

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 MARC LAIDLER) Account Number: SR AS 53-002537
 6 Petitioner) Case ID 358821
)
) Los Angeles, Los Angeles County

7 Type of Liability Responsible person liability

8 Liability Period: 4/1/99 – 9/30/03

9 Items Amounts in Dispute

10 Responsible person liability \$118,573.73

	<u>Tax</u>	<u>Penalties</u>
11 As determined	\$138,966.67	\$16,074.46
12 Adjustment: Sales and Use Tax Department	-2,017.00	+17,605.88 ¹
Appeals Division		<u>-20,795.93²</u>
13 Proposed redetermination	\$136,949.67	\$12,884.41
14 Less concurred	<u>-30,606.99</u>	<u>-653.36</u>
14 Balance, protested	<u>\$106,342.68</u>	<u>\$12,231.05</u>

15
 16
 17 ¹ This consists of an amnesty interest penalty of \$19,912.71 imposed on the corporation and asserted to petitioner pursuant to Revenue and Taxation Code section 6563, less reductions to other penalties totaling \$2,306.83 discussed in the next footnote.

18 ² The corporation failed to file a sales and use tax return for the third quarter 2003 (3Q03). On June 23, 2004, a Notice of Determination was issued to the corporation for tax of \$21,778.00 and a failure to file (FTF) penalty of \$2,177.80. The Notice of Determination also reflects a payment of \$726.66 which the Department had applied on September 12, 2003, so the net tax due was shown as \$21,051.34. Since the corporation did not petition or pay the determination before it went final, a finality penalty of \$2,105.13 was imposed on the corporation. The unpaid balance for 3Q03 was included in the responsible person liability imposed against petitioner. In 2006, based on documentation provided by the corporation, the Department concluded that the tax liability should be reduced by \$2,017.00, which served to also reduce each penalty by \$201.70. After these adjustments, the remaining balance was \$19,034.34 in tax, \$1,976.10 in FTF, and \$1,903.43 in finality penalty. Also in 2006, the Department applied two other payments retroactively to the amounts due for 3Q03. The Department applied a payment of \$8,105.56 effective on September 23, 2003, to reduce the tax remaining due to \$10,928.78, and then applied a payment of \$11,655.00 effective on November 6, 2003, to pay the tax liability and interest in full and a portion of the FTF penalty, leaving unpaid FTF penalty of \$1,322.74 (\$1,976.10 - \$653.36). Because the tax liability was paid in full, the Department deleted the remaining finality penalty of \$1,903.43. Thus, the Department deleted \$2,306.83 in penalties as a result of the audit adjustment and the retroactively applied payments (the amount referred to in the prior footnote). However, upon our review in preparing this summary, we asked the Department why it had not adjusted the FTF for the September 12, 2003 payment made prior to the due date of the return and the 2006 payment which the Department retroactively applied as of September 23, 2003, also before the due date of the return. The Department agreed to treat those payments as prepayments and thus reduced the FTF by \$883.22 to \$439.52. The \$20,795.93 adjustment noted in the table above is comprised of this \$883.22 adjustment plus the amnesty interest penalty of \$19,912.71 which we recommend be relieved.

1	Proposed tax redetermination	\$136,949.67
	Interest to 3/31/11	72,969.73
2	Penalty for failure to file a return	1,092.88
	Finality penalty	<u>11,791.53</u>
3	Total tax, interest, and penalties	\$222,803.81
4	Payments	<u>-131,060.56</u>
	Balance due	<u>\$91,743.25</u>
5	Monthly interest beginning 4/1/11	<u>\$38.59</u>
6		

7 This matter was scheduled for Board hearing on October 20, 2010, but the oral hearing was
8 postponed because petitioner's representative had a scheduling conflict.

9 UNRESOLVED ISSUES

10 **Issue 1:** Whether the disputed liability of 310 Motoring Inc., SR AS 97-547042 (3MI) is
11 excessive or resulted from disallowed claimed exempt sales for which no sales tax reimbursement was
12 collected. We conclude that the audited liability of 3MI is not excessive and that the disputed liability
13 is not from disallowed claimed exempt sales but instead from sales for which 3MI collected sales tax
14 reimbursement.

15 3MI sold auto parts and accessories and customized luxury cars from January 1, 1999, through
16 September 30, 2003, the effective date of the close out of its seller's permit. 3MI had outstanding
17 liabilities based on a Notice of Determination issued on March 26, 2004, based on an audit for the
18 period April 1, 1999, to March 31, 2002, and a second Notice of Determination issued on June 23,
19 2004, based on a compliance assessment after 3MI failed to file a sales and use tax return for the third
20 quarter of 2003 (3Q03). Since 3MI did not file a timely petition for redetermination for either
21 determination, both determinations became final. A finality penalty was added to the first
22 determination. The Sales and Use Tax Department (Department) found that petitioner is a responsible
23 person pursuant to Revenue and Taxation Code section 6829 for these unpaid liabilities and issued a
24 Notice of Determination to him on that basis.

25 Petitioner acknowledges he is liable as a responsible person pursuant to section 6829 for the
26 unpaid liabilities incurred by 3MI. However, he asserts that unreported taxable sales established in the
27 audit resulted from disallowed claimed exempt sales, not sales for which sales tax reimbursement was
28 collected and not remitted. On that basis, petitioner contends that the liability related to those sales

1 should be deleted from his liability as a responsible person (a responsible person can be held liable
2 under section 6829 for the sales tax incurred by a corporation only if sales tax reimbursement was
3 added to or included in the sales prices of the tangible personal property sold).

4 According to the audit work papers, the Department found discrepancies between recorded and
5 reported taxable sales, accrued and reported taxes, recorded and claimed exempt sales, and recorded
6 and claimed nontaxable sales for resale. The Department also found that 3MI claimed deductions for
7 tax-paid purchases resold although none were recorded; that bank deposits exceeded reported total
8 sales; and that total sales reported on sales and use tax returns exceeded gross receipts reported on
9 federal income tax returns. In addition, the Department was unable to trace sales invoices to the
10 general ledger and, although the invoices were numerically sequenced, the sequencing was not in
11 chronological order. As a result of these discrepancies and issues with the records, the Department
12 concluded that, except for the recorded sales during 2002, 3MI's records were incomplete, inaccurate,
13 and unreliable. The Department decided to establish taxable sales on a markup basis.

14 3MI's controller could not explain the differences, claiming that he was new to the
15 organization, having been hired after the audit started, but claimed that sales were accurately recorded
16 for the year 2002 because of better internal controls. Thus, the Department used the records for the
17 year 2002 to establish an average markup of 46.21 percent by comparing gross receipts from taxable
18 and nontaxable sales of parts and accessories with the corresponding cost of sales. The Department
19 also examined sales invoices for March 2002 to establish that 22.32 percent of petitioner's sales were
20 taxable. The Department applied the average markup of 46.21 percent to the audited cost of sales to
21 establish audited total sales, and applied the taxable percentage of 22.32 percent to establish audited
22 taxable sales, which exceeded reported taxable sales by \$1,316,828.

23 Petitioner argues that the audited taxable sales were excessive and that the Department should
24 have used recorded nontaxable labor in place of reported nontaxable labor to compute estimated
25 taxable sales. We note that 3MI's books and records contained many unexplained differences between
26 recorded and reported amounts, and many invoices could not be traced to the general ledger.
27 Accordingly we find that the Department was justified in not accepting 3MI's books and records and in
28 using the markup method to establish understated taxable sales. The Department established the mark

1 up based on actual information obtained from 3MI's records for 2002, which 3MI's controller
2 indicated were fairly accurate due to a better system of internal controls. Thus, we find the
3 Department has used the best available information, and petitioner has not met its burden of proving
4 that the audited amount of taxable sales is excessive. In addition, petitioner has provided no evidence
5 that the recorded amount of exempt sales is accurate or more reliable than the reported amounts, which
6 the Department used in its calculations.

7 Petitioner also argues that the Department has failed to produce a single invoice that impeached
8 the amounts recorded in the general ledger or on which sales tax was billed and collected but not
9 remitted to the Board. With respect to the audit item in dispute, petitioner notes that the item is labeled
10 "estimated *underreported* taxable sales," rather than sales for which tax was collected but not *remitted*.
11 Accordingly, petitioner argues that "estimated unreported taxable sales" are actually unsubstantiated
12 exempt sales which cannot be assessed against him as a responsible person because they are sales with
13 respect to which 3MI did not collect tax reimbursement.

14 Of necessity, because of inadequate records, 3MI's sales were estimated on the basis of an
15 alternate audit approach (the markup method). The Department then computed a percentage of taxable
16 sales to total sales by comparing sales invoices in which sales tax reimbursement was added to the total
17 sales invoices. Thus, contrary to petitioner's contention, the amount of underreported taxable sales
18 was based on a sample percentage calculated from sales invoices which *included sales tax*
19 *reimbursement*, and therefore does not represent disallowed exempt sales. Additionally, disallowed
20 claimed nontaxable and exempt sales were calculated separately and were not included in the
21 assessment against petitioner. Accordingly, we find the Department correctly included the liability
22 based on underreported taxable sales in the liability against petitioner as a responsible person, and we
23 conclude no adjustments are warranted.

24 **Issue 2:** Whether reasonable cause has been established to relieve the finality penalty and the
25 penalty for failure to file a return incurred by 3MI. We conclude there is no basis for relief.

26 Petitioner submitted a request for relief of all penalties on behalf of 3MI, signed under penalty
27 of perjury. With respect to the finality penalty, petitioner asserts that 3MI did not timely pay the
28 liability or timely file a petition for redetermination because it was going to file a bankruptcy petition

1 by the time the audit determination became final, and therefore believed the audit liability would be
2 settled by the bankruptcy court. Petitioner also repeats the argument in Issue 1 that we reject. In
3 addition, petitioner believes that imposing the finality penalty before issuing a bill to a corporate
4 officer is equivalent to imposing a penalty before issuing a tax assessment.

5 The audit determination was issued to 3MI on March 26, 2004, and became final on April 25,
6 2004, 30 days after issuance. 3MI did not enter bankruptcy until August 2004. Thus, 3MI could have
7 filed a petition for redetermination with the Board, or entered into an installment payment plan, before
8 the liability became final, but chose not to do so. Further, petitioner's argument that all sales tax
9 reimbursement collected by 3MI has been remitted to the Board (which we reject) does not address the
10 question of why petitioner did not timely pay the determination or file a petition for redetermination.

11 Based on the foregoing, we find that petitioner has not shown that its failure to timely petition or pay
12 its tax liability was the result of reasonable cause and circumstances beyond 3MI's control. With
13 respect to the argument that the finality penalty was imposed prior to issuing a tax assessment,
14 petitioner is mistaken. The penalty was imposed *after* issuance of the *relevant* assessment, that is, the
15 Notice of Determination issued to 3 MI which it failed to timely petition or pay. The penalty was
16 billed to petitioner as a responsible person for 3 MI personally liable under section 6829, and he
17 therefore became liable for all the penalties that had been incurred by 3MI. We conclude that relief of
18 the finality penalty is not warranted.

19 Regarding the penalty for failure to file a return, petitioner argues that 3MI fully paid the
20 liability due for the 3Q03, even though it did not file a return. However, the 3Q03 return was due on
21 October 31, 2003, while the last payment made to fully pay the liability due for the 3Q03 was applied
22 effective November 6, 2003, after the failure to file penalty had fully accrued. Additionally, 3MI did
23 not file the 3Q03 return to which the payments applied until August 16, 2006. Consequently, we find
24 that reasonable basis has not been provided for 3MI's failure to file a timely return and we are not
25 otherwise aware of any. Therefore, we find that relief from the failure-to-file penalty is not warranted.

26 **Amnesty**

27 Since 3MI did not participate in the amnesty program, an amnesty interest penalty of
28 \$19,912.71 was imposed on 3MI. This amount was not included in the Notice of Determination to

1 petitioner. The Department asserted an increase to the determination in this amount pursuant to
2 Revenue and Taxation Code section 6563.

3 3MI filed for Chapter 7 bankruptcy protection in August 2004, long before the amnesty
4 program began. By the time of the amnesty program, 3MI's assets had been liquidated and it would
5 have had no means to pay the liability or enter into a payment plan. Thus, we conclude 3MI's failure
6 to participate in the amnesty program was due to reasonable cause and circumstances beyond its
7 control. Accordingly, we recommend that relief from the amnesty interest penalty be granted, subject
8 to timely payment of the amounts due. We note that the usual payment conditions imposed on relief of
9 amnesty penalties are payment of the amnesty-eligible tax and interest due within 30 days of the final
10 decision, or, within that same 30-day period, entry into a qualifying installment agreement and
11 successful completion of it. However, in the D&R, our recommendation used a 60-day period rather
12 than a 30-day period. Since the D&R was issued more than two years ago and because we do not
13 believe this will make any practical difference under the circumstances, we are not changing our
14 recommendation in this matter at this time. Accordingly, we recommend that the amnesty interest
15 penalty be relieved if, within 60 days of the issuance of the Notice of Redetermination in this matter,
16 petitioner either pays the amnesty-eligible tax and interest due or enters into a qualifying installment
17 agreement to pay such amounts within 13 months and successfully completes that agreement.

18 **OTHER DEVELOPMENTS**

19 The Department also issued responsible person determinations for the unpaid liabilities of 3MI
20 to Raul Becerril (SR AS 53-002538), James J. Brennan (SR AS 53-002541), Constantina Susie Frial
21 (SR AS 53-002540), and Dornell Griffin (SR AS 53-002539). The 3MI liabilities asserted against
22 Mr. Becerril and Mr. Griffin are limited to the period April 1, 1999, to March 31, 2002, and the
23 liabilities asserted against Mr. Brennan are only for the period July 1, 2003, to September 30, 2003.
24 Mr. Becerril, Mr. Brennan, and Ms. Frial, all timely filed petitions for redetermination, and their
25 hearings are scheduled for the same meeting as petitioner's appeal. Mr. Griffin did not timely petition
26 the determination and his liability is now final.

27
28 Summary prepared by Rey Obligacion, Retired Annuitant