

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Administrative Protest)
Under the Sales and Use Tax Law of:)
RICHARD L. GARRETT, dba NBS Motors) Account Number SR BH 100-193165
Taxpayer) Case ID 467929
San Ramon, Contra Costa County

Type of Business: Used car dealer
Audit period: 07/01/04 – 06/30/07

<u>Item</u>	<u>Disputed Amount</u>
Tax-paid purchases of fuel resold with vehicles	Unstated
Additional losses due to bad debts	Unstated
Tax as determined and protested	\$228,041.11 ¹
Interest through 03/31/12	105,222.34
Negligence penalty	22,804.14
Finality penalty	<u>22,779.03</u>
Total tax, interest, and penalty	\$378,846.62
Payments	<u>-111,851.30</u>
Balance Due	<u>\$266,995.32</u>
Monthly interest beginning 04/01/12	<u>\$ 677.77</u>

This matter was scheduled for Board hearing in December 2011, but was postponed at taxpayer's request due to a scheduling conflict.

UNRESOLVED ISSUES

Issue 1: Whether an adjustment is warranted for tax-paid purchases of fuel resold with vehicles. We find no adjustment is warranted.

Taxpayer operated as a used car dealer from May 2003 through February 2011. For audit, taxpayer provided federal income tax returns, sales summary reports, sales detail reports, car jackets, repossession summary reports, rewind summary reports, and repossession/rewind jackets.

¹ Taxpayer does not protest any of the audit items that represent understatements of reported taxable measure, but he argues that additional amounts should be allowed for unclaimed deductions. Since taxpayer has not identified amounts of those deductions, we show the entire amount of tax as disputed.

1 When the Sales and Use Tax Department (Department) reconciled recorded and reported
2 amounts, it discovered a difference of \$162,657 between the amount of sales tax reimbursement
3 collected and the amount of sales tax reported, which the Department computed to equate to a taxable
4 measure of \$1,979,430. The Department also traced sales from dealer jackets to the detailed sales
5 reports and found unrecorded sales of \$949,943. Taxpayer does not these understatements. However,
6 taxpayer contends that he is entitled to a deduction for tax-paid purchases of fuel resold with vehicles,
7 which he estimates as \$40 per vehicle sold (i.e., it appears taxpayer is claiming he purchased a full tank
8 of tax-paid fuel for each vehicle). Although taxpayer has provided no evidence to show that such was
9 the case, we believe it is reasonable to assume that there was *some* fuel in the vehicles when they were
10 sold. It is similarly reasonable to assume that there was *some* fuel in these used vehicles when he
11 purchased them for resale, and such fuel would have been purchased without payment of tax or tax
12 reimbursement to the vendor as part of the purchase for resale. It is also reasonable to assume that, *if*
13 taxpayer had added fuel to the vehicles prior to reselling them, that he would have paid *some* sales tax
14 on the purchase. (See, e.g., Rev. & Tax. Code, § 6480, et seq.) If such were the case, he would be
15 entitled to a deduction only with respect to the tax-paid fuel he added to vehicles, and not for any fuel
16 in the vehicles when he purchased them. Since he has not provided any evidence whatsoever to
17 indicate he added fuel to the vehicles and resold the vehicles with more fuel than in the vehicles when
18 he acquired them, we conclude that no adjustment is warranted.

19 **Issue 2:** Whether taxpayer has shown that the amount of losses related to bad debts and
20 repossessions of vehicles should be increased. We find no adjustment is warranted.

21 Taxpayer stated that he had losses related to bad debts and repossession of vehicles and he
22 provided records for the first two quarters of 2007. The Department computed the repossession losses
23 by deducting Kelley Blue Book wholesale values from the net contract price using the pro rata method,
24 computing the allowable bad debt losses for those quarters at \$63,689. Taxpayer claims that the
25 Department should not have used the Kelley Blue Book wholesale values as the value of repossessed
26 vehicles, asserting that the vehicles usually had sustained damage, and that the wholesale value used in
27 the computations should be 20 percent less than the values shown in the Kelley Blue Book. The
28 Department has used information from an industry-recognized price guide. While adjustments to those

1 prices should be made where the automobile is in other than average condition (Cal. Code Regs., tit.
2 18, § 1642, subd. (f)(4),) taxpayer has not provided any evidence to show the condition of the vehicles
3 upon repossession, and he concedes that such evidence is not available. Thus, we recommend no
4 increase in the allowed amount of bad debt losses.

5 **Issue 3:** Whether taxpayer was negligent. We find that he was.

6 The Department added a negligence penalty because the understatement is substantial in
7 relation to reported amounts. Taxpayer disputes the penalty on the basis that he used a software
8 program used by many vehicle retailers and was unaware that the program was computing tax
9 incorrectly.

10 The deficiency of about \$2.75 million is substantial, and it represents a percentage of error
11 greater than 32 percent when compared to reported taxable sales. The percentages of error for the first
12 two quarters of the audit period were 69 percent and 99 percent. Errors of that magnitude should have
13 been readily apparent to any business person, even one with limited experience. Accordingly we find
14 that the understatement was the result of negligence, and the penalty was properly applied, even
15 though taxpayer had not been audited previously.

16 **OTHER MATTERS**

17 Since taxpayer did not timely pay the determination or file a petition for redetermination, a
18 finality penalty was automatically applied. In an email, we reminded taxpayer's representative, who is
19 fully experienced in sales and use tax matters, that taxpayer could request relief of the finality penalty.
20 However, taxpayer has not requested relief of the penalty, and we have no basis to consider
21 recommending relief. The D&R does note, though, that taxpayer's untimely appeal states that the
22 failure to file a timely petition was the result of his former representative's illness. The D&R further
23 notes that, under those circumstances, relief might be warranted if a request for relief, supported by
24 sworn statements, were filed, and the amount of determined tax were paid.

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