

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matters of the Administrative Protest)
 4 and Petition for Redetermination Under the)
 Sales and Use Tax Law of:)
 5) Account Number: SR KH 28-712563
 CALDRON'S JEWELERS, INC.,) Case ID 418580
 6 dba Caldron's Jewelers)
) Account Number: SR KH 53-002849
 7 RICHARD CALDRON) Case ID 422927
)
 8 Petitioners) Tracy, San Joaquin County

9 Type of Business: Jeweler
 10 Liability Period: 07/01/01 – 09/30/05

11 <u>Item</u>	<u>Disputed Amount</u>	
12 Unreported taxable sales	\$239,245	
13 Negligence penalty	\$4,196	
14 Amnesty double negligence penalty	\$1,833	
15 Penalty for failure to timely pay determination (finality)	\$4,196	
16 Amnesty double finality penalty	\$1,833	
17 Amnesty interest penalty	\$2,038	
	<u>418580 & 422927</u>	
	<u>Tax</u>	<u>Penalty</u>
18 As determined:	\$106,204.99	\$42,402.00
19 Adjustments: Tax	-45,069.74	
	-19,173.83	
20 Fraud penalty		-26,551.36
21 Amnesty fraud penalty		-15,850.64
22 Negligence penalty		+4,196.17
23 Amnesty double negligence penalty		+1,833.26
24 Finality penalty		+4,196.14
25 Amnesty double finality penalty		+1,833.25
26 Amnesty interest penalty		+2,038.45
27 Tax and Penalty	\$41,961.42	\$14,097.27
28 Less concurred	<u>23,628.92</u>	
29 Protested	<u>\$18,332.50</u>	<u>\$14,097.27</u>
30 Tax	\$41,961.42	
31 Interest through 2/28/11	23,619.20	
32 Penalties	<u>14,097.27</u>	
33 Total tax, interest, and penalties	\$79,677.89	
34 Payments	<u>-18,100.00</u>	
35 Balance Due	<u>\$61,577.89</u>	
36 Monthly interest beginning 3/1/11	<u>\$139.19</u>	

BACKGROUND

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2 Caldron's Jewelers, Inc., (Caldron's) was incorporated in 1981, but its corporate status was
3 suspended by the Franchise Tax Board effective March 1, 1985. Mr. Richard Caldron, the sole
4 corporate officer of Caldron's Jewelers, Inc., did not notify the Board of this suspension, and continued
5 to operate the business under the corporate name. The Sales and Use Tax Department (Department)
6 concluded that Mr. Caldron is a responsible person pursuant to California Code of Regulations, title
7 18, section (Regulation) 1702.6, which he does not dispute. The Department audited Caldron's records
8 and concluded that Caldron's was fraudulent in preparing its sales and use tax returns. The
9 Department issued a Notice of Determination (NOD) to Caldron's on July 12, 2007, for tax of
10 \$106,204.99 for the period January 1, 1996, through September 30, 2005, plus a fraud penalty of
11 \$26,551.36 pursuant to Revenue and Taxation Code section 6485 and an amnesty double fraud penalty
12 of \$15,850.64 (only a portion of the fraud penalty was imposed for the amnesty-eligible period). Since
13 Caldron's did not file a timely petition for redetermination, the NOD became final and a finality
14 penalty was imposed along with an amnesty double finality penalty and amnesty interest penalty. On
15 August 28, 2007, the Department issued a NOD to Mr. Caldron as a responsible person for the same
16 liability, except that the finality penalty, amnesty double finality penalty, and amnesty interest penalty
17 were not assessed against Mr. Caldron because these penalties had not been assessed against Caldron's
18 at the time the NOD was issued to him. Mr. Caldron filed a timely petition for redetermination.

19 Based on additional documentation Mr. Caldron provided at the appeals conference, the
20 Department recommended that the fraud penalty be replaced with a negligence penalty. Since the
21 NOD to Caldron's was timely for the period October 1, 1996, through June 30, 2001, only if the fraud
22 penalty were sustained, the Department agrees the liability for that period should be deleted, resulting
23 in a reduction for both NOD's in the tax due from \$106,204.99 to \$61,135.25 for the period July 1,
24 2001, through September 30, 2005, with the applicable negligence, finality, and amnesty penalties.¹

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26 ¹ The Statement of Account dated April 16, 2010, issued to Mr. Caldron replaced the fraud and amnesty double fraud
27 penalties with negligence and amnesty double negligence penalties, and also included the applicable finality, amnesty
28 double finality, and amnesty interest penalties that had not been included in the NOD issued to him. Since the total of the
penalties imposed in the Statement of Account are less than the total of the penalties imposed in the NOD issued to Mr.
Caldron for the remaining liability period, the Department is not required to assert the additional penalties pursuant to
section 6563.

1 Mr. Caldron and Caldron's (petitioners) argue that the statute of limitations has expired for the liability
2 assessed for the period July 1, 2001, through March 31, 2004.

3 UNRESOLVED ISSUES

4 **Issue 1:** Whether the NOD's were timely issued for the period July 1, 2001 through December
5 31, 2002. We conclude that they were.

6 Caldron's issued waivers of limitation which expired on January 31, 2007, prior to the
7 Department's July 12, 2007 issuance of the NOD to Caldron's (which was timely under the general
8 three-year statute of limitations for the period beginning April 1, 2004). Thus, since the Department
9 no longer asserts fraud, the NOD was not timely for the period prior to April 1, 2004, absent the
10 application of the 10-year amnesty statute of limitations under Revenue and Taxation Code section
11 7073. We conclude that the 10-year amnesty statute of limitations does apply for the amnesty-eligible
12 period, that is, through December 31, 2002, because all five conditions for its application have been
13 met: Caldron's did not participate in the amnesty program or report the amnesty-eligible
14 understatement; the Department did not previously audit the periods in question; the periods in
15 question are contiguous with the normal three-year audit period; and the Department has found direct
16 evidence of a deficiency in the quarters at issue. Thus we find that the NOD issued to Caldron's was
17 timely for the period July 1, 2001, through December 31, 2002.²

18 **Issue 2:** Whether Caldron's was negligent. We conclude that it was.

19 The Department imposed the negligence penalty because there was a large percentage of error
20 in reporting taxable sales, and because Caldron's maintained two sets of sales journals, the first journal
21 to record taxable sales and the second journal to record only nontaxable repair labor. The Department
22 found that Mr. Caldron assumed the second journal only contained nontaxable sales. However, the
23 Department's found that the second journal included large sales of jewelry on which sales tax
24 reimbursement was collected, but Caldron's failed to report such taxable sales. The Department also
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27 ² The Board has concluded that the 10-year amnesty statute of limitations applies only to periods that were still open as of
28 the date the amnesty legislation was passed on August 16, 2004. On August 16, 2004, the otherwise applicable three-year
statute of limitations had expired for periods before July 1, 2001. Thus, the 10-year amnesty statute of limitations is not
applicable to such periods.

1 determined that Caldron's was negligent because it erroneously believed that fabrication labor and
2 sales of loose stones were not subject to tax.

3 Petitioners argue that this was Caldron's first audit since the business started in the 1940's,
4 there has not been any change in the manner in which the business was operated, Mr. Caldron believed
5 he maintained the proper records and correctly reported taxable sales, and Caldron's hired an outside
6 bookkeeper to prepare the business tax returns. In sum, petitioners assert the underreporting occurred
7 due to Mr. Caldron's lack of knowledge, not negligence.

8 We disagree. Caldron's should have known that the high dollar sales recorded in the second
9 journal were taxable sales that should have been recorded in the first journal, rather than charges for
10 nontaxable repair labor. Petitioners had no explanation for such recording error. We find that such
11 unexplained failure to properly record these taxable sales indicates negligence. Additionally, since
12 these journals were Caldron's own records, it could have performed a cursory review for reporting
13 purposes. We find that Caldron's was negligent in failing to review its records. Further, Caldron's
14 collection of sales tax reimbursement indicates that it knew of its reporting obligation, but petitioners
15 could not explain why these taxes were not reported. We find that Caldron's unexplained failure to
16 remit the reimbursement on these sales is below the standard of care of a reasonably prudent person.
17 Finally, we note that for the remaining liability period, Caldron's had a deficiency measured by
18 \$544,134 while reporting tax measured by \$124,410, a 437 percent error ratio. We find that this very
19 large percentage of reporting error indicates negligence. Based on the foregoing, we conclude that
20 Caldron's was negligent, and the negligence penalty was properly applied.

21 **Issue 3:** Whether relief from the penalty for failure to timely pay the NOD should be denied.
22 We conclude that relief should be denied.

23 Caldron's submitted a request for relief of this penalty, signed under penalty of perjury. (Rev.
24 & Tax. Code, § 6592.) To consider relief of the finality penalties, the Board has provided specific
25 direction to us in the *Memorandum Opinion of Davinder Singh Pabla* (9/1/05). First, we must consider
26 whether the taxpayer has established a reasonable, non-negligent basis for his or her failure to timely
27 pay or petition the tax due. Second, we must consider whether it is reasonable for the taxpayer to have
28 withheld payment of the tax until the resolution of the administrative protest.

1 With respect to the first condition, we conclude that petitioners have established that there were
2 reasonable, non-negligent basis for Caldron's failure to timely pay or petition the NOD. That is,
3 Caldron's relied upon its representative to respond to the NOD, and the representative expressly
4 requested the Department to send him a copy when the NOD was issued to Caldron's. We find that the
5 NOD was mailed to the representative; however it was mailed at an incorrect address and the
6 representative did not become aware of the NOD until a Demand for Immediate Payment was issued,
7 after the NOD was final.

8 With respect to the second factor, based on the unique circumstances of this case, we concluded
9 in the Decision and Recommendation (D&R) that Caldron's could satisfy the second factor if the
10 undisputed portion of the determined tax, which, herein, covers the tax for the period April 1, 2004,
11 through September 30, 2005, were paid within 30 days of the issuance of the D&R. That is, petitioners
12 concede tax of \$23,628.92, and by the time we issued the D&R, \$17,000 in payments had been
13 applied. Thus, the initial condition for our recommendation that the penalty be relieved was that
14 petitioners pay the remaining \$6,628.92 in conceded tax within 30 days of the D&R. If it had done so,
15 our recommendation would have been to grant relief of this penalty subject to the standard condition
16 that the remaining tax be paid within 30 days of the mailing of notice of the Board's final decision.
17 However, only \$800 in additional payments have been made (\$500 within 30 days of the issuance of
18 the D&R, and \$300 over four months later). Since petitioners have not paid the undisputed amount in
19 full in the required time, we conclude that relief of the finality penalty, as well as the automatically
20 imposed amnesty finality penalty, is not warranted.

21 **Amnesty Penalties**

22 An amnesty interest penalty of \$2,038.45 was imposed because the NOD issued against
23 Caldron's became final and Caldron's did not participate in the amnesty program. Petitioners
24 submitted a statement signed under penalty of perjury pursuant to section 6592 arguing they did not
25 participate in the amnesty program because they had no knowledge or reason to suspect that Caldron's
26 underreported its taxable sales until the audit was conducted, which did not commence until December
27 2005, after the amnesty participation period expired.

1 We note that petitioners did not assert that they were unaware of the amnesty program. We
2 find that they were aware of the program since Caldron's held a seller's permit and filed its fourth
3 quarter 2004 sales and use tax return, and they must have received the Tax Information Bulletin that
4 discussed the amnesty program, which was mailed with the fourth quarter 2004 return to all active
5 permit holders. Thus, we conclude that Caldron's knew or should have known of the amnesty
6 program. We also find that Caldron's knew or should have known of its additional tax liability
7 because it recorded large taxable sales in its nontaxable repair journal but failed to review its own
8 records, which resulted in its failure to report these taxable sales. Thus, we conclude that Caldron's
9 should have known of the additional amnesty eligible tax liability and that its failure to participate in
10 the amnesty program was not due to circumstances beyond its control. We recommend that relief from
11 the amnesty penalties be denied.

12 **RESOLVED ISSUE**

13 In preparing this matter for hearing, the Department observed to the Appeals Division that in
14 applying the 10-year statute of limitation, the D&R applied it to the period January 1, 2003, through
15 June 30, 2004, which is not a period of liability that was covered by the amnesty program. Since the
16 10-year statute of limitations is *not* applicable to any period not covered by the amnesty program and
17 the NOD was not issued within the three-year limitations period applicable to the liability incurred
18 during the period January 1, 2003, through June 30, 2004, the NOD for that period is barred. The table
19 above reflects the Department's adjustments to remove this liability, reducing the tax by \$19,173.83,
20 from \$61,135.25 to \$41,961.42, and reducing the applicable penalties accordingly.

21 **OTHER DEVELOPMENTS**

22 None.

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24 Summary prepared by Rey Obligacion, Retired Annuitant
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