STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
CAPITAL CITY RESTAURANTS, INC., dba's Crush 29 and T.G.I. Friday's	)	Account Number SR Y KH 100-260562 Case ID 522640
Petitioner	)	Roseville, Placer County

Type of Business: Restaurants

Audit period: 4/1/06 – 12/31/08

Item	Disputed Amount
Mandatory tips	$1,128,700
Sales of fixed assets	$2,500,000
Self-consumed supplies	$ 141,425

	Tax	Penalty
As determined	$285,451.98	$28,545.19
Post-D&R adjustment	0.00	-28,545.19
Proposed redetermination, protested	$285,451.98	$ 0.00
Interest through 08/31/12	115,040.83	
Total tax and interest	$400,492.81	
Monthly interest beginning 09/01/12	$1,427.26	

A Notice of Appeals Conference was mailed to petitioner's address of record and was not returned by the Post Office. Petitioner did not respond to the notice or appear at the appeals conference, which was held as scheduled. We sent petitioner a letter offering it the opportunity to provide any additional arguments and evidence in writing it wished us to consider, but it did not respond. This matter was scheduled for Board hearing in March 2012, but petitioner did not respond to the Notice of Hearing, and the matter was scheduled for decision on the nonappearance calendar. Petitioner subsequently requested that the matter be rescheduled for hearing, and it was rescheduled for June 2012, but was postponed to allow petitioner additional time to submit an opening brief.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the calculation of mandatory tips. We conclude that no adjustment is warranted.

Petitioner operated five "T.G.I. Friday's" (TGIF) restaurants and a "Crush 29" restaurant, and it did not collect tax reimbursement or report and pay tax on the 18 percent mandatory tips that it charged for parties of eight or more at all of its locations. The TGIF accounting software did not track that information, but the Crush 29 accounting software did. The Sales and Use Tax Department (Department) computed Crush 29's mandatory tip ratios and applied them to petitioner's reported sales for all of its locations to compute the mandatory tips subject to tax. In sum, the Department calculated unreported mandatory tips of $1,128,700 for the audit period.

Petitioner contends that the operations of Crush 29 and TGIF are dissimilar, so the mandatory tip ratio of Crush 29 is not representative and should not be used to establish the amount of TGIF's mandatory tips. In addition, petitioner claims the unreported mandatory tips should be based on cash sales instead of total sales since some credit card customers tip less than 18 percent.

Petitioner did not segregate TGIF's mandatory tips in its records, provide documentation to show that the ratio of mandatory tips at the TGIF restaurants is less than at Crush 29, or provide documentation to show that its credit card customers tipped less than the 18 percent mandatory tip amount. Accordingly, we conclude no adjustment is warranted.

Issue 2: Whether petitioner sold the restaurants. We conclude that petitioner sold the restaurants and owes tax on the sale of the tangible personal property.

The Department found that petitioner sold the TGIF restaurants to TGIA Restaurants, Inc. (TGIA) and to Ten Forward Dining, Inc. (TFD) on June 29, 2007, without reporting and paying sales tax to the Board on the sale of the tangible personal property. The Department relied on purchase agreements, escrow closing statements, and the federal income tax returns of TGIA and TFD in establishing the $2,500,000 measure of tax.

Petitioner contends that the sales were never consummated because it had not satisfied all the conditions of the purchase agreement (e.g., the Internal Revenue Service had liens on the restaurants so they could not be transferred free of liens, and petitioner had not filed federal and state income tax returns for years 2003 through 2007, while the agreement required that all such returns be filed). We find that the evidence indicates that the sales did occur. The escrow closing statements are signed and certified by the title company, and at least one is signed by petitioner's president. TGIA and TFD's

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

federal income tax returns list purchase amounts for "furniture and décor" totaling $2,500,000 which indicates that the sales did occur. Since petitioner has not provided any documentation showing that the purchase agreements or escrows were canceled, we conclude that the sales occurred and that petitioner is liable for the tax due on those sales.

Issue 3: Whether an adjustment is warranted to the taxable cost of self-consumed supplies. We conclude that no adjustment is warranted.

The Department found that petitioner purchased uniforms, menus, and cleaning products of $48,242 from out-of-state vendors who were not authorized to collect California use tax for 2008, representing an error rate of 0.31146 percent when compared with petitioner's reported taxable sales of $15,488,994. The Department applied the error rate to petitioner's reported taxable sales for the audit period and computed a $141,425 measure of tax for the unreported taxable consumption of supplies. Petitioner argues that it purchased its supplies tax-paid from Costco and that the audit approach in estimating the use tax liability is not accurate.

We find that the Department established the amount of self-consumed supplies purchased from unregistered out-of-state retailers using the best available information. Petitioner's books and records for periods prior to 2008 were incomplete. The Department's use of a block sample and application of sample results to the rest of the reporting period is authorized by Audit Manual section 405.20. There are no purchases from Costco without tax in the Department's test, and petitioner has not shown that it paid or reported tax on any of the purchases that were found to be errors in the test.

RESOLVED ISSUE

The Department imposed a negligence penalty because the books and records were incomplete. Petitioner disputes the penalty, arguing only that it is not warranted. We find petitioner was not negligent because: 1) the error ratio for unreported taxable sales is low (2.54 percent); 2) petitioner reported its sales of food and beverage accurately; and 3) this was petitioner's first audit, and the errors found do not seem unusually large for a first audit. Thus, we recommend that the penalty be deleted.

OTHER MATTERS

None.

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

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL