

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:)
JACK NADEL, INC., dba Jack Nadel Division) Account Number: SR AS 18-624656
Petitioner) Case ID 382431
Culver City, Los Angeles County

Type of Business: Promotional products

Audit period: 07/01/02 – 09/30/05

<u>Item</u>	<u>Disputed Amount</u>
Disallowed adjustments to sales tax accrual account	\$965,321
Tax as determined:	\$249,437.04
Adjustment - Sales and Use Tax Department	- 44,920.48
Proposed redetermination	<u>\$204,516.56</u>
Less concurred	<u>-124,877.88</u>
Balance, protested	<u>\$ 79,638.68</u>
Proposed tax redetermination	\$204,516.56
Interest through 3/31/11	<u>50,931.30</u>
Total tax and interest	\$255,447.86
Payments	<u>-174,785.85</u>
Balance Due	<u>\$ 80,662.01</u>
Monthly interest beginning 4/1/11	<u>\$ 173.43</u>

This matter was previously scheduled for Board hearing on October 21, 2010, but was postponed at petitioner's request.

UNRESOLVED ISSUE

Issue: Whether adjustments are warranted to the amount of disallowed deductions intended to recover amounts of tax overpaid in prior periods. We recommend no adjustment.

Petitioner makes wholesale and retail sales of marketing and promotional products. During the audit, the Sales and Use Tax Department (Department) found various areas of understatement.

Although petitioner protested five of the six audit items in the original audit, it disagreed with only one element of the reaudit issued March 12, 2007. The disputed item represents a portion of audit item 3,

1 disallowed adjustments to the sales tax accrual account.¹ Petitioner accrued tax when it billed its
2 customer sales tax reimbursement. When it concluded, for various reasons, that it had accrued tax on a
3 transaction that was not subject to tax, it made adjustments to the sales tax accrual account that reduced
4 the amount of sales tax paid. The Department disallowed five specific adjustments to the sales tax
5 accrual account. Four of the adjustments were disallowed because petitioner's conclusions were
6 incorrect, and the transactions at issue were in fact subject to tax.² Those items are not in dispute.

7 Petitioner protests only one disallowed adjustment to the sales tax accrual account, a reduction
8 of \$79,368.68 in tax accrued for the third quarter 2002 (3Q02), which represents the tax on sales
9 totaling \$965,321 to Cisco Systems (Cisco). Petitioner had made the sales to Cisco in 3Q01, 1Q02,
10 and 2Q02, and, according to petitioner, it had erroneously included sales tax reimbursement and
11 reported tax. When petitioner discovered that the sales were not subject to tax, it reduced the amount
12 of tax accrued for the 3Q02 by \$79,368.68 and made an adjustment of \$965,321 to the amount of
13 deductions claimed on its return for that quarter. The Department disallowed this adjustment to the tax
14 accrual account, not because the sales of \$965,321 were in fact taxable, but because, instead of filing a
15 claim for refund of the overpaid tax, petitioner effectively granted itself a refund without the Board's
16 review and approval, which is not authorized by law. Since the audit did not begin until October 11,
17 2005, the three-year period during which petitioner could have filed timely claims for refund had
18 expired before the Department became aware of petitioner's attempt to recover the overpayment of tax
19 by adjusting the amounts reported on its return.³ Petitioner contends that the adjustment to the sales
20 tax accrual account in 3Q02 should be allowed because, at the time it reclassified the sales to Cisco
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23 ¹ This item is labeled as "disallowed taxable sales adjustment" in the audit report, and the issue in dispute is described in the
24 D&R as disallowed "self help" deductions. In fact, the audit item represents disallowed adjustments to taxpayer's tax
25 accrual account (which it called "sales tax billed"). The description used in this summary, "disallowed adjustments to the
26 sales tax accrual account," is more precise than the descriptions used in the audit or in the D&R.

27 ² Our understanding is that, although it had billed sales tax reimbursement and initially included such amount in its tax
28 accrual account, when petitioner concluded that tax was not due on the transaction and adjusted its sales tax accrual account
accordingly, it also reduced the billing to its customer in the same amount, such as when a customer provided a resale
certificate to justify not paying petitioner sales tax reimbursement. Thus, petitioner did not collect, and "zeroed out" any
billing for, tax reimbursement on both the disputed and the undisputed transactions.

³ The three-year period for filing claims with respect to overpayments in the 3Q01, 1Q02, and 2Q02 expired on October 31,
2004, April 30, 2005, and July 31, 2005, respectively. (Rev. & Tax. Code, § 6902.)

1 catalogs, we find the deficiencies should have been apparent to petitioner if it had undertaken the kind
2 of review of past returns the amnesty program was intended to encourage. Accordingly, we are not
3 persuaded that petitioner's failure to participate in the amnesty program as to these audit items was due
4 to a reasonable and good faith belief that it had no amnesty-eligible liability. However, with respect to
5 the self-help deductions, petitioner underreported its liability during the audit period because it had
6 *over-reported* tax in prior periods. Although this attempt to recover amounts reported in excess of
7 amounts due was not permissible, we conclude that petitioner believed it had claimed the deductions
8 appropriately. Thus, we find that petitioner believed in good faith that it had no additional liability
9 related to the self-help deductions, and that such belief was reasonable cause for petitioner's failure to
10 participate in amnesty in connection therewith. Therefore, we recommend the amnesty interest penalty
11 applicable to the disallowed self-help deductions be relieved provided that, within 30 days from the
12 Notice of Redetermination, petitioner either pays in full the amnesty-eligible taxes and interest due or
13 enters into an installment payment agreement to pay those amounts within 13 months and successfully
14 completes the agreement.

15 **OTHER DEVELOPMENTS**

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