

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
4 Under the Sales and Use Tax Law of:)5 DAWIT DAGNE TEKELWOLD and)
6 HELEN YOHANNES,)
7 dba Alcatel Bottle Shop & Ethio Deli)Account Number: SR CH 100-422555
Case ID 4915688 Petitioner)

Oakland, Alameda County

9 Type of Business: Liquor store

10 Audit period: 01/01/05 – 12/31/07

11 Item Disputed Amount

12 Unreported taxable sales \$569,983

13 Negligence penalty \$ 5,127

TaxPenalty

14 As determined: \$52,866.55 \$5,286.67

15 Adjustment – Appeals Division -1,591.80 -159.21

16 Proposed redetermination \$51,274.75 \$5,127.46

17 Less concurred -1,401.14 0.0018 Balance, protested \$49,873.61 \$5,127.46

19 Proposed tax redetermination \$51,274.75

20 Interest through 09/30/11 22,540.30

21 Negligence penalty 5,127.4622 Total tax, interest, and penalty \$78,942.5123 Monthly interest beginning 10/1/11 \$256.3724 **UNRESOLVED ISSUES**25 **Issue 1:** Whether further adjustments are warranted to the audited understatement of reported
26 taxable sales. We recommend no further adjustment.27 Petitioner has operated a liquor store selling liquor, beer, wine, cigarettes, soft drinks, sundries,
28 newspapers, and food in Oakland, since August 1, 2004. Petitioner also operated an Ethiopian
delicatessen in the liquor store during 2006, but closed the delicatessen counter within two weeks of
opening due to lack of sales. Petitioner's accountant determined reported total sales amounts by
marking up petitioner's merchandise purchases by 35 percent. Petitioner did not explain its

1 methodology for computing its claimed exempt sales. Comparing petitioner's 2006 federal income tax
2 return with petitioner's 2006 sales and use tax return, the Sales and Use Tax Department (Department)
3 found that petitioner had reported gross receipts of \$421,481 on the federal return but reported total
4 sales of only \$299,678 on its sales tax return, a difference of \$121,803. Of petitioner's total sales
5 reported on its sales and use tax returns for the audit period, petitioner had reported only 24.75 percent
6 as taxable, which the Department found to be unreasonably low for a liquor store. The Department
7 thus concluded that petitioner's reported taxable sales were substantially understated, and decided to
8 establish audited taxable sales on a markup basis.

9 The Department segregated the purchase invoices that petitioner provided for the second
10 quarter of 2005 into various product categories, and found that 90.34 percent of petitioner's purchases
11 were taxable. The Department then applied the 90.34 percent taxable ratio to the purchase totals from
12 petitioner's federal returns for 2005, 2006, and 2007 to compute audited purchases of taxable
13 merchandise. The Department reduced those purchases by three percent for pilferage and, in the post-
14 D&R reaudit, by three percent for self-consumption to establish the audited cost of taxable
15 merchandise sold of \$585,129. The Department conducted a shelf test using cost from purchase
16 invoices and posted selling prices or prices provided orally by the petitioner or store employee, to
17 compute a weighted average markup for taxable sales of 35.92 percent (after the adjustment
18 recommended in the D&R). Using the audited cost of taxable merchandise sold and the audited
19 markup, the Department computed taxable sales which exceeded reported amounts by \$569,983.

20 Petitioner contends that the audited percentage of taxable to total purchases of 90.34 percent is
21 overstated because the purchase segregation test did not include petitioner's purchases of Ethiopian
22 bread called enjerra. Petitioner explained that the enjerra is purchased with cash from neighborhood
23 women who bake the bread, and that enjerra is typically a great source of income for most Ethiopian
24 stores. The Department agrees that purchases of enjerra were not included in the purchase segregation
25 test, but pointed out that petitioner provided no record of any purchases of enjerra. The Department
26 thus doubts that purchases of enjerra were included in petitioner's purchases reported on the federal
27 returns, which was the basis for audited costs of taxable merchandise. The Department also notes that
28 purchases of \$57,199 from the 2Q05 segregation test are approximately one fourth of total purchases

1 reported on the 2005 federal return, which indicates that enjerra purchases are not included in those
2 reported purchases. Nor did the Department observe any enjerra for sale during any of its visits to the
3 store.

4 Petitioner also claims that the audited markup is too high because, in the shelf test, the
5 Department failed to take into account petitioner's special pricing on sales of kegs of beer. Petitioner
6 states that it offered special pricing or free merchandise with purchases of kegs in order to encourage
7 the college students in the area to patronize its store. As support, petitioner has provided copies of
8 several undated signs or fliers that advertised the specials, but no other documentation.

9 Petitioner has provided no records to support its contention regarding the Department's
10 omission of purchases of enjerra in the purchase segregation test. We conclude that, if petitioner
11 purchased enjerra for resale, its purchases must have been minimal since the Department did not notice
12 enjerra on display or sales of enjerra during its visits to the store. In the absence of any records
13 showing purchases of enjerra (or that such purchases were included in purchases reported on federal
14 returns), we do not to recommend any adjustment in the purchase segregation test.

15 With respect to petitioner's assertion that it offered special pricing on kegs of beer, the
16 Department noted that it did not observe any signs or fliers advertising special prices when visiting the
17 store, and neither the partners nor employee raised the issue of special pricing during the shelf test or
18 when the results of the audit were originally discussed with petitioner. Moreover, since the signs or
19 fliers are not dated, it cannot be determined what periods the special pricing may have been offered. In
20 addition, petitioner has not provided records to show how often the selling prices may have been
21 reduced or free merchandise may have been given with purchases of kegs. Therefore, we find there is
22 insufficient evidence to support an adjustment to the markup analysis to allow for special pricing or
23 free merchandise provided with purchases of kegs of beer.

24 **Issue 2:** Whether petitioner was negligent. We conclude it was.

25 The Department imposed the negligence penalty because it concluded that high reporting error
26 rates show petitioner failed to exercise due care in preparing its sales and use tax returns. Petitioner
27 contends that it was not negligent in reporting because it relied on the advice of a CPA who prepared
28 petitioner's returns.

1 We find petitioner's records were inadequate and incomplete. Further, audited taxable sales
2 were \$795,308, while petitioner's reported taxable sales were \$225,325, which constitutes an
3 understatement of \$569,983 and an error rate of 253 percent. We find that the inadequate records and
4 significant understatement are evidence that petitioner did not exercise due care in record-keeping or
5 reporting. Petitioner's argument that it relied upon its CPA to properly report tax is unavailing because
6 petitioner was responsible for reporting its sales accurately, and it should have reviewed the returns to
7 verify that they were correct. Although we recognize this was petitioner's first audit, we would expect
8 any business person, even one with limited experience, to recognize the magnitude of error which is
9 applicable here.

10 **OTHER DEVELOPMENTS**

11 None.

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14 Summary prepared by Thea Etheridge, Business Taxes Specialist II
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28**MARKUP TABLE**

Percentage of taxable vs. nontaxable purchases	90.34%
Mark-up percentages developed	35.92%
Self-consumption allowed in dollars	\$5,338 per year
Self-consumption allowed as a percent of total purchases	2.33%
Pilferage allowed in dollars	\$18,592
Pilferage allowed as a percent of total purchases	2.71%