

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
JANET CHAVEZ, dba Compare Prices)
Petitioner)

Account Number: SR X AC 100-190439
Case ID 469083
Woodland Hills, Los Angeles County

Type of Business: Used car dealership
Audit period: 03/27/03 – 02/28/05

<u>Item</u>	<u>Disputed Amount</u>		
Unreported sales	\$5,168,382		
Unclaimed bad debts	not stated		
Fraud penalty	\$ 100,717 ¹		
		<u>Tax</u>	<u>Penalty</u>
As determined:		\$444,721.43	\$111,180.40
Adjustment - Appeals Division		- 41,852.24	- 10,463.06
Proposed redetermination, protested		<u>\$402,869.19</u>	<u>\$100,717.34</u>
Proposed tax redetermination		\$402,869.19	
Interest through 10/31/10		228,136.50	
Fraud penalty		100,717.34	
Total tax, interest, and penalty		<u>\$731,723.03</u>	
Monthly interest beginning 11/1/10		<u>\$ 2,350.07</u>	

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the amount of unreported sales. We recommend no further adjustment.

Petitioner operated two used car dealerships from March 27, 2003, through February 28, 2005 (the audit period), at which time the business was discontinued with no successor. The Investigations

¹ The Notice of Determination was issued October 3, 2008, more than three years after the last day of the month following the final quarter of the audit period. Thus, absent a finding of fraud, the determination was not timely for any portion of the audit period.

1 Division decided to audit petitioner after it received an anonymous letter stating that petitioner
2 collected amounts as sales tax on many vehicle sales without remitting tax to the Board.

3 When the audit began, petitioner stated she sold approximately 100 vehicles during the audit
4 period. However, Department of Motor Vehicles (DMV) informed the Investigations Division that it
5 had issued 2,481 reports of sales (ROS) to petitioner. The Investigations Division concluded, based on
6 the large discrepancy between the number of ROS issued and petitioner's stated number of sales, that
7 further investigation was warranted. The only records provided for audit were sales contracts for 528
8 sales and various ROS. Of the 2,481 ROS issued, petitioner was able to show that 452 ROS had been
9 returned to DMV unused, 497 had been voided, and 824 were used to record vehicle sales, leaving 708
10 missing ROS. The Investigations Division did not regard the evidence as sufficient to show that the
11 missing ROS represented vehicle sales and thus did not include the missing ROS in its calculation of
12 taxable sales. Rather, it concluded that petitioner made the 824 sales of vehicles represented by the
13 824 ROS known to have been used to record vehicle sales. From the 528 available sales contracts, the
14 Investigations Division compiled taxable sales of \$3,436,393. For 137 of the other ROS, DMV
15 provided information regarding selling prices, which the Investigations Division used to compile
16 taxable sales of \$1,082,164. For the remaining 159 ROS, the Investigations Division compiled total
17 sales of \$1,183,825, using the Kelley Blue Book to estimate selling prices. In its revised audit, the
18 Investigations Division established total vehicle sales of \$5,702,382 ($\$3,436,393 + \$1,082,164 +$
19 $\$1,183,825$). Thus, since petitioner reported taxable sales of \$534,000, the understatement of taxable
20 sales is \$5,168,382.

21 Petitioner contends that the understatement should be reduced to account for "unwinds." Also,
22 petitioner asserts that some of the selling prices established using the Kelley Blue Book are excessive,
23 but she has not identified specific transactions or provided more accurate selling prices. With respect
24 to unwinds, petitioner stated at the appeals conference that she has no documentation but believes the
25 finance companies she worked with could have information regarding unwinds. Petitioner asserts that
26 unwinds and bad debts account for most, if not all, of the audited understatement. The Investigations
27 Division contacted 15 of the finance companies that petitioner frequently used and found evidence of
28 only four unwinds. No adjustment was made for those unwinds because they involved vehicle sales

1 that were not included in the revised audit. (The Investigations Division believes that these four
2 unwinds might have involved vehicle sales recorded on ROS among the 708 missing ROS that were
3 *not* used to establish taxable sales.)

4 We find that petitioner's arguments regarding unwinds to be entirely implausible. First, it
5 difficult to believe that petitioner did not have records of any unwinds because each such transaction
6 would involve the return of the vehicle by the purchaser, petitioner's return of the down payment to the
7 purchaser, and the cancellation of any financing agreement. Further, we do not accept that 90.6
8 percent of petitioner's sales ($\$5,168,382 \div \$5,702,382$) were unwound or resulted in bad debts, as
9 petitioner contends. In any event, petitioner has provided no documentation to support any unwinds
10 and we recommend no adjustment.

11 With regard to petitioner's assertion that some of the selling prices are excessive, we note that
12 the Investigations Division used petitioner's own records to determine that she made 824 sales of
13 vehicles during the audit period, for 528 of which petitioner's sales contracts were used to determine
14 selling prices and for 137 of which DMV selling price information was used. Thus, for only 159 sales,
15 less than 20 percent of the total, the Department established selling prices based on information from
16 the Kelley Blue Book, which we find to be an acceptable source for such information, especially when
17 the retailer does not provide records of the prices, as here. In the absence of evidence of excessive
18 selling prices, we recommend no adjustment.

19 **Issue 2:** Whether the audited amount of bad debts should be increased. We recommend no
20 further adjustment.

21 Although petitioner provided no documentation to support bad debts deductions, the
22 Investigations Division estimated bad debt losses at 5 percent of the amount of taxable sales. The
23 D&R noted an error in the calculation of the amount of bad debts, which resulted in a reduction of the
24 audited bad debts from \$311,820 to \$285,120. Petitioner contends that the audited amount of bad
25 debts should be much greater, but she has provided no documentation to support any bad debts. In
26 fact, petitioner has not even provided copies of her federal income tax returns to show that she wrote
27 off bad debts for income tax purposes. In the absence of evidence, we find no further adjustment is
28 warranted for bad debts.

1 **Issue 3:** Whether the Investigations Division has established that the understatement was the
2 result of fraud or intent to evade the tax by clear and convincing evidence. We find that it has.

3 The Investigations Division imposed the fraud penalty because: 1) the understatement is very
4 large in relation to the reported measure of tax; 2) petitioner had knowledge regarding her
5 responsibility to report her sales and remit tax; 3) petitioner failed to remit to the Board significant
6 amounts of sales tax for which she had collected reimbursement from her customers; and 4) the
7 substantial discrepancies in this audit cannot be explained satisfactorily as being due to negligence.
8 Petitioner disputes the penalty on the basis that she did not intentionally under-report her sales.
9 Further, petitioner contends that she does not owe most of the determined tax, but, if there were errors
10 in reporting, they were the result of her lack of sophistication in matters of accounting. Petitioner
11 asserts that, if she had wanted to conceal her sales, she would not have given the auditor the 528 sales
12 contracts she had available.

13 Petitioner had knowledge regarding her responsibility to report sales, as evidenced by the fact
14 that she charged sales tax reimbursement and filed sales and use tax returns. Further, the amounts of
15 sales tax reimbursement collected from customers, but not remitted to the Board, were substantial. The
16 understatement of \$4,883,262 (\$5,168,382 unreported sales - \$285,120 bad debts) represents an
17 understatement of approximately 914 percent when compared to reported taxable sales of \$534,000.
18 Even considering only the sales for which petitioner provided sales contracts, the understatement
19 would be \$2,730,564 (\$3,436,393 total sales contracts - \$534,000 reported - \$171,829 bad debts,
20 computed at 5 percent), a difference between *recorded and reported* taxable sales of 511 percent
21 ($\$2,730,564 \div \$534,000$). We note that the audit period is 704 days long, and the audited number of
22 vehicle sales is 824, for an average of 1.17 sales per day. Even a person unsophisticated in matters of
23 accounting should be able to accurately record one or two sales each day. Given the relatively low
24 number of sales made during the audit period, we find an understatement of this magnitude cannot be
25 explained as being due to anything but a willful and deliberate attempt to evade the tax. In addition,
26 since petitioner provided 528 sales contracts for audit, we find she knowingly provided false
27 information when she told the Investigations Division that she had sold only 100 vehicles during the
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1 audit period. We find that the Investigations Division has provided clear and convincing evidence of
2 fraud.

3 **OTHER DEVELOPMENTS**

4 None.

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6 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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EVIDENCE OF FRAUD RELIED ON BY DEPARTMENT

1.	Substantial deficiency, which cannot be explained as due to negligence or honest mistake.	Yes
2.	More than one set of records.	No
3.	Falsified records.	No
4.	Substantial discrepancies between recorded and reported amounts for which there is no valid explanation.	Yes
5.	Permit or license held by taxpayer for prior period indicating that taxpayer was knowledgeable about the requirements of law.	No
6.	Tax properly charged to customers, evidencing a knowledge of the requirements of the law, but not reported.	Yes
7.	Transfers of amounts of unpaid tax from the tax accrual account to another income account.	No
8.	Consistent substantial underreporting.	Yes