

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Administrative Protest and)
Claim for Refund Under the Sales and Use Tax)
Law of:)
WEST COAST STORM, INC.,) Account Number SR S EH 100-967957
Taxpayer) Case ID's 627343, 805282
Rialto, San Bernardino County

Type of Business: Construction contractor

Audit period: 10/01/08 – 12/31/11

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Unreported taxable sales	\$2,864,227		
As determined		\$393,531.48	\$39,353.12
Finality penalty added			+39,353.15
Post-D&R adjustment		-153,225.56	-30,645.11
Post-SD&R adjustment		<u>- 5,745.92</u>	<u>-48,061.16¹</u>
Tax, as adjusted		\$234,560.00	<u>\$ 00.00</u>
Less concurred		<u>00.00</u>	
Balance protested		<u>\$234,560.00²</u>	
Tax, as adjusted		\$234,560.00	
Interest through 02/29/16		37,094.28 ³	
Finality penalty		<u>23,456.00</u>	
Total tax, interest, and penalty		\$295,110.28	
Payments		<u>-122,944.34</u>	
Balance Due		<u>\$172,165.94</u>	
Monthly interest beginning 03/01/16		<u>\$ 558.08</u>	

¹ Taxpayer has filed a request for relief from the finality penalty, and we have recommended relief, on the condition that the tax is paid within 30 days from the date the final notice of the Board's action is issued. Thus, we have deducted the finality penalty here. However, we include the penalty in the table below because the conditions for relief have not yet been met.

² The protested tax amount is net of the tax on credit measure of \$147,025 for costs of tax-paid purchases resold. Taxpayer has not filed a claim for refund of the tax on this credit measure, and the statute of limitations for filing a claim has expired. Thus, if taxpayer prevails in this appeal such that the deficiency measure for unreported taxable sales is deleted, a refund of the tax on the credit measure will not be available.

³ Interest of \$37,094.28 is net of \$2,839.45, the amount of interest for which we recommend relief, as explained under "Other Matters."

UNRESOLVED ISSUE

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2 **Issue:** Whether any additional adjustments to the amount of unreported taxable sales are
3 warranted. We find that no additional adjustments are warranted.

4 Taxpayer was a construction contractor that furnished and installed catch basin drain screens at
5 sewer entrances to keep out debris from sewage pipe systems primarily for the City of Los Angeles
6 (City of LA) from August 2007 through December 2012. Taxpayer billed on a time-and-materials
7 basis with sales tax reimbursement added to the billed price of the materials. For audit, taxpayer
8 provided its sales and use tax returns, bank statements, profit and loss statements, and purchase
9 invoices for the audit period, and its federal income tax returns for 2008 and 2009. Since taxpayer did
10 not provide its sales records for audit, the Sales and Use Tax Department (Department) contacted the
11 City of LA directly and obtained the bid package for each sale showing the selling price of the catch
12 basin drain screens and the charge for installation labor, a detailed payment history report, and a
13 contract purchase order. The Department divided sales of catch basin drain screens of \$28,092,600 by
14 the total contract price of \$36,940,300 to calculate an audited taxable sales ratio of 76.05 percent.
15 Using the audited taxable sales ratio and recorded payments from the City of LA payment history
16 reports, the Department established audited taxable sales to the City of LA of \$27,828,530, which
17 exceeded petitioner's reported taxable sales for the audit period by \$4,655,845.

18 However, to address petitioner's contentions on appeal, the Department obtained an updated
19 and detailed payment history schedule from the City of LA, which included the amount of sales tax
20 reimbursement paid by the City of LA for each of the sales invoices billed by taxpayer. Based on this
21 new information, the Department initially calculated that the amount of unreported taxable sales should
22 be reduced by \$1,902,249, from \$4,655,845 to \$2,753,596. However, in making adjustments in a
23 post-D&R reaudit, the Department discovered several errors in its initial calculations, which, when
24 corrected, resulted in unreported taxable sales of \$2,864,227.

25 At the appeals conference, taxpayer objected to using the taxable sales ratio of 76.05 percent to
26 establish audited taxable sales, because that methodology was based on estimates and not on the actual
27 invoices paid by the City of LA. However, the amount of unreported taxable sales in the post-D&R
28 reaudit is based on the actual payment history with sales tax details obtained directly from the City of

1 LA and sales invoices for sales to other cities. After the appeals conference, the Department contacted
2 taxpayer to discuss the reaudit adjustments, and to determine if any areas of disagreement remained.
3 While taxpayer indicated by email that its board of directors had not approved the revised measure of
4 tax, it did not present any other contentions or identify any errors in the revised computations.

5 We note that the deficiency measure established in the reaudit is based on the difference
6 between recorded taxable sales with sales tax reimbursement added and taxpayer's reported taxable
7 sales. Taxpayer has not argued or shown that the payment history records provided by the City of LA
8 contain any errors, or that the Department's computations in the post-D&R reaudit contain errors. Our
9 examination of the reaudit computations has shown no uncorrected errors. In the absence of any
10 evidence supporting a reduction to unreported taxable sales of \$2,864,227, we conclude that no
11 additional adjustments are warranted.

12 Taxpayer made payments towards the determination of \$41,869.90 on April 8, 2013,
13 \$61,422.05 on August 15, 2013, and \$9,301.14 on September 6, 2013. On April 16, 2014, taxpayer
14 filed a claim for refund, which was timely for all three payments. Based on our conclusion that these
15 payments do not represent any overpayment of the amount of tax due, we recommend that the claim for
16 refund be denied.

17 **RESOLVED ISSUES**

18 The Department imposed the negligence penalty because taxpayer did not provide sales
19 records, such as sales journals, a general ledger, sales contracts, and sales invoices to support its
20 reported sales. Further, since taxpayer clearly charged sales tax reimbursement, but did not provide
21 sales tax worksheets, or any records of accrued sales tax, the Department found that taxpayer was
22 negligent in recordkeeping. Additionally, the Department deemed the large amount of unreported
23 taxable sales relative to taxpayer's reported taxable sales to be evidence of negligence in reporting.
24 Taxpayer argued that the complexity and timing of its invoicing system, including its conversion from
25 a cash basis to an accrual basis in 2009, affected the availability of its records. In the D&R, we found
26 that the inadequacy of taxpayer's records and the reporting error rate showed that taxpayer was
27 negligent. However, upon reconsideration in our SD&R, we found that the reporting error rate of
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1 Section from November 28, 2012, through November 26, 2013, to prepare a Summary Analysis. We
2 have been advised that based on staffing and inventory levels at that time, it typically took up to eight
3 months to review an appeal and prepare a Summary Analysis. Accordingly, we conclude that it is
4 appropriate to relieve interest for the extra four-month delay, from August 1, 2013, through
5 November 30, 2013, and we compute the amount of such interest to be \$2,839.45

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Summary prepared by Lisa Burke, Business Taxes Specialist III