

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 KRISHNA DEVI, ET AL.) Account Number: SR CH 97-921852
 6 dba Cigarettes 4 Less & Liquor) Case ID 341721
 7 Petitioner) Antioch, Contra Costa County

8 Type of Business: Retailer of cigarettes and tobacco products

9 Audit Period: 1/01/02 – 12/31/04

10 Item Amount in Dispute

11 Unreported cigarette rebates \$132,497¹
 12 Unreported sales \$607,474²
 13 Negligence penalty \$6,077
 14 Amnesty penalties \$2,649

	<u>Tax</u>	<u>Penalties</u>
14 As determined and protested	\$60,774.64 ³	\$7,903.96
15 Proposed tax redetermination	\$ 60,774.64	
16 Interest through 1/31/10	32,097.50	
17 Negligence penalty	6,077.47	
18 Amnesty double negligence penalty	1,826.49	
19 Amnesty interest penalty	<u>822.45</u>	
20 Total tax, interest, and penalties	\$101,598.55	
21 Payments	<u>-5,565.26</u>	
22 Balance due	<u>\$ 96,033.29</u>	
23 Monthly interest beginning 2/1/10	<u>\$ 322.05</u>	

21 The Board held the oral hearing in this matter on July 21, 2009, granting petitioner 30 days to
 22 provide additional records for 2002 and the Sales and Use Tax Department (Department) 30 days to
 23 respond.

26 ¹ Petitioner disputes an unspecified portion of this amount.

27 ² In our post hearing analysis, based on petitioner's post-hearing submission and other available information that petitioner
 was seeking a reduction of \$22,980 to the audited measure of deficiency for 2002 of \$171,662. However, because there has
 been no clear concurrence in any of the audited deficiency, this table continues to show all amounts as disputed.

28 ³ This amount is net of a concurred credit of \$273.07. The total amount protested is \$61,047.71 (\$60,774.64 + \$273.07).

UNRESOLVED ISSUES

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2 **Issue 1:** Whether the audited amount of unreported taxable sales is excessive. We conclude
3 that no adjustments are warranted.

4 At the Board hearing on July 21, 2009, petitioner argued that the combined error ratio
5 calculated for 2003 and 2004 should not have been projected to 2002 to calculate the audited measure
6 of understatement for that year of \$171,662. The Board granted petitioner 30 days to present records
7 to support its contention. After the hearing, petitioner provided a schedule on which it had compiled
8 taxable merchandise purchases of \$321,978 for 2002, along with copies of purchase invoices and bank
9 statements. Although petitioner did not calculate its taxable sales for 2002, based on petitioner's
10 scheduled purchases for 2002 reduced by pilferage of three percent and adding the audited markup of
11 12.14 percent, we estimate that petitioner seeks a reduction in measure of about \$22,980 for 2002
12 (\$171,662 audited measure of deficiency less \$148,682 measure of deficiency based on petitioner's
13 schedule of purchases).

14 The Department concludes that petitioner's post-hearing submission actually supports an
15 *increase* in the determination because of errors in petitioner's compiled purchases for 2002 (an
16 increase has not been asserted because the statute of limitations for doing so has expired). As
17 explained in our Post Hearing Analysis, using petitioner's schedule with necessary corrections, the
18 Department has computed that petitioner's taxable merchandise purchases for 2002 total \$409,289
19 rather than the \$321,978 compiled by petitioner.

20 We have reviewed the parties' submissions and find that the Department has correctly
21 calculated petitioner's taxable merchandise purchases for 2002, with two exceptions. After making
22 these corrections, we calculate taxable merchandise purchases of \$393,370. Reducing this amount by
23 three percent for pilferage and then adding the audited markup of 12.14 percent, we compute taxable
24 sales of \$427,891, which results in an understatement measured by \$226,339 (\$427,891 - \$201,552).
25 Since this understatement is greater than the determined understatement of \$171,662 for 2002, we
26 conclude that petitioner's post-hearing submission does not support a reduction to the determination.

27 With respect to the years 2003 and 2004, the Department found that the costs of good sold
28 reported on petitioner's federal income tax returns were calculated figures instead of amounts based on

1 records. Accordingly, the Department used cancelled checks and credit card payment information for
2 2003 and 2004 to establish audited purchases. The Department reduced audited purchases by an
3 estimated pilferage loss of three percent to calculate the audited cost of taxable goods sold. It
4 computed an audited markup for taxable sales of 12.14 percent, based on a shelf test for the months of
5 August and September 2005. The Department added the markup of 12.14 percent to the audited cost
6 of taxable goods sold to compute audited taxable sales of \$484,039 for 2003 and \$463,476 for 2004.
7 Upon comparison to reported taxable sales, the Department computed understatements of \$219,551
8 (\$484,039 - \$264,488) for 2003 and \$216,264 (\$463,476 - \$247,212) for 2004.

9 Petitioner contends that, except for the cigarette rebates, taxable sales are not understated. In
10 addition to its contention that the percentage of error for 2003 and 2004 combined should not be
11 applied to 2002, addressed above, petitioner also contends that the audited amounts of taxable
12 merchandise purchases from H.F. Hillman and Pepsi are overstated. However, in the reaudit
13 recommended in the D&R, the Department found that audited taxable sales for the years 2003 and
14 2004 were actually understated, although the statute of limitations prevented the Department from
15 asserting an increase in the tax pursuant to section 6563.

16 We find that no adjustments are warranted to the audited understatement for any year of the
17 audit period.

18 **Issue 2:** Whether the audited amount of taxable rebates received from cigarette manufacturers
19 is excessive. We recommend no adjustment.

20 During the audit, the Department found that petitioner received both taxable cigarette rebates
21 and nontaxable shelf display income from cigarette manufacturers. Petitioner agrees that the cigarette
22 rebates are taxable, but argues that the allowance for nontaxable shelf display income should be
23 greater. However, during the reaudit recommended in the D&R, the Department found that no further
24 adjustments were warranted for nontaxable shelf display income because petitioner did not provide the
25 necessary documentation

26 **Issue 3:** Whether petitioner was negligent. We conclude that it was.

27 The Department imposed the negligence penalty because the understatement is large in relation
28 to the reported measure of tax, and petitioner's records were incomplete. Petitioner responds that this

1 was its first audit, petitioner is not sophisticated in matters of accounting, and English is a second
2 language for petitioner's partners.

3 If the Department relied solely on the lack of books and records provided for audit, we would
4 give petitioner the benefit of doubt since this was petitioner's first audit, and petitioner is not
5 sophisticated in matters of accounting. However, when the lack of records is considered in
6 conjunction with petitioner's understatement of taxable sales of 85.17 percent, and the fact that
7 reported taxable sales were less than its costs, we find that petitioner was negligent and that the
8 negligence penalty was appropriately applied.

9 AMNESTY

10 Although petitioner applied for amnesty, it did not enter into a qualifying installment payment
11 plan or pay the amnesty-eligible tax and interest by May 31, 2005. Thus, an amnesty double
12 negligence penalty of \$1,826.49 was included in the Notice of Determination, and an amnesty interest
13 penalty of \$1,240.93 will be imposed when the liability becomes final.

14 Petitioner filed a request for relief of the amnesty penalties pursuant to section 6592 on the
15 basis that it did not understand the amnesty program, and it is appealing the audit results. Although it
16 appears that petitioner was confused about the amnesty program, its confusion does not warrant relief
17 of the amnesty penalties because petitioner acknowledges that, had it understood the amnesty program,
18 it nevertheless would *not* have fulfilled the requirements for amnesty because it intended to appeal the
19 audit results and did not want to pay the audit liability.

20 Petitioner's hope to prevail in the appeals process and to avoid having to pay the liability is not
21 a basis for relief of the amnesty penalties. However, as part of its order on March 18, 2008, in
22 connection with another taxpayer's appeal, the Board ordered that the amnesty interest penalty be
23 relieved with respect to tax on cigarette rebates, with the usual payment conditions. The portion of the
24 amnesty interest penalty imposed with respect to such tax is \$418.48. We therefore recommend that
25 \$418.48 of the amnesty interest penalty be relieved if, within 30 days of the Notice of
26 Redetermination, petitioner either pays in full the amnesty-eligible tax and interest due with respect to
27 rebates or enters into an installment payment agreement to do so within 13 months and successfully
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1 completes that agreement. We recommend that relief of the amnesty double negligence penalty and
2 \$822.45 of the amnesty interest penalty be denied.

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

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28**MARKUP TABLE**

Percentage of taxable vs. nontaxable purchases	88.09%
Weighted mark-up percentage developed	12.14%
Self-consumption allowed in dollars	None
Self-consumption allowed as a percent of total purchases	None
Pilferage allowed in dollars	\$26,133 for 2003 and 2004 combined
Pilferage allowed as a percent of total purchases	3%

Mark up was based on a test of purchases established for the two year period 2003 and 2004. Petitioner did not provide purchase information for 2002.