



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)  
ROBERTO AND MARIA MUNOZ, )  
CHOW YEEKUNG AND LUKE YING )  
SAECHOW, GEORGE I. AND JENNIE )  
**PAPAN**, WOLFGANG GRAHL, AND )  
CHARLES LANGEWEG )

Appearances:

For Appellants: Roberto Munoz, et al, /

For Respondent: **Vicki Musto McNair**  
Counsel

O P I N I O N

These appeals are made pursuant to section **18593<sup>2/</sup>** of the Revenue and Taxation Code from the actions of the Franchise **Tax** Board on the protests of Roberto and Maria Munoz, Chow **Yeekung**, and Luke Ying Saechow, George **I.** and Jennie **Papan**,<sup>3/</sup> Wolfgang Grahl, and Charles Langeweg against proposed assessments of additional personal income tax and penalties in the amounts and for the years as follows:

1/ In each of the **appeals**, each taxpayer represented **himself**.

2/ Unless otherwise specified, all section references **are** to sections of the Revenue and Taxation Code as in effect for the years in issue.

3/ Maria Munoz, Luke Ying Saechow, and Jennie **Papan** appear in these proceedings only because they filed joint personal income tax returns with their husbands, who are referred to individually herein as appellants.

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<u>Appellants</u>	<u>Year</u>	<u>Proposed Tax</u>	<u>Penalty Assessment</u>
Roberto and Maria Munoz	1978	'\$213.78	\$10.68
	1979	<b>252.00</b>	12.60
Chow Yeekung and Luke Ying Saechow	1978	202.57	10.12
	1979	270.00	13.50
George I. and Jennie Papan	1978	437.32	21.86
	1979	429.00	21.45
Wolfgang Grahl	1978	130.00	6.50
<b>Charles Langeweg</b>	<b>1978</b>	391.94	<b>19.59</b>
	1979	414.00	20.70

At issue in each **appeal** is whether the **appel-**  
lant has demonstrated error in respondent's reconstruc-  
tion of his underreported tip income and whether respon-  
dent has properly assessed a penalty for negligence.

Each appellant was employed as a waiter at Perino's during the appeal years. **Perino's** enjoys a reputation as one of Los Angeles' fine restaurants. The restaurant serves continental cuisine, providing lunch and dinner service **Monday** through Friday and dinner service Saturday. Service is a la carte. Dinner entrees range from \$14 to \$30 in price; the average estimated expenditure per dinner customer is approximately \$50.

The primary income of the waiters employed at **Perino's** is the gratuities **or** tips received for the service of these meals. Waiters pool their individual tips. Lunch and dinner tips are pooled separately. The pools are divided weekly on Mondays. Perino's keeps no records of each waiter's tips; it simply requires that each waiter submit **periodic summaries** of his tips. Each waiter has the individual responsibility of keeping accounting records detailed enough to insure his summaries are accurate. Perino's determines withholding taxes on the basis of the summaries plus the hourly wages which the restaurant pays each waiter. Yearly summations of tips received appear on each waiter's W-2 form.

In 1981, respondent **conducted** a general exami-  
nation of Perino's records to verify the accuracy of each  
waiter's tip income reported on his returns for 1978 and

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1979, Respondent found that in 1978, **Perino's** charge sales were 87 percent of its total sales; in 1979, its charge sales were 95 percent of its total sales, **Perino's** records detailed how much each charge customer was billed for the sale of the meal and how much each customer additionally charged for the tip. Respondent took a **28-day** random sample for each year under examination and totaled the amounts charged for the **sale** of meals and the amounts charged for the tips. **During the** sample days, tips equaled 17.5 percent of sales in 1978 and **17.8** percent of sales in 1979. These percentages were reduced **10** percent to account for tip sharing with busboys and **maitre d's (termed "payouts")**, and then multiplied by **total** restaurant receipts, cash as well as **charge**, in each year. Each product was divided by total waiter hours worked that year to reach an estimated average hourly tip income **per waiter** of **\$7.50** in 1978 and **\$7.61** in 1979.

In cases where discrepancies appeared between **waiter's** reports and respondent's computations, respondent held conferences in which the method of its computations was explained, and each waiter was asked to bring all records upon which he based his own reports. Each waiter was invited to demonstrate any way in which respondent's calculations resulted in the attribution of excessive income. Individual **waiter's** reports were accepted to the extent that they could be substantiated.

As a result **of** these conferences, respondent reduced its previously estimated average hourly tip income by 10 percent to allow for an additional 5 percent payout (15 percent **total** payout) and to **allow** for **non-tipping** hours included in waiters' total hours worked, This average was multiplied by the number of hours each waiter worked at the restaurant during each year to obtain an estimated yearly tip income for each waiter. Those amounts **were** compared with each waiter's W-2 reports. When a discrepancy greater than \$50 appeared, respondent arranged a conference with each waiter to review his records, When a waiter was unable to present evidence sufficient to establish the correctness of his reports, respondent relied upon its formulary computations.

In the five cases here considered, respondent issued assessments for the differences between the amount of tip income it estimated for each waiter and the amount reported by that waiter. Respondent also included penalties for negligence, After protests, respondent affirmed its proposed **assessments**, and these appeals followed.

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The California Personal Income Tax Law requires a taxpayer to state specifically the items and amount of his gross income during the taxable year. Gross income includes all income from whatever source derived unless otherwise provided in the law. (Rev. & Tax. Code, § 17071.) Every taxpayer is required to maintain accurate accounting records that will enable the taxpayer to file an accurate return. (Former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4), repealer filed June 25, 1981 (Register 81, No. 26).)

In the absence of such records, the Franchise Tax Board is authorized to compute income by whatever method will, in its opinion, clearly reflect the income. (Rev. & Tax. Code, § 17561, subd. (b); Breland v. United States, 323 F.2d 492 (5th Cir. 1963); Harbin v. Commissioner, 40 T.C. 373 (1963); Appeal of John and Codele Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) No particular method of reconstructing income is required, since the circumstances will vary in individual cases, and mathematical exactness is not required. (Harbin v. Commissioner, supra.) The existence and amount of unreported income may be demonstrated by any practical method of proof that is available. (See, e.g., Davis v. United States, 226 F.2d 331 (6th Cir. 1955); Agnellino v. Commissioner, 302 F.2d 797 (3rd Cir. 1962); Mitchell v. Commissioner, ¶ 68,137 T.C.M. (P-H) (1968), affd., 416 F.2d 101 (7th Cir. 1969); Appeal of John and Codele Perez, supra; Appeal of Walter L. Johnson, Cal. St. Bd. of Equal., Sept. 17, 1973.) It is sufficient if the method employed produces a result which is substantially correct. (Mendelson v. Commissioner, 305 F.2d 519 (7th Cir. 1962).)

Where appellant has not supplied detailed records of his income, respondent's determination of a deficiency resulting from its estimate of his income through the use of an approximately accurate formula is presumed correct. (Mendelson v. Commissioner, supra; Meneguzzo v. Commissioner, 43 T.C. 824 (1965); Marvin v. Commissioner, ¶ 80,509 T.C.M. (P-H) (1980).) The presumption of correctness is rebutted, however, where the computation, or reconstruction is shown to be arbitrary and excessive or based on assumptions which are not supported by the evidence. (Shades Ridge Holding Co., Inc. v. Commissioner, ¶ 64,275 T.C.M. (P-H) (1964), aff'd. subnom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of Paul Joseph Kelner, Cal. St.-Bd. of Equal., Sept. 30, 1980; Appeal of Robert Abraham Rubin, Cal. St. Bd. of Equal., June 21, 1983.) However, the

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fact that the formula used may not be the most detailed or the most precise formula which could be applied under the circumstances to determine an individual's income would not rebut that presumption. (Cf. Lerner et al. v. Commissioner, ¶ 65,267 T.C.M. (P-H) (1965).) If the presumption of correctness of respondent's assessment is not rebutted, the burden is on the taxpayer to prove that the correct income was an amount less than that on which the deficiency assessment was based, (Kenney v. Commissioner, 111 F.2d 374 (5th Cir. 1940); Appeal of John and Codelle Perez, supra.)

On numerous occasions, the federal courts have recognized the applicability of these principles in the reconstruction of income from tips, specifically approving a variety of formulary estimates. (Anson v. Commissioner, 323 F.2d 703 (10th Cir. 1964); Mendelson v. Commissioner, supra; Meneguzao v. Commissioner, supra; Maryin v. Commissioner, supra.) Respondent's method of estimating appellant's income from tips was generally similar to methods of estimating tip income previously contemplated and approved by federal courts.

The burden of proof also rests with the taxpayer who has been assessed a penalty for negligence to show that the addition of the penalty by respondent was in error. (Appeal of Ronald Ippolito, Cal. St. Bd. of Equal., Nov. 18, 1980; Appeal of Myron E. and Alice Z. Gire, Cal, St. Bd. of Equal., Sept. 10, 1969,)

Roberto and Maria Munoz

Robert Munoz was employed as a waiter at **Perino's** a total of 1,933 hours in 1978 and 1,949 hours in 1979, Applying respondent's estimated average hourly tip income, respondent computed appellant's 1978 tip income at \$14,004 and his 1979 income at \$14,218. Appellant reported only \$9,563 tip income in 1978, \$4,441 less than respondent's computations. In 1979, he reported only \$8,693 tip income, some \$5,525 less than respondent's computations.

Appellant has presented no records supporting the tip income he reported, and he has presented only a general disagreement with the procedure and the amount of the assessment. Appellant's general disagreement with the procedure and the amount of the assessment is simply equivalent to a statement by him that respondent's estimate is incorrect. As such, it is insufficient to sustain his burden of proof that respondent's estimate was

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incorrect. (Meneguzzo v. Commissioner, supra; Marvin v. Commissioner, supra.)

As to the negligence penalty imposed by respondent, appellant's unexplained failure to produce accurate, detailed records from which his income can be calculated is negligence in itself. (Mendelson v. Commissioner, supra; Meneguzzo v. Commissioner, supra; Marvin v. Commissioner, supra.)

Chow Yeekung and Luke Ying Saechow

Chow Yeekung was employed as a waiter at **Perino's** a total of 1,117 hours in **1978** and 1,396 hours in 1979, Applying respondent's estimated average hourly tip income, respondent computed appellant's 1978 tip **income** at \$8,039 and **his** 1979 income at \$10,183. Appellant reported only \$4,909 tip income in 1978, \$3,050 less than respondent's computations. In 1979 he reported only \$6,218, some \$3,965 less than respondent's computations.

Appellant has presented no records supporting the tip income he reported. Appellant contends that he worked the dinner shift exclusively, including non-tip hours, and that his tips were therefore less than average. Apparently, some waiters who worked only the evening shift were required to work the six-hour period from 4:00 p.m. to 10:00 p.m. The other waiters who worked both the lunch and dinner shifts were required to work a four-hour period surrounding the noon hour and also the four-hour period from 6:00 p.m. to 10:00 p.m. Apparently, the two hours from 4:00 p.m. to 6:00 p.m. were slow business hours which did not generate many tips and in which the waiters were primarily engaged in setting up the dining room. Appellant argues that the average hourly tip income attributed to those initial two hours of his shifts result in attributing excessive income to him. This argument implies, but does not in any way demonstrate, that the waiters who worked both the lunch and dinner shifts did not encounter slow business hours in which they primarily engaged in setting up the dining room. The respondent's method necessarily averaged the slow hours with the productive hours to arrive at an estimated average hourly tip income for all the waiters. Appellant's argument fails, however, not **because** it does not point to a possible imprecision in the results produced by respondent's method, but because it fails to demonstrate that his own income during- **1978** and 1979 was in amounts less than the amounts of respondent's assessments.

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(Cf. Kenney v. Commissioner, supra; Appeal of John and Codelle Perez, supra.)

Here also, **appellant's** unexplained failure to produce **accurate**, detailed records from which his income can be calculated is negligence in itself and justified **respondent's** imposition of the negligence penalty.

(Mendelson v. Commissioner, supra; Meneguzzo v. Commissioner, supra; Marvin v. Commissioner, supra,)

George I. and Jennie Papan

**George I. Papan** was employed as a waiter at Perino's a total of 1,780 hours in 1978 and 1,756 hours in 1979. Applying respondent's estimated average hourly tip income, respondent computed appellant's 1978 tip **income** at \$12,657 and his 1979 tip **income** at \$12,618, Appellant reported only \$6,418 tip income in 1978, \$6,239 less than **respondent's** computations, In 1979, he reported only \$5,909 tip income, some \$6,709 less than respondent's computation,

Appellant has presented no records. **He** states that he discarded any records he kept after he reported his periodic tip summaries to **Perino's**. Appellant states also that during the audited **years**, he worked only three or four days a week and worked only dinner shifts from **5:00** p.m. until closing, a single eight-hour shift. Thus, he did not normally share in the lunch tip pools; the other waiters, without exception, worked split shifts, serving both lunch and dinner and so shared in both the lunch and dinner tip pools. Appellant argues that respondent's estimate of his income was defective because, by not separately estimating a lunch tip pool amount and a dinner tip pool amount, **respondent's** audit method erroneously attributed shares of both pools to a **single** shift waiter. Appellant maintains that this failure results in one average hourly tip amount which is excessive when used to estimate his single-shift income.

Appellant does not explain how, if at all, his share of the six-day dinner tip pool, the larger of the two pools, was affected by the fact that he worked only three or four days (24 or 32 hours) in the week.

Apparently Perino's **records** did not distinguish between **lunch and** dinner tipping and did not contain any tip pool amounts, Thus respondent's audit method could not distinguish between lunch and dinner tip allocations.

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That failure does not make the audit method defective, The audit estimate does not have to use the best imaginable estimating method, it need **only** use 'a reasonable method under the circumstances,

It appears to us that **Perino's** records **allowed** respondent to estimate an apparently close approximation of the cumulative total amounts tipped by the restaurant's customers. Respondent then estimated average hourly tip income and applied that **average**, as adjusted, to the actual hours each employee worked, **In this** case, the custom of the restaurant to pool tips and divide the pools among the employees would have a similar averaging effect on their individual tip incomes, We find the application of that method to be reasonable under the circumstances.

Appellant's argument that he was not **precisely** in the typical or average position of the majority of the waiters at Perino's does not demonstrate that respondent's method of estimating his income by using an average is unreasonable or not based on **evidence**. Therefore, the burden is on the appellant to demonstrate with other evidence that his income was **less** than the **amount** contemplated by the respondent's determination, Appellant has attacked respondent's method, but he has presented no evidence which would suggest **what his** income was for the years in question. Accordingly, he has not sustained his burden of proving that the **respondent's** determination was incorrect.

Likewise, his unexplained failure to produce detailed records of his income merits **respondent's** imposition of the negligence **penalty**.

Wolfgang Grahl

Wolfgang Grahl was employed as a waiter at Perino's during the first half of 1998 a **total** of 654 hours. Applying respondent's estimated average hourly tip **income**, respondent computed appellant's tip income for that period in **1978** at \$4,960. Appellant reported only \$3,459, some \$1,303 less. He was then employed by the Windsor, a Los Angeles restaurant of **comparable** quality and reputation to **Perino's**, from June 1998 to the end of that year. Appellant reported tip income in the amount of \$963 from his employment at the Windsor, Respondent increased **appellant's** income by an additional **\$879** for that later period in **1998**, a **total** increase of \$2,182, by including as tip income from the Windsor an amount **equal**



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to the same percentage of **appellant's** wages from the Windsor as appellant's estimated tip income from Perino's bore to his wages from **Perino's**. (Wage information was taken from appellant's W-2 forms,)

Appellant has not presented adequate records of his tip income and has not challenged respondent's method of determining his Windsor tips. He contends only that he worked the dinner shift **exclusively**, including non-tip hours, so that his hours were less than average.

For the same reasons set forth in our discussions above, this appellant also has failed to sustain his burden of proving error in respondent's assessments of tax and penalty.

Charles **Langeweg**

Charles Langeweg was employed by **Perino's** a total of 1,568 hours in 1978 and 1,544 hours in 1979. Applying respondent's estimated average hourly tip income, respondent computed appellant's 1978 tip income at \$11,317 and his 1979 income at \$12,251. Appellant reported only \$7,328 tip income in 1978, \$3,989 less than respondent's computations and only \$8,277 in 1979, some \$3,974 less than respondent's computations.

Appellant contends that he had kept records of his tip income received on a daily basis. The file contains copies of the front side (dates 1 through 16) of Department of the Treasury Form **4040A, (rev. 3-75)**, entitled "Employee's Daily Record of Tips," for all the months during 1978 and 1979. Each of the copied pages contained two or three amounts entered in the left column, entitled "**Tips** received directly from customers." A few **more** of the spaces in that column are marked "**off**" or "vacation." The rest of the spaces in that column and all of the spaces in the right-hand column, entitled "**Tips** received on charge **receipts**" are blank. The last page for **each year** has a written schedule of the months of the year with two figures entered **for each** month (perhaps for cash and credit tip totals) and a total amount at the bottom. Those totals do not match the totals appellant reported to Perino's in those years, and they do not appear to be records of the tips received weekly. Indeed, they have no apparent relationship to the known practices of **Perino's**. Even regarded as monthly estimates of tips **received**, they would not be contemporaneous records, but merely later estimates (guesses) of amounts received on earlier dates and so would be entitled to

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little or no weight in estimating appellant's income.  
(Cf. Meneguzzo v. Commissioner, supra.)

Appellant also contends that the **28-day** sample periods used by respondent in its formula were days in which the restaurant's sales receipts were much higher than the restaurant's sales receipts on other days in the years sampled. So to arrive at an average yearly income for the waiters based on the restaurant's yearly receipts, the formula should have used the daily receipts of the restaurant for the whole period being examined. Following the hearing of his appeal, appellant submitted a schedule which listed the dates of the 18 sample days which respondent had selected in the **period May** through **November 1979**, and **20** sample days which appellant **selected** in the same period. On the schedule, appellant listed **individual** daily gross receipts for the restaurant **for** each of the sample days. The average daily gross receipts appellant reported for the days he selected were roughly half of the average daily gross receipts for the random days respondent selected. Appellant maintains that the apparent disparity in gross receipts between the two sets of sample days requires that **the sampling** include all the restaurant's gross receipts during the audit period,

Appellant's point is not well taken. The sample days were used only to determine the ratio of meal receipts to tips. There is no reason to conclude that the meal-tip ratio changed significantly between random days and slow days. After that ratio was established, the formula did apply that ratio to the restaurant's yearly, actual gross receipts during all its business days in 1978 and 1979.

For the above reasons, appellant also has not sustained his burden of proving error in respondent's assessments of tax and penalty.

For all the **reasons** stated above, we must sustain respondent's actions in all the appeals here considered.

