

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Administrative Protest)
Under the Sales and Use Tax Law of:)
MARWA AHMAD HARB) Account Number: SR AS 53-002722
Taxpayer) Case ID 401718
Torrance, Los Angeles County

Type of Liability: Responsible person liability

Liability period: 01/01/01 – 06/30/04

Item Disputed Amount

Responsible person liability \$826,119

	<u>Tax</u>	<u>Penalty</u>
As determined:	\$869,714.08	\$347,252.45
Adjustment - Sales and Use Tax Department	<u>- 250,633.46</u>	<u>-123,435.73</u>
As redetermined	\$619,080.62	\$223,816.72
Less concurred	<u>- 12,646.50</u>	<u>- 4,131.80</u>
Balance, protested	<u>\$606,434.12</u>	<u>\$219,684.92</u>
Redetermined tax:	\$ 619,080.62	
Interest through 3/31/11	430,353.64	
Negligence penalty	60,643.50	
Finality penalty	60,643.51	
Amnesty double negligence penalty	31,272.59	
Amnesty double finality penalty	31,272.59	
Amnesty interest penalty	35,852.73	
Late payment penalties (returns)	<u>4,131.80</u>	
Total tax, interest, and penalty	\$1,273,250.98	
Payments	<u>- 10,676.11</u>	
Balance Due	<u>\$1,262,574.87</u>	

Monthly interest beginning 4/1/11 \$ 3,549.03

UNRESOLVED ISSUES

Issue 1: Whether taxpayer is personally liable as a responsible person, pursuant to Revenue and Taxation Code section 6829, for the unpaid liabilities of A-1 M & M Enterprise, Inc. We conclude taxpayer is personally liable.

A-1 M & M Enterprise, Inc., dba Auto Mall (A-1) (seller's permit SR AS 100-485830) operated a used car dealership. The Sales and Use Tax Department (Department) issued a seller's

1 permit to taxpayer to operate the business as a sole proprietor beginning October 3, 2000. On
2 November 4, 2004, the Department issued the corporation's seller's permit after becoming aware that
3 the business was operated by the corporation, which had been established September 28, 2000. The
4 Department also transferred all the sales and use tax returns to the corporate permit number. At the
5 time its business terminated, A-1 had unpaid liabilities related to sales and use tax returns filed with no
6 remittance for the first quarter 2004 (1Q04) and 2Q04, and an audit of the period January 1, 2001,
7 through December 31, 2004 (there was no liability established by audit for the last two quarters of
8 2004, which is the reason the liability period here ends with June 30, 2004).

9 The Department concluded that taxpayer was personally liable, pursuant to section 6829, for
10 the unpaid tax-related liabilities of A-1 and issued the Notice of Determination in dispute. Taxpayer
11 concedes she is liable under section 6829 for the amounts A-1 self-reported in its returns for 1Q04 and
12 2Q04, but disputes that she is liable for any of the liability established by audit (which includes
13 deficiencies for both 1Q04 and 2Q04). Taxpayer's sole dispute with the determination to her for the
14 liability of A-1 established by audit is that A-1 properly reported the tax, and the sales included as
15 deficiencies in the audit never occurred. Thus, although taxpayer concedes that A-1 did collect sales
16 tax reimbursement on all retail sales, she asserts that since the sales reflected in the audit deficiency
17 never occurred, it follows that A-1 did not collect sales tax reimbursement on such non-existent sales
18 and that taxpayer could not have willfully failed to pay, or to cause to be paid, the amounts due.¹

19 Taxpayer's argument regarding sales not having occurred is not really an argument against her
20 liability under section 6829 for the tax debts incurred by A-1. Rather, she is actually arguing that A-1
21 never incurred the audit liability. If that were true and the audited deficiency of A-1 were reduced to
22 zero, that would, of course, completely remove that liability from the amounts owed by taxpayer, since
23 she can be held liable only for the amounts actually owed by A-1. Based on taxpayer's concessions
24 and the evidence, we find that taxpayer was a responsible person liable under section 6829 for the tax
25
26

27 ¹ These are two of the required elements of establishing liability pursuant to section 6829, and taxpayer does not dispute the
28 other two elements, that A-1's business has been terminated and that taxpayer was a person responsible for sales and use tax
matters for A-1.

1 debts incurred by A-1. We address whether any of the amounts in dispute should be removed from the
2 liability of A-1, and in turn from that of taxpayer, below.

3 **Issue 2:** Whether adjustments are warranted to the understatement of reported taxable sales
4 established in the audit of the period January 1, 2001, through December 31, 2004.

5 The Department began its audit of A-1 in April 2004. The records provided were limited and
6 disorganized. The Department therefore requested that A-1 organize the documents and create a sales
7 journal with all relevant information. A-1 did so, but the sales recorded in the journal did not reconcile
8 with reported amounts, and the Department asked A-1 to prepare a more complete and accurate
9 journal. The second journal provided by A-1 was also incomplete. The Department then compared the
10 sales journal to amounts deposited in the bank, and it found that the two figures did not reconcile for
11 any month of the period reviewed. After several attempts to obtain consistent and reliable sales
12 information from A-1, the Department turned to an analysis of the report of sales (ROS) forms issued
13 by the Department of Motor Vehicles (DMV). Using the number of missing ROS forms and an
14 average selling price computed from the first sales journal prepared by A-1, the Department computed
15 an understatement of approximately 92 percent, which it applied to reported taxable sales in the audit.

16 After the determination issued to A-1 had become final and the dual determination had been
17 issued to taxpayer, taxpayer provided additional records, which consisted primarily of taxpayer's
18 analysis of bank deposits. In reviewing this information, the Department discovered a previously
19 undisclosed bank account into which A-1 had deposited over \$1 million during the 1Q01 and 2Q01.
20 Some additional deposits were made through 1Q02, and the account was closed during or after 1Q02.
21 The parties agreed that the combined deposits in the *two* bank accounts were fairly representative of
22 taxable sales for 1Q01 (\$1,168,121) and 2Q01 (\$1,249,067) and that there were no taxable sales during
23 3Q04 or 4Q04. However, the Department remained convinced that, when A-1 stopped using the
24 account that was closed in early 2002, a substantial amount of sales revenue was going somewhere
25 other than the single bank account originally identified by taxpayer.

26 The Department conducted a reaudit in which it made adjustments for the 208 vehicles sold in
27 1Q01 and 2Q01, as recorded on the sales journal taxpayer prepared for the audit. It also regarded
28 10 percent of the ROS forms as lost or destroyed forms or forms that represented sales that were not

1 consummated, such as unwinds. The Department concluded that the remaining 1335 unaccounted-for
2 ROS forms represented retail sales. It computed a quarterly sales average for the period 3Q01 through
3 2Q04, using an average of 116 vehicles for the first 11 quarters and 59 sales for the final quarter, when
4 the business was closing. The Department multiplied the number of vehicles sold by the average
5 selling price (computed using taxpayer's journal) and compared audited sales to reported amounts to
6 establish the understatement of reported taxable sales of \$7,412,330 at issue. As a secondary audit
7 technique to validate the audit findings, the Department analyzed bank deposits for the two bank
8 accounts active during 1Q01 and 2Q01. Using the audited average selling price, the Department
9 computed that 113 vehicles were sold in each of those two quarters. The Department regarded that
10 information as secondary support for the audit findings, which were based on a comparable number of
11 sales, 116 per quarter.

12 Taxpayer contends that the audit is fatally flawed and that it is not adequately validated as
13 required by Departmental policy. She argues that an audit based solely on missing ROS forms is
14 unreliable and inaccurate and notes that the Department has acknowledged this issue in a June 12,
15 2006 memorandum from Jeffrey L. McGuire, Tax Policy Division Chief. That memorandum states
16 that audits based solely on missing ROS forms are "not necessarily accurate" and should be supported
17 by additional or secondary audit techniques. Taxpayer asserts that the secondary audit technique used
18 by the Department is flawed because it utilizes bank deposits for 1Q01 and 2Q01 to estimate sales for
19 the entire audit period. Taxpayer states that this procedure is inaccurate because it is based on the
20 Department's false assumption that there was another undisclosed bank account used to conceal
21 taxable sales during and after 3Q01. In addition, taxpayer contends that the audit has not allowed a fair
22 and reasonable reduction for lost or destroyed ROS forms or for ROS forms used to report sales for
23 resale. Finally, taxpayer contends she has more accurately determined A-1's tax liability using a bank
24 deposit analysis. In fact, taxpayer asserts that there was no understatement, except for 1Q01 and 2Q01,
25 the two quarters during which substantial deposits were made to the second bank account, the
26 existence of which was not disclosed until taxpayer protested the audit findings.

27 Taxpayer states she believes there were no unreported sales, but she proposes some additional
28 measure, \$1,478,721, only because her representatives have recommended that she do so. Taxpayer

1 asserts that her proposal is further supported by a markup analysis in which she has computed a
2 markup of about 41 percent, using her proposed sales numbers and recorded costs. Taxpayer asserts
3 that the 41 percent markup is evidence that her sales numbers are overstated, if anything, because
4 A-1's typical markup was 20-25 percent. Moreover, she argues that the markup of about 135 percent
5 computed using the audited sales is evidence that the audited amount is overstated.

6 For audits of a used car dealership, a reconciliation of ROS forms and reported sales is a
7 common and reliable audit method, and in the absence of complete and accurate records, it was
8 entirely reasonable for the Department to conduct an analysis of ROS forms and to use the number of
9 missing ROS forms to establish unreported sales. We specifically reject taxpayer's assertion that
10 certain blocks of ROS forms in sequence were probably lost or destroyed. It was within the power of
11 A-1 and taxpayer, more than anyone else, to track and preserve any damaged or unused forms and to
12 provide them during the audit. Lacking evidence to the contrary, we find the Department's estimate
13 that 10 percent of the missing ROS forms did not relate to taxable sales to be reasonable. Taxpayer's
14 claim regarding sales for resale reported on ROS forms is based on her assertion that 42 of the sales
15 recorded in the sales journal were sales for resale. However, not only does the available evidence
16 indicate that those sales were at retail, but also sales for resale are reported on different forms than the
17 ROS forms at issue here. In sum, we reject taxpayer's claim that A-1 reported sales for resale on any
18 of the subject ROS forms, we find that the audit method used by the Department was appropriate, and
19 we conclude that taxpayer has not provided no basis for further adjustments.

20 Regarding taxpayer's claim that the Department has not provided adequate secondary support
21 for the audit because the secondary audit method was also flawed, we note that the weight we give an
22 audit of this nature depends on all the evidence or lack thereof. Given the absence of reliable business
23 records or verifiable sources of data, we reject taxpayer's argument that the Department's bank deposit
24 analysis, using 1Q01 and 2Q01, was a fatally flawed technique for validating the audit results.
25 Similarly, we find that the markup of 135 percent computed by taxpayer using audited sales and
26 recorded costs has no evidentiary value because, in the absence of records, we find the recorded costs
27 to be an unreliable figure.

28

1 Taxpayer has provided various computations, and our difficulty with the presentation lies less
2 with what taxpayer does with the numbers than with the source of the numbers. We find that the
3 numbers taxpayer offers have not been subject to critical examination and verification, and we do not
4 deem them reliable. Among other concerns, we note that taxpayer originally failed to disclose a bank
5 account into which A-1 had deposited over \$1 million during the first two quarters of the audit period.
6 We are not convinced that taxpayer forgot about the account, as she claims. Taxpayer agrees that the
7 amounts deposited in the two bank accounts for 1Q01 and 2Q01, \$1,168,121 and \$1,249,067,
8 respectively, after various adjustments, represented taxable sales for those quarters.² Bank deposits,
9 net of the same adjustments, for the next 10 quarters averaged \$756,490. Taxpayer's explanation of
10 the significant decrease is that a high rate of loan defaults led to a more conservative lending policy
11 and fewer sales. We find that explanation is not supported by reliable evidence and lacks credibility.
12 We simply are not convinced that the amounts deposited in the single bank account A-1 used
13 throughout the audit period represent reliable evidence of A-1's total sales. In addition, taxpayer has
14 made deductions for bad debts in her bank deposit analysis, and the source of information regarding
15 those alleged bad debts is unknown and the information unverified. In short, taxpayer has not provided
16 sufficient business records, and her submissions make representations of fact that are not supported.
17 We find that taxpayer has not provided evidence to support any adjustments to the audit.

18 **Issue 3:** Whether A-1 was negligent. We conclude that it was.

19 The Department imposed the 10-percent negligence penalty because the records provided for
20 audit were not adequate for sales and use tax purposes, and taxpayer failed to report over 39 percent of
21 its taxable sales. Although denying that A-1 underreported its tax, taxpayer admits, and the evidence
22 shows, that A-1 did not keep adequate records. Thus, it is undisputed that A-1 did not exercise
23 ordinary and reasonable care to keep and provide to the Department records that were adequate for a
24 sales tax audit. That lack of due care, in conjunction with the significant understatement of almost \$8
25 million (\$7,412,330 of unreported taxable sales and \$512,022 of disallowed claimed nontaxable sales),

27 ² These figures differ from the figures quoted in the D&R, \$1,517,945 and \$1,423,454, for 1Q01 and 2Q01, respectively,
28 because the amounts used in the D&R represent total bank deposits before adjustments for returned checks, refunds, audited
sales for resale, DMV fees, and tax included.

1 is evidence of negligence, at a minimum, and we find that the negligence penalty was properly
2 imposed.

3 **Issue 4:** Whether taxpayer has established reasonable cause sufficient for relieving the finality
4 penalty originally assessed against A-1, which was also included in the determination to taxpayer. We
5 conclude she has not.

6 There is no statutory or regulatory authority for relieving this penalty in section 6829
7 determinations, but if taxpayer could show that the penalty should be relieved as to A-1 under Revenue
8 and Taxation Code section 6592, the relief would also inure to taxpayer's benefit. Taxpayer has
9 submitted a request for relief, signed under penalty perjury, based on the grounds that A-1 believed,
10 and taxpayer still believes, that all taxable sales were reported on sales and use tax returns. Taxpayer
11 also states that A-1 ceased doing business in mid-2004, and, by the time the determination was issued
12 to the corporation on September 1, 2005, A-1 had insufficient liquid assets to pay the determination.

13 Taxpayer's declaration does not establish that A-1's failure to timely pay or petition the
14 determination was due to reasonable cause and circumstances beyond A-1's control. Consequently,
15 we find no basis for relief from the finality penalty.

16 **Issue 5:** Whether taxpayer has established reasonable cause to relieve the amnesty double
17 negligence penalty, the amnesty double finality penalty, and the amnesty interest penalty assessed
18 against A-1, which were also included in the determination issued to taxpayer. We find she has not.

19 Since A-1 did not participate in the amnesty program and the determination was issued after the
20 end of the amnesty period, the determination included an amnesty double negligence penalty and an
21 amnesty double finality penalty. Also, an amnesty interest penalty was added when A-1 did not pay or
22 petition the determination and the determination became final. After the reaudit, the amnesty double
23 negligence penalty and the amnesty double finality penalty are each \$31,272.59, and the amnesty
24 interest penalty is \$35,852.73.³ As with the finality penalty discussed above, there is no statutory or
25 regulatory authority for relieving the amnesty penalties in section 6829 determinations, but if taxpayer

26
27 ³ In accordance with Board policy, no additional amnesty interest penalty was imposed against taxpayer when the
28 determination against her became final.

1 could show that the penalties should be relieved as to A-1 under Revenue and Taxation Code section
2 6592, the relief would also inure to taxpayer's benefit.

3 The request for relief from penalty, addressed previously under Issue 4, also requests relief of
4 the amnesty penalties on the grounds that A-1 had a good faith belief in the accuracy of the sales and
5 use tax returns filed. It also states that "any past failure to make a return ... was due to reasonable
6 cause and circumstances beyond the corporation's control" and asserts that A-1 did not have sufficient
7 liquid assets to pay the determination when it was issued in September 2005.

8 Taxpayer discussed the original audit results with the Department in December 2004, and
9 therefore had a reasonably accurate understanding of the understatement before the amnesty program
10 began on February 1, 2005. Also, the audit workpapers include a copy of a letter to A-1, to the
11 attention of taxpayer, with a copy to the outside accountant, which explained the amnesty process.
12 Thus, the evidence shows that A-1 was aware of the amnesty program and was aware that the
13 Department had established a large deficiency. The evidence does not establish A-1's good faith
14 belief, at the time of the amnesty program, that no tax was owed for the amnesty-eligible period.
15 Moreover, the purpose of the amnesty program was for taxpayers to pay their tax deficiencies,
16 including audit liabilities with which they disagreed. A-1 could have filed amnesty returns and entered
17 into an installment payment agreement, but it chose not to do so. Thus, we find taxpayer has not
18 shown reasonable cause for A-1's failure to participate in the amnesty program, and we find there is no
19 basis to recommend relief of the amnesty penalties.

20 **OTHER DEVELOPMENTS**

21 None.

22
23 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
24
25
26
27
28