CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Claims for Refund Under the Sales and Use Tax Law of: JETHANI & ASSOCIATES, INC., dba Campbell Shell Claimant	Account Number: SR GH 97-938506 Case IDs 560580 and 611299 Campbell, Santa Clara County

Type of Business: Service station

Audit Period: 7/1/02 – 12/31/05

Item	Claimed Refund
Unreported taxable sales	Unstated
Credit for unclaimed prepaid sales tax	$1,999.28

BACKGROUND

The Sales and Use Tax Department (Department) issued a determination to claimant for the period July 1, 2002, through June 30, 2004, for tax of $11,836.62, plus interest and penalties, prior to completing the audit at issue here. The Department subsequently completed a revised audit that showed an increase of $509,032 to the amount of unreported taxable sales for this period, from $135,013 to $644,045. However, the determined tax could not be increased since the liability already was final by the time the revised audit was completed. For the period July 1, 2004, through December 31, 2005, the Department issued a determination for tax of $31,172.83 tax, plus interest and a penalty for negligence, based on unreported taxable sales of $377,851.

Claimant has paid the tax and interest in full for both periods, and it filed a claim for refund of an unstated amount on November 29, 2010, contending that the audited mark-up percentages were too high (case ID 560580). This claim was timely for eight payments totaling $14,336.99. Claimant filed a second claim for refund of an unstated amount on May 22, 2012 (case ID 611299), which was timely for six additional payments totaling $1,800.00.

UNRESOLVED ISSUES

Issue 1: Whether claimant is entitled to a refund based on adjustments to the audited understatement of taxable sales. We conclude no adjustments are warranted.

Claimant has operated a gas station with a mini-mart and auto repair shop since November 2001. For audit, claimant provided federal income tax returns, purchase invoices for July 2005, a sales tax worksheet for the fourth quarter of 2004, and a cash register tape for November 24, 2004. Claimant's fuel vendor provided claimant's purchase information for the years 2003 through 2005. To compute claimant's fuel sales, the Department compared claimant's recorded fuel sales with its recorded fuel purchases from 2005 and computed a book mark-up of about 6.60 percent, which it then added to fuel purchases of $7,055,167 for the years 2003 through 2005 to establish audited fuel sales of $7,521,020. Reducing audited fuel sales by $18,300 for claimed exempt sales of fuel to the U.S. Government resulted in audited taxable fuel sales of $7,502,720 for the three-year period. Since no fuel purchase information was available for the third and fourth quarters of 2002, the Department compared audited taxable fuel sales for 2003 with claimant's reported taxable sales for that year and computed a ratio of 90.22 percent, which it then applied to claimant's reported taxable sales to establish audited taxable fuel sales of $966,192 for the third and fourth quarters of 2002 combined. For the audit period, the Department established audited taxable fuel sales of $8,468,912.

To compute claimant's taxable sales of mini-mart merchandise, the Department segregated claimant's mini-mart merchandise purchase invoices for July 2005 into various categories and found that 4.75 percent of claimant's merchandise purchases were purchases of exempt food products. The Department's examination of claimant's reported amounts on its sales and use tax returns showed that the amounts claimed as exempt sales of food products were relatively similar for 10 of the 14 quarters in the audit period. For those 10 quarters, the Department divided the claimed exempt food sales by 4.75 percent to compute audited total sales of mini-mart merchandise of $991,971, or $99,197 per quarter, on average. The Department subtracted claimed exempt food sales to establish audited taxable sales of mini-mart merchandise of $944,886 for those 10 quarters, an average of $94,489 per quarter. Adding audited taxable mini-mart sales of $94,489 per quarter for the other four quarters to audited taxable mini-mart sales of $944,886 resulted in audited taxable sales of mini-mart merchandise of $1,322,841 for the audit period.

To compute claimant's auto part sales, the Department first computed auto parts sales of $4,059 for July 2005 by adding an estimated markup of 50 percent to claimant's auto parts purchases for that month. The Department then multiplied $4,059 by 12 to establish auto parts sales of $48,708 for 2005, which represented 51.79 percent of the amount claimed for nontaxable labor for that year. Multiplying claimed nontaxable labor for the audit period by 51.79 percent resulted in audited taxable sales of auto parts of $173,567.

In total, the Department established audited taxable sales of $9,965,319 ($8,468,912 + $1,322,841 + $173,567) for the audit period, which exceeded claimant's reported taxable sales by $1,021,896. However, since the amount determined for the period July 1, 2002, through June 30, 2004, could not be increased by the time the revised audit was completed, the amount of unreported taxable sales at issue is $512,865. Claimant contends that the markup used to establish audited fuel sales is too high, and also contends that audited taxable sales of mini-mart merchandise and auto parts are overstated.

We note that the book markup of 6.81 percent for fuel computed in claimant's subsequent audit for the period July 1, 2006, through June 30, 2009, is consistent with the mark-up of 6.60 percent computed in the audit at issue here, which constitutes evidence that the markup is reasonable. Further, claimant has provided no evidence to support its assertion that the markup for fuel is overstated. Moreover, we have reviewed the audit procedures and computations used to establish audited taxable sales of fuel, mini-mart merchandise and auto parts, and have found no errors. We conclude that the audit results are based on the best information available, and no adjustments are warranted. Since the amounts for which timely claims have been filed do not exceed the amounts due for the determinations, we find there is no overpayment related to the determined understatement of reported taxable sales.

Issue 2: Whether claimant is entitled to a refund based on additional credits for unclaimed prepaid sales tax paid to fuel suppliers. We conclude that claimant is not entitled to additional credits.

The Department compared claimant's claimed credits for sales tax prepaid to fuel suppliers with the amounts reported by claimant's fuel suppliers, and found that claimant had overstated its credits by $682, which was assessed in the audit. Claimant submitted a schedule of sales tax prepayments reported by its fuel suppliers, which it contends includes two invoices with sales tax prepayments totaling $1,999.28 that represent credits that were not allowed in the audit. However, we find that the Department previously corrected these two entries when it computed the amount of sales tax claimant prepaid on its fuel purchases. Therefore, we find that this issue has been previously addressed and resolved by the Department, and no further adjustment is warranted.

RESOLVED ISSUE

In the D&R, we found that claimant's error ratio of 11 percent was not unusually large for a taxpayer that had not been audited previously. Although we note that the lack of books and records concerned us, we recommend that the negligence penalties be deleted from both determinations. As a result, the amnesty double negligence penalty of $238.05 applied to the first determination was also deleted. Regarding the amnesty interest penalty applied to the first determination, we found that claimant was not aware of the amnesty program and did not know of the potential audit liability prior to March 31, 2005, which was the deadline for filing for amnesty. Therefore, we also recommend that the amnesty interest penalty of $212.34 be relieved. Regarding the finality penalty that was added to the second determination when the unpaid liability became final, we find that claimant's failure to pay the determination before it became final was due to claimant's mistaken belief that the disputed liability had been timely petitioned by its new accountant, and therefore was due to reasonable cause and circumstances beyond its control. Accordingly, we recommend that the finality penalty be relieved. In the SD&R, we noted that two payments totaling $428.55 had been applied towards penalties, and claimant had not yet filed a claim for refund for these payments. At the time the SD&R was issued, time remained for claimant to file a timely claim for refund of the $428.55, and we found that the amount could not be refunded unless a claim was timely filed. However, although claimant did not file a timely claim for refund, the Department has applied these two payments to the tax liability resulting from claimant's subsequent audit for the period July 1, 2006, though June 30, 2009. By applying the overpayment to another liability, the Department has effectively refunded the overpayment to claimant.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

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:	
JETHANI & ASSOCIATES, INC., dba Campbell Shell	Account Number: SR GH 97-938506 Case ID 563266
Petitioner	Campbell, Santa Clara County

Type of Business: Service station

Audit period: 7/1/06 – 6/30/09

Item	Disputed Amounts
Unrecorded taxable mini-mart sales	$214,179

	Tax	Penalty
As determined	$18,277.65	$1,827.80
Post-D&R adjustments	- 4.94	-1,827.80
Proposed redetermination	$18,272.71	$ 00.00
Less concurred	- 961.12	
Proposed redetermination, protested	$17,311.59	
Proposed tax redetermination	$18,272.71	
Interest through 09/30/13	6,790.95	
Total tax and interest	$25,063.66	
Payments	- 1,569.55	
Balance Due	$23,494.11	
Monthly interest beginning 10/01/13	$ 83.52	

UNRESOLVED ISSUES

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

Petitioner has operated a service station selling gasoline, auto parts, cigarettes, soda, food, and miscellaneous grocery products in Campbell, California since November 2001.

For audit, petitioner provided federal income tax returns, sales and use tax returns, monthly sales reports, and purchase invoices. The Sales and Use Tax Department (Department) compared taxable sales of $11,537,792 recorded in petitioner's monthly sales reports with petitioner's reported taxable sales of $11,516,771, and computed a difference of $21,021. Based on its computation of gasoline sales using the gallons of fuel petitioner purchased and the average retail selling prices published by the California Department of Energy, the Department concluded that recorded sales of fuel were substantially accurate.

The Department decided to establish taxable sales of mini-mart merchandise on a markup basis. Based on information provided by petitioner's main vendors, Pitco and Costco, for the first six months of 2009, the Department concluded that petitioner's recorded purchases from Pitco were substantially complete. However, purchases of $94,889 shown in the information provided by Costco exceeded petitioner's recorded Costco purchases of $54,255 by $40,634. Also, for a third vendor, Blue Rhino, the Department concluded that petitioner made weekly purchases and that some of the invoices for those weekly purchases were missing. Thus, for Blue Rhino, the Department estimated the amounts of the missing purchase invoices for the six-month period. In all, the Department computed audited merchandise purchases of $14,694 from Pitco, $94,889 from Costco, and $4,119 from Blue Rhino, a total of $113,702 for the six-month period.

After segregating the purchases shown in the available purchase invoices into various product categories, the Department computed an audited purchase ratio for each category. The Department then used shelf tests to compute markups for each product category. Using audited markups and audited purchase ratios, the Department computed a weighted average markup of 26.88 percent. In the audit, the Department reduced audited merchandise purchases for the first six months of 2009 by 1 percent for pilferage. In the post-conference reaudit, based on discussions at the conference, the Department increased the pilferage allowance to 2 percent and further reduced the cost of goods sold by 2 percent for the cost of self-consumed merchandise. The Department then multiplied the balance by the taxable merchandise purchase ratio of 96.88 percent to establish the audited cost of taxable merchandise sold for the first six months of 2009. In the post-conference reaudit, the Department then added the weighted average markup of 25.19 percent (which had been reduced from 26.88 percent) to the audited cost of taxable merchandise sold to establish audited taxable mini-mart sales for the six-month period, which exceeded recorded taxable mini-mart sales for those six months by 39 percent. The Department applied that percentage to recorded taxable mini-mart sales to compute unrecorded taxable sales of mini-mart merchandise of $214,179, which petitioner continues to protest. In the post-conference reaudit, the Department also established a separate deficiency measure of $13,058 for unreported taxable costs of self-consumption, and a separate measure for the difference between recorded and reported taxable sales (as recommended in the D&R), which petitioner does not dispute.

Petitioner contends that the purchases shown in the information provided by Costco are overstated, probably due to someone else using petitioner's Costco card to make purchases. However, a comparison of the purchase amounts shown in the information provided by Costco for the first six months of 2009 with petitioner's recorded Costco purchases shows that, while the amounts of monthly purchases in the information provided by Costco are relatively consistent for the six-month period, petitioner provided no purchase receipts from Costco for the three months from March 4, 2009, through June 3, 2009. Since retailers of mini-mart merchandise tend to consistently replenish their inventory, and petitioner has provided no explanation for the three-month gap in its recorded Costco purchases, we find that petitioner did not maintain records of all of its purchases from Costco, and conclude that the purchase information provided by Costco accurately reflects petitioner's purchases from Costco for the six-month period. Accordingly, we find no further adjustments are warranted.

RESOLVED ISSUE

At the appeals conference, the Department reached the conclusion that the negligence penalty was not warranted because petitioner has improved its record keeping since the prior audit was completed, and because the error ratio in this audit is significantly less than the error ratio in the prior audit. We concur with the Department's conclusion and recommend that the negligence penalty be deleted.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	96.88%
Mark-up percentage developed	25.19%
Self-consumption allowed in dollars	$13,058
Self-consumption allowed as a percent of taxable purchases	2%
Pilferage allowed in dollars	$13,058
Pilferage allowed as a percent of taxable purchases	2%