

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

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3 In the Matter of the Petition for Redetermination)
4 Under the Sales and Use Tax Law of:)
5 LYNNE MARIE GALLAGHER and) Account Number: SR BH 99-267506
6 FRANCIS XAVIER GALLAGHER, dba) Case ID 459368
7 Galigula/San Francisco)
8 Petitioner) San Francisco, San Francisco County

9 Type of Business: Sewing studio

10 Audit period: 07/01/03 – 06/26/06

<u>Item</u>	<u>Disputed Amount</u>
12 Disallowed claimed nontaxable alteration charges	\$156,253
13 Disallowed claimed nontaxable sales for resale	\$ 54,234
14 Tax as determined and proposed to be redetermined	\$24,900.87
15 Less concurred	<u>- 7,009.44</u>
16 Balance, protested	<u>\$17,891.43</u>
17 Proposed tax redetermination	\$24,900.87
18 Interest through 8/31/10	<u>11,612.97</u>
19 Total tax and interest	<u>\$36,513.84</u>
20 Monthly interest beginning 9/1/10	<u>\$ 145.26</u>

21 This matter was previously scheduled for Board hearing on July 14, 2010, but was postponed
22 at petitioner's request because its representative had a scheduling conflict.

UNRESOLVED ISSUES

23 **Issue 1:** Whether adjustments are warranted to the disallowed claimed nontaxable alteration
24 charges. We recommend no adjustment.

25 Petitioner operated a full service sewing studio from April 21, 1993, through June 26, 2006,
26 when its business operations were consolidated with a related partnership. The application of tax to
27 the alteration of clothing performed by petitioner depends on whether that clothing was new or used.
28 The alteration of new clothing is fabrication, which is a sale under the Sales and Use Tax Law even if
the customer provides all the tangible personal property that is fabricated. (Rev. & Tax. Code, § 6006,

1 subd. (b); Cal. Code Regs., tit. 18, § 1524, subd. (b)(1)(A).) Thus, fabrication for a consumer is a sale
2 that is subject to sales tax. (Rev. & Tax. Code, § 6051.) On the other hand, the alteration of used
3 clothing is regarded as a repair, and the charges for that repair are not subject to tax. (Cal. Code Regs.,
4 tit. 18, § 1524, subd. (b)(1)(B).) For the audit period, petitioner reported a total taxable measure of
5 \$522, all reported for fiscal year ending (FYE) 2004, claiming nontaxable sales of \$223,263 for FYE
6 2004, \$141,019 for FYE 2005, and \$206,395 for FYE 2006 (\$570,677 claimed nontaxable sales for the
7 entire audit period, which includes claimed sales for resale and claimed nontaxable alteration charges).

8 The Sales and Use Tax Department (Department) tested petitioner's claimed nontaxable
9 alteration charges for FYE 2004. The Department questioned \$73,919.18 of the claimed nontaxable
10 alternation charges. The Department contacted customers whose telephone numbers were listed on the
11 sales invoices and sent XYZ letters to customers whose addresses were available, asking whether the
12 altered clothing was new or used. The Department received responses to 17 of the XYZ letters, and 14
13 of the replies indicated the altered garments had been used, rather than new, at the time the alterations
14 were done. The total amount of sales represented by those 14 transactions was \$3,902.50, which the
15 Department accepted as nontaxable. It disallowed the remaining \$70,017 of the questioned
16 transactions (\$73,919.18 - \$3,902.50). The Department computed a percentage of error in claimed
17 nontaxable sales of 31.36 percent ($\$70,017 \text{ disallowed claimed nontaxable alteration charges} \div$
18 $\$223,263 \text{ claimed nontaxable sales}$). The Department applied that percentage to the claimed
19 nontaxable sales for the audit period to compute the disallowed claimed nontaxable alteration charges
20 of \$178,968.

21 Petitioner contends that the percentage of error should be reduced from 31.36 percent to
22 3.98 percent, and the disallowed amount should be reduced to \$22,715. Petitioner asserts that most of
23 the alterations it performed involved used clothing. As support, petitioner has provided sales invoices
24 for the test period of FYE 2004 on which it has written notations indicating whether each transaction
25 was recorded in the general ledger as "alteration" or "alteration other." Petitioner states that the
26 alterations of used clothing were recorded as "alteration other," and it has computed that those
27 alterations represented all but 3.98 percent of the claimed nontaxable alteration charges for FYE 2004.
28 In addition, petitioner states that a significant number of the alterations at issue were performed on

1 sample wedding dresses its customers purchased from bridal salons, which petitioner contends were
2 used, rather than new because they had been worn at the bridal salons by a number of prospective
3 brides.

4 Petitioner did not, at the time of each transaction, indicate on the invoice whether the clothing
5 altered was new or used. Further, although petitioner states that the notations in its general ledgers of
6 “alteration” and “alteration other” represent alterations to new and used clothing, respectively,
7 petitioner has not produced evidence of the distinction between those categories in the records.
8 Further, for the three responses to XYZ letters that indicate the customer had new clothing altered, two
9 of the three transactions were categorized in the general ledger as “alteration other.” We thus find that
10 the notations “alteration” and “alteration other” are not reliable indicators of whether the clothing
11 involved was new or used. With respect to petitioner’s contention that the sample wedding dresses
12 altered were used rather than new, there is no dispute that the sample wedding dresses were first sold
13 by the bridal salons to the brides who had their dresses altered by petitioner. In other words, prior to
14 the alterations completed by petitioner, the dresses had not been worn by brides at their weddings, and
15 the bridal salons’ use of the sample wedding dresses was limited to the purposes of demonstration and
16 display in the regular course of business. Accordingly, we find the dresses had not been functionally
17 used (worn at a wedding) until after petitioner altered them, the sample wedding dresses were new
18 items when they were altered by petitioner, and the charges for those alterations were subject to tax.
19 Since petitioner has not produced credible evidence to support a reduction of the disallowed claimed
20 nontaxable alteration charges, we recommend no adjustment.

21 **Issue 2:** Whether adjustments are warranted to the disallowed claimed nontaxable sales for
22 resale. We recommend no adjustment.

23 Petitioner did not obtain resale certificates to support claimed nontaxable sales for resale. The
24 Department reviewed the claimed nontaxable sales for resale for FYE 2004 and questioned sales
25 totaling \$73,790.42. It sent XYZ letters to customers whose addresses were listed on sales invoices
26 and reviewed the Board’s computer records to determine if petitioner’s customers held active seller’s
27 permits at the time of the sales and were in a business that would likely make purchases of tangible
28 personal property from petitioner for resale. The Department found adequate evidence to support

1 nontaxable sales of \$29,197.45 and disallowed the remaining claimed nontaxable sales of \$44,593
2 (\$73,790.42 - \$29,197.45). The Department computed a percentage of error of 19.97 percent (\$44,593
3 disallowed ÷ \$223,263 claimed nontaxable sales), which it applied to claimed nontaxable sales,
4 combined, for the audit period to compute disallowed claimed nontaxable sales for resale of \$113,983.

5 Petitioner contends the percentage of error should be reduced to 10.47 percent, or disallowed
6 claimed nontaxable sales for resale of \$59,749, based on petitioner's having provided the Department
7 either copies of the customers' seller's permits or credit applications on which the customers had
8 written their seller's permit numbers. Petitioner states this evidence should be regarded as adequate
9 because it was not aware that a resale certificate was required.

10 Since petitioner did not obtain resale certificates from its customers, it has the burden of
11 proving that the sales at issue were not sales at retail. (Rev. & Tax. Code § 6091.) With respect to the
12 sales disputed by petitioner, the documents submitted by petitioner do not include the essential
13 elements of a resale certificate (purchaser's name, address, seller's permit number, and signature; a
14 description of the general character of the tangible personal property sold by the purchaser in the
15 regular course of business; a description of the property to be purchased from petitioner for resale; and
16 a specific statement that the purchase is for resale). Reg. 1668, subd. (b)(1).) We note that the
17 providing of a seller's permit number is *not* equivalent to a claim that a particular purchase is for
18 resale. In fact, Regulation 1668, subdivision (b)(5) expressly provides that a seller is not relieved from
19 liability for the tax, or from the burden of proving that the sale was for resale, simply because the
20 purchaser has provided a seller's permit to the seller. We find that petitioner has not provided the
21 requisite proof that the sales at issue were nontaxable sales for resale, and we recommend no
22 adjustment.

23 OTHER DEVELOPMENTS

24 None.

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