

## 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 SUR TRADING, INC., dba Nativa ) Account Number SR Y FH 97-948871  
 6 Petitioner ) Case ID 575609  
 ) San Diego, San Diego County

7  
 8 Type of Business: Furniture store  
 9 Audit period: 07/01/05 – 06/30/08

10 <u>Item</u>	<u>Disputed Amount</u>
11 Taxable rentals of furniture	\$ 121,792
12 Unrecorded taxable sales	\$ 96,262
13 Disallowed claimed nontaxable sales	\$ 51,403
14 Unreported taxable sales (based on sales tax accrual account)	\$ 64,088
15 Unreported taxable sales (based on sales journal)	\$1,425,310

	<u>Tax</u>	<u>Penalty</u>
16 As determined	\$150,968.48	\$15,096.87
17 Post-D&R adjustment	- 7,882.22	- 788.25
18 Proposed redetermination	\$143,086.26	\$14,308.62
19 Less concurred	- 6,774.97	00.00
20 Balance, protested	<u>\$136,311.29</u>	<u>\$14,308.62</u>
21 Proposed tax redetermination	\$143,086.26	
22 Interest through 10/31/14	87,074.74	
23 Negligence penalty	<u>14,308.62</u>	
24 Total tax, interest, and penalty	<u>\$244,469.62</u>	
25 Monthly interest beginning 11/01/14	<u>\$ 715.43</u>	

26 This matter was scheduled for Board hearing in June 2014, but was postponed at petitioner's  
 27 request because of a scheduling conflict. It was rescheduled for Board hearing in August 2014, but  
 28 was postponed at petitioner's request to allow its new representative additional time to prepare.

## UNRESOLVED ISSUES

29 **Issue 1:** Whether any adjustments are warranted to the amount of taxable rentals of furniture.  
 30 We find no adjustments are warranted.

1           Petitioner has operated a furniture store since November 2001, and it manufactures the  
2 furniture in Argentina. For audit, petitioner provided various records, but it did not provide complete  
3 documentation to support its claimed nontaxable sales.

4           In its review of the general ledger, the Sales and Use Tax Department (Department) noted a  
5 sales account for the rental of furniture. Further, it noted that petitioner had not charged sales tax  
6 reimbursement on its rentals of furniture. Since petitioner manufactured the furniture and provided no  
7 evidence that tax had been paid on the rented furniture, the Department concluded that all receipts from  
8 furniture rentals (\$121,792, compiled from sales invoices) were subject to tax.

9           Petitioner contends that 85 to 90 percent of the charge for rentals of furniture represents design  
10 services and the placement of the rental furniture in the customer's home. Although petitioner stated  
11 that it could provide contracts to support this assertion, nothing has been provided. In the absence of  
12 evidence, we find no adjustment is warranted since tax applies to petitioner's rentals of furniture,  
13 measured by the rentals payable. (Cal. Code Regs., tit. 18, § 1660, subd. (c)(1).)

14           **Issue 2:** Whether adjustments are warranted to the amount of unrecorded taxable sales. We  
15 find no adjustments are warranted.

16           The Department noted that some sales invoices showed a zero dollar amount, and it found an  
17 account in the general ledger listing unapplied deposits. The Department scheduled deposits, by  
18 customer, and compared the deposits to total sales invoiced, by customer. It found that deposits of  
19 \$761,408 could not be accounted for in the sales invoices, and that \$681,654 of those deposits were  
20 attributable to seven customers. The Department reviewed the sales and deposits to those seven  
21 customers on an actual basis and identified deposits of \$86,182 for which petitioner was not able to  
22 show that the sales did not occur. Thus, the Department concluded that \$86,182 represented  
23 unrecorded taxable sales, and it used that figure to compute a percentage that it applied to the  
24 unaccounted-for deposits by other customers to compute unrecorded taxable sales of \$10,081, for a  
25 total of \$96,263.

26           Petitioner contends that the amounts regarded as unrecorded taxable sales may be deposits for  
27 sales made outside the audit period or for sales that were canceled, with the deposits forfeited.  
28 However, petitioner has provided no supporting documentation.

1           Petitioner receives cash deposits from customers at the time of the order for the furniture to be  
2 manufactured. Upon delivery of the furniture, sales invoices are generated and the cash deposits are  
3 applied to the sales invoices. Petitioner has the burden to show that some of the deposits relate to sales  
4 that were not consummated during the audit period. In the absence of evidence, we find no  
5 adjustments are warranted.

6           **Issue 3:** Whether further adjustments are warranted to the amount of disallowed claimed  
7 nontaxable sales. We find no further adjustments are warranted.

8           The Department identified six transactions for which sales tax reimbursement had been  
9 collected on only a portion of the contract price, with the remainder of the contract price claimed as  
10 nontaxable receipts. The Department disallowed the claimed nontaxable sales associated with those  
11 six sales, which totaled \$58,225. Petitioner disputed the Department's findings regarding two of those  
12 sales, which totaled \$53,903. As explained below, we recommend a reduction of \$2,500, and the  
13 protested amount has been reduced to \$51,403.

14           The first transaction in dispute is represented by invoice 3593, dated April 3, 2007, to Gerry  
15 Martin and Diane Hodges. It involves a contract for petitioner to design, manufacture, and install  
16 custom cabinets, for a total of \$80,000. Petitioner charged \$25,000 for design services, \$30,000 for  
17 manufacturing of the cabinets, and \$25,000 for installation, and it collected sales tax reimbursement  
18 only with respect to the \$30,000 charge for manufacturing the cabinets. The Department concluded  
19 that the entire amount charged, \$80,000, was subject to tax (an understatement of \$50,000).

20           Petitioner contends that the \$25,000 of design services represents charges for meeting with the  
21 clients; developing blue prints to show how the furniture will be distributed throughout the house;  
22 selecting appropriate lighting fixtures, interior finishes, and window treatments; and procuring all  
23 furniture and accessories. Petitioner has provided an Interior Design Proposal, listing a price of  
24 \$25,000, which contains a procurement clause stating that all furniture, accessories, and art work will  
25 be purchased through petitioner.

26           With respect to the \$25,000 installation charge, petitioner has provided an unsigned and  
27 undated custom cabinetry installation contract showing a price of \$25,000 for the installation of the  
28 cabinets that customer purchased from petitioner pursuant to the design proposal agreement. The

1 contract describes the project and, in short, provides that petitioner is required to install the custom  
2 cabinets and furnish and install all materials necessary to complete such installation. At the  
3 conference, we asked petitioner to provide a signed copy of the contract, plans, specifications,  
4 drawings, and any other jobsite records pertaining to this contract. Although petitioner agreed to  
5 attempt to locate that documentation, it has provided nothing further.

6 We note that the design fee proposal includes the selection and procurement of furniture, rugs,  
7 accessories, art, and other tangible personal property, and specifies that the property must be purchased  
8 from taxpayer. Therefore, the charge for the design fee is regarded as part of the sale of the tangible  
9 personal property (here, the cabinets) because the customer was required to purchase the cabinets from  
10 petitioner as a condition of the design fee agreement, and did in fact purchase the custom cabinets from  
11 petitioner. (Rev. & Tax. Code, § 6012, subd. (b)(1).) Accordingly, we find that tax applies to the  
12 \$25,000 design fee.

13 Regarding the \$25,000 charged for installation of custom cabinets, petitioner has not provided  
14 any plans, specifications, drawings, or other jobsite records to establish whether the custom cabinets  
15 were fixtures (prefabricated) or materials. It also has not provided information from which the cost of  
16 materials or the selling price of the fixtures could be developed. Nevertheless, it seems reasonable that  
17 a portion of this charge represented nontaxable installation labor. In the absence of any documentation  
18 from which to establish a more accurate amount, we estimate the nontaxable portion at \$2,500, and we  
19 recommend that reduction.

20 The second transaction in dispute is represented by invoice 2574, dated November 11, 2005, to  
21 Montana Homefitters. For this sale, petitioner regarded \$3,903 as an exempt sale in interstate  
22 commerce.

23 Petitioner has not provided shipping documents or any other documentation to show that the  
24 tangible personal property was required to be shipped and was shipped to a point outside this state by  
25 the petitioner. In the absence of such documentation, we find that petitioner has not shown that the  
26 sale for \$3,903 was an exempt sale in interstate commerce. (Rev. & Tax. Code § 6396).

1           **Issue 4:** Whether adjustments are warranted to the amount of understatement of reported  
2 taxable sales established in a reconciliation of accrued sales tax reimbursement and sales tax paid. We  
3 find no adjustments are warranted.

4           For the period October 1, 2005, through June 30, 2008, the Department computed that accrued  
5 sales tax reimbursement exceeded sales tax paid by \$4,967, and it used that difference to compute an  
6 understatement of reported taxable sales of \$64,088. At the appeals conference, petitioner stated it  
7 would review the accrued sales tax account to determine if any of the amounts recorded therein related  
8 to sales that were canceled or reported after June 30, 2008. Petitioner also stated it would attempt to  
9 provide records of accrued sales tax reimbursement for July and August 2005, which were previously  
10 unavailable.

11           Petitioner has provided no evidence that its recorded amounts of accrued sales tax  
12 reimbursement are incorrect. Therefore, we find no adjustment is warranted.

13           **Issue 5:** Whether further adjustments are warranted to the amount of unreported taxable sales  
14 based on sales recorded in sales journals. We find no further adjustments are warranted.

15           The Department found that total sales recorded in petitioner's sales journals exceeded reported  
16 total sales for ten of the quarters of the audit period and were less than reported total sales for the  
17 remaining six quarters. The Department accepted reported total sales for the six quarters for which  
18 reported amounts exceeded recorded sales. For the remaining 10 quarters, the Department found that  
19 recorded total sales exceeded reported total sales by \$1,772,095, which it reduced by \$247,579, to  
20 \$1,524,516, based on its review of petitioner's journal entries.

21           Petitioner contends that the differences represent sales orders that were either canceled or  
22 reported after the end of the audit period. Although petitioner stated it would provide evidence to  
23 support this assertion, it has not done so. Petitioner also contended that timing differences account for  
24 some of the discrepancy and argued that the overall difference should be reduced by the differences in  
25 the six quarters for which reported total sales exceeded recorded amounts.

26           We find that the sales journals are evidence of petitioner's total sales, and petitioner has not  
27 provided evidence that any of the recorded sales were canceled or reported after the end of the audit  
28 period. Accordingly, we do not recommend adjustments based on that assertion. However, we note

1 that the Department did regard credit differences as timing differences in its reconciliation of accrued  
2 sales tax reimbursement and reported sales tax. We find it reasonable to use the same approach here,  
3 particularly since it is undisputed that petitioner accepts deposits at the beginning of the manufacturing  
4 process, which could result in timing differences in the records. Therefore, we have recommended that  
5 the differences for all 16 quarters be used in the computation of the understatement.<sup>1</sup> Further, we find  
6 no basis for the Department's reduction of \$247,579, mentioned above. Accordingly, we have  
7 compared recorded and reported total sales to establish a difference of \$1,425,310, a reduction of  
8 \$99,206 from the \$1,524,516 established by the Department. We find no basis for further adjustments.

9 **Issue 6:** Whether the understatement was the result of negligence. We find that it was.

10 The Department imposed the negligence penalty because petitioner failed to report taxable  
11 sales it had recorded and did not provide adequate documentation to support all its nontaxable sales,  
12 and because the understatement is significant. Petitioner states that it was not negligent, but has  
13 provided no specific arguments.

14 Although petitioner provided numerous records, we find that its failure to provide source  
15 documents, such as sales contracts, to support its claimed nontaxable sales is evidence of negligence in  
16 recordkeeping. Also, after the post-D&R reaudit, the total understatement of reported taxable measure  
17 is \$1,846,274, which represents an error ratio of 52 percent when compared to reported taxable sales of  
18 \$3,541,290. In addition, \$1,508,407 of the understatement represents a difference between recorded  
19 and reported taxable sales. We find that the significant percentage of error and petitioner's failure to  
20 report taxable sales recorded in its own records are strong evidence of negligence. Accordingly, we  
21 find the penalty was properly applied even though the business had not been audited previously.

## 22 OTHER MATTERS

23 None.

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25 Summary prepared by Lisa Burke, Business Taxes Specialist III  
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28 <sup>1</sup> Since petitioner was unable to provide sales data for July and August 2005, we find that reported total sales should be  
accepted as accurate for the third quarter 2005.