

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination and)
Claim for Refund under the Sales and Use Tax Law of:)
JOHN PAUL RICHARD, INC.) Account Number SR AC 99-932027
Petitioner) Case ID 613971
Calabasas, Los Angeles County

Type of Business: Manufacture and sale of women’s apparel
Audit period: 07/01/07 – 06/30/10

<u>Item</u>	<u>Disputed Amount</u>
Unclaimed tax-paid purchases resold	\$ 7,279
Unreported purchases subject to use tax	\$122,454
Tax as determined	\$12,265.23
Pre-D&R adjustment	- 1,451.89
Proposed redetermination, protested	\$10,813.34 ¹
Interest through 06/30/15	<u>3,174.05</u>
Total tax and interest	\$13,987.39
Payments	- 6,700.00
Balance Due	<u>\$ 7,287.93</u>
Monthly interest beginning 07/01/15	<u>\$ 20.57</u>

UNRESOLVED ISSUES

Issue 1: Whether an additional adjustment is warranted for tax-paid purchases resold. We find no further reduction is warranted.

Petitioner has manufactured and sold women’s apparel since November 1996. Petitioner provided records for audit that were reasonably complete for some portions of the audit period. The Sales and Use Tax Department (Department) reviewed petitioner’s paid bills for the year 2009 and found that, for that year, petitioner had purchased 30.17 percent of its consumable supplies ex-tax from

¹ The total amount of unreported measure determined is \$120,402, comprised of \$122,454 of unreported purchases of supplies subject to use tax, \$24,544 of unreported purchases of fixed assets subject to use tax, offset by credit amounts of \$16,724 for unclaimed tax-paid purchases resold, and \$9,872 for an error in compiling returns. Since the disputed amount exceeds the total determined measure, we show the entire amount of tax determined as protested. Since petitioner has filed a claim for refund, a refund will be made if petitioner prevails in this matter.

1 out-of-state retailers. The Department applied that percentage to petitioner's total recorded supply
2 purchases of \$405,874 to establish the amount of unreported purchases of supplies subject to use tax of
3 \$122,454 (rounded).

4 After the notice of determination was issued, petitioner provided evidence it had paid tax on
5 some purchases of certain items that it had resold without any intervening use. Thus, the Department
6 prepared a reaudit in which it created a credit item of \$16,724 for tax-paid purchases resold.

7 Petitioner contends that the amount of tax-paid purchases resold should be increased.
8 Specifically, petitioner asserts that it paid tax on purchases of note pads and pick tickets (described
9 below) and argues that they were sold without any intervening use by petitioner. The Department has
10 reviewed the purchases and concluded that petitioner purchased the note pads and pick tickets for use,
11 rather than for resale.

12 Petitioner argues that the pick tickets are nontaxable labels. Petitioner describes a pick ticket as
13 a single page form with a carbon copy attachment which contains a description of the item sold, the
14 quantity sold, sizing information, a customer purchase order number, the ship date, and a bill-to and a
15 ship-to address. Petitioner explains that it uses the item description and quantity on the pick tickets to
16 assist in pulling merchandise from the warehouse for packaging customer orders. The top page of the
17 pick ticket is included with the shipment to the customer and the carbon copy is retained by petitioner
18 for billing. Sometimes the top copy is placed inside a non-returnable shipping container, and other
19 times it is placed inside a clear plastic envelope labelled "packing list enclosed," which is affixed to the
20 non-returnable shipping container. When the top copy is placed inside the shipping container, a
21 separate adhesive -backed packing list describing the contents of the container is affixed to the
22 container. Petitioner also argues that its purchases of clear plastic envelopes are not subject to tax on
23 the basis that they are non-taxable labels affixed to the exterior of non-returnable shipping containers.

24 It is undisputed that petitioner first used the pick tickets for billing purposes and to select
25 merchandise from its warehouse in order to fill the orders placed by its customers. Thus, we find
26 petitioner first used the pick tickets, that use of the pick tickets is subject to tax, and petitioner is not
27 entitled to a tax-paid purchases resold deduction. Further, even if we found that petitioner had not first
28 used the pick ticket, we note that the pick ticket would not qualify as a nontaxable label in the

1 instances when it was placed in the shipping container. (See Cal. Code of Regs., tit. 18, § 1589, subd.
2 (b)(2).) Moreover, petitioner retained the carbon copy portion of the pick ticket, which is clearly a use
3 of that portion of the pick ticket. Accordingly, since there is no partial exemption for labels, and there
4 is no question that petitioner used a portion of the pick ticket, petitioner's use of the carbon copy is a
5 separate basis for concluding that petitioner's purchases of the pick tickets are subject to tax.

6 Regarding petitioner's assertion that its purchases of clear plastic envelopes are not subject to
7 tax, we note that the envelopes themselves do not convey any useful information to petitioner's
8 customers. Instead, the envelopes are used by petitioner to hold the pick tickets. Thus, petitioner's
9 purchases of clear plastic envelopes are subject to tax, and there is no basis for a tax-paid purchases
10 resold deduction with respect to those purchases.

11 **Issue 2:** Whether adjustments are warranted to the amount of unreported purchases of supplies
12 subject to use tax. We find no adjustment is warranted.

13 Petitioner contends that the allowance for tax-paid purchases resold should be used to reduce
14 the amount of unreported purchases of supplies subject to use tax in the test period (2009) and thus
15 reduce the percentage of error applied to its total purchases of supplies to develop the amount for the
16 audit period. Petitioner asserts that, since the amount of unreported purchases of supplies has been
17 established on a test basis, the amount of tax-paid purchases resold should also be determined based on
18 a sample. In support, petitioner cites section 0402.20 of the Sales and Use Tax Audit Manual, which
19 states in relevant part that, when examining sample items, analyzing the sample results, and projecting
20 the resulting errors, both underpayments and overpayments should be treated equally, and that any
21 allowable credit offsets resulting from the sample should be a part of the calculation of the percentage
22 of error to be applied to the population.

23 Petitioner also notes that the District Principal Auditor contacted California Supply, Inc. and
24 discovered there were seven invoices from that company for which petitioner paid sales tax
25 reimbursement for purchases of garment bags and hangers. Four invoices represent the purchases that
26 relate to the Department's allowance for tax-paid purchases resold of \$16,724. Petitioner did not
27 provide copies of the remaining three invoices. According to the Department, petitioner's tax-paid
28 purchases of garment bags and hangers from California Supply, Inc. were non-recurring purchases.

1 We note that petitioner did not provide complete purchase records for the audit period.
2 Therefore, the Department reviewed a sample of paid bills, for the year 2009. We find that the sample
3 of paid bills for one year of the audit period was representative of the population, and petitioner has not
4 argued otherwise. After the Department examined the sample of paid bills, petitioner provided four
5 purchase invoices from California Supply, Inc., which the Department accepted as evidence of tax-paid
6 purchases resold. Consequently, the Department made the adjustment of \$16,724, for those purchases
7 of garment bags and hangers. However, the Department found that petitioner had inadvertently paid
8 tax reimbursement to one retailer, as a result of that retailer's computer billing errors. Accordingly, the
9 Department regarded the payment of tax reimbursement on items that were subsequently resold
10 without intervening use as a nonrecurring error that should not be projected to the remainder of the
11 population of purchases. Further, in its examination of the sample of paid bills for 2009, the
12 Department found no evidence of other tax-paid purchases resold. Therefore, we concur with the
13 Department's conclusion that the instances of tax-paid purchases resold from one vendor were non-
14 recurring. As for petitioner's assertion that the Department is required to treat underpayments and
15 overpayments equally, we find that the Department has done so. The Department concluded that the
16 instances of tax-paid purchases resold were not representative of the sample examined and that the
17 errors should not be projected. Similarly, if there had been non-recurring errors found in the sample of
18 paid bills examined by the Department, the Department would not have projected the resulting errors.
19 Accordingly, we find no adjustment is warranted.

20 OTHER MATTERS

21 None.

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23 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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