

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:)
BENALEX WINDOWS & DOORS CORP.) Account Number SR AA 97-750114
Petitioner) Case ID 446664
Los Angeles, Los Angeles County

Type of Business: Sales of windows

Audit period: 07/01/04 – 06/30/07

| <u>Item</u> | <u>Disputed Amount¹</u> | |
|--|------------------------------------|--------------------|
| Disallowed claimed and netted nontaxable sales | \$4,896,656 | |
| Unreported taxable sales | \$2,616,705 | |
| Negligence penalty | \$ 62,432 | |
| | <u>Tax</u> | <u>Penalty</u> |
| As determined | \$667,763.73 | \$66,776.41 |
| Pre-D&R adjustment | + 12,309.35 | + 1,230.95 |
| Post-D&R adjustment | <u>- 55,757.42</u> | <u>- 5,575.75</u> |
| Proposed redetermination | \$624,315.66 | \$62,431.61 |
| Less concurred | - 4,463.33 | 00.00 |
| Balance, protested | <u>\$619,852.33</u> | <u>\$62,431.61</u> |
| Proposed tax redetermination | \$ 624,315.66 | |
| Interest through 02/28/13 | 330,439.12 | |
| Negligence penalty | <u>62,431.61</u> | |
| Total tax, interest, and penalty | \$1,017,186.39 | |
| Payments | <u>- 132,128.24</u> | |
| Balance Due | <u>\$ 885,058.15</u> | |
| Monthly interest beginning 03/01/13 | <u>\$ 2,460.94</u> | |

This is an appeal that is covered by Revenue and Taxation Code section (Section) 40.

Therefore, after the Board has made a determination in this matter, a written opinion that, among other things, sets forth the relevant factual findings and the legal analysis on which that determination is

¹ Petitioner has not specified what portion of the audit items it disputes, so the entire amounts are treated as disputed.

1 based must be published on the Board's website within 120 days from the date the Board renders a
2 final decision in this matter. Accordingly, the Board may wish to consider the following two options:

3 (A) The Board could follow its usual practice in business tax appeals, in which it typically
4 votes to resolve the appeal on the day of the hearing. Under the usual practice, a notice of the
5 Board's determination will be mailed within 45 days of the date of the Board's vote, and the
6 30-day period for the filing of a Petition for Rehearing (PFR) would begin on the date the
7 notice is mailed. If a PFR is not filed, the Board's determination will become final and its
8 decision will be rendered at the expiration of the 30-day PFR period. Unless the Board
9 specifically directs that it desires to issue a precedential (Memorandum Opinion) decision in
10 this matter, staff would then expeditiously bring back a proposed (nonprecedential) Summary
11 Decision that complies with Section 40 for the Board's approval on a later calendar. The
12 adopted decision will be published timely on the Board's website. If a PFR is filed, no decision
13 will be rendered until the conclusion of the petition for rehearing process.

14 (B) The Board could inform staff of its tentative determination and direct staff to prepare a
15 proposed Summary Decision (or Memorandum Opinion) that reflects the tentative
16 determination for Board approval as soon as practicable. Under this option, the Board would
17 hold any determination of the appeal in abeyance until it has the opportunity to consider the
18 proposed decision. The Board's later vote to adopt the decision would also constitute its vote
19 to resolve the appeal, and within 45 days a notice of decision would be mailed. The 30-day
20 PFR period would begin running when the notice of the Board's determination was mailed. If
21 no PFR is filed, the Summary Decision (or Memorandum Opinion) would then be timely
22 posted on the Board's website pursuant to Section 40.

23 We also note that petitioner could request during the oral hearing that the Board take Option B
24 above and defer its vote to determine the appeal until it adopts a Summary Decision (or Memorandum
25 Opinion). Such a request would, of course, defer resolution of the appeal and interest would continue
26 to accrue. On the other hand, petitioner may prefer that the Board follow its usual practice in business
27 tax appeals, which typically would result in a vote to resolve the appeal on the day of the hearing, thus
28 accelerating the resolution process, but potentially requiring petitioner to file a PFR before it sees the
content of the Summary Decision (or Memorandum Opinion) adopted by the Board.

This matter was scheduled for Board hearing in April 2012 but was postponed at petitioner's
request to allow additional time to prepare. It was rescheduled for hearing in October 2012 but was
postponed at petitioner's request due to a scheduling conflict.

UNRESOLVED ISSUES

1
2 **Issue 1:** Whether adjustments are warranted to the disallowed claimed and netted nontaxable
3 sales. We find no further adjustment is warranted.

4 Petitioner manufactures and sells window frames, glass, and screens. Petitioner did not provide
5 a general ledger or other summary records that had been completed contemporaneously with the sales.
6 However, it did provide source documents that the Sales and Use Tax Department (Department) found
7 to be reasonably complete. In its review of nontaxable sales, the Department used the third quarter
8 2004 (3Q04) as a test period. The Department found that petitioner's invoices for nontaxable sales
9 (which included both sales for resale and charges for labor) totaled \$536,675, which exceeded the
10 claimed deduction for nontaxable sales of \$360,529 by \$176,146. Accordingly, the Department used
11 \$536,675 as the amount of claimed and netted nontaxable sales for the 3Q04, and it computed a
12 percentage of error in the claimed deduction of 48.86 percent ($\$176,146/\$360,529$). To establish the
13 audited amount of claimed and netted nontaxable sales for the remainder of the audit period, the
14 Department applied 48.86 percent to the claimed deduction for each quarter. (The ratio was not used
15 to determine the measure of tax, but as an audit shortcut to determine the total amount of claimed and
16 unreported nontaxable sales.) The Department then reviewed each of the invoices for nontaxable sales
17 for 3Q04 and found that 71.62 percent of those sales were not adequately documented, and it applied
18 that percentage to the audited amount of claimed and netted nontaxable sales to establish the
19 disallowed amount for the audit period.

20 After the appeals conference, the Department concluded that it was inappropriate to apply the
21 48.86 percent to claimed deductions for nontaxable sales for the entire audit period. Instead, the
22 Department noted that it had compared recorded and reported taxable sales on a quarterly basis for the
23 period January 1, 1995, through March 31, 2007, and it observed that the percentage fluctuated from
24 quarter to quarter. The Department reasoned that the percentage of understatement in claimed
25 nontaxable sales would fluctuate in a similar manner. Based on our review of the audit workpapers,
26 we concur, and we recommended that adjustment in the D&R. Accordingly, to establish the claimed
27 and netted nontaxable sales in the reaudit, instead of applying 48.86 percent to claimed nontaxable
28 sales for the entire audit period, the Department applied the percentage of understatement in reported

1 taxable sales to the claimed deduction for nontaxable sales, on a quarter-by-quarter basis for periods
2 beginning January 1, 2005. It then applied 71.62 percent to the claimed and netted nontaxable sales for
3 each quarter to compute the disallowed amount.

4 Petitioner concedes that the amount of claimed and netted nontaxable sales is overstated, but
5 argues that the difference established in the audit should be adjusted by an unspecified amount.

6 Petitioner asserts that its reporting practices improved in the later portions of the audit period but has
7 provided no documentation to show that its reporting became more accurate in the later quarters of the
8 audit period. Also, petitioner has provided no evidence that the percentages of error in its claimed
9 nontaxable sales were less than the percentages of error in its reported taxable sales. Accordingly, in
10 the absence of supporting documentation, we find no further adjustment is warranted.

11 **Issue 2:** Whether adjustments are warranted to the unreported taxable sales. We find no
12 adjustment is warranted.

13 After the Department notified petitioner of the impending audit, petitioner retained an
14 accountant to produce a rudimentary single-entry sales journal. Using that journal, the Department
15 reconciled the amount of sales tax accrued and sales tax reported for the period January 1, 2005,
16 through March 31, 2007. Using the difference between the accrued and reported sales tax, the
17 Department computed a difference between recorded and reported taxable sales of \$2,246,858. It then
18 used that difference to compute a percentage of error of 347.88 percent, which it applied to reported
19 taxable sales to establish the unreported amount for 3Q04 and 4Q04. Based on its review of the
20 records, the Department concluded that reported taxable sales for 2Q07 were substantially accurate.
21 Petitioner concedes that it had recorded taxable sales that were not reported, but argues that the audited
22 difference is overstated by an unspecified amount.

23 The amount of unreported taxable sales is based primarily on petitioner's recorded taxable
24 sales. Petitioner has provided no evidence that its recorded taxable sales were overstated. Further, the
25 Department reconciled recorded and reported taxable sales for nine quarters, and we find it was
26 appropriate for the Department to apply the percentage of error computed for those nine quarters to
27 reported amounts for two earlier quarters for which no summary records were provided. Thus, we find
28 no adjustment is warranted.

