

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 EAST BAY SUPPLY, INC.) Account Number: SR CH 97-149026
) Case ID 436174
 6 Petitioner) San Leandro, Alameda County

7 Type of Business: Retailer of roofing material

8 Audit period: 7/1/01 – 6/30/04

9 Item Disputed Amount

10 Understated taxable sales \$3,737,022

11 Tax determined \$266,825.79

12 Post-D&R adjustment - 92,253.38

12 Proposed redetermination, protested \$174,572.41¹

13 Proposed tax redetermination \$174,572.41

14 Interest through 11/30/12 138,165.40

14 Total tax and interest \$312,737.81

15 Payments - 6,328.00

15 Balance Due \$306,409.81

16 Monthly interest beginning 12/1/12 \$841.22

18 UNRESOLVED ISSUES

19 **Issue 1:** Whether petitioner has shown that additional adjustments to the audited amount of
 20 understated taxable sales are warranted. We conclude that it has not.

21 Petitioner sells but does not install roofing materials. In 2002, it began providing optional
 22 rooftop loading/spreading services of the materials on the rooftops. Petitioner believed that its charges
 23 for rooftop loading/spreading services were nontaxable, and claimed labor deductions of \$7,162,273
 24 for such charges on its sales and use tax returns for the period April 1, 2002, through June 30, 2004.

25 The Sales and Use Tax Department (Department) compared petitioner's reported material sales from
 26 its sales and use tax returns with its cost of material sales from its federal income tax returns and

27 _____
 28 ¹ The determined amount of tax is net of a concurred-in credit of \$130,169.21.

1 computed book markups of 28.56 percent for 2001, -15.18 percent for 2002, and -21.13 percent for
2 2003. It concluded that petitioner overstated its deductions for nontaxable rooftop loading/spreading
3 charges for 2002 and 2003, computed allowable nontaxable rooftop loading/spreading charges of
4 \$2,299,392, and calculated additional taxable sales of \$4,868,149 characterized as “disallowed claimed
5 exempt labor.” On appeal, we concluded that reported taxable sales for 2002 and 2003 were likely
6 understated because petitioner did not allocate enough of its gross receipts to its taxable sales of
7 roofing material, but that the Department’s calculation of additional taxable sales was flawed for
8 several reasons. We recommended that the 2002 and 2003 audited taxable sales be established by
9 adding the 2001 recorded book markup of 28.56 percent to the 2002 and 2003 cost of material sales.
10 The Department prepared a reaudit, reducing the measure of understated taxable sales by \$1,020,280,
11 to \$3,847,869. Petitioner filed a timely request for reconsideration (RFR) alleging that the Department
12 failed to consider the accuracy of the cost of goods sold, self-consumed merchandise, inventory
13 shrinkage or adjustments, the segregation of purchases, and the computation of a markup for each class
14 of merchandise. Petitioner argued that the markup was lower for periods after 2001, and requested that
15 another reaudit be performed using standard markup audit procedures. In response to the RFR, the
16 Department stated that there was insufficient documentation to warrant any adjustment to the markup
17 computations, but that the reaudit failed to account for \$110,847 in allowable sales for resale. It
18 further reduced the measure of understated taxable sales to \$3,737,022 in the second reaudit.

19 Petitioner has not stated what it believes its true markup was after 2001. We do not accept that
20 petitioner would sell its products at or below cost simply because it had a new revenue stream from
21 which it derived additional profits. Rather, we believe that petitioner’s markup of its materials would
22 have been about the same after it began offering loading/spreading services as it was before that time.
23 We find that the price quotes and price lists from petitioner’s competitors are not relevant to the
24 computation of petitioner’s markup. We requested that petitioner provide representative purchase and
25 sales invoices to establish a markup for the period January 1, 2002, through June 30, 2004. The
26 Department’s second reaudit test disclosed a markup of 27.2 percent, which supports the 28.56 percent
27 achieved book markup for 2001. Therefore, in the absence of further documentation to support a lower
28 markup, we conclude that petitioner’s markup for 2001 was representative for 2002 and 2003.

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OTHER MATTERS

Since petitioner did not participate in the amnesty program, an amnesty interest penalty of \$7,320 will be imposed with respect to the amnesty-eligible liability when this matter is final. We informed petitioner at the appeals conference that we could consider recommending relief of this penalty if it submitted a relief request, signed under penalty of perjury, providing a reasonable cause for its failure to apply for amnesty. Petitioner has not filed such a request for relief. Accordingly, we have no basis upon which to consider recommending relief.

Summary prepared by Pete Lee, Business Taxes Specialist II