

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION SUMMARY FOR BOARD HEARING**

In the Matter of the Petitions for Redetermination )  
Under the Sales and Use Tax Law of: )  
JEFF'S EXOTIC FISH, INC. )  
JEFF'S EXOTIC FISH, COSTA MESA, INC. )  
JEFF'S EXOTIC FISH, COSTA MESA, LLC )  
Petitioners )  
Account Number: SR AS 101-135221  
Case ID 484114  
Account Number: SR EA 100-492887  
Case ID 484116  
Account Number: SR EA 100-604629  
Case ID 484115  
Orange, Orange County

Type of Business: Tropical fish stores

Audit period: 01/01/05 – 02/01/07 (484114, Store #1<sup>1</sup>)  
01/01/05 – 12/31/07 (484116, Store #2)  
08/01/05 – 12/31/07 (484115, Store #3)

<u>Item</u>	<u>Disputed Amount</u>
Disallowed claimed exempt sales in interstate commerce	\$1,036,782 (484114, Store #1)
Disallowed claimed nontaxable sales for resale	\$ 998,724 (484116, Store #2)
Disallowed claimed nontaxable sales for resale	\$ 654,184 (484115, Store #3)
Negligence penalty	\$ 8,553 (484114, Store #1)
Negligence penalty	\$ 7,740 (484116, Store #2)
Negligence penalty	\$ 5,070 (484115, Store #3)

	<u>484114, Store #1</u>		<u>484116, Store #2</u>		<u>484115, Store #3</u>	
	<u>Tax</u>	<u>Penalty</u>	<u>Tax</u>	<u>Penalty</u>	<u>Tax</u>	<u>Penalty</u>
As determined and protested:	<u>\$85,534.56</u>	<u>\$8,553.43</u>	<u>\$77,401.15</u>	<u>\$7,740.12</u>	<u>\$50,699.31</u>	<u>\$5,069.92</u>
Proposed tax redetermination	\$ 85,534.56		\$ 77,401.15		\$50,699.31	
Interest through 6/30/11		39,821.88		33,944.77		19,023.80
Negligence penalty		<u>8,553.43</u>		<u>7,740.12</u>		<u>5,069.92</u>
Total tax, interest, and penalty		<u>\$133,909.87</u>		<u>\$119,086.04</u>		<u>\$74,793.03</u>
Monthly interest beginning 7/1/11		<u>\$ 427.67</u>		<u>\$ 387.01</u>		<u>\$ 253.50</u>

This matter was scheduled for Board hearing on March 25, 2011, but was postponed at petitioners' request to allow them additional time to hire a representative.

<sup>1</sup> This summary identifies the three businesses as Store #1, Store #2, and Store #3, as does the D&R.

**UNRESOLVED ISSUES**

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2       **Issue 1:** Whether adjustments are warranted to the disallowed claimed exempt sales in  
3 interstate commerce or the claimed nontaxable sales for resale. We recommend no adjustment.

4       Petitioners operated stores selling tropical fish, aquariums, and related items. Mr. Jeffrey  
5 Majdali was a corporate officer in both corporations and one of the members of the LLC. All three  
6 stores made sales at their store locations, and Store #1 also made online sales and offered aquarium  
7 installation, setup, and maintenance services for a fee. That store was sold to an unrelated corporation  
8 on February 1, 2007. According to Mr. Majdali, until its closure, Store #1 acted as a warehouse and a  
9 clearinghouse, handling transfers of inventory to and from Stores #2 and #3. On their returns,  
10 petitioners claimed deductions for nontaxable sales for resale and exempt sales in interstate commerce,  
11 although the amounts were sometimes inadvertently claimed under different deduction titles such as  
12 labor or returned merchandise. For Store #1, the claimed amounts were segregated between  
13 nontaxable sales for resale and exempt sales in interstate commerce. For the other two stores, the  
14 claimed nontaxable and exempt sales were combined as a single deduction on each return. Each of the  
15 three businesses provided limited records for audit.

16       The Sales and Use Tax Department (Department) conducted concurrent audits of the three  
17 businesses. The Department found that reported total sales substantially reconciled with the available  
18 records, but petitioners reported only a small percentage of their sales as taxable (6, 18, and 19 percent  
19 for Stores #1, #2, and #3, respectively). Since petitioners provided source documents only for the third  
20 quarter 2006 (3Q06), the Department used that quarter as a test period. The Department found that  
21 virtually all of the claimed nontaxable sales for resale represented transfers of inventory among the  
22 stores, but that petitioners did not have an adequate accounting system to track those transfers. The  
23 Department explained that some of the invoices provided for Store #1 actually listed transfers of  
24 inventory, and the sales journals for Store #1 included recorded transfers of inventory to the other two  
25 stores. However, the available records did not support any transfers of inventory from Stores #2 or #3  
26 to the other stores.

27       Based on the available records and on petitioner's description of Store #1 as a warehouse for all  
28 three stores, the Department concluded that the claimed nontaxable sales for resale for Store #1 were

1 substantially accurate, but it disallowed all of the claimed nontaxable sales for resale for Stores #2 and  
2 #3. As a secondary verification of its conclusion, the Department reallocated inventory for the year  
3 2006, adjusting inventories for all stores using the recorded transfers of inventory from Store #1 to the  
4 other two stores. The Department then used the adjusted cost of goods sold and reported sales for  
5 2006 to compute book markups of 89 percent, 50 percent, and 77 percent for Stores # 1, #2, and #3,  
6 respectively. Since the Department considered those book markups reasonable for these businesses, it  
7 regarded them as additional evidence that the claimed transfers of inventory from Store #1 to the other  
8 two stores were valid, while the claimed transfers of inventory from the other two stores were not.  
9 With respect to claimed exempt sales in interstate commerce, the Department found that Store #1 had  
10 adequate evidence to support about 35 percent of the claimed amounts, while the other stores had no  
11 evidence to support any of the claimed amounts. Accordingly, the Department disallowed about 65  
12 percent of claimed exempt sales in interstate commerce for Store #1 and all of claimed exempt sales in  
13 interstate commerce for the other two stores (which, for those two stores, are included in the  
14 disallowed claimed nontaxable sales for resale because, as noted previously, those stores claimed  
15 combined deductions on returns that included both nontaxable sales for resale and exempt sales in  
16 interstate commerce).

17         Petitioners contend that all claimed nontaxable sales for resale, for all three stores, were  
18 inventory transfers among the stores. Petitioners also contend that all claimed exempt sales in  
19 interstate commerce were valid, arguing that the claimed amounts should not be disallowed simply  
20 because petitioners can no longer obtain copies of shipping documents from the shipper due to the age  
21 of the transactions. Petitioners further state some of the relevant documentation was left behind when  
22 Store #1 was sold, and the new owner is unwilling or unable to provide the documents.

23         It is presumed that all gross receipts from retail sales of tangible personal property are taxable  
24 until proven otherwise. (Rev. & Tax. Code, § 6091.) The burden of proving that a sale of tangible  
25 personal property is not at retail is upon the seller unless the seller timely takes, in good faith, a  
26 certificate from the purchaser stating that the property is purchased for resale. (Cal. Code of Regs., tit.  
27 18, § 1668, subd. (a).) Petitioners have not provided adequate evidence to support the claimed  
28 transfers of inventory from Stores #2 and #3 to the other stores, nor have petitioners provided any

1 resale certificates to support nontaxable sales for resale to entities other than the three stores at issue.  
2 Accordingly, we recommend no adjustment to the disallowed claimed nontaxable sales for resale for  
3 Stores #2 and #3.

4 To prove that it is entitled to the exemption claimed for sales in interstate commerce, a taxpayer  
5 must retain bills of lading or other documentary evidence of delivery of the property outside of  
6 California. The Department has allowed the claimed exempt sales in interstate commerce for which  
7 Store #1 has provided documentation, and petitioners have provided no evidence to support any of the  
8 disallowed claimed amounts. We reject petitioner's assertion that the disallowed amounts should  
9 nevertheless be accepted as accurate, and we find no basis for adjustment.

10 **Issue 2:** Whether petitioners were negligent. We conclude that they were.

11 The Department imposed the penalties for negligence because the records petitioners provided  
12 were inadequate, and the amounts of understatement were substantial. Petitioners dispute the penalties  
13 on the grounds that they were not trying to cheat the state, but simply were unable to effectively  
14 manage three stores.

15 Petitioners did not furnish a cohesive set of books and records for audit, and we find that the  
16 failure to provide adequate records is evidence of negligence. In addition, the audited understatements  
17 of \$1,036,782, \$998,724, and \$654,184 for Stores #1, #2, and #3, respectively, represent  
18 understatements of 416 percent, 460 percent, and 426 percent when compared to reported taxable sales  
19 of \$248,972, \$216,927, and \$153,503. We find that those substantial understatements further support  
20 our finding that petitioners were negligent. Accordingly, we find that the negligence penalties were  
21 properly applied.

## 22 **OTHER DEVELOPMENTS**

23 None.

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