

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petitions for Redetermination)
 4 Under the Sales and Use Tax Law of:) Account Number: SR Y AS 97-884213
 5 M & Y SAFAR BROTHERS, INC.) Case ID 466345
 6 dba Lomita Mobil) Account Number: SR AS 12-843064
 7 Petitioner) Case ID 467762
 8 _____) Corona, Riverside County

9 Type of Business: Gas stations with mini-marts

10 Audit period: 07/01/03 – 06/30/06 (466345)
 11 05/01/04 – 12/31/05 (467762)

12 Item Disputed Amount

13 Unreported sales of fuel \$455,753 (466345)
 14 Negligence penalty \$151,013 (466345)
 \$ 34,801 (467762)

	<u>466345</u>		<u>467762</u>	
	<u>Tax</u>	<u>Penalty</u>	<u>Tax</u>	<u>Penalty</u>
15 As determined:	\$1,523,950.67	\$152,395.09	\$348,006.63	\$34,800.69
16 Post-D&R adjustment	- 13,817.00	- 1,381.70	00.00	00.00
17 Proposed redetermination	\$1,510,133.67	\$151,013.39	\$348,006.63	\$34,800.69
18 Less concurred	-1,472,534.05	00.00	-348,006.63	00.00
Balance, protested	<u>\$ 37,599.62</u>	<u>\$151,013.39</u>	<u>\$ 00.00</u>	<u>\$34,800.69</u>
19 Proposed tax redetermination	\$1,510,133.67		\$348,006.63	
Interest through 04/30/12	845,557.66		206,104.83	
20 Negligence penalty	<u>151,013.39</u>		<u>34,800.69</u>	
21 Total tax, interest, and penalty	\$2,506,704.72		<u>\$588,912.15</u>	
22 Payments	- 86,162.35			
Balance Due	<u>\$2,420,542.37</u>			
23 Monthly interest beginning 05/01/12	<u>\$ 8,306.50</u>		<u>\$ 2,030.04</u>	

24 This matter was scheduled for Board hearing in October 2010, but was postponed for
 25 settlement consideration.

26 **UNRESOLVED ISSUES**

27 **Issue 1:** Whether adjustments are warranted to the audited amount of fuel sales under seller's
 28 permit SR Y AS 97-884213. We recommend no adjustment.

1 During the audit period, petitioner operated four Mobile gasoline stations with mini-marts
2 under seller's permit SR Y AS 97-884213 and one station under a separate permit, SR AS 12-843064.¹
3 The Sales and Use Tax Department (Department) concluded that recorded mini-mart sales were
4 substantially accurate for both audit periods, and recorded sales of fuel were substantially accurate for
5 the audit period prior to 2006 for seller's permit SR Y AS 97-884213 and for the entire audit period for
6 seller's permit number SR AS 12-843064. However, the Department noted that petitioner's claimed
7 exempt sales of food products represented approximately 44 percent of reported total sales, which
8 appeared excessive. Petitioner's accountant explained that the claimed deductions for exempt sales of
9 food products included sales of fuel for which customers had paid with credit cards, since the credit
10 card payments had not cleared the bank. However, the Department noted that the sales were also not
11 reported in subsequent periods when the payments should have cleared the bank. Thus, the
12 Department concluded that petitioner had significantly overstated the claimed exempt sales of food
13 products on the sales and use tax returns. For the periods before 2006, the audited understatement of
14 reported taxable sales represents the difference between recorded and reported taxable sales.²
15 Petitioner does not protest the understatements for periods prior to 2006.

16 For the first two quarters of 2006, the Department found that the book markups, computed
17 using recorded sales and purchases of fuel, were -3.64 percent, 1.46 percent, and 4.86 percent for the
18 Lomita, Torrance, and Long Beach stations, respectively. Although it was lower than the markups
19 computed for earlier portions of the audit period, the Department concluded that the markup of 4.86
20 percent for the Long Beach station was acceptable and that the recorded sales of fuel for that location
21 were reasonably accurate. However, the Department found the negative markup (indicating costs in
22 excess of sales) for the Lomita location and the minimal markup of 1.46 percent for the Torrance
23 location were evidence that recorded fuel sales for those locations were understated for 2006.

24 For the Lomita location and the Torrance location, for the period January 1, 2006, through
25 June 30, 2006, only, the Department established audited fuel sales on a markup basis, using the overall
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28 ¹ This station was located in Torrance. Effective January 1, 2006, petitioner closed this permit and added the Torrance station to the permit under which the other stations were operated.

1 markup of 8.76 percent that it had computed from petitioner's records for all the stations for the period
2 July 1, 2003, through December 31, 2005, and the recorded purchases of fuel. After the appeals
3 conference, petitioner provided evidence of additional purchases of fuel in 2006, requesting that
4 additional credit be allowed for prepaid sales tax to fuel vendors. Although the Department should
5 have allowed the additional credit for prepaid sales tax *and* increased the audited taxable sales of fuel
6 to account for the additional purchases, it instead allowed additional credit for prepaid sales tax of
7 \$13,817 without increasing the audited taxable sales.

8 Petitioner contends the Department should have accepted its recorded sales of fuel for the
9 Lomita and Torrance stations for 2006 rather than establishing fuel sales on a markup basis. Petitioner
10 contends further that, if a markup analysis is used, it would be more reasonable to use the markup
11 percentages calculated for these two stations for 2005 (3.46 percent for Lomita and 3.21 percent for
12 Torrance). However, this contention overlooks the fact that the book markups in 2005 for petitioner's
13 two other stations were 17 percent and 14 percent. The broad variation in markups indicates that the
14 sales or costs (or both) had not been correctly recorded for the individual stations.³ Nevertheless,
15 while the Department concluded that the markups for the individual stations were unreliable, with the
16 markups for Lomita and Torrance lower than actual and the markups for the other two stations higher
17 than actual, it accepted that the mistakes offset each other and that the overall book markup of
18 8.81percent for 2005 (almost identical to the 8.76 percent markup for the period July 1, 2003, through
19 December 31, 2005), indicates that total recorded sales for all four stations combined were
20 substantially correct. We agree, and petitioner has not submitted any documentation to support a
21 contrary result. Furthermore, the Department's allowance of additional prepaid sales tax credits
22 without an offsetting increase to the audited taxable sales and its acceptance of sales as reported at the
23 Long Beach station are very favorable to petitioner. We find no adjustment is warranted.

24 **Issue 2:** Whether petitioner was negligent. We conclude that it was.
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26 ² As a result of a lapse in the periods covered by waivers of the statute of limitations, the determination was not timely
27 issued for the first quarter 2004. Accordingly, there is no liability for that quarter included in the determination.

28 ³ Also, by providing evidence of additional purchases, petitioner itself effectively concedes that not all costs were recorded
in 2006, which is additional reason for concern regarding the accuracy of the allocation of sales and costs to individual
stores in 2005.

1 The Department imposed the negligence penalty because petitioner consistently understated its
2 taxable sales by claiming approximately 44 percent of its total sales as nontaxable sales of food
3 products, and the understatements were substantial. Petitioner disputes the penalty on the basis that
4 this was its first audit, and it was reasonable for petitioner to rely on its accountant to accurately
5 prepare the sales and use tax returns.

6 Although we find petitioner demonstrated no negligence in maintaining records, the
7 understatements are over \$20 million for SR Y AS 97-884213 and over \$5 million for SR AS 12-
8 843064, and they represent percentages of error of approximately 73 percent and 90 percent,
9 respectively, when compared to reported taxable sales.⁴ The primary reason for these understatements
10 was petitioner's erroneously claimed deductions for exempt sales of food representing more than 40
11 percent of its total sales, even though its actual exempt sales of food represented only a small fraction
12 of its sales. We find that the magnitude of the errors and the patently obvious overstatement of
13 claimed exempt sales of food show that petitioner did not exercise due care in reporting, even though
14 petitioner had not been audited previously.

15 Petitioner states it was advised by the accountant that its prepayments of sales tax to vendors
16 represented its entire liability for sales tax related to fuel sales. We do not believe that petitioner
17 received such advice because the accountant did not prepare the returns in a manner consistent with
18 such alleged advice (claiming that a taxpayer's sales tax prepayments equaled the taxpayer's liability
19 for sales tax on its sales of fuel would not be accomplished by way of an erroneous claim of exempt
20 food sales). Even if petitioner had received such erroneous advice from its accountant, petitioner's
21 failure to verify the accuracy of the returns also is evidence that it did not exercise due care. We find
22 petitioner was negligent, and the penalty was properly applied.

23 OTHER MATTERS

24 None.

25 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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27 ⁴ In fact, the percentages of error in understated taxable sales would have been even greater except that the understatements
28 were partially offset by credits for its prepayments of sales tax to vendors of fuel that petitioner also failed to report (claim)
in the amount of \$163,851 for SR Y AS 97-884213 and \$76,770 for SR AS 12-843064.

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MARKUP TABLE-FUEL SALES 1/1/06-6/30/06
LOMITA and TORRANCE STATIONS

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Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentages developed	8.76%*
Self-consumption allowed in dollars	N/A**
Pilferage allowed in dollars	N/A**

9 * This is the percentage markup used to compute audited sales of fuel based on recorded purchases, but
10 the effective markup is lower than this because, after petitioner established additional fuel purchases
11 (to obtain additional credit for prepaid sales tax), the Department did *not* increase audited sales to
account for the additional purchases.

12 ** Since the audited markup is based on petitioner's book markup for the remainder of the audit
13 period, it already accounts for self-consumption and pilferage.
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