

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:)
THE WIRELESS SOLUTION STORE) Account Number SR Y FH 100-255229
Petitioner) Case ID 530773
Escondido, San Diego County

Type of Business: Sales of cellular devices

Audit period: 10/01/04 – 07/31/08

| <u>Item</u> | <u>Disputed Amount</u> | <u>Tax</u> | <u>Penalty</u> |
|---|------------------------|---------------------|--------------------|
| Unreported taxable sales | \$2,465,288 | | |
| Negligence penalty | \$ 19,231 | | |
| As determined and proposed to be redetermined | | \$192,308.01 | \$19,230.81 |
| Less concurred | | <u>- 1,248.02</u> | <u>00.00</u> |
| Balance, protested | | <u>\$191,059.99</u> | <u>\$19,230.81</u> |
| Proposed tax redetermination | | \$192,308.01 | |
| Interest through 10/31/14 | | 124,508.43 | |
| Negligence penalty | | <u>19,230.81</u> | |
| Total tax, interest, and penalty | | \$336,047.25 | |
| Payments | | <u>- 1,087.89</u> | |
| Balance Due | | <u>\$334,959.36</u> | |
| Monthly interest beginning 11/01/14 | | <u>\$ 956.10</u> | |

This matter was scheduled for Board hearing in October 2013, but was postponed for settlement consideration. It was rescheduled for Board hearing in June 2014, but was postponed upon petitioner's request due to a scheduling conflict.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the amount of unreported taxable sales. We find no adjustment is warranted.

Petitioner was a multi-location retailer of cellular telephones and related accessories from August 2003 through July 2008. Petitioner provided reasonably complete records for six of the eight

1 locations that were active during the audit period, but provided no sales records for two locations,
2 referred to in the D&R as the Encinitas and Hillcrest locations.

3 To establish audited sales for the Encinitas and Hillcrest locations, the Sales and Use Tax
4 Department (Department) obtained recorded purchases from the balance sheets and added a markup of
5 18 percent, as provided in California Code of Regulations, title 18, section (Regulation) 1585,
6 subdivision (b), which resulted in audited sales of \$2,137,609. For the remaining six locations, the
7 Department determined that petitioner had not reported the correct selling price on its sales of cellular
8 phones in bundled transactions prior to October 2007 (when the Department explained to petitioner the
9 correct amount to report). To establish audited sales for periods before October 2007, the Department
10 used the period October 1, 2004, through September 30, 2006 as a test period. The Department used
11 recorded selling prices and costs from the vendor's price lists to identify sales for which the book
12 markup was less than 18 percent. For those sales, the Department established the audited selling prices
13 by adding a markup of 18 percent to cost. The Department computed an understatement of reported
14 taxable sales of 8.57 percent for the test period, and it applied that percentage to recorded taxable sales
15 for the period October 1, 2004, through September 30, 2007, to establish unreported taxable sales of
16 \$327,679. Thus, the total amount of unreported taxable sales is \$2,465,288 (\$2,137,609 + \$327,679).

17 With respect to the audited sales for the six locations other than Encinitas and Hillcrest,
18 petitioner asserts that the cost of phones established by the Department is overstated. Specifically,
19 petitioner contends that the cost of the devices should be adjusted for monthly "volume activation
20 bonuses" received. In addition, petitioner contends that it is not responsible for reporting tax on the
21 sales made at the Encinitas and Hillcrest locations, arguing that those locations were operated by
22 Dustin Brown, as a "sub agent." Petitioner stated at the appeals conference that it allowed Mr. Brown
23 to operate the two locations under petitioner's seller's permit, using petitioner's "Premiere" Cingular
24 Franchise license. Further, petitioner purchased all of the inventory directly from Cingular and then
25 sold it to Mr. Brown "on credit." According to petitioner, it deducted the cost of equipment from
26 future commissions before forwarding the remainder of the commissions to Mr. Brown. Petitioner
27 states that Mr. Brown operated the Encinitas and Hillcrest locations independently, maintained his own
28 payroll service, made independent business decisions, and displayed business cards and cash register

1 receipts with the “West Coast Services Communication” name and logo. According to petitioner, Mr.
2 Brown originally planned to purchase the two locations, but he was unable to obtain financing. After
3 the D&R was issued, petitioner filed a request for reconsideration arguing that its relationship with Mr.
4 Brown was similar to that of a landlord and tenant and that Mr. Brown was not a concessionaire under
5 Regulation 1699, subdivision (d). On the basis that Mr. Brown was not a concessionaire, petitioner
6 asserts that it was not responsible for remitting sales tax for the Encinitas and Hillcrest stores.

7 Regarding petitioner’s argument that the audited costs for the first six locations should be
8 adjusted for volume discounts, we recognize that it is possible that the “volume bonus” paid to
9 petitioner monthly by Cingular may represent purchase discounts. If that is the case, it is possible that
10 some of the costs used in the Department’s calculations of the markups for individual transactions may
11 have been overstated, as petitioner states. However, the documentation provided by petitioner neither
12 clearly shows that such payments represented purchase discounts nor otherwise clarifies the nature of
13 the “volume bonus” payments. As explained in the D&R, the fact that there were both debits and
14 credits in the “volume bonuses” is one indicator that they may not represent purchase discounts (which
15 would rarely have offsetting reductions to the discounts allowed). Moreover, even if it were
16 established that the “volume bonus” payments represent purchase discounts, the available information
17 is not complete enough to trace specific discounts to specific purchases by petitioner. Accordingly, we
18 find that there is insufficient evidence to conclude that the costs of telephones used to compute the
19 markups for individual transactions were excessive, and we recommend no adjustment.

20 Regarding petitioner’s contention that it is not responsible for retail sales made at the Encinitas
21 or Hillcrest locations, there is no dispute that petitioner held seller’s permits for these locations and
22 allowed Mr. Brown to operate the locations under its permits. Also, only petitioner held a Franchisor
23 agreement with Cingular for the two locations. Further, sales of bundled phones and services made at
24 the two locations were reported to Cingular under petitioner’s Cingular Franchise license. In addition,
25 petitioner purchased inventory sold at the locations directly from Cingular. There is also no dispute
26 that petitioner received commission income from Cingular for retail sales that were made at the two
27 locations. Moreover, there is evidence that petitioner paid certain expenses of each business location,
28 such as rent, equipment rentals, and alarm services. We find that petitioner’s payment of expenses for

1 the locations indicates that petitioner was ultimately responsible for keeping the locations operational.
2 Petitioner's control and possession of the Hillcrest and Encinitas locations is further evidenced by the
3 fact that, after Mr. Brown was unable to obtain financing to purchase the locations, petitioner assumed
4 control until the locations were either sold or closed.

5 With respect to petitioner's assertion that its relationship with Mr. Brown was similar to that of
6 a landlord and tenant, and that Mr. Brown was not a concessionaire, we find that the available evidence
7 is insufficient to show that Mr. Brown was able to purchase inventory from other Cingular agents, that
8 he operated the business under a different business name, established his own selling prices,
9 independently hired and fired employees, and deposited sales proceeds into a separate account.

10 Instead, there is no dispute that the Encinitas and Hillcrest stores were operated as Cingular stores
11 under an exclusive Franchise agreement petitioner had with Cingular, and that Mr. Brown had no
12 direct relationship (contractual or otherwise) with Cingular. Petitioner (not Mr. Brown) had control of
13 both the inventory purchases and the commissions received, petitioner leased the business premises
14 throughout the periods at issue, and petitioner took control of the operations of the two stores when its
15 relationship with Mr. Brown ended because he could not secure financing to purchase the stores.

16 Thus, we find that Mr. Brown's operation of the Encinitas and Hillcrest stores appeared to be wholly
17 under petitioner's control. We also find there is no evidence that a member of the general public
18 would have believed that sales made at the two locations were made by Mr. Brown, particularly since
19 the seller's permit that would have been displayed in each location was issued to petitioner. (See Rev.
20 & Tax. Code, § 6067.) Accordingly, we find that Mr. Brown was petitioner's concessionaire for the
21 Encinitas and Hillcrest stores. (Cal. Code Regs, tit. 18, § 1699, subd. (d).) We note that petitioner
22 states it did not allow Mr. Brown to operate under its seller's permit, but we find that petitioner had at
23 least constructive knowledge that Mr. Brown was operating under its seller's permit. However,
24 regardless of whether petitioner explicitly or implicitly consented to Mr. Brown's use of its seller's
25 permit, it is undisputed that Mr. Brown did not obtain his own seller's permit, and petitioner has not
26 produced a signed affirmation from Mr. Brown to relieve the prime retailer (petitioner) for any
27 unreported tax liabilities incurred by the concessionaire. Accordingly, we find petitioner is jointly and
28 severally liable for the sales tax due on the retail sales of tangible personal property made at the

1 Encinitas and Hillcrest locations because Mr. Brown was petitioner's concessionaire for those stores.
2 (Cal. Code Regs, tit. 18, § 1699, subd. (d).) Nonetheless, for the reasons explained previously, we
3 continue to find petitioner is liable for the sales tax due on the retail sales made at the two stores,
4 without regard to whether Mr. Brown was petitioner's concessionaire.

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

6 The Department imposed a negligence penalty because it found petitioner's records were
7 inadequate. Specifically, petitioner provided no sales records for the Encinitas and Hillcrest locations.
8 For the other six locations, the Department found petitioner's recorded costs were unreliable.
9 Petitioner disputes the penalty on the basis that it did not have records for sales made at the Hillcrest or
10 Encinitas locations because it was not responsible for paying tax on those sales. Petitioner also argues
11 that it had impeccable records.

12 We find that petitioner did not maintain adequate records. Specifically, petitioner did not
13 provide purchase invoices to support the recorded costs of cellular phones that were sold in bundled
14 transactions. Further, petitioner did not maintain sales records for sales at the Hillcrest and Encinitas
15 retail stores, which were made under petitioner's seller's permit throughout the liability period. In
16 addition, the unreported taxable measure of \$2,481,393 (including concurred amounts totaling
17 \$16,105) represents an error rate of 51.37 percent when compared to reported taxable sales of
18 \$4,830,649. We find an error ratio of that magnitude to be additional evidence of negligence.
19 Consequently, we find petitioner was negligent, and the penalty was properly applied, even though
20 petitioner had not been audited previously.

21 **OTHER MATTERS**

22 None.

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24 Summary prepared by Lisa Burke, Business Taxes Specialist III
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