

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:)
D & H SERVICE STATION) Account Number: SR EA 97-858582
Petitioner) Case ID 435924
Westminster, Orange County

Type of Business: Gas station with mini-mart

Audit period: 04/01/04 – 03/31/07

<u>Item</u>	<u>Disputed Amount</u>
Unreported taxable sales	\$861,600
Disallowed nontaxable sales	\$170,743
Negligence penalty	\$ 25,114

	<u>Tax</u>	<u>Penalty</u>
As determined and proposed to be redetermined:	\$251,142.62	\$25,114.26
Less concurred	<u>-171,136.03</u>	<u>00.00</u>
Balance, protested	<u>\$ 80,006.59</u>	<u>\$25,114.26</u>
Proposed tax redetermination	\$251,142.62	
Interest through 6/30/10	116,684.30	
10% penalty for negligence	<u>25,114.26</u>	
Total tax, interest, and penalty	\$392,941.18	
Payments	<u>- 4,209.11</u>	
Balance Due	<u>\$388,732.07</u>	
Monthly interest beginning 7/1/10	<u>\$ 1,440.45</u>	

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the amount of unreported taxable sales based on an examination of daily sales reports. We recommend no adjustment.

Petitioner has operated a gasoline station with a mini-mart since May 2001. Using petitioner's daily sales reports for the period January 1, 2005, through December 31, 2006, the Sales and Use Tax Department (Department) compiled recorded taxable sales of \$14,531,402 (including estimated amounts for six days in 2005 and three days in 2006, for which daily sales reports were not available). That amount exceeded reported taxable sales for the years 2005 and 2006 by \$3,049,515, which represented a percentage of error of 26.56 percent. To establish the understatement for the remainder

1 of the audit period, the Department applied 26.56 percent to reported taxable sales for the last three
2 quarters of 2004 and the first quarter of 2007.

3 Petitioner does not dispute that reported taxable sales were understated by \$3,049,515 for the
4 years 2005 and 2006. However, petitioner protests the application of the 26.56 percent of error to the
5 remainder of the audit period. During the appeals conference, petitioner provided schedules of
6 recorded taxable sales for the fourth quarter 2004 (4Q04) and 1Q07. Using those schedules, petitioner
7 computed an understatement of 21.7 percent, which it contends should be used to compute the audited
8 understatement for the last three quarters of 2004 and 1Q07.

9 The D&R expresses concern regarding the accuracy of petitioner's schedules for 4Q04 and
10 1Q07. It notes that the amount of taxable sales recorded on petitioner's schedule for 4Q04 was
11 \$1,202,419, which was significantly lower than the lowest recorded quarterly taxable sales of
12 \$1,560,416 for the years 2005 and 2006. For 1Q07, the amount of taxable sales recorded on
13 petitioner's schedule was \$1,975,544, which was within the range of amounts observed for 2005 and
14 2006. However, for that quarter the percent of error computed by petitioner was 7.1 percent, which
15 was significantly lower than the lowest error rate of 15.5 percent observed for any quarter in 2005 or
16 2006. As a result of these discrepancies, we recommended that the Department investigate further in a
17 reaudit. We recommended that the Department expand its comparison of recorded and reported
18 taxable sales, but only if petitioner provided daily sales reports for 4Q04 and 1Q07. Petitioner did not
19 provide the sales reports upon the Department's request. Accordingly, we recommend no adjustment
20 to the audited amount of unreported taxable sales.

21 **Issue 2:** Whether adjustments are warranted to the audited amount of disallowed recorded
22 nontaxable sales¹ related to repair labor and referral fees. We recommend no adjustment.

23 Petitioner did not provide any sales invoices for auto repairs. For the period October 1, 2004,
24 through December 31, 2006, the Department noted that the amount of recorded sales of auto parts was
25 \$1,687, which it found much lower than expected in relation to recorded nontaxable labor of \$225,701
26 for the same period. Also, the Department noted that, on the daily sales reports printed from the
27

28 ¹ Some recorded amounts were claimed as deductions on returns, and the remainder were netted from reported total sales.

1 computer, there were handwritten amounts next to the amounts of recorded nontaxable labor, which
2 the Department concluded were additional charges associated with auto repairs. The Department used
3 the handwritten amounts on the available daily sales reports to establish additional garage sales of
4 \$119,157 and to establish total garage sales of \$344,858 (\$225,701 + \$119,157) for the audit period.
5 The Department estimated, based on its experience auditing similar businesses, that 50 percent of this
6 amount (\$172,430, computed on a quarterly basis), represented taxable sales of parts. Accordingly, the
7 Department established an understatement of reported parts sales of \$170,743 (\$172,430 - \$1,687).

8 Petitioner contends the entire understatement of \$170,743 should be deleted. Petitioner states
9 that all recorded labor represented nontaxable repair labor. Petitioner asserted at the conference that it
10 does not perform major repairs, and most of its auto repairs involve smog checks and oil changes,
11 which require minimal parts. Petitioner further stated at the conference that the handwritten amounts
12 represent nontaxable referral fees. Petitioner asserted that, when asked to perform major auto repairs,
13 it refers customers to other repair shops, and petitioner receives a referral fee from those repair shops.

14 The D&R notes that the handwritten amounts at issue are written on petitioner's daily sales
15 reports, which petitioner used to record gross receipts. Furthermore, petitioner acknowledges that the
16 handwritten amounts represent business revenue. Thus, both the handwritten amounts and the
17 recorded amounts of nontaxable labor represent gross receipts, and petitioner has the burden of proving
18 those amounts are not subject to tax. (Rev. & Tax. Code, § 6091.) The D&R finds the Department's
19 estimate that 50 percent of these amounts represent nontaxable labor to be reasonable. However, the
20 D&R recommended that petitioner be given the opportunity in a reaudit to provide invoices for the
21 auto repairs showing recorded labor and sales of auto parts and to provide documentation, such as
22 cancelled checks from other repair shops, showing that the handwritten amounts represent referral fees.
23 Petitioner did not provide invoices or other documentation for reaudit, and we thus recommend no
24 adjustment to the disallowed amount of recorded nontaxable labor.

25 **Issue 3:** Whether petitioner was negligent. We conclude that it was.

26 The Department imposed a negligence penalty because petitioner failed to report substantial
27 amounts of taxable sales that had been recorded in its own records, and the understatement was
28 significant in comparison to reported taxable sales. Petitioner disputes the penalty because its sole

