CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matters of the Petition for Redetermination Under the Sales and Use Tax Law of: ELIAS ABDALLAH HAGGAR, dba Capuchino Market Petitioner	Account Number SR BH 100-295031 Case ID 597730 Millbrae, San Mateo County

Type of Business: Liquor store

Audit period: 04/01/08 – 03/31/11

Item	Disputed Amount
Unreported taxable sales	$144,599
Negligence penalty	$ 1,317

	Tax	Penalty
As determined	$13,461.01	$1,346.11
Post-D&R adjustment	- 295.26	- 29.52
Proposed redetermination, protested	$13,165.75	$1,316.59

Proposed tax redetermination	$13,165.75
Interest through 1/31/15	4,103.98
Negligence penalty	1,316.59
Total tax, interest, and penalty	$18,586.32
Payment	- 1.00
Balance due	$18,585.32
Monthly interest beginning 2/1/15	$ 65.82

UNRESOLVED ISSUES

Issue 1: Whether any additional adjustments to the amount of unreported taxable sales are warranted. We find that no additional adjustments are warranted.

Petitioner has operated a liquor store since October 2003. For audit, petitioner provided his federal income tax returns for 2008 and 2009, and sales tax worksheets, daily sales worksheets, and purchase invoices for the audit period. The Sales and Use Tax Department (Department) found immaterial differences between the gross receipts reported on petitioner's income tax returns and the total sales reported on his sales and use tax returns. A comparison of the gross receipts with the purchases reported on the income tax returns showed book markups of 56 percent and 64 percent for 2008 and 2009, respectively, which the Department found to be acceptable for this business. The

Department segregated the purchases shown in petitioner's purchase invoices for the second quarter of 2008 and the third quarter of 2010 into various merchandise categories, and calculated that 76.31 percent of petitioner's merchandise purchases were of taxable merchandise. The Department multiplied audited merchandise purchases[1] by the taxable merchandise purchase ratio of 76.31 percent to compute audited taxable merchandise purchases, and then compared those amounts with petitioner's reported taxable sales to compute book markups of 4 percent for 2008, 15 percent for 2009, and -36 percent for 2010. In contrast, a comparison of audited purchases of nontaxable or exempt merchandise with petitioner's claimed exempt sales of food products showed book markups of 222 percent for 2008, 229 percent for 2009, and 314 percent for 2010. The Department concluded that the very low book markups for taxable merchandise and high book markups for nontaxable merchandise indicated that petitioner was not ringing up his taxable sales on the cash register correctly and that a markup analysis would be required to establish audited taxable sales.

The Department compared the costs shown in purchase invoices for March and April 2011 with the respective selling prices provided by petitioner to compute average markups for the various categories of merchandise. The Department then weighted the average markups based on the ratios computed for each merchandise category in the purchase segregation test to calculate a weighted average markup of 38.68 percent. The Department reduced audited merchandise purchases by 2 percent to allow for pilferage, and by $392 per year for supplies, and then applied the taxable merchandise purchase ratio of 76.31 percent to compute audited costs of taxable merchandise sold for 2008, 2009, and 2010. The Department then added the weighted average markup to establish audited taxable sales, which it compared with petitioner's reported taxable sales to compute reporting error rates for each year. Applying the error rates to petitioner's reported taxable sales for the audit period resulted in unreported taxable sales of $148,783 in the original audit.

On appeal, petitioner prepared a markup test in which he compared costs from purchase invoices for October 2013 with "current" selling prices to compute higher average markups for liquor

[1] For 2008 and 2009, audited merchandise purchases were comprised of reported purchases from petitioner's income tax returns. For 2010, since petitioner had not yet filed his income tax return for that year, the Department multiplied the total amount of purchases compiled for the third quarter of 2010 by four to establish audited merchandise purchases.

and beer than the average markups computed in the audit, and lower average markups for soda and tobacco products. We calculated that substituting the average markups that petitioner computed for liquor, beer, soda, and tobacco products into the markup computations would result in a weighted average markup of 36.45 percent. Petitioner also contends that he should not be held liable for taxes that he never collected from his customers.

While we found that petitioner's markup test appears to be more extensive than the markup test conducted during the audit, we were not convinced that petitioner's test is more accurate. However, we found that the average markup of 45.70 percent computed in the audit for cigarettes and tobacco products should be reduced to 29.15 percent. While petitioner computes that his average markup for cigarettes is 26.69 percent, we note that petitioner's computation does not include markups for tobacco products other than cigarettes. Substituting the markup of 29.15 percent for cigarettes and tobacco products into the markup computations in the audit results in a weighted average markup of 34.91 percent, which is slightly lower than the markup computed by petitioner.[2] In the post-D&R reaudit, the Department corrected the allowance for annual supply purchases, applied the adjusted weighted average markup of 34.91 percent, and corrected the error rates used to establish unreported taxable sales for the first quarter of 2009 and the first quarter of 2010. The adjustments in the reaudit resulted in a reduction to the amount of unreported taxable sales, from $148,783 to $144,599 for the audit period.

Regarding petitioner's contention that he should not be held liable for taxes that he never collected from his customers, we note that, even if we were able to verify that petitioner did not collect sales tax reimbursement on his taxable sales, there is no provision in the law that allows an exemption from tax for failure to collect sales tax reimbursement. We have reviewed the computations in the reaudit and conclude that no further adjustment is warranted.

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

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[2] Although the D&R recommended that the markup be reduced to 35.11 percent, the markup was reduced slightly to 34.91 percent in the Department's reaudit calculations.

The Department imposed a negligence penalty because petitioner failed to maintain documents such as cash register z-tapes and summary reports to support his recorded total and taxable sales. Petitioner contends that he and his employees were never shown the proper way to ring up sales on the cash register such that taxable sales could be properly recorded and reported. Thus, petitioner contends that his errors were due to inexperience, rather than to negligence.

There is no indication that petitioner thought that any of the liquor, beer, soda, or cigarettes and tobacco products he sold were exempt from tax. Since petitioner has operated this business since October 2003, we find that petitioner had ample time to learn how to ring up his taxable sales on the cash register with reasonable accuracy. We note that more than 76 percent of petitioner's merchandise purchases were of taxable merchandise. In contrast, petitioner reported less than 46 percent of his total sales as taxable sales during the audit period. We would expect a reasonably prudent businessperson to notice the discrepancy. Furthermore, we note that the percentage of petitioner's total sales that he reported as taxable sales decreased significantly during the audit period, and the reporting error rates computed in the reaudit increased from 26 percent in 2008 to 106 percent in 2010. Moreover, we calculated that petitioner reported between 36 percent and 52 percent of his total sales as taxable sales during the two-year period after the end of the audit period. Given that petitioner reported much less accurately near the end of the audit period than he reported at the beginning of the audit period, and given that he failed to apply the experience gained from the audit to report his taxable sales more accurately, we find that petitioner's reporting errors were not due to inexperience, but instead were due to negligence. A comparison of unreported taxable sales of $144,599 with reported taxable sales of $345,268 shows an error rate of 42 percent, which we find is significant and constitutes additional evidence of negligence in reporting. Accordingly, even though this was petitioner's first audit, we conclude that petitioner was negligent and the penalty was properly applied.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

MARKUP TABLE

Liquor Store Taxable Sales

Percentage of taxable vs. nontaxable purchases	76.31%
Markup percentage developed in the reaudit	34.91%
Self-consumption allowed in dollars	$0*
Pilferage allowed in dollars	$9,964
Pilferage allowed as a % of cost of taxable goods available for sale	2.00%

* Petitioner informed the Department that no taxable merchandise was withdrawn from inventory for personal use, so no adjustment was made for self-consumption. On January 9, 2014, we contacted petitioner by email and explained that taxpayers who operate liquor stores typically withdraw some taxable merchandise from inventory for self-consumption, and that, in markup audits, an adjustment for self-consumed taxable merchandise benefits the taxpayers. We offered petitioner the opportunity to reconsider whether he had withdrawn any taxable merchandise from his inventory for self-consumption during the audit period. On January 21, 2014, petitioner replied by email, reiterating that neither he nor any family members took part in such activity.