

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 BEAR DATA SOLUTIONS, INC.) Account Number: SR Y GH 100-484567
 6 Petitioner) Case ID 521430
 7) Santa Clara, Santa Clara County

8 Type of Business: Retailer of network storage devices

9 Audit period: 04/01/05 – 03/31/08

10 Item Disputed Amount

11 Disallowed claimed nontaxable sales \$998,471

12 Tax

13 As determined \$103,654.66

14 Adjustment – Appeals Division -19,711.66

15 Proposed redetermination \$ 83,943.00

16 Less concurred - 1,955.87

17 Balance protested \$ 81,897.13

18 Proposed tax redetermination \$ 83,943.00

19 Interest through 12/31/11 29,252.46

20 Total tax and interest 113,195.46

21 Payments -13,161.00

22 Balance Due \$100,034.46

23 Monthly interest beginning 01/01/12 \$412.90

24 **UNRESOLVED ISSUES**

25 **Issue 1:** Whether any further adjustments are warranted to the disallowed claimed nontaxable
 26 and exempt transactions. We find no further adjustments are warranted.

27 Petitioner is a retailer and broker of network storage devices with consulting and support
 28 services. Petitioner claimed deductions on returns for nontaxable sales for resale, nontaxable labor,
 exempt sales to the U.S. Government, exempt sales in interstate or foreign commerce, and “other,”
 which included nontaxable freight charges, consulting fees and support services. The Sales and Use
 Tax Department (Department) segregated petitioner’s claimed nontaxable and exempt sales into two
 strata. It examined sales of up to \$100,000 based on a statistical sample, and examined all sales greater

1 than \$100,000. In the reaudit the D&R recommended, the Department disallowed five claimed
2 nontaxable sales, four from the sample and one from the sales in excess of \$100,000.

3 Petitioner contends that all five sales were valid sales for resale. Alternatively, for two
4 invoices, petitioner contends that the sales were exempt sales in interstate commerce. For a third
5 invoice, petitioner argues that the transaction was a construction contract (petitioner did not explain
6 how this fact alone would affect the liability), and, failing that, petitioner claims the invoice should be
7 removed from the sample because it is a unique non-reoccurring error (this is addressed in Issue 2).

8 For all the transactions in question, we find that petitioner has failed to provide a resale
9 certificate which contains all the elements required pursuant to California Code of Regulations, title
10 18, section (Regulation) 1668 subdivision (b)(1), and has failed to provide sufficient proof, such as an
11 XYZ letter response, that the sales were in fact for resale. Regarding the claimed sales in interstate
12 commerce, we do not understand petitioner to dispute that it shipped the merchandise to its purchasers
13 in California. Rather, petitioner contends that, because its customers subsequently shipped the
14 merchandise out-of-state and first functionally used the merchandise out-of-state, the sales were
15 exempt as sales in interstate commerce. Petitioner is mistaken: since it delivered the products to its
16 purchasers in California, the sales do not qualify for the exemption. (Cal. Code Regs., tit. 18, § 1620
17 subd. (a)(3)(A).) With respect to the claim that one transaction was a construction contract, we find
18 petitioner has failed to provide sufficient documentation to support this assertion. In summary,
19 petitioner has failed to establish that any of the sales in question were nontaxable or exempt. Thus, we
20 find that no further adjustments are warranted.

21 **Issue 2:** Whether adjustments are warranted to the sampling method. We find no adjustments
22 are warranted.

23 Transactions were selected at random from claimed nontaxable sales made throughout the audit
24 period of up to \$100,000. In the reaudit, four sales were disallowed resulting in an error rate of 3.99
25 percent, which was applied to recorded nontaxable sales up to \$100,000 to compute disallowed
26 nontaxable sales for the first strata of \$882,407. Petitioner contends that the sample errors should be
27 assessed only on an actual basis and not be projected because they all occurred during a period for
28 which it had new and inexperienced employees and its Chief Financial Officer, who normally

1 supervised these employees, was also absent (October 2006 through June 2007). Alternatively,
2 petitioner argues that one invoice should be removed from the sample as a non-reoccurring error
3 because, as a construction contract, it was a unique transaction.

4 We recognize that all the disallowed sales in the first strata occurred between October 30, 2006,
5 and February 28, 2007. However, petitioner has not provided any documentation to support its
6 assertion that, during the period October 2006 through June 2007, its sales records were maintained by
7 inexperienced employees or that the employees lacked supervision. Thus, we find petitioner has not
8 established that the sample was not representative. Further, since the test was done based on a sample
9 basis and the Department did not examine every transaction during the periods petitioner believes there
10 were better controls in place, there cannot be an automatic conclusion that the only errors made during
11 the audit period were the ones *within* the sample. We note further that, even if we accepted petitioner's
12 argument that it made errors only during the period of October 2006 through June 2007, we would not
13 agree that the sample errors should be assessed on an actual basis, with no projection. The Department
14 chose the sample of sales at random, and it identified four errors, which exceeds the minimum number
15 of three errors required in order for sample results to be projected. (Audit Manual, § 1308.05.) Thus,
16 we find no basis for concluding that the percentage of error should not be projected. Since the actual
17 test performed was based on the entire period, and was not segregated by date, we find that the proper
18 statistical method requires that the error rate be applied to the entire audit period.¹ With respect to the
19 alleged construction contract, we find petitioner has not shown that the transaction was in fact a
20 construction contract or that the error was non-reoccurring. We conclude that no further adjustment is
21 warranted.

22 OTHER DEVELOPMENTS

23 None.

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25 Summary prepared by Thea C. Etheridge, Business Taxes Specialist II

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27 ¹ We note further that the alternative to applying the correct statistical method of applying the 3.99 percent error to the
28 entire audit period would be to recalculate the error based on the test population for the nine months from which the errors
were drawn. That would result in a much larger error applied to a smaller population. The net result is that the measure of
deficiency would be just about the same.

Statistical Sample

Transactions Examined	Claimed exempt sales
Confidence level	80%
Confidence interval	74.92%
Total number of items in the population	3534
Number of items randomly selected for the test <i>(Strata one sample units were selected randomly. Strata two was examined on a census basis)</i>	Strata one random 312 Strata two census <u>112</u> Total sample 424
Number of errors found	Strata one 4 Strata two <u>1</u> Total 5
Whether stratification was used, and if so what was stratified	Strata one sales 0-\$100,000 Strata two sales in excess of \$100,000
Average dollar value of population	\$ 6,462.65 strata one \$233,472.28 strata two
Dollar value of remaining errors	\$ 88,436 strata one <u>\$116,064</u> strata two \$204,500 total errors in sample.
Dollar value of sample	\$ 2,216,392 strata one <u>\$26,148,895</u> strata two \$28,365,287 total dollar value of items examined in the sample.
Percentage of error	3.99% strata one
Were XYZ letters sent	yes
Number of XYZ letters sent	Unknown*
Percentage of XYZ letters sent in relation to number of questioned items	Unknown*
Number of responses to XYZ letters received	Unknown*
Percentage of responses to XYZ letters received in relation to the number of XYZ letters sent	Unknown*
Number of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	Unknown*
Percentage of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	Unknown*
Number of responses to XYZ letters treated as taxable	3
Percentage of responses to XYZ letters treated as taxable	Unknown*

* The audit did not list or indicate the number of XYZ letters sent to petitioner's customers or the number of responses to XYZ letters received.