

## 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 ALI JAMIL CHAHINE, dba La Mexicana ) Account Number: SR AA 14-641547  
 6 Petitioner ) Case ID 488734  
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8 Type of Business: Retailer and Wholesaler of clothing

9 Audit period: 04/01/04 – 03/31/07

10 Item Disputed Amount

11 Disallowed claimed sales for resale \$603,046  
 12 Negligence penalty \$ 4,975

	<u>Tax</u>	<u>Penalty</u>
13 As determined	\$55,411.37	\$5,541.16
14 Post-D&R adjustment	- 5,660.01	- 565.96
15 Proposed redetermination	<u>\$49,751.36</u>	<u>\$4,975.20</u>
16 Proposed redetermination	\$49,751.36	
17 Interest through 10/31/13	31,820.43	
18 Negligence penalty	<u>4,975.20</u>	
19 Total tax, interest, and penalty	\$86,546.99	
20 Less payment	- 20.00	
21 Balance due	<u>\$86,526.99</u>	
22 Monthly interest beginning 11/1/13	<u>\$ 248.66</u>	

21 This matter was scheduled for Board hearing in June 2011, but was postponed at petitioner's  
 22 request to allow additional time to prepare for the hearing. It was rescheduled for Board hearing in  
 23 October 2011, but was deferred for settlement consideration. The matter was then rescheduled for  
 24 Board hearing in July 2013, but was postponed at petitioner's request to allow additional time for his  
 25 new representative to prepare for the hearing.

26 **UNRESOLVED ISSUES**

27 **Issue 1:** Whether adjustments are warranted to the measure of disallowed claimed sales for  
 28 resale. We find no further adjustments are warranted.

1           Petitioner sold casual clothing and accessories at a location located within a retail shopping  
2 district from July 1976 through October 2011. Petitioner did not maintain cash register tapes or  
3 summary sales reports to support his reported sales, but instead, relied on his bank deposits to report  
4 total sales. Petitioner claimed approximately 69 percent of his reported total sales as nontaxable sales  
5 for resale. While the Sales and Use Tax Department (Department) accepted the accuracy of  
6 petitioner's reported total sales based on a reasonable book markup, it questioned the accuracy of  
7 petitioner's claimed sales for resale when it found that petitioner maintained no resale certificates.  
8 Petitioner stated that he sold inventory for resale to other retailers that did not have accounts with his  
9 clothing suppliers, and he provided the names, addresses, and seller's permit numbers for his alleged  
10 wholesale customers. However, petitioner declined to send XYZ confirmation letters to these  
11 customers, and when the Department attempted to contact the listed customers, the two customers that  
12 the Department was able to reach indicated that they did not make any purchases from petitioner.

13           The Department asked petitioner to save his cash register tapes for a two-week period and  
14 observed petitioner's business operations for two days, on June 5 and 6, 2008. However, neither an  
15 examination of the cash register tapes nor the Department's observation showed any evidence that  
16 petitioner made sales for resale. The Department also noted that petitioner's store had very limited  
17 storage space and no stock room large enough to store a substantial amount of resale inventory.  
18 However, two of petitioner's customers held seller's permits and were engaged in businesses that  
19 typically would purchase clothing and accessories for resale. Initially, the Department established  
20 petitioner's sales to these two customers totaling approximately \$300,000 as audited nontaxable sales  
21 for resale. However, in response to petitioner's objections, the Department decided to prepare a credit  
22 card sales ratio analysis to establish sales to end users from the retail location, which it regarded as  
23 petitioner's taxable sales. While the cash register tapes for the two-week period showed that  
24 28 percent of petitioner's sales were credit card sales and the two-day site observation test showed that  
25 12 percent were credit card sales, the Department used a higher estimated credit card sales ratio of  
26 30 percent, to petitioner's benefit, based on petitioner's statement that approximately 30 to 40 percent  
27 of his retail customers paid by credit card, to compute audited taxable sales of \$1,479,918 (credit card  
28 deposits of \$443,975 ÷ 30 percent). Initially, the Department subtracted audited taxable sales of

1 \$1,479,918 from reported total sales of \$2,480,555 to establish audited nontaxable sales for resale of  
2 \$1,000,637, which were \$715,834 less than petitioner's claimed nontaxable sales for resale of  
3 \$1,716,471. However, in preparing for the Board hearing for this case, the Department noted that its  
4 computations had resulted in sales tax reimbursement being included in audited taxable sales of  
5 \$1,479,918 in error. Therefore, the Department performed a reaudit to exclude sales tax  
6 reimbursement from audited taxable sales, which resulted in a reduction to the amount of disallowed  
7 claimed sales for resale, from \$715,834 to \$603,046. Credit measure of \$44,182 for unclaimed sales  
8 tax reimbursement included in reported total sales had been established separately in the original audit,  
9 but this credit measure no longer was warranted in the reaudit, and therefore it was deleted.

10         Petitioner contends that his claimed sales for resale are accurate. In response to the  
11 Department's observation regarding a lack of storage space, petitioner states that his storage space was  
12 sufficient. As support, he has provided photographs of the storage areas in his store. Further,  
13 petitioner contends that, if audited taxable sales were based on average daily sales of \$559.55  
14 computed from the cash register tapes for two weeks and the two-day site observation tests, there  
15 would be no understatement. Lastly, petitioner contends that he has a low gross profit margin, and  
16 claims this is evidence that the majority of his sales were sales for resale because sales for resale have  
17 a lower profit margin than taxable retail sales.

18         In the absence of documentary evidence to verify claimed sales for resale, such as valid resale  
19 certificates or XYZ letters, the Department used an unusual audit approach that resulted in an  
20 allowance of over one million dollars in undocumented claimed sales for resale. We consider the  
21 Department's decision to use this unusual audit approach, and the very favorable results of this test, to  
22 be extremely generous. We reject petitioner's argument that average daily sales of \$559.55 from the  
23 two tests should be used to establish audited taxable sales because the two tests reflected *no* sales for  
24 resale, and *that* is the factor we would focus on if we were to apply those tests to the present dispute.  
25 We find that petitioner has provided no evidence showing that any greater allowance for nontaxable  
26 sales for resale is warranted.

27         **Issue 2:** Whether petitioner was negligent. We find that he was.

28         The Department imposed the negligence penalty because petitioner's records were inadequate

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for sales and use tax purposes. Petitioner argues that the assessment is erroneous and based on estimates, which is not the proper basis for imposing the negligence penalty.

Although this was petitioner’s first audit, we find his failure to provide *any* documentation to support the substantial amount of claimed sales for resale indicates the lack of ordinary care expected of a reasonably prudent person, which is evidence of negligence. Further, the audited understatement of \$603,046 represents an error rate of 78.92 percent, which, under the circumstances here, is clear evidence of negligence. We conclude petitioner was negligent and the penalty was properly imposed.

**OTHER MATTERS**

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III