CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
ZENAIDA LAXAMANA, ET AL., dba Zem Philippine Grocery	)	Account Number: SR BH 19-740648 Case ID 389908
Petitioner	)	San Francisco, San Francisco County

Type of Business: Grocery store with sales of beer

Audit period: 04/01/03 – 03/31/06

Item	Disputed Amount
Unreported taxable sales	$370,325
Negligence penalty	$ 2,879

	Tax	Penalty
As determined:	$31,970.39	$3,197.07
Adjustment - Appeals Division	- 3,178.07	- 317.80
Proposed redetermination, protested	$28,792.32[1]	$2,879.27

Proposed tax redetermination	$28,792.32
Interest through 1/31/09	11,222.27
10% penalty for negligence	2,879.27
Total tax, interest, and penalty	$42,893.86
Monthly interest beginning 2/1/09	$ 191.95

This matter was previously scheduled for Board hearing on November 12, 2008, but petitioner did not respond; thus, petitioner was informed by Board Proceedings Division that this matter will be presented to the Board for decision without oral hearing. Subsequently, the matter was rescheduled for Board hearing because not all the parties were notified of the Board hearing.

[1] Petitioner protests the entire amount of determined tax, based on a measure of tax of $338,732, which is the total of $370,325 (understatement of reported taxable sales) and $2,880 (unreported cost of self-consumed merchandise) net of a credit amount of $34,473 (unclaimed deductions for tax-paid purchases resold). Petitioner has filed a claim for refund with respect to the tax paid on purchases that were resold. Therefore, if petitioner were to prevail, there would be a net overpayment subject to refund.

UNRESOLVED ISSUES

Issue 1: Whether further adjustments are warranted to the audited amount of unreported taxable sales. We recommend no further adjustments.

Petitioner is a partnership that has operated the subject grocery store since February 1988 and has been audited twice before. In the present audit, the Sales and Use Tax Department (Department) found that audited taxable merchandise purchases were $245,405[2] for the two years 2004 and 2005, which is about 2.5 times greater than reported taxable sales of $97,018 for the same two years. The Department concluded that reported taxable sales were significantly understated and performed a markup audit. The Department made an allowance of $100 per month for self-consumed taxable merchandise and an allowance of 2 percent for pilferage to calculate audited cost of taxable goods sold for 2004 and 2005 of $238,096. Based on a shelf test, the Department calculated a markup of 56.08 which it added to audited cost of taxable goods sold of $238,096 to compute audited taxable sales of $371,615 for 2004 and 2005. Compared to reported taxable sales of $97,018 for the same period, this results in an error ratio of 283.04 which was applied to reported taxable sales for the audit period of $143,795 to compute unreported taxable sales of $406,994.

Petitioner contends that its reported taxable sales are correct and that the audited markup of 56.08 percent is excessive. Petitioner states that its markup is approximately 40 percent but has offered no documentation to support that assertion.

As noted above, audited taxable purchases are approximately 2.5 times greater than reported taxable sales. That broad discrepancy is virtually certain proof that reported taxable sales were significantly understated. However, we agree that a markup of 56.08 percent appears high for this business, and at the appeals conference, the Department acknowledged that it would normally expect a markup of 30 to 45 percent for this business. The D&R recommends that the audited markup be reduced to 45.13 percent, which is the markup calculated in the shelf test for the prior audit period of

---

[2] Audited taxable merchandise purchases were calculated by applying 57.36 percent, calculated in a purchase segregation test for the 2nd quarter 2006, to petitioner's recorded purchases.

July 1, 1996, through June 30, 1999.[3] Petitioner has not provided documentation to support a markup lower than 45.13 percent, and we recommend no further adjustments.

Issue 2: Whether petitioner was negligent. We conclude that it was.

The Department applied the negligence penalty to this determination because the understatement was significant in relation to reported taxable sales, and because similar errors were noted in the audit of the period July 1, 1996, through June 30, 1999. Petitioner has not raised any specific argument regarding the negligence penalty but requests leniency because it will be difficult to pay the amount of the liability.

The difficulty petitioner may experience paying the determination is not relevant to whether petitioner was negligent, and we thus do not consider that factor in our analysis. We also do not rely on similar errors in the first audit because of our uncertainty about the meaning of an intermediate audit that showed no tax due and because we find that the facts during the current audit are clear without regard to any prior audit. The partners of the business are knowledgeable business people who should have been aware of the grocery store's purchasing practices. Petitioner should have recognized that taxable purchases were 2.5 times greater than reported taxable sales, but throughout the audit and appeals process, petitioner has not explained this considerable discrepancy. The audited unreported taxable sales of $370,325 (after the adjustment recommended by the D&R) represents an error ratio of 259 percent when compared to reported taxable sales of $143,075. This unexplained error shows that petitioner did not exercise the level of care of a reasonably prudent business person in similar circumstances, and that the penalty was properly imposed.

OTHER DEVELOPMENTS

None.

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

[3] A shelf test was not conducted for the more recent prior audit period of July 1, 1999, through June 30, 2002.

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	57.36%
Mark-up percentages developed	45.13%
Self-consumption allowed in dollars	$1,200 per year
Self-consumption allowed as a percent of total purchases	1% (approximately)
Pilferage allowed in dollars	$2,443 for 2004 $2,465 for 2005
Pilferage allowed as a percent of total purchases	2%