

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:)
SONJA M. CRAIGHTON, dba Folsom Wireless) Account Number SR KH 100-979833
Petitioner) Case ID 558975
Folsom, Sacramento County

Type of Business: Retailer of cellular phones and accessories

Liability period: 10/01/07 – 06/30/10

<u>Item</u>	<u>Disputed Amount</u>
Unreported taxable sales	\$672,721
Negligence penalty	\$ 5,546
Tax as determined and protested	\$55,462.33
Interest through 01/31/13	14,198.11
Negligence penalty	<u>5,546.23</u>
Total tax, interest, and penalty	\$75,206.67
Payments	<u>- 3.11</u>
Balance Due	<u>\$75,203.56</u>
Monthly interest beginning 02/01/13	<u>\$ 277.30</u>

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the amount of unreported taxable sales. We find no adjustment is warranted.

Petitioner has operated an authorized MetroPCS dealership since October 2007, selling unbundled cellular phones and related accessories. For audit, petitioner provided federal income tax returns, sales summary reports from a computerized point of sales system (POS reports) for the liability period, and monthly accounts receivable reports. She provided no purchase or sales invoices.

The Sales and Use Tax Department (Department) found that the total sales reported on petitioner’s sales and use tax returns exceeded the amounts recorded in the POS reports and were substantially lower than gross receipts reported on federal tax returns. The Department compared the gross receipts and purchases reported on the federal tax returns to compute book markups of about

1 2 percent for 2008, 44 percent for 2009, and 25 percent for the two years combined. The Department
2 also found that taxable sales reported on sales and use tax returns of \$37,506 for 2008 and \$28,704 for
3 2009 were substantially less than the cost of goods sold reported on federal tax returns for those years,
4 respectively, of \$114,770 and \$207,349. The Department concluded that petitioner would not
5 routinely sell devices for prices dramatically lower than costs, and it considered the book markup of 25
6 percent computed using the gross receipts reported on federal tax returns to be lower than expected.
7 Since petitioner provided no purchase invoices or sales invoices, and the Department did not have
8 information to perform a shelf test, it estimated petitioner's markup at 50 percent. The Department
9 added that markup to the amounts of purchases reported on the federal tax returns for 2008 and 2009 to
10 compute taxable sales, and it used those figures to compute average monthly taxable sales for the last
11 three months of 2007 and the first six months of 2010.¹ The Department compared computed and
12 reported taxable sales to establish unreported taxable sales of \$672,721.

13 Petitioner asserts that the POS reports captured all sales of devices, and contends that reported
14 taxable sales, which exceed the amounts recorded on the POS reports, are not understated. Petitioner
15 asserts that she sells devices well below cost as an inducement for customers to sign up for utility
16 services because she receives commissions from MetroPCS for selling its services, and she asserts that
17 those commissions explain the substantial differences between total sales reported on sales and use tax
18 returns and gross receipts reported on federal tax returns. However, petitioner has provided no
19 documentation of the amount of commissions received from MetroPCS. After the appeals conference,
20 petitioner provided two sales invoices and associated purchase invoices that show selling prices well
21 below cost. She also provided Indirect Dealer Agreements between petitioner and MetroPCS that list
22 suggested retail selling prices for phones. The Department compared those suggested retail prices with
23 average costs for the same models of phones, which it established based on its prior audit experience
24 with other MetroPCS retailers, to compute markups ranging from 30 percent to 98 percent.

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27 ¹ The Department did not make adjustments for changes in inventory because petitioner did not provide documentation to
28 support the inventory and the ending inventory amounts appeared unreasonably high. It did not make adjustments for
pilferage because the phones were kept in a secure area in a back room, making pilferage unlikely, and because petitioner's
records were not sufficiently complete to ensure that all purchases were reported on federal tax returns

1 Petitioner is liable for tax on her sales of wireless telecommunication devices in unbundled
2 transactions. (Cal. Code Regs., tit. 18, § 1585, subd. (b)(2).) When a cellular phone dealer receives
3 commissions from a service carrier in connection with sales of devices in unbundled transactions,
4 those commissions are not taxable. However, petitioner has not provided evidence to show that any
5 portion of the gross receipts reported on her federal tax returns represented commissions received from
6 MetroPCS. Petitioner has not provided adequate records of her selling prices and costs from which a
7 markup could be computed, and we find the two sets of purchase and sales invoices provided after the
8 conference are insufficient evidence of her customary pricing policy. Further, the Department's
9 estimated markup of 50 percent is well within the range of the markups of 30 to 98 percent the
10 Department computed using suggested retail prices from Indirect Dealer Agreements and average costs
11 for similar phones. In short, we find that the Department has used the best available information
12 (purchases reported on federal tax returns and a reasonable estimated markup) to compute taxable
13 sales, and petitioner has not provided evidence to support adjustments.

14 **Issue 2:** Whether petitioner was negligent. We conclude that she was.

15 The Department imposed the negligence penalty because petitioner did not provide adequate
16 records, and the understatement was substantial. Petitioner disputes the penalty on the basis that she
17 reported all sales of devices.

18 Petitioner provided records that were incomplete and conflicting. The amounts of taxable sales
19 reported on sales and use tax returns were only a fraction of the purchases reported on federal tax
20 returns, and the substantial amount of unreported taxable sales of \$672,721 represents an error ratio of
21 876 percent when compared to reported taxable sales of \$76,793. We find that the incomplete records
22 and the substantial understatement are clear evidence of negligence. Further, we find that any
23 businessperson, even one with limited experience, should have recognized that her reported taxable
24 sales of \$37,506 for 2008 and \$28,704 for 2009 were substantially less than the cost of goods sold
25 reported on federal tax returns of \$114,770 for 2008 and \$207,349 for 2009. Accordingly, we find that
26 the understatement was the result of negligence, and the penalty was properly applied, even though
27 petitioner had not been audited previously.

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OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentage estimated	50%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None