

## 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 GATEWAY AUTO CENTER, INC. )

6 Petitioner )

Account Number SR AS 100-050915

Case ID 437262

Rolling Hills Estates, Los Angeles County

7  
8 Type of Business: Used car dealership

9 Audit period: 01/01/03 – 09/30/05

10 Item Disputed Amount

11 Unreported sales \$798,633

12 Negligence penalty \$ 6,468

TaxPenalty

13 As determined \$129,122.99 \$12,912.29

14 Pre-D&amp;R adjustment + 4,455.00 + 445.50

15 Post-D&amp;R adjustment - 68,901.26 - 6,890.13

16 Proposed redetermination, protested \$ 64,676.73 \$ 6,467.66

17 Proposed tax redetermination \$ 64,676.73

18 Interest through 07/31/12 34,546.13

Negligence penalty 6,467.66

19 Total tax, interest, and penalty \$105,690.52

20 Payments - 8,584.36

21 Balance Due \$ 97,106.1622 Monthly interest beginning 08/01/12 \$ 280.4623 **UNRESOLVED ISSUES**24 **Issue 1:** Whether adjustments are warranted to the unreported sales based on an analysis of  
25 bank deposits. We find no further adjustment is warranted.26 Petitioner provided bank statements for three business checking accounts. The Sales and Use  
27 Tax Department (Department) used bank deposits to establish taxable sales for the period January 1,  
28 2004, through September 30, 2005, compiling total amounts deposited in the three accounts that  
exceeded reported total sales for the period. (Taxable sales for 2003 are discussed under "Resolved  
Issue.") The Department increased the amount of bank deposits by 5.84 percent as an estimate of

1 trade-in allowances, based on customers' responses to inquiry letters,<sup>1</sup> and then reduced the total for  
2 sales tax included. The Department accepted reported taxable sales for the first quarter 2004 (1Q04)  
3 and 1Q05, since reported amounts exceeded the adjusted bank deposits. The D&R recommends  
4 adjustments to the audited amount for certain exempt charges, such as optional warranties and smog  
5 fees. The D&R also finds that the 5.84 percent adjustment for trade-in allowances should be applied  
6 only to the amount of bank deposits net of all exempt transactions and charges. After those revisions,  
7 the audited amount of understated sales based on the bank deposit analysis is \$798,633.

8         Petitioner contends that the amount of understatement should be reduced by the amounts of  
9 credit measure established for 1Q04 and 1Q05. Petitioner also contends that no adjustment should be  
10 made for trade-in allowances, arguing that it did not accept vehicles in trade.

11         We find that the evidence suggests there may have been additional bank accounts for which  
12 petitioner did not provide statements. Further, if reductions were made for the asserted credit measure  
13 in 1Q04 and 1Q05, the resulting amount of computed taxable sales would be less than the amounts  
14 compiled from petitioner's deal jackets. Thus, we concur with the Department's finding that reported  
15 taxable sales are substantially accurate for 1Q04 and 1Q05, and we conclude that the amount of  
16 understatement should not be reduced for the credit measures for those quarters. In addition, we reject  
17 petitioner's assertion that it did not accept vehicles in trade since that assertion is directly contradicted  
18 by customers' responses to inquiry letters, and petitioner has provided no evidence that those responses  
19 were inaccurate. Forty percent of the responses, two out of five, indicated that trade-ins were involved  
20 in the sale. Given the small sample size, the Department used half that percentage to estimate trade-ins  
21 were applicable to 20 percent of the transactions. We find that no further adjustments are warranted.

22         **Issue 2:** Whether the deficiency measure should be reduced to account for additional taxable  
23 sales reported on amended returns. We find no adjustment is warranted.

24         On August 1, 2006, petitioner filed amended returns for 1Q05 and 2Q05, reporting additional  
25 taxable sales and making a payment of \$22,996. The Department did not accept the returns, but  
26 applied the full amount of the payment to the understatement established by audit. Petitioner contends  
27

28 <sup>1</sup> The Department sent 30 letters and received 5 responses. Two of the five responses referred to a trade-in allowance.

1 that the amended returns were filed prior to commencement of the audit and argues that the deficiency  
2 measure in the audit should be reduced by the amount reported in the amended returns. (Since this  
3 liability will either be included in the determination or a represent a final reported liability, the amount  
4 of tax will be the same in either situation, and the actual issue primarily relates to the amount of the  
5 total determined deficiency for purposes for analyzing whether to impose a penalty on the determined  
6 liability.)

7 The Department began the audit field work on April 19, 2006, and the available records  
8 indicate that the audit had progressed sufficiently by August 1, 2006, that petitioner should have been  
9 aware the Department likely would find an understatement. We further find that the additional sales  
10 reported on the amended returns were not truly “self-reported” because those additional sales were  
11 discovered in the audit. Accordingly, we concur with the Department’s decision to assess the  
12 understatement in the audit rather than accepting the amended returns and reducing the audited  
13 understatement.

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

15 The Department imposed a negligence penalty because petitioner did not provide a summary  
16 record of sales or sales and use tax return worksheets and because the understatement was substantial.  
17 Petitioner disputes the penalty on the basis that this is the first audit of the business and that the  
18 understatement was significantly lower than the amount established by audit.

19 During the audit, petitioner informed the Department that the amounts reported on sales and  
20 use tax returns were estimates. We find that any businessperson, even one with limited experience,  
21 should have realized that reported amounts should have been based on business records rather than  
22 estimates. In addition, the understatement of \$783,960 is substantial and represents about 18 percent  
23 of reported taxable sales of \$4,255,690. We find that the inadequate records, the estimated amounts of  
24 reported sales, and the substantial understatement are evidence of negligence, even though petitioner  
25 had not been audited previously, and that the penalty was properly applied.

### 26 **RESOLVED ISSUE**

27 For 2003, the Department compared retail sales of vehicles recorded in deal jackets with  
28 reported taxable sales and found that reported amounts exceeded recorded sales. In the audit and first

1 reaudit, the Department concluded that the reported sales for 2003 were substantially accurate, and did  
2 not accept that petitioner had over-reported taxable sales for 2003. Petitioner contended that the  
3 apparent over-reporting for 2003 was the result of timing differences caused by petitioner's reporting  
4 of sales using estimates. We find that the records for 2003 appear substantially accurate and that the  
5 taxable measure should be established based on the deal jackets. Since petitioner reported taxable  
6 sales in excess of the amounts recorded in the deal jackets for 2003, we recommended that the excess  
7 be allowed as a credit measure in the audit item for errors compiling returns, thus more than offsetting  
8 the understated measure resulting from compiling errors for 2004 and 2005. As a result, we  
9 recommended a net credit measure for this item of \$7,584 for the audit period. Upon the reaudit we  
10 recommended, the Department apparently found additional compiling errors in petitioner's favor  
11 because it established this item as a credit measure of \$14,673.

12 **OTHER MATTERS**

13 None.

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