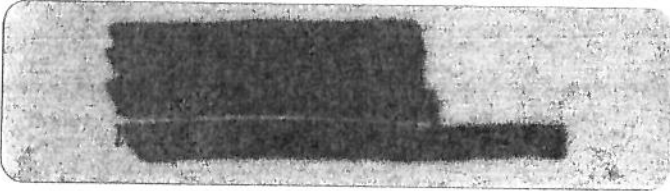


BT-165 REV. 2 (4-63)  
PRELIMINARY HEARING REPORT

395.1115  
4-30-64

STATE BOARD OF EQUALIZATION  
DEPARTMENT OF BUSINESS TAXES

Report of Hearing Officer Marshall Welch (4-27-64)



Taxpayer

Account Number

*Rulings*

Form Number S-432

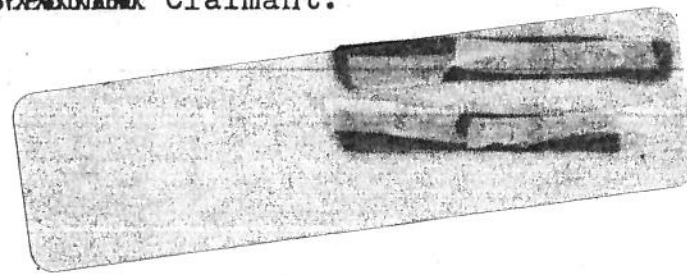
Date of Billing 8-21-63

Period (From 1-1-60  
(To 12-31-62)

Date of Hearing Thurs., Feb. 27, 1964 Time 1:30 p.m.

Place San Francisco

Appeared on behalf of ~~XXXXXXXX~~ Claimant:



*Bar Sale  
Escrow Established  
Equipment Sales Price*

Board of Equalization Representatives M. D. Toohig, R. S. Goldflam, W. R. Porter  
and Leslie Clarke

Comments and Recommendations

Disputed Items:

State and Local Tax

A. Additional bar and restaurant sales	\$19,112
B. Sale of equipment and fixtures	<u>10,000</u>
	\$29,112

Contentions of Claimant:

- A. That the bar and restaurant sales were not understated but that there were errors in extending purchases to sales in the audit.
- B. That the escrow instructions are not a part of the sales agreement.

Report on Facts:

The claimant operated a bar and restaurant until 12-31-62 when the business was sold for \$28,000 to [redacted]. During the audit period meals represented about 25% of total sales. There was a "cocktail hour" from 5 to 7 p.m. each day when regular drinks sold for 50¢ and double drinks for 75¢.

[redacted] said that he generally worked most of the time between 10 a.m. and 2 a.m. and that the night bartender named [redacted] worked for him until the last few months of the audit period. [redacted] also said that he had the only key to the liquor storeroom and that it was his practice to mark the liquor bottles periodically for the purpose of making a rough comparison of liquor poured and bar receipts.

The records were complete in all respects. They included cash register tapes with customer counts, customer checks for meals, purchase invoices and financial statements. The achieved markup after deducting self-consumed was about 160%.

In the audit a shelf test was made for each category of sales and then costs were extended to sales after allowances for self-consumed. The allocation of purchases to the various kinds of bar sales was based on the actual segregation of purchases for the second quarter of 1962. Food purchases were segregated in the claimant's records. The overall markup indicated by the audited sales was about 180%. The computed understatement was:

Sch. R1C, R1D & R1E	1960	1961	1962	Total
Audited total sales	\$80,707	\$107,562	\$96,683	\$284,952
Reported total sales	78,689	97,905	87,242	263,836
Difference	\$ 2,018	\$ 9,657	\$ 9,441	\$ 21,116
Percentage	2.565%	9.874%	10.827%	8.003%

Since the indicated difference was small in 1960, the deficiency determination included only the additional sales for 1961 and 1962.

Food sales were computed by adding a 100% markup to the cost of food sales.

Bar sales were computed on the basis of a normal 1 oz. pour and a 1½ oz. cocktail pour with an 8% allowance for overpouring. It was estimated that 21.09% of drinks were sold at reduced prices during the "cocktail hour".

The preliminary hearing was devoted to discussing controls, pours, glass sizes, prices, etc. It was evident that the claimant having discussed the matter previously with the auditor and at the office discussion was well prepared for the preliminary hearing. For example, the petitioner said that a glass previously submitted for measurement had been purchased on the way to the hearing but that he probably bought the wrong size.

With respect to the sale of equipment for \$15,000, it was the claimant's position that the escrow instructions signed by the seller and the buyer should be disregarded and that the value of the equipment should be \$5,000 as reported. Paragraph 7 of the escrow instructions provided:

"It is mutually agreed by the vendee and the vendor that the consideration paid is \$9,000 for the license, \$15,000 for the fixtures and equipment and \$4,000 for the covenant not to complete."

The basis of the claimant's argument was that the equipment was not worth \$15,000. He said that after operating the business only one month the successor had sold the equipment for \$6,500. It was pointed out to the claimant that the depreciated book value of the equipment was \$10,961 so that he could hardly claim that the equipment was only worth \$5,000 even if the value of the equipment was the measure of the tax. We also pointed out that the measure of the tax was the sales price at which he sold the equipment, not the value of the equipment or the price at which it was sold at some other time, and we indicated to the claimant that there appeared to be no basis for recommending an adjustment of this item.

Conclusions:

Although considerable time has been spent before and during the hearing discussing the bar operations it appears that the major portion of the deficiency is in connection with sales of meals. In the audit sales of meals were established by marking up the food costs 100% after allowing for self-consumed. The realized food markups were:

	1960	1961	1962*
Recorded food sales	\$23,906	\$20,138	\$4,267
Food costs	13,172	12,089	2,981
Gross profit	\$10,734	\$ 8,049	\$1,286
Realized markup	81.5%	66.6%	43.1%

\*Figures available for 2-62 only (Sch. 1A, page 5)

Applying the realized markups to costs discloses the following understatement of food sales:

	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>Total</u>
Food costs	\$13,172	\$12,089	\$11,660	\$36,921
Realized markup factors	181.5%	166.6%	143.1%	
Food sales	23,906	20,138	16,685	60,729
Audited food sales	<u>26,344</u>	<u>24,178</u>	<u>23,320</u>	<u>73,842</u>
Additional food sales	\$ 2,438	\$ 4,040	\$ 6,635	\$13,113

The figures indicate that of a possible deficiency of \$21,116 about \$13,113 or 62% represents additional food sales, but we have not made adequate tests to establish the proper food markup or food markups if conditions varied during the audit period. On the other hand there is a possible bar sales deficiency of \$8,003 or a bar sales understatement of less than 4%.

In addition the claimant had adequate records and purportedly personally supervised the day-to-day operations. Pouring practices, quantities served during cocktail hours and self-consumed were subject to dispute. Costs were allocated on the basis of a test for 2-62 which may or may not have been representative.

It does not appear that further investigation would be productive as the facts have become obscure with the passage of time and by the various conflicting statements made by the claimant.

With respect to the sale of equipment for \$15,000, there appears to be no basis for an adjustment for the reasons stated during the hearing.

Recommendations:

That the claim be granted with respect to item A (\$19,112).

That no adjustment be made with respect to items B and C.

Manuel A. Webb  
Hearing Auditor

MW:gs  
Approved:

Charles H. Ottum  
Tax Counsel

4/30/64  
Date

W. A. Simpson  
Principal Tax Auditor

5-1-64  
Date