

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION SUMMARY FOR BOARD HEARING**

In the Matter of the Administrative Protest )  
and Claim for Refund Under the Sales and )  
Use Tax Law of: )  
UNIVERSAL CITY STUDIOS, INC. ) Account Number: SR AC 11-784389  
dba Universal Studios – Tour Division ) Case ID’S 378248, 373822  
Taxpayer/Claimant ) Universal City, Los Angeles County

Type of Business: Theme park with sales of food and merchandise

Audit Period: 7/01/96 – 4/30/02

<u>Items</u>	<u>Amount in Dispute</u>
Unreported taxable sales from catered events	\$4,557,044
Test of paid bills	\$133,201 <sup>1</sup>
Purchases of fixed assets over \$25,000	\$1,072,723
Claim for refund	\$ 200,000 or as determined

	<u>Tax</u>
As disclosed by audit dated 4/14/06	\$1,630,265.41
Adjustments: Appeals Division	<u>- 68,051.90</u>
Tax by reaudit dated 9/10/08	\$1,562,213.51
Amount concurred in	<u>-1,088,531.12</u>
Protested	<u>\$473,682.39</u>
Tax liability	\$1,562,213.51
Interest (tax paid in full 6/21/06)	<u>933,143.82</u>
Total	\$2,495,357.33
Payments on determination	-36,928.74
Payments per amnesty returns	<u>-2,570,689.45</u>
Balance to be refunded	<u>-\$112,260.86</u>

Taxpayer applied for amnesty, filed amnesty returns, and paid the amount reported thereon prior to the issuance of the Notice of Determination. After deducting those payments from the audited tax due, the Sales and Use Tax Department (Department) issued a Notice of Determination to taxpayer for the remaining tax due of \$25,519.41. Taxpayer did not file a timely petition for redetermination,

<sup>1</sup> The measure of tax for the test of paid bills based on the reaudit dated September 10, 2008 is \$5,245,723. Taxpayer’s own computation of the paid bills test resulted in an understatement of \$5,112,522. Thus, the protested measure of tax for this item is \$133,201 (\$5,245,723 - \$5,112,522).

1 but the Department accepted taxpayer's letter protesting the audit as an administrative protest. This  
2 appeal covers all protested amounts, most of which were reported and paid with the amnesty returns.

3 This matter was scheduled for Board hearing on April 29, 2009, but was postponed because  
4 petitioner's representative had a scheduling conflict.

### 5 UNRESOLVED ISSUES

6 **Issue 1:** Whether the Department's computation of taxable sales from catered events is  
7 excessive. We conclude that the Department's computation of taxable sales is not excessive.

8 Taxpayer is a division of Universal Studios, Inc., and reported the theme park operations under  
9 this permit. The business was sold to Universal City Studios, LLLP, and thus this permit was closed  
10 out effective April 30, 2002. Taxpayer provided catered events, which involved the serving of food  
11 and beverages and granting the customer the right to use the theme park for a certain number of hours.  
12 The catered events were typically for groups from 100 to 5,000 persons. For the catered events, the  
13 customers did not rent the entire park, but instead were granted access to certain rides and attractions  
14 for specified periods of time. In most cases, the catering was provided by taxpayer's own employees,  
15 but in some cases the catering was provided by Gladstone's, a restaurant located within the theme park  
16 that is not owned by taxpayer. Taxpayer's contracts for catered events were lump sum, and the  
17 contracts stated that sales tax and gratuity were included in the lump sum price. Taxpayer reported  
18 taxable sales from catered events using its profit and loss statements.

19 Initially, the Department established taxpayer's taxable sales by markup, calculating 54.981  
20 percent markup based on its examination of 11 sample catered event contracts. The markup was then  
21 applied to recorded food and beverage costs to compute audited taxable sales. Taxpayer protested the  
22 markup method of computing taxable sales, and the Department decided to use a different method.  
23 The Department calculated the taxable portion of an average lump sum charge meal and beverage  
24 prices from February 2006, plus the mandatory gratuity and the nontaxable portion based on the  
25 admission price from February 2006, to calculate that 52 percent of taxpayer's lump sum charge for  
26 catered events was taxable. However, the Department then arbitrarily reduced that percentage to 45  
27 percent in order to be conservative. The 45 percent ratio was applied to total catered event contract  
28 prices as recorded in the profit and loss statements for the third quarter of 1996 and the period

1 January 1, 1997, through September 30, 1999, to compute audited taxable sales of \$6,960,227 for those  
2 periods. This amount was reduced by \$151,455 to account for tax-paid purchases resold (taxpayer  
3 paid sales tax reimbursement to Gladstone's) to compute audited taxable sales of \$6,808,772. Upon  
4 comparison to reported taxable sales for catered events of \$4,814,861 for those same periods, an  
5 understatement of \$1,993,911 was computed, which represents an error ratio of 41.4116 percent. The  
6 error ratio of 41.4116 percent was applied to taxable sales of \$11,004,273 reported for taxpayer's  
7 catered events for the audit period to compute unreported taxable sales of \$4,557,044.

8 Taxpayer contends that the taxable sales it reported for the catered events represent the fair  
9 retail selling price of the food, beverages, and other tangible personal property provided in the catered  
10 events. Subsequent to the appeals conference, taxpayer provided its own analysis for six of its catered  
11 event contracts based on selling prices of similar food items from local restaurants (such as  
12 Gladstone's, Daily Grill, and Tony Roma's). Taxpayer computed that its average selling price for food  
13 and beverages (excluding sales tax reimbursement and mandatory gratuity) averaged \$28.15 per person  
14 for the six catered events while the equivalent charge by local restaurants was \$30.67. Taxpayer thus  
15 argues that the selling prices it reported for food and beverages are reasonable when compared to the  
16 selling prices it has computed for local restaurants. Taxpayer also provided an analysis of the  
17 nontaxable portion of the same six catered events, indicating that the nontaxable portion of the charges  
18 for the six catered events represents about 69 percent of the regular admission charge for a "front-of-  
19 the-line" admission ticket. Thus, taxpayer argues that it has not allocated an unreasonable amount of  
20 the lump sum contract amount to nontaxable services.

21 The Department rejects taxpayer's computations because, for all six contracts analyzed by  
22 taxpayer, the customers only received access to the park during evening hours, and for 13 quarterly  
23 periods in the audit, reported taxable sales from catered events was less than the recorded food and  
24 beverage *costs* for those events. Taxpayer counters that the recorded costs are not really costs, and that  
25 the amounts in the profit and loss statements that are labeled as "costs" represent retail sales.

26 Gross receipts are subject to tax until the contrary is established. (Rev. & Tax. Code, § 6091.)  
27 We are not persuaded that the amounts in the profit and loss statements that are labeled as "costs"  
28 represent anything other than costs. A markup is added to the costs listed in taxpayer's worksheets to

1 compute the revenue amounts, and the costs listed in the worksheets are the same costs that are  
2 recorded in the profit and loss statements. The fact that taxpayer added a markup to the amounts in  
3 question in order to compute revenue is a strong indication that such amounts represent costs. Further,  
4 when Gladstone's catered an event, the recorded costs represented the amounts that Gladstone's  
5 charged taxpayer to cater the event, which confirms that the amounts labeled as costs were, in fact,  
6 costs.

7 Nor are we persuaded by taxpayer's argument that it had not allocated an unreasonable amount  
8 of the lump sum contract amount to nontaxable services. For most of the catered events, the customer  
9 did not get access to the park for a full day, or did not get access to all of the rides and attractions.  
10 That is, the purchase of a "front-of-the-line" admission ticket, or any other regular admission ticket, is  
11 simply not comparable to the access a person obtained as part of a catered event.

12 During the audit, taxpayer provided profit and loss statements for all quarters of the audit  
13 except for the third and fourth quarters of 2000, the first quarter of 2001, and the first quarter 2002.  
14 Taxpayer's recorded costs of food, beverages and other taxable merchandise for the periods for which  
15 it provided such statements was \$8,584,608, while its reported taxable sales from catered events for the  
16 same periods totaled \$8,525,794. That is, taxpayer's reported taxable sales for catered events was less  
17 than its costs for those sales. We find that this shows taxpayer failed to report all of its taxable sales  
18 from catered events

19 We find that the Department's audit methodology was conservative, and that no adjustments  
20 are warranted.

21 **Issue 2:** Whether miscellaneous other adjustments are warranted. We conclude that no further  
22 adjustments are warranted.

23 The Department tested paid bills using a stratified statistical sample examining paid bills from  
24 January 1, 2000, through April 30, 2002 (the test period). In performing this test, the Department  
25 selected payments recorded under certain general ledger accounts which relate to purchases of tangible  
26 personal property. From the test period, the Department randomly selected 350 paid bills from \$100 to  
27 \$999 (strata 1), and 350 paid bills from \$1,000 to \$24,999 (strata 2). Subsequently, during the appeals  
28 conference, taxpayer provided evidence that the Department concluded supported adjustment to the

1 established understatement of taxable purchases. We recommended that these adjustments be made in  
2 a reaudit, which the Department prepared on September 10, 2008.

3 For strata 1, the Department computed an error ratio of 10.9642 percent which was applied to  
4 the amount of paid bills between \$100 and \$999 during the test period to compute the unreported  
5 taxable measure of \$39,598 for the test period. This amount was divided by 28, the number of months  
6 in the test period, to compute an average monthly unreported taxable measure of \$1,414. This monthly  
7 average was multiplied by 42, the number of months outside the test period, to compute that the  
8 unreported taxable measure for this strata for the audit period outside the test period was \$59,388.  
9 This amount was adjusted for inflation in the reaudit, reducing it to \$54,531. Thus, for strata 1, the  
10 unreported taxable measure is \$94,129 ( $\$39,958 + \$54,531$ ).

11 For strata 2, the Department computed an error ratio of 11.7528 percent which was applied to  
12 the amount of paid bills between \$1000 and \$24,999 during the test period to compute the unreported  
13 taxable measure of \$559,008 for the test period. This amount was divided by 28 to compute an  
14 average monthly unreported taxable measure of \$19,964.57. This monthly average was multiplied by  
15 42 to compute that the unreported taxable measure for this strata for the audit period outside the test  
16 period was \$838,530. This amount was adjusted for inflation in the reaudit, reducing it to \$769,951.  
17 Thus, for strata 2, the unreported taxable measure is \$1,328,959 ( $\$559,008 + \$769,951$ ).

18 In the test of strata 2, some of the errors involved progress payments which were handled  
19 separately from other errors. Progress payments totaled \$172,830. This amount was divided by 28 to  
20 compute additional taxable measure of \$6,172.50 per month during the test period. Multiplying this  
21 figure by the 42 months outside the test period, the Department computed additional taxable progress  
22 payments of \$259,266, which was reduced in the reaudit for inflation to \$238,062. Thus, for progress  
23 payments category, the total unreported amount is \$410,892 ( $\$172,830 + \$238,062$ ).

24 Combing the three categories for the audit period results in understated taxable measure of  
25 \$1,833,980 ( $\$94,129 + \$1,328,959 + \$410,892$ ).

26 The Department also found that taxpayer did not begin to accrue use tax until March 1999.  
27 Since the test period was after March 1999, during a period when taxpayer did report and pay tax on at  
28 least some purchases, many of the tested paid bills in the statistical sample were not picked up as errors

1 because taxpayer accrued and reported tax on the purchase price. However, these non-errors were not  
2 representative of the period prior to April 1999. Thus, the Department concluded that the test results  
3 did not reflect taxpayer's actual understatement of tax prior to April 1999, when it reported and paid no  
4 use tax on its purchases. The Department concluded that an additional adjustment was needed to  
5 account for the allowance in the statistical sample (projected to the pre-April 1999 period during which  
6 no use tax was accrued) for purchases for which taxpayer reported and paid use tax. To make this  
7 adjustment, the Department compiled use tax accrued of \$1,969,829 for the period April 1, 1999,  
8 through June 30, 2000. This amount was divided by 6 to compute a quarterly average of \$328,305.  
9 This amount was multiplied by the number of quarterly periods in the audit for which use tax was not  
10 accrued (11) to compute additional taxable measure of \$3,612,345 for the period July 1, 1996, through  
11 March 31, 1999. This amount was reduced to \$3,411,743 to account for use tax accrued and reported  
12 in March 1999 and for inflation.

13 Combining the amounts based on the test period and amounts established outside of the test  
14 period, the Department established unreported measure of use tax on paid bills of \$5,245,723  
15 (\$1,833,980 + \$3,411,743).

16 Taxpayer objected to the inclusion of several specific transactions as part of the taxable  
17 measure due. As explained in the D&R, we reject those objections and find that the Department  
18 properly included each of the protested transactions.

19 **Issue 3:** Whether further adjustments to the audited cost of fixed assets subject to use tax are  
20 warranted. We conclude that no further adjustments are warranted.

21 All fixed asset purchases in excess of \$25,000 were examined on an actual basis. Taxpayer  
22 submitted documentation to support deleting or reducing the measure of tax for some of the other fixed  
23 asset purchases. The Department reviewed taxpayer's documentation, and recommended certain  
24 adjustments, but rejected others. With respect to a \$417,889 purchase from Soundelux on April 28,  
25 1997, we conclude that \$79,766 of the charge qualifies for exemption under California Code of  
26 Regulations, title 18, section 1527, subdivision (a)(1) (an \$80,000 charge, less the \$234 selling price of  
27 the unprocessed recording media). Except for this adjustment, we find that taxpayer has failed to  
28 establish that any further adjustment is warranted.

**AMNESTY**

Taxpayer participated in the amnesty program, filed amnesty returns, and made full payment of the amount due. Thus, the amnesty interest penalty does not apply.

**OTHER DEVELOPMENTS**

Since the Notice of Determination was issued only for the \$25,519.41 audited deficiency in excess of the amounts reported on amnesty returns and the adjustments we recommend exceed this determined liability for which the administrative protest was accepted, we recommend that the administrative protest be granted. Taxpayer's payments towards the audit liability exceeds the remaining audit liability by \$112,260.86. We therefore recommend that the claim for refund be granted in this amount, and otherwise denied.

Summary prepared by Rey Obligacion, Business Taxes Specialist III