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:

TARUN MAITRA, et al, dba M & S Liquor

Petitioner

Account Number: SR AA 100-452872
Case ID 473027

Lakewood, Los Angeles County

Type of Business: Liquor store

Audit period: 10/01/04 – 07/11/07

Item	Disputed Amount
Understatement of reported taxable sales	$1,065,523
Tax-paid purchases resold	Unstated
Negligence penalty	$ 8,926

	Tax	Penalty
As determined:	$91,418.68	$9,141.91
Adjustment - Appeals Division	- 2,161.17	- 216.15
Proposed redetermination	$89,257.51	$8,925.76
Less concurred	- 1,309.82	00.00
Balance, protested	$87,947.69	$8,925.76

Proposed tax redetermination	$ 89,257.51
Interest through 07/31/12	32,649.25[1]
Negligence penalty	8,925.76
Total tax, interest, and penalty	$130,832.52
Payments	- 14,050.00
Balance Due	$116,782.52
Monthly interest beginning 08/01/12	$ 376.04

This matter was scheduled for Board hearing on October 27, 2011, but was postponed because the afternoon session of that meeting was cancelled. The matter was rescheduled for hearing on January 31, 2012, but was postponed at petitioner's request due to a trip abroad. It was rescheduled on April 25, 2012, but petitioner did not respond to the Notice of Hearing, and the matter was scheduled

[1] This is net of the $4,611.62 of interest for which we recommend relief, as discussed below.

for decision on the nonappearance calendar. Petitioner subsequently requested that the matter be rescheduled for hearing.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the understatement of reported taxable sales. We find no further adjustment is warranted.

Petitioner operated a liquor store from September 1, 2004, through July 11, 2007. Petitioner provided sales journals, federal income tax returns, and incomplete purchase invoices for audit. Also, petitioner provided some cash register tapes in December 2007, but it did not provide them again later, in June 2008, when the Sales and Use Tax Department (Department) requested them for additional review.

The Department conducted a markup audit. To establish audited purchases, the Department used information provided by petitioner's vendors and, for vendors that did not provide data, based audited purchases on petitioner's records. The Department made adjustments of two percent each for self consumption and pilferage to establish the audited cost of taxable goods sold. Since the business had been sold before the audit commenced so that the Department could not perform a shelf test, the Department estimated markups for each of the merchandise categories and, using percentages established in a purchase segregation test, computed a weighted average markup of 23 percent. The Department computed audited taxable sales using the 23 percent markup and audited cost of taxable goods sold. In the D&R, we noted an error in the calculation of taxable merchandise purchased from one vendor, and we recommended an adjustment for changes in inventory. After those adjustments, the audited understatement of reported taxable sales has been reduced by $26,299, from $1,091,822 to $1,065,523.

Petitioner disputes the audited amount of taxable sales. It asserts that the markup of 23 percent used for the audit is excessive because petitioner routinely offered special discount prices to its regular customers and because competition in the area required it to keep prices low. Further, petitioner claims that the estimated markup of 19 percent for cigarettes is too high because petitioner participated in rebate programs which petitioner argues reduced the markup. In addition, petitioner asserts that the amounts of purchases provided by its vendors may be excessive.

We note that petitioner's purchases of taxable merchandise from Sam's Club, just one of petitioner's several vendors, totaled $501,140 during the audit period, while petitioner reported taxable sales of $351,071 for that same period. This discrepancy makes it virtually certain that petitioner substantially underreported its taxable sales. Regarding the markup percentage used by the Department, our experience examining audits of liquor stores indicates that the expected markup would be in the range of 25 to 40 percent. Since petitioner has submitted no evidence to impeach the 23 percent markup used by the Department and the markup is less than the markup we would have expected, we find the markup used in the audit is reasonable and that no reduction is warranted.

Regarding the cigarette rebates, petitioner's concession that those rebates were subject to tax resolves the issue. Since, as petitioner effectively concedes, his taxable receipts from sales of cigarettes were not reduced as a result of the rebates, the rebates could *not* serve to reduce the 19 percent markup used by the Department, which it estimated based on petitioner's regular selling prices of cigarettes.

With respect to the audited cost of taxable goods sold, petitioner has provided no evidence that the amounts provided by the vendors were incorrect, and we note that the information from the vendors is detailed. Thus, we find no reason to conclude that the vendors' information is incorrect. We conclude that no further adjustments are warranted to the understatement of reported taxable sales.

Issue 2: Whether the audited amount of tax-paid purchases resold should be increased. We find it should not.

The information provided by Sam's Club to the Department showed that petitioner had paid sales tax reimbursement with respect to $8,519 of its taxable purchases. Accordingly, the Department allowed a tax-paid purchases resold adjustment of $8,519 in the audit. Petitioner contends that the amount of tax-paid purchases resold was greater than $8,519, but states it has no documentation to support a greater amount. In the absence of documentation, we find no adjustment is warranted.

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

The Department imposed the penalty because the records were inadequate and because the understatement was substantial. Petitioner disputes the penalty on the basis that this was its first business venture, and it was unaware of the records it should maintain. Petitioner further claims that it provided cash register tapes and purchase invoices to an outside bookkeeper and relied on the bookkeeper to properly prepare the records and report the accurate amount of sales and use tax.

Petitioner provided incomplete, conflicting records. The amounts of total sales reported on sales and use tax returns were substantially less than the cost of goods sold reported on federal tax returns. Reported taxable sales for the audit period were significantly less than petitioner's purchases of taxable merchandise from just one of its several vendors, and represent only 17 percent of reported total sales, although the inventory reports show that taxable merchandise represented about 91 percent of petitioner's merchandise. The understatement of $1,065,523 represents an error ratio greater than 300 percent when compared with reported taxable sales of $351,071. We believe any reasonably prudent business person, even one with limited experience and without a prior audit, would recognize discrepancies of this magnitude, and we do not believe that they can be explained in any way other than as a result of petitioner's negligence. We also reject petitioner's assertion that negligence is not applicable because it relied on an outside bookkeeper since petitioner is responsible for the negligence of its agents. (Sales and Use Tax Department Audit Manual § 0506.20.) We therefore conclude that the negligence penalty was properly imposed.

RESOLVED ISSUE

Petitioner requested relief of interest on the basis that there was an unreasonable delay on the part of a Board employee in the processing of this audit. Petitioner originally requested relief of all interest, but later amended the amount to $4,000.00, which it estimated to be the amount of interest accrued from April 1, 2008, through November 30, 2008. The Department conceded that relief of interest is warranted for the period June 1, 2008, through October 31, 2008, because, under the unusual facts of this case, there was an unreasonable delay caused by the auditor's use of an inappropriate audit method, and the audit should have been completed by the end of May 2008. The amount of interest accrued for the five months for which the Department concedes relief is $3,885. We concluded there was an additional month of delay because the audit should completed by the end of March 2008. Thus, we recommend relief of interest totaling $4,611.42. (We do *not* recommend relief for May 2008 because we find that petitioner was responsible for the delay during that month.)

OTHER MATTERS

None.

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

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	Unknown*
Mark-up percentages estimated	Beer, liquor, wine, and soda 25% Cigarettes 19% Misc. Taxable 35% Weighted average markup 23%
Self-consumption allowed in dollars	$24,021 for the audit period
Self-consumption allowed as a percent of taxable purchases	2%
Pilferage allowed in dollars	$23,540
Pilferage allowed as a percent of taxable purchases	2%

* The Department did not compute a percentage of taxable to total merchandise purchased, instead computing taxable purchases based on information provided by vendors and some purchase record provided by petitioner.