STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

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: JOHNNY ZEGARRA, dba J. J. Wholesale Petitioner	Account Number SR AA 97-560408 Case ID 600482 Bell Gardens, Los Angeles County

Type of Business: Used car dealer

Audit period: 01/01/07 – 12/31/09

Item	Disputed Amount
Disallowed claimed nontaxable sales for resale	$169,117

	Tax	Penalty
As determined	$18,372.76	$1,837.28
Pre-D&R adjustment	- 4,151.81	- 415.18
Post-D&R adjustment	00.00	- 1,422.10
Proposed redetermination, protested	$14,220.95	$ 00.00

Proposed tax redetermination	$14,220.95
Interest	6,472.83
Total tax and interest	$20,693.78
Payments	- 22,115.88
Overpayment	$ 1,422.10[1]

UNRESOLVED ISSUE

Issue: Whether additional adjustments are warranted to the amount of disallowed claimed nontaxable sales for resale. We find no further adjustment is warranted.

Petitioner has operated as a used car dealer since June 1999. For the audit period, he reported total sales of $2,365,608, and claimed the entire amount as nontaxable sales for resale. For audit, petitioner provided federal income tax returns, Department of Motor Vehicle (DMV) Reports of Sale (ROS), personal bank account statements, and a limited number of purchase invoices.

[1] Petitioner has not yet filed a claim for refund, but time remains to do so. A claim for refund will be timely if it is filed within six months from the date this liability becomes final. (Rev. & Tax. Code, §6902, subd. (a).)

The Sales and Use Tax Department (Department) obtained information from petitioner's major suppliers from which it determined that petitioner had purchased 733 vehicles during the audit period. Although petitioner provided no resale certificates, the Department determined that 405 of the vehicles had been sold for resale, based on its review of the ROS. For the remaining 328 vehicles, the Department decided to review a sample of the sales, compute a percentage of taxable to total sales for the sample, and use that percentage to establish audited taxable sales.

The Department selected 60 vehicles and requested information regarding the vehicle transactions from the Board's Consumer Use Tax Section. The Department originally found there was sufficient documentation to conclude that 48 of the sales were nontaxable sales for resale. Subsequently, in a reaudit, the Department concluded that two more sales were adequately supported as sales for resale. Thus, in the reaudit, the Department totaled the cost of the remaining 10 vehicles and divided that amount by the total cost of all 60 vehicles to compute a percentage of purchases of vehicles sold at retail of 10.638298 percent. The Department applied that percentage to the total cost of the 328 vehicles, $1,322,655, to compute purchases of vehicles sold at retail of $140,708. Since petitioner did not provide complete sales and purchase records, the Department did not conduct a shelf test to establish the markup but instead used an industry average markup of 20.19 percent to compute audited taxable sales of $169,117.

Petitioner contends that adjustments are warranted to the audited amount of taxable sales, stating that the industry average markup is excessive and that the 10 sales at issue were in fact sales for resale to King Auto Sales and Danavans Auto. In addition, petitioner objects to the projection of the percentage of error computed for the sample to the data regarding the remainder of the 328 vehicles.

There is no dispute that petitioner sold the vehicles in question and did not obtain any valid, timely resale certificates. Accordingly, petitioner owes tax on those vehicle sales unless he can prove that the vehicles were sold for resale. (Rev. & Tax. Code, §§ 6091, 6092; Cal. Code Regs. tit. 18, § 1698, subd. (a).)

As support for his assertion that the 10 sales were in fact sales for resale, petitioner has provided ten Computerized Vehicle Registration (CVR) reports and ten hand-written ROS. However, five of the 10 CVR reports show that Notices of Transfer and Release of Liability were received in

December 2011, at least two years after the alleged sales of the vehicles. Also, by that time, both King Auto Sales and Danavans Auto had ceased business operations. The remaining five CVR reports have no connection to petitioner's name or the names of the alleged purchasers, and there is no record that petitioner filed Notices of Transfer and Release of Liability for the vehicles. Also, the ownership information provided in the hand-written ROS, which shows that the disputed vehicles were allegedly sold to King Auto Sales and Danavans Auto, is different from the ownership information reflected in the CVR reports. Thus, we find the information provided by petitioner to be unreliable, and petitioner has not provided reliable records such as resale certificates, sales invoices, vehicle contracts, deal jackets, or any other relevant financial records to help corroborate the identity of the purchasers and to help establish that the vehicles were sold for resale. Consequently, we find petitioner has failed to overcome the presumption that the sales at issue were sales at retail. (Rev. & Tax. Code, § 6091.)

Regarding petitioner's assertion that the 20.19 percent markup is too high, we note that petitioner did not provide reliable sales and purchase records from which the Department could have computed a representative markup percentage during the audit. Although petitioner provided additional information after the appeals conference regarding eight vehicles, the Department found that the information reflected costs in excess of selling price. Moreover, the selling prices provided by petitioner were not supported by objective, reliable evidence such as sales invoices or contracts. Since it is atypical for a business to sell merchandise at amounts less than cost, we find that the information provided by petitioner, based on undocumented selling prices, is not sufficient to warrant adjustments to the markup used in the audit.

With respect to petitioner's assertion that the percentage computed for the sample of 60 sales should not be projected to the remainder of the 328 transactions, we note that petitioner does not argue that the Department incorrectly applied the percentage or that the test was unrepresentative. Nevertheless, petitioner asserts that we should assume that no errors were made in the remainder of the 328 transactions. We find that the Department correctly projected the percentage computed for the sample to the population from which the sample was selected. (See Sales and Use Tax Department Audit Manual, § 0405.20.) In addition, we note that, since petitioner provided no resale certificates or other evidence that the 328 vehicles had been sold for resale, it would have been entirely reasonable

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for the Department to conclude that all 328 sales were subject to tax. The Department has used a reasonable audit approach, testing a sample of 60 sales, and petitioner has not provided records from which a more accurate determination can be made. Thus, we reject petitioner's assertion that the understatement should be limited to the 10 sales identified in the sample of 60 sales as taxable sales.

RESOLVED ISSUE

The Department imposed a negligence penalty because petitioner's records were inadequate for sales and use tax purposes. Specifically, the Department noted that petitioner claimed all sales of vehicles as nontaxable sales for resale, but he provided no resale certificates, sales invoices, or other standard sales records to support the claimed nontaxable amounts.

In the D&R, we concurred with the Department's finding that petitioner's records were inadequate, finding that a reasonable and prudent business person would retain records to show that his sales were not subject to tax, particularly when he made 733 sales and claimed every sale as nontaxable. The Board's own regulation expressly states that the failure to maintain records is evidence of negligence (Cal. Code Regs., tit. 18, § 1698, subd. (k)). Also, if a businessperson is making sales of vehicles, sales that are typically taxable unless proven otherwise, we would generally expect him to know that it is necessary to maintain records to document that the sales are not subject to tax, and the failure to do so for *any of its claimed nontaxable sales* is strong evidence of negligence. Nevertheless, we note that the amount of disallowed claimed sales for resale of $169,117 represents 7 percent of reported total sales of $2,365,608. In light of the relatively small percentage of error, and the fact that petitioner had not been audited before, we give petitioner the benefit of the doubt and find that the understatement was not the result of negligence. Accordingly, we recommend that the penalty be deleted.

OTHER MATTERS

None.

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

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%[2]
Mark-up percentages developed	20.19%[3]
Self-consumption allowed in dollars	None[4]
Pilferage allowed in dollars	None

[2] Petitioner sold vehicles, which are always taxable if sold at retail, although the majority of his sales were nontaxable sales for resale.

[3] Since petitioner did not provide records of sales and purchases that were sufficiently complete to conduct a shelf test, the Department used an industry average markup of 20.19 percent.

[4] Since petitioner was selling used cars, and there was no evidence of self-consumption or theft of vehicles, no adjustment was made for self-consumption or pilferage.