

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:)

GUARANTY RV, INC., dba Guaranty RV Centers)
Petitioner)

Account Number: SR EHC 21-874006
Case ID 391657

Junction City, Oregon

Type of Business: RV sales

Audit period: 04/01/01 – 03/31/05

<u>Item</u>	<u>Disputed Amount</u>
-------------	------------------------

Disallowed claimed nontaxable sales for California locations	\$ 7,464,117 ¹
Disallowed claimed nontaxable sales for the Oregon location	\$37,401,947
Purchases subject to use tax	\$ 1,629,192
Negligence penalty	\$ 363,475
Amnesty double negligence penalty	\$ 142,757
Amnesty interest penalty	\$ 168,631

	<u>Tax</u>	<u>Penalty</u>
As determined:	\$2,392,311.40	\$345,703.22
Adjustment - Sales and Use Tax Department	+ 825,075.90	+ 115,131.76
- Appeals Division	+ 417,359.75	+ 45,396.81
Proposed redetermination	<u>\$3,634,747.05</u>	<u>\$506,231.79</u>
Less concurred	- 31,712.50	00.00
Balance, protested	<u>\$3,603,034.55</u>	<u>\$506,321.79</u>

Proposed tax redetermination	\$3,634,747.05
Interest through 2/28/11	2,337,485.08
10% penalty for negligence	363,474.81
Amnesty double negligence penalty	142,756.98
Amnesty interest penalty	<u>168,630.55</u>
Total tax, interest, and penalty	\$6,647,094.47
Payments	- 218,539.25
Balance Due	<u>\$6,428,555.22</u>

Monthly interest beginning 3/1/11 \$ 19,927.88

¹ Petitioner protests an unstated portion of this audit item, and we thus show the entire amount as disputed.

1 This appeal was scheduled for oral hearing on September 14, 2010, but was postponed so that
2 we could issue a Supplemental Decision and Recommendation (SD&R) to make a correction and
3 provide clarification.

4 UNRESOLVED ISSUES

5 **Issue 1:** Whether adjustments are warranted to the disallowed claimed nontaxable sales. We
6 recommend no further adjustment.

7 Petitioner operated an RV dealership and held a California seller's permit from April 1, 1992,
8 through June 30, 2007. During the audit period, petitioner operated locations in Gilroy and Indio,
9 California, and in Junction City, Oregon. The Sales and Use Tax Department (Department) conducted
10 separate tests of the claimed nontaxable sales for the California locations and for the Oregon location.
11 For both tests, the Department selected random stratified samples for the period from June 1, 2001,
12 through March 31, 2004. In those tests, the Department identified several sales which were incorrectly
13 recorded as nontaxable and which were instead subject to either sales tax or use tax because petitioner
14 did not have sufficient documentation to show otherwise, such as resale certificates, evidence of out-
15 of-state delivery, and evidence that the RV had been purchased for use outside California.

16 Petitioner argues that the statistical sampling procedures used by the Department should be
17 revised. Specifically, petitioner concedes that one sale, to Karl Edward Miller, is taxable, but asserts
18 that it should be removed from stratum 2 of the sample and be either discarded or placed in stratum 3.
19 Also, petitioner argues that the missing transactions (transactions for which records were not available)
20 should be discarded or replaced with other transactions for which records are available. In addition,
21 petitioner protests certain disallowed claimed nontaxable sales for the California locations.

22 With respect to petitioner's objections regarding the statistical sampling methodology, we find
23 that the sale to Mr. Miller was selected without bias and was initially within stratum 2 parameters.
24 Specifically, the sample items in each stratum were chosen by random selection from amounts
25 recorded on petitioner's sales register. The sale to Mr. Miller was recorded in the register as a sale of
26 \$100,000, and that sale was chosen as an item in stratum 2 (from \$10,001 through \$100,000). The
27 Department thereafter reviewed the purchase order for the sale and discovered the actual taxable
28 measure was \$100,745, an amount in excess of the stratum 2 parameters. As a result, petitioner asserts

1 that this transaction, if retained in the test, should be regarded as an error in stratum 3. We find that the
2 Department stratified the population and randomly selected items to be reviewed from each stratum
3 based on amounts recorded in the sales register, which was the procedure agreed to by petitioner and
4 the Department before the random samples were chosen. Each transaction, including the sale to
5 Mr. Miller, belongs in the stratum from which it was selected, regardless of the fact that information
6 gathered during the test indicates that the actual total sale was greater or less than indicated by the sales
7 register, which was used to choose the samples. We conclude that the sale in question is representative
8 of the errors in stratum 2 that were not selected for sampling, and that the agreed test methodology
9 requires that it remain in the test as an error in stratum 2.

10 With regard to petitioner's argument that missing transactions should be discarded or replaced
11 with transactions for which records are available, we note that the Department did not handle missing
12 transactions consistently. In the audit and pre-conference re-audits, while the Department regarded
13 some missing transactions as errors, it replaced other missing transactions in the sample. Petitioner
14 believes that it is statistically unsound to assume all of the missing transactions are taxable when the
15 majority of the transactions reviewed are nontaxable. In the Decision and Recommendation (D&R),
16 we noted that the audit sampling plan, which the Department discussed with petitioner, states that
17 missing sample units were to be considered errors, instead of removing or replacing those transactions,
18 and we also noted that there was sufficient information for the Department to establish the purchase
19 price for each missing transaction. Thus, we find that the missing sales identified by petitioner should
20 be regarded as errors. In addition, we find that all missing transactions the Department had removed or
21 replaced in the tests should be regarded as errors.

22 Regarding the specific disallowed nontaxable sales made by petitioner's California locations,
23 three sales remain in dispute after the adjustments in the D&R and SD&R. Two of these sales
24 occurred outside California, so sales tax is not applicable. These two purchasers, Riley Steesy and
25 Bruce Butler, were known by petitioner to be California residents. As such, it is presumed, as to
26 petitioner, that the RV's were purchased for use in California, and that petitioner is required to collect
27 and remit the applicable California use tax. (Rev. & Tax. Code, §§ 6203, 6247.) This presumption
28 may be controverted by petitioner's having timely taken in good faith a written statement signed by the

1 purchasers that the RV's were purchased for use at a designated point or points outside California. The
2 Board provides a form that can be used for this purpose, BOE-447. Although both of these purchasers
3 signed and provided a BOE-447 to petitioner, neither purchaser completed the line on the form to
4 identify the out-of-state location at which the RV would be used.

5 Petitioner asserts that the BOE-447 forms for these sales are sufficient because the form
6 specifically states that the purchaser signing the form is claiming the vehicle is not purchased for use in
7 California. Petitioner argues that requiring the purchaser to identify an arbitrary point of use on the
8 form would effectively force many purchasers to perjure themselves because they do not have a
9 specific point of usage. However, section 6247 is explicit as to the requirements for a statement that
10 will controvert the presumption: "a statement in writing, signed by the purchaser or his authorized
11 representative, and retained by the vendor, that the property was purchased for use at a designated
12 point or points outside this State." Since the statements issued by these two purchases did not include
13 this statutorily required information, they are not sufficient to controvert the presumption as to
14 petitioner that the purchasers, known by petitioner as being California residents, purchased the RV's
15 for use in California. Thus, for these two transactions, we find that the RV's were purchased for use in
16 California, and that petitioner is liable for the use tax it was required to collect and remit to the Board.

17 The third sale remaining in dispute was to Stanley and Nila Combs, who were known to be
18 California residents by petitioner. Petitioner provided a BOE-447 form completed by Ms. Combs and
19 also provided a "Get Ready Order" it apparently prepared which includes a \$125 charge for out-of-
20 state delivery. However, petitioner has not provided evidence that the RV was actually delivered
21 outside California. Since there is no satisfactory evidence that the RV was, in fact, delivered outside
22 California, we find that petitioner has not established such was the case. Accordingly, we find the sale
23 occurred in California, and that the sales tax applies.

24 With respect to the sales from the Oregon location, the Department found several sales in the
25 tests to known California residents for which petitioner did not provide adequate documentation to
26 overcome the presumption under section 6247 that the RV's were purchased for use in California.
27 Petitioner argues that requiring it to collect and report use tax on these transactions violates the due
28 process, equal protection, and Commerce Clauses of the United States Constitution, under precedent

1 set in *Montgomery Ward & Company v. State Board of Equalization* (1969) 272 Cal.App.2d 728.
2 Petitioner asserts that, similar to the situation considered in *Montgomery Ward*, it operated independent
3 retail locations inside and outside the state and was not obligated to collect use tax on the transactions
4 completed outside the state. On that basis, petitioner contends that the full measure of tax asserted for
5 sales made at its Oregon location should be deleted from the audit.

6 The court in *Montgomery Ward* focused on the lack of a connection between the retailer's in-
7 state activities and its out-of-state sales to California customers. Thus, in order to determine whether
8 the court's decision is relevant here, we must examine what connection, if any, existed between
9 petitioner's California activities and its sales to California customers at its Oregon location. A
10 substantial number of petitioner's sales to California residents were made to individuals living in
11 Central or Southern California, who could have purchased an RV from one of petitioner's locations
12 much closer to home. Absent a credible explanation from petitioner, we conclude petitioner was
13 actively involved in marketing or soliciting California customers from its California locations to
14 purchase RV's from its Oregon location for the purpose of avoiding payment of California sales tax.
15 Accordingly, we find that the facts in *Montgomery Ward* are readily distinguished from the facts here,
16 and the court's decision in that case is not applicable. We recommend no adjustment to the disallowed
17 claimed nontaxable sales for the Oregon location.

18 **Issue 2:** Whether an adjustment is warranted for tax-paid purchases resold of gasoline and
19 diesel sold with RV's. We recommend no adjustment.

20 Petitioner contends that a reduction is warranted for tax-paid purchases of gasoline and diesel
21 that it placed into fuel tanks of RV's and resold. The D&R recommends that the Department review
22 this matter during the recommended reaudit. However, during that reaudit, petitioner did not provide
23 documentation to show that it had paid tax on purchases of gasoline and diesel that it resold in RV's.
24 In the absence of that documentation, we recommend no adjustment.

25 **Issue 3:** Whether adjustments are warranted to the audited amount of purchases subject to use
26 tax. We recommend no adjustment.

27 The Department selected a random sample of petitioner's recorded purchases and found
28 petitioner owed use tax that had not been reported with respect to consumable supplies withdrawn

1 from inventory for its own use. Petitioner contends that adjustments are warranted to the amount of
2 purchases subject to use tax because it may include supplies withdrawn from inventory in Oregon that
3 were not subject to California use tax. Petitioner states it is not clear from the audit workpapers
4 whether this audit item included inventory withdrawals from petitioner's California locations only.

5 Based on our review of the audit workpapers, we find that the audited purchases subject to use
6 tax include items withdrawn from inventory from petitioner's California locations only. Petitioner has
7 offered no evidence suggesting otherwise, and we recommend no adjustment.

8 **Issue 4:** Whether petitioner was negligent. We conclude that it was.

9 The Department imposed a 10-percent penalty for negligence because the understatement was
10 substantial, and petitioner failed to keep adequate records to support its claimed nontaxable sales. The
11 Department also notes that, in a 1999 federal criminal court case, petitioner pled guilty to mail fraud
12 regarding a scheme to assist out-of-state RV purchasers in evading sales tax and registration fees they
13 owed their home states after purchasing an RV from petitioner's Oregon location by helping the
14 purchasers obtain Oregon addresses. The Department opines that, as a result of that criminal action,
15 petitioner should have had knowledge of the requirement to keep detailed records to support claimed
16 nontaxable sales.

17 Petitioner protested the negligence penalty at the appeals conference, arguing that the asserted
18 liability represents only 18 percent of petitioner's reported total sales and asserting its belief that the
19 understatement would be reduced by the adjustments it requested. Petitioner further notes this was its
20 first audit, and the Department accepted petitioner's recorded sales as accurate and used them as a
21 basis to conduct the audit. In other words, petitioner notes that the Department did not assert petitioner
22 underreported its total sales. As to the criminal proceedings referenced by the Department, petitioner
23 argues that the court case is irrelevant to the imposition of negligence in this audit because the court
24 proceedings concluded over eight years prior to the audit. According to petitioner, as a result of that
25 court case, three of its Oregon salespersons were found guilty and summarily dismissed from
26 employment.

27 We disregard the 1999 federal criminal court case because the conduct at issue in that case
28 occurred prior to the audit period at issue. Referring to the facts of this audit only, the audited

1 understatement, after the adjustments in the post-SD&R reaudit, totals \$46,904,489, which represents
2 77 percent of petitioner's reported taxable sales for the audit period of \$61,274,053. Thus, the
3 understatement is substantial, both as an absolute value and in relation to reported amounts. We
4 further note that the amount of understatement did not decrease in the post-D&R reaudit, as predicted
5 by petitioner, but instead increased, and although the understatement did decrease in the post-SD&R
6 reaudit, the net adjustment in the two post-conference reaudits is an increase. We also find petitioner's
7 failure to obtain or retain proper documentation to overcome the presumption that vehicles are
8 purchased for use in this state (if the purchaser is a California resident) evidences a lack of due care in
9 record-keeping. Further, as discussed above, we believe that petitioner, through its California
10 locations, was actively involved in marketing and soliciting California customers to purchase RV's in
11 Oregon for the purpose of avoiding California sales tax. In sum, we find that the negligence penalty is
12 amply supported.

13 AMNESTY

14 Petitioner did not apply for amnesty, or pay the tax due for amnesty-eligible periods, by
15 March 31, 2005. Therefore, since the determination was issued after the amnesty period ended, it
16 included an amnesty double negligence penalty. After the adjustments in the most recent reaudit, the
17 amount of that penalty is \$142,756.98. (Rev. & Tax. Code § 7073, subd. (c).) Also, when the
18 determination becomes final, an amnesty interest penalty of \$168,630.55 will be added. (Rev. & Tax.
19 Code § 7074, subd. (a).) Petitioner has filed a request for relief of the amnesty penalties, signed under
20 penalty of perjury, on the grounds that it made every effort to determine whether or not its participation
21 in the amnesty program was necessary. Petitioner's chief financial officer states that he reviewed all of
22 petitioner's sales and use tax returns and found no errors. Petitioner states it was not aware of a
23 potential error until August 10, 2005, several months after the deadline for applying for amnesty.
24 Petitioner further notes that it promptly paid the tax found due for two use tax audit issues which it did
25 not contest. Petitioner argues that, under these circumstances, its failure to participate in the amnesty
26 program was due to circumstances beyond its control.

27 We note that petitioner held an active seller's permit in January 2005 when the Department sent
28 amnesty notices to active permit holders. Also, the audit comments indicate that the Department first

1 contacted petitioner in May of 2004 regarding the pending audit and discussed the lack of supporting
2 documents with petitioner in June 2004. In August 2004, the Department provided schedules to
3 petitioner showing the sales for which it requested documentation. Thus, we find that petitioner had
4 notice both of the amnesty program and of a potential amnesty-eligible liability before the deadline for
5 filing an amnesty application. Petitioner has not shown reasonable cause why, with that knowledge, it
6 did not participate in the amnesty program. Therefore, we find no basis to recommend relief of the
7 amnesty penalties.

8 **OTHER DEVELOPMENTS**

9 None.

10
11 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Statistical Sample – Nontaxable Sales (California locations)

Transactions Examined	Nontaxable sales from California location			
Confidence level	80%			
Confidence interval	28.2604%			
	<u>Stratum 1</u>	<u>2</u>	<u>3</u>	<u>4</u>
Total number of items in the population	63	241	453	14
Number of items randomly selected for the test	24	88	180	14
Number of errors found	10	8	9	0
Whether stratification was used, and if so what was stratified	Stratum 1 – less than \$10,000.01 Stratum 2 – \$ 10,000.01 - \$100,000.00 Stratum 3 - \$100,000.01 - \$500,000.00 Stratum 4 – greater than \$500,000.00			
	<u>Stratum 1</u>	<u>2</u>	<u>3</u>	<u>4</u>
Average dollar value of population	\$4,608	\$ 60,290	\$ 213,059	\$620,765
Dollar value of remaining errors	\$43,400	\$ 460,450	\$1,863,252	None
Dollar value of sample	\$107,030	\$5,378,476	\$38,408,850	
Percentage of error	40.55%	8.56%	4.85%	
Number of XYZ letters sent	6			
Percentage of XYZ letters sent in relation to number of questioned items	Unknown, but minimal (The substantial majority of the sales at issue are claimed exempt sales in interstate commerce rather than nontaxable sales for resale.)			
Number of responses to XYZ letters received	6			
Percentage of responses to XYZ letters received in relation to the number of XYZ letters sent	100%			
Number of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	5			
Percentage of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	83%			
Number of responses to XYZ letters treated as taxable	1			
Percentage of responses to XYZ letters treated as taxable	17%			

Statistical Sample – Nontaxable Sales (Oregon location)

Transactions Examined	Nontaxable sales from Oregon location		
Confidence level	80%		
Confidence interval	25.4702%		
	<u>Stratum 1</u>	<u>2</u>	<u>3</u>
Total number of items in the population	352	352	11
Number of items randomly selected for the test	20	30	11
Number of errors found	8	10	5
Whether stratification was used, and if so what was stratified	Stratum 1 – less than \$100,000.01 Stratum 2 –\$100,000.01 - \$500,000.00 Stratum 3 – greater than \$500,000.00		
	<u>Stratum 1</u>	<u>2</u>	<u>3</u>
Average dollar value of population	\$ 43,642	\$208,767	\$594,085
Dollar value of remaining errors	\$250,703	\$1,628,989	\$2,847,464
Dollar value of sample	\$928,640	\$5,996,936	\$6,534,930
Percentage of error	27.0%	27.16%	Actual basis review
Were XYZ letters sent	N/A (the sales at issue are exempt sales in interstate commerce rather than nontaxable sales for resale)		

Statistical Sample – Purchases Subject to Use Tax

Transactions Examined	Purchases subject to use tax
Confidence level	80%
Confidence interval	55.7099%
Total number of items in the population	10,098
Number of items randomly selected for the test	1,815
Number of errors found	13
Whether stratification was used, and if so what was stratified	Not stratified
Average dollar value of population	\$538
Dollar value of remaining errors	\$152,370
Dollar value of sample	\$538,464
Percentage of error	28.3%
Were XYZ letters sent	N/A