his list of the
28 products, and therefore, we reject the costs and selling prices provided by petitioner.

1 Petitioner reported \$60,224 as his ending inventory on his 2005 FITR. On August 3, 2006,
2 petitioner had a physical inventory taken disclosing that the cost of inventory on that date was
3 \$264,030. Even though petitioner reported a lower amount of ending inventory on his 2005 FITR, the
4 Department considered the \$264,030 amount as the ending inventory on December 31, 2005.
5 Petitioner contends that the audit allowance for inventory increases is insufficient. Petitioner states
6 that his ending inventory on his 2007 FITR was \$167,169, and argues that he had over \$300,000 of
7 inventory during the audit period. Petitioner has not provided any documentation, such as a physical
8 inventory report, to show that his inventory was ever \$300,000. The ending inventory amount on
9 petitioner's 2007 FITR is not helpful to petitioner because that amount is much lower than the
10 \$264,030 amount that was used in the audit. Therefore, we recommend no additional adjustments for
11 inventory.

12 Petitioner contends that the sales reported by its predecessor should be taken into consideration
13 in the audit of petitioner. We find that the amounts of sales reported by the petitioner's predecessor are
14 of no use in resolving this dispute. The predecessor's account was not audited, and therefore, the sales
15 reported by the predecessor have not been verified as accurate.

16 **Issue 2:** Whether petitioner was negligent. We conclude that he was.

17 The Department imposed the penalty because petitioner underreported 86.8 percent of his
18 taxable sales, and the gross receipts reported on petitioner's FITR's greatly exceeded the reported sales
19 to the Board. Petitioner opposes the penalty because he believes that the tax is not due.

20 We conclude that petitioner was negligent. Petitioner has not explained the discrepancy
21 between the gross receipts reported on the FITR and the sales reported to the Board. The taxable sales
22 reported to the Board were much less than the amount of audited cost of taxable goods sold. Petitioner
23 is knowledgeable regarding his purchasing practices, and thus petitioner knew, or should have known,
24 that the reported taxable sales were understated because they were less than the taxable merchandise
25 purchases. We find that petitioner was negligent because he did not exercise due care in ensuring that
26 reported taxable sales were sufficient to account for his merchandise purchases, plus a reasonable
27 profit. Also, petitioner underreported 86.8 percent of his taxable sales. This large error ratio cannot be
28 explained as being due to anything but negligence in reporting sales.

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OTHER DEVELOPMENTS

None.

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

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	89.889%
Mark-up percentages developed	28.61%
Self-consumption allowed in dollars	\$1,800 per year
Self-consumption allowed as a percent of cost of goods sold	.415%
Pilferage allowed in dollars	\$8,666 per year
Pilferage allowed as a percent of cost of goods sold	2%