

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:)
DORA, LLC, dba Jimenez Car Sales) Account Number SR DF 100-185011
Petitioner) Case ID 513022
Livingston, Merced County)

Type of Business: Used car dealer

Audit period: 01/01/04 – 12/31/07

<u>Item</u>	<u>Disputed Amount</u>
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Unreported taxable sales	\$3,329,349
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Fraud penalty	\$ 51,599
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	<u>Tax</u>	<u>Penalty</u>
As determined	\$219,679.50	\$54,920.15
Pre-D&R adjustment	<u>- 13,285.63</u>	<u>- 3,321.38</u>
Proposed redetermination, protested	<u>\$206,393.87¹</u>	<u>\$51,598.77</u>
Proposed tax redetermination	\$206,393.87	
Interest through 03/31/15	138,872.73	
Fraud penalty	<u>51,598.77</u>	
Total tax, interest, and penalty	\$396,865.37	
Payments	<u>- 11,771.98</u>	
Balance Due	<u>\$385,093.39</u>	
Monthly interest beginning 04/01/15	<u>\$ 973.11</u>	

This matter was scheduled for Board hearing in May 2013, but was postponed for settlement consideration. It was rescheduled for Board hearing in March 2014 and April 2014, but was postponed both times at petitioner's request because of scheduling conflicts. It was rescheduled for Board hearing in May 2014, but was postponed again for settlement consideration.

¹ The proposed redetermination of tax is based on an understatement of reported taxable measure of \$2,744,860, which is net of a concurred credit measure of \$584,489 for unclaimed bad debts. Since petitioner has filed a claim for refund of the tax reported with respect to the unclaimed bad debts, a refund will be possible if petitioner prevails in this matter.

UNRESOLVED ISSUES

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

4 Petitioner has operated a used car dealership since April 2003. For audit, petitioner provided
5 reasonably complete records, including sales contracts for the entire audit period. However, prior to
6 the audit, the Sales and Use Tax Department (Department) received copies of 387 of petitioner's sales
7 contracts from the California Department of Justice (DOJ) for the period January 1, 2005, through
8 November 27, 2006. The DOJ had seized those sales contracts during a search (in an unrelated matter)
9 of the house of petitioner's managing member, Pedro Jimenez, in January 2007. The Department
10 compared the seized sales contracts to the corresponding contracts petitioner had provided for audit,
11 and it found that the dates of sale, purchaser names, and vehicle identification numbers were the same
12 on both sets of contracts, but the vehicle sale prices and charges for sales tax reimbursement on the
13 seized contracts were significantly higher. Also, most of the seized contracts provided by DOJ show
14 charges for smog and smog certificate transfer fees, and some show separately stated document
15 preparation fees, license fees, or Department of Motor Vehicles (DMV) registration fees.

16 The Department used the 387 seized contracts for the period January 1, 2005, through
17 November 27, 2006, along with 144 contracts provided by petitioner, for which no seized counterparts
18 were available, to establish recorded taxable sales for 2005 and 2006 of \$4,048,671 (after adjustments
19 in a reaudit to exclude a sale that had been counted twice). The Department compared that amount to
20 reported taxable sales and computed a percentage of error of 68.1620 percent. Although petitioner had
21 provided sales contracts for 2004 and 2007, the Department considered those contracts unreliable, and
22 it applied the error rate of 68.1620 percent to reported taxable sales to establish an understatement for
23 those years. As secondary support for the audit results, the Department conducted a bank deposit
24 analysis and four markup analyses, which are described fully in the D&R.

25 Petitioner contends that the amount of unreported taxable sales is excessive, arguing first that
26 the sales amounts shown on the seized contracts are overstated because they include nontaxable
27 financing charges. Petitioner states that it maintained those contracts only as evidence of the full value
28 of the transaction, for use in litigation. According to petitioner, it previously had sued a customer for

1 breach of contract and had won a judgment for the full amount of the contract, but it had not recovered
2 the full value of the transaction because the contract failed to include the financing charge and the sale
3 price of accessories. To explain the differences between the two sets of contracts, petitioner used the
4 sale of a Lincoln Navigator as an example. For that transaction the sales contract petitioner provided
5 for audit showed a total contract price of \$10,903 (\$10,100 selling price of the vehicle, \$20 DMV
6 registration fee, and \$783 sales tax reimbursement), and the sales contract seized by the DOJ showed a
7 total contract price of \$17,500 (\$16,100 selling price of the vehicle, \$50 smog fee, \$76 charge for
8 “trans,” which apparently was a transaction fee, and \$1,274 sales tax reimbursement). Petitioner
9 claims that the true contract total was \$10,903, and the difference of \$6,597 between that amount and
10 \$17,500 represents \$3,597 for the selling price of accessories and \$3,000 for financing. Petitioner
11 states that it began creating a second set of contracts in early 2005 (purportedly for use only in
12 litigation) and it ceased this practice after hiring a former Board auditor in October 2006, who advised
13 against maintaining two different sets of contracts. As support, petitioner has provided a statement by
14 that former auditor, Juan Benavides, and 31 statements by customers. The customer statements assert
15 that the amounts paid are those shown on the contracts petitioner provided for audit. Those statements
16 also indicate the customers were aware of the contracts that were prepared and retained by petitioner
17 (the contracts seized by DOJ), and that they understood the financing charges would be reduced by
18 50 percent if the contracts were paid within a year of the sale. The customers also stated that they
19 understood the second contract to be a document that would only be used in the event of litigation for
20 failure to make payments. In addition to the written statements, petitioner says that it presented three
21 customers to the Department, but the Department refused to interview them.² Since it asserts that the
22 seized contracts overstate the actual selling prices of the vehicles, petitioner also argues that the
23 percent of error applied to reported taxable sales for 2004 and 2007 is overstated. In addition,
24 petitioner argues that the bank deposit analysis and markup analyses the Department used as secondary
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27 ² Petitioner asserts that the Department’s refusal to consider the statements from its customers is a violation of petitioner’s
28 right to procedural due process under the California Constitution. We find this argument has no basis in law, and therefore
we do not address it in this summary.

1 verification are flawed. Further, petitioner argues that a bank deposit analysis is the most accurate
2 method of establishing audited taxable sales.

3 It is undisputed that the totals listed on each of the seized contracts for 2005 and 2006 represent
4 the total amounts customers were expected to pay for those sales of tangible personal property. The
5 only dispute is whether the totals include nontaxable financing charges. As noted previously, all of the
6 seized contracts separately state a charge for sales tax reimbursement, and many separately state
7 various fees. In its compilation of recorded taxable sales, the Department included all amounts in the
8 seized contracts except the sales tax reimbursement and the nontaxable fees.

9 Neither the contracts petitioner provided for audit nor the seized contracts included separately
10 stated amounts for finance charges. Instead, petitioner argues that it created handwritten payment
11 cards for each sale, which separately stated the finance charges. We note that those handwritten
12 payment cards do include notations indicating that the total would be reduced by a predetermined
13 amount if the contract were paid in full within a specific period. Although those notations on the
14 payment cards are some indication that the seized contracts included financing charges, there were no
15 separately stated financing charges on the seized contracts, despite the fact that the contracts did
16 provide a space where financing charges could be entered. Thus, we find that the notations on the
17 handwritten payment cards are directly contradicted by the sales contracts themselves. Further, the
18 contracts are signed by the customers, while the payment cards were maintained solely for petitioner's
19 records. Moreover, petitioner's assertion regarding finance charges included in the sale price on the
20 seized contracts is contradicted by the fact that the amount of sales tax reimbursement shown on those
21 contracts is computed on the stated selling price of the vehicle, with no adjustment for finance charges.
22 Accordingly, we find that the information on the payment cards is not sufficient to show that the sale
23 prices on the seized contracts included nontaxable finance charges. We are not persuaded otherwise by
24 the statements from Mr. Benavides or the 31 customers, which were all obtained well after the disputed
25 transactions took place. In contrast, the written sales contracts were prepared and signed
26 contemporaneously with the sales and embody the parties' agreement of the terms of sale. Thus, we
27 conclude that the sales amounts shown on the seized contracts do not include finance charges, and no
28 adjustment is warranted to the amount of recorded taxable sales for 2005 and 2006.

1 With respect to the understatement for the years 2004 and 2007, we note that petitioner
2 maintained two sets of contracts, with inconsistent sale prices, for almost half of the audit period. The
3 mere presence of a second set of contracts for almost half of the audit period renders unreliable the
4 contracts petitioner provided for 2004 and 2007. Accordingly, we find it was appropriate for the
5 Department to compute a percentage of error using the seized contracts for 2005 and most of 2006 and
6 to apply that percentage to reported taxable sales for 2004 and 2007. Regarding petitioner's assertion
7 that adjustments are warranted to the Department's bank deposit analysis and markup analyses, we
8 first note that none of these analyses were used to establish audited sales; they were only used as
9 secondary verification of the audit results. Although there may be some minor discrepancies in those
10 secondary tests, we find that none are sufficiently significant to warrant further adjustments to the
11 primary audit approach, which was a comparison of recorded and reported taxable sales for two of the
12 four years of the audit period and a projection of the percentage of error for that period to the
13 remainder of the audit period. As for petitioner's argument that a bank deposit analysis is the most
14 accurate method for determining taxable sales, we note there is no convincing evidence that petitioner
15 deposited all proceeds into one bank account. Further, even if it did, the amount deposited would not
16 correspond to petitioner's taxable sales because petitioner's customers often financed vehicles and thus
17 did not pay the entire amount at the time of the sale. Thus, we reject petitioner's argument that audited
18 taxable sales should be established using a bank deposit analysis.

19 **Issue 2:** Whether the Department has established fraud by clear and convincing evidence. We
20 find that it has.³

21 The Department has imposed a fraud penalty, asserting that petitioner's managing member is
22 knowledgeable regarding sales and use tax requirements. Further, petitioner maintained two sets of
23 sales contracts, and the amounts of sales tax reimbursement on the second set of contracts, which were
24 seized by DOJ, were correctly computed on the full selling prices of the vehicles. However, petitioner
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27 ³ Without regard to whether the finding of fraud is upheld, the July 28, 2009 Notice of Determination (NOD) was timely
28 issued for the entire audit period because petitioner had signed a series of waivers of the three-year statute of limitations,
the most recent of which extended the period for issuing a NOD to July 31, 2009.

1 provided for audit a set of contracts that reflected significantly lower selling prices, with sales tax
2 reimbursement correctly computed on those lower amounts.

3 Petitioner disputes the fraud penalty on the basis that the amounts shown in the sales contracts
4 it provided for audit were accurate and the amounts reflected in the contracts seized by DOJ were
5 overstated, for the reasons addressed under Issue 1. On that basis, petitioner asserts that the seized
6 contracts are not evidence of fraud. Petitioner also argues that the Department has failed to consider
7 circumstantial evidence relevant to the intent of Mr. Jimenez, petitioner's managing member.

8 Although petitioner had not been audited previously, Mr. Jimenez had operated the business
9 previously as a sole proprietorship for over 17 years. During that time, the business was audited three
10 times. Thus, we find petitioner's managing member was fully knowledgeable regarding sales tax
11 matters. Further, the amounts of sales tax reimbursement charged were correctly computed on the
12 selling prices stated in both the contracts petitioner provided for audit and the contracts seized by DOJ,
13 which is strong evidence that petitioner was aware of the application of tax. We note that the primary
14 reason for the understatement of reported taxable sales for 2005 and 2006 is the discrepancy between
15 the sales amounts shown on the seized contracts and those shown on the contracts provided by
16 petitioner, and the percent of difference, 68.1620 percent, is substantial. We are not persuaded by
17 petitioner's assertion that it maintained the second set of sales contracts for purposes of possible
18 litigation only. Further, even if we were to accept petitioner's explanation, it fails to account for the
19 fact that taxable charges such as smog fees, document preparation fees, and transaction fees did not
20 remain constant between the two sets of contracts. In light of these inconsistencies, we find the only
21 reasonable conclusion is that petitioner created two sets of contracts to evade payment of sales tax.
22 Thus, we find the existence of two sets of contracts, in conjunction with the significant understatement
23 reflected by a comparison of the two sets of contracts, is highly indicative of fraud. Consequently, we
24 find there is clear and convincing evidence of fraud, and that the fraud penalty was properly applied to
25 the entire deficiency. (Rev. & Tax. Code, § 6485.)

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RESOLVED ISSUE

In the petition for redetermination, petitioner argued that the audited amount of unclaimed bad debts might be understated. However, in a conversation with us on September 10, 2012, petitioner stated that it concurs with the audited amount of unclaimed bad debts.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III