

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:)

ROBERT RAMOS,
dba La Tiendita Market and Café Del Sol

Petitioner

Account Number SR X EA 100-940294
Case ID 612720

San Clemente, Orange County

Type of Business: Grocery store and restaurant

Audit period: 01/01/08 – 12/31/10

<u>Item</u>	<u>Disputed Amount</u>
-------------	------------------------

Disallowed claimed exempt food sales	\$163,009
--------------------------------------	-----------

	<u>Tax</u>	<u>Penalty</u>
As determined	\$22,884.80	\$2,288.52
Post-D&R adjustment	- 00.00	-2,288.52
Proposed redetermination	\$22,884.80	<u>\$ 00.00</u>
Less concurred	- 9,416.92	
Balance protested	<u>\$13,467.88</u>	
Proposed tax redetermination	\$22,884.80	
Interest through 02/29/16	<u>9,658.12</u>	
Total tax and interest	<u>\$32,542.92</u>	

Monthly interest beginning 03/01/16	<u>\$ 114.42</u>
-------------------------------------	------------------

This matter was scheduled for Board hearing in August 2015, but it was postponed for settlement consideration.

UNRESOLVED ISSUE

Issue: Whether any adjustments to the amount of disallowed claimed exempt sales of food are warranted. We conclude that no adjustments are warranted.

Petitioner has operated a grocery store with a deli and hot food counter (hereafter referred to as La Tiendita) since January 2006. Petitioner's son had operated La Tiendita under a different seller's permit number since November 1996. In July 2007, petitioner added a restaurant serving Mexican-style hot prepared food (hereafter referred to as Del Sol). During the audit period, the dine-in capacity for La Tiendita was 20 people and the dine-in capacity for Del Sol was 32 people. For audit, petitioner

1 provided his federal income tax returns, a handwritten sales journal, La Tiendita cash register z-tapes
2 for the period February 17, 2011, through June 30, 2011, Del Sol cash register z-tapes for the period
3 April 1, 2011, through June 30, 2011, a purchase journal, merchandise purchase invoices for the period
4 April 1, 2011, through June 30, 2011, and bank statements for most months during the audit period.
5 Petitioner stated that he recorded sales in a manual sales journal from the cash register z-tape totals,
6 and provided the sales journal to an outside accountant for preparation of his sales and use tax returns.

7 The Sales and Use Tax Department (Department) found only immaterial differences between
8 petitioner's recorded total sales, the gross receipts reported on his income tax returns, and the total
9 sales reported on his sales and use tax returns. The Department compared recorded total sales for La
10 Tiendita and for Del Sol with the corresponding recorded merchandise purchases and computed book
11 markups for both businesses that it found to be acceptable. Based on the acceptable book markups, the
12 Department accepted the accuracy of petitioner's reported total sales.¹

13 The Department found that all of petitioner's sales at Del Sol were taxable under the 80/80 rule,
14 a finding that petitioner does not dispute, and therefore, petitioner's claimed exempt sales of food only
15 included sales at La Tiendita. Using La Tiendita's cash register z-tapes for the period February 17,
16 2011, through June 30, 2011, the Department compiled exempt sales of \$73,676 and total sales,
17 excluding sales tax reimbursement, of \$177,779, which represented a ratio of exempt sales to total
18 sales of 41.44 percent. The Department applied that ratio to recorded sales of \$1,484,653 for
19 La Tiendita for the audit period to establish audited exempt sales of food of \$615,276. Since
20 petitioner's claimed deductions for exempt sales of food of \$892,263 for the audit period exceeded the
21 audited amount, the Department established the difference of \$276,987 (\$892,263 - \$615,276) as
22 disallowed claimed exempt sales of food.

23 Petitioner contends that the exempt sales ratio of 41.44 percent for La Tiendita is not
24 representative of the audit period. Using the sales recorded in the manual sales journal for La Tiendita
25

26 ¹ Initially, the Department noted a significant increase in petitioner's recorded and reported total sales in the second quarter
27 2011 (2Q11), after audit field work had commenced. Based on its initial conclusion that reported total sales for 2Q11 likely
28 represented petitioner's total sales for the earlier quarters in the audit period, the Department established additional taxable
sales of \$398,192, as well as disallowed claimed exempt sales of food. However, following additional analysis, the
Department deleted the measure for additional taxable sales in a revised audit.

1 for the period January 1, 2011, through June 30, 2011, petitioner computed an exempt sales ratio of
2 51.57 percent. However, petitioner states that he is unable to provide support for the amounts recorded
3 in his sales journal because the cash register z-tapes for periods prior to February 17, 2011, were
4 damaged by mold and could not be retained for examination. Petitioner also argues that his claimed
5 exempt sales of food for the second quarter 2011 (2Q11) were overstated in the audit computations.
6 Petitioner computes that correcting this error and applying an exempt sales ratio of 51.57 percent
7 would result in disallowed claimed exempt sales of food of \$113,978, an amount that he concedes.

8 While petitioner's cash register z-tapes for periods prior to February 17, 2011, are no longer
9 available, we note that La Tiendita's cash register z-tapes for the period February 17, 2011, through
10 June 30, 2011, show an exempt sales ratio of 41.44 percent. Thus, in order for an exempt sales ratio of
11 51.57 percent for the six-month period to be accurate, we calculate that the exempt sales ratio for the
12 period for which no cash register z-tapes are available (January 1, 2011, through February 16, 2011)
13 would be 75.14 percent. Petitioner has offered neither evidence nor explanation to show that the
14 nature of the business changed during the first six months of 2011, such that the exempt sales ratio
15 dropped significantly, from 75.14 percent during the first six weeks to 41.44 percent for the remainder
16 of the six months. Consequently, we find that the recorded amounts in petitioner's sales journal are
17 unreliable. In the absence of reliable evidence showing that the exempt sales ratio of 41.44 percent
18 computed from the cash register z-tapes petitioner provided does not accurately reflect petitioner's
19 sales for the audit period, we recommend no increase to that ratio.

20 We note that petitioner claimed a deduction of \$37,540 for exempt sales of food on his sales
21 and use tax return for 2Q11, and claimed another deduction of \$12,649 for sales tax reimbursement
22 included in reported total sales. However, when the Department compared recorded total sales of
23 \$199,745, excluding sales tax reimbursement, for that quarter with petitioner's reported total sales of
24 \$194,745 for 2Q11, and noted that reported total sales were \$5,000 less than his recorded total sales, it
25 concluded that petitioner's reported total sales for 2Q11 did not include sales tax reimbursement.
26 Thus, the Department combined the claimed deductions for both sales tax included and exempt sales of
27 food products for 2Q11, and compared the combined deduction of \$50,189 with audited exempt sales
28 of food for that quarter to establish disallowed claimed exempt sales of food for 2Q11. We note that

petitioner did not claim sales tax reimbursement included in reported total sales on any other sales and use tax return filed for the audit period. Given that petitioner's recorded total sales, excluding sales tax reimbursement, exceeded his reported total sales, we find that the reported total sales amount did not include sales tax reimbursement, and that petitioner claimed a deduction for sales tax reimbursement included in reported total sales in error. While establishing a separate measure of tax for disallowed claimed sales tax reimbursement included in reported total sales of \$12,649 would have been more precise, we note that there would have been no difference in the liability, and we did not recommend in our D&R that the misclassification be corrected.

We find that the Department computed disallowed claimed exempt sales of food products based on the best information available. In the absence of documentation or other evidence to support an adjustment, we conclude that no adjustment is warranted.

RESOLVED ISSUE

The Department imposed the negligence penalty because petitioner failed to retain sufficient records to support his reported sales. Petitioner argued that the records he provided were sufficient. We found that petitioner's failure to maintain cash register z-tapes or other source documents to support his reported amounts was an indication of negligence. However, we noted that the understatement represents an error rate of 16.87 relative to petitioner's reported taxable sales, and found that the error rate is not sufficiently large to conclusively demonstrate negligence. Giving petitioner the benefit of the doubt, we recommend that the negligence penalty be deleted.

OTHER MATTERS

Petitioner alleges that the audit results are not what he had discussed with the Department, and states that he believes that the Department changed its methods in order to establish a liability. Further, petitioner asserts that the subsequent audit was adversely affected by the results of this audit.

We note that petitioner has not identified or provided evidence showing how the Department's audit methods changed. Based on our experience in examining audits, we note that the Department may employ different audit methods during the course of an audit and may present the taxpayer with preliminary findings. Although the Department may have presented preliminary findings to petitioner, we note that a primary purpose of the Board's audit program is to provide reasonable assurance that

1 taxpayers pay neither more nor less than required by law. (Audit Manual § 0402.10.) Therefore, the
2 Department is required to correct its audit methodology during the course of the audit if it determines
3 that more accurate information is available, and that its previous conclusions are incorrect. In this
4 case, the Department prepared a revised audit report, in which taxable measure of \$398,192 for
5 additional taxable sales was deleted, and the amount of disallowed claimed exempt sales of food was
6 reduced from \$358,273 to \$276,987. We find that these adjustments were appropriate, and conclude
7 that it was reasonable for the Department to have revised its findings from the findings originally
8 presented to petitioner.

9 We note that petitioner also has not identified or provided evidence showing how the audit
10 findings in this case have adversely affected the subsequent audit. Since the subsequent audit is not
11 before us, we have no opinion regarding the audit procedures in that audit.

12
13 Summary prepared by Lisa Burke, Business Taxes Specialist III
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28