

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:)
MAS N ZUL, INC., dba Ride-way Auto Service) Account Number: SR AR 97-733371
Case ID 434597
Petitioner) Santa Clarita, Los Angeles County

Type of Business: Automobile repair shop

Audit period: 04/01/04 – 03/31/07

<u>Item</u>	<u>Disputed Amount</u>
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Unreported taxable sales	\$315,693 ¹
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Tax as determined and proposed to be redetermined:	\$27,064.44
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Less concurred	<u>1,019.70</u>
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Balance, protested	<u>\$26,044.74</u>
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Proposed tax redetermination	\$27,064.44
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Interest through 6/30/10	<u>9,991.43</u>
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Total tax and interest	\$37,055.87
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Payments	<u>-7,000.00</u>
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Balance Due	<u>\$30,005.87</u>
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Monthly interest beginning 7/1/10	<u>\$117.04</u>
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This matter was originally scheduled for Board hearing on February 24, 2010, but was postponed for settlement consideration.

UNRESOLVED ISSUE

Issue: Whether adjustments are warranted to the audited amount of unreported sales. We recommend no adjustment.

Petitioner operates an auto repair shop. In addition to making repairs, petitioner made over-the-counter sales of auto parts, both at retail and for resale. The Sales and Use Tax Department (Department) reduced recorded merchandise purchases by the recorded amounts of subcontractor labor included therein to compute an audited cost of parts sold of \$416,595 for the period January 1, 2004, through March 31, 2007. That figure significantly exceeded the total of reported taxable sales of parts

¹ Petitioner protests an unspecified portion of the audited understatement of reported sales.

1 and claimed sales for resale of \$180,433 (\$122,355 + \$58,078) for the audit period. The Department
2 decided to establish audited taxable sales on a markup basis.

3 The Department computed an audited markup of 28.44 percent in a shelf test, using selling
4 prices from sales invoices and costs from purchase invoices for the months of January, November, and
5 December 2005. The Department added that markup to the audited cost of parts sold to compute
6 audited parts sales of \$496,126 for the audit period.² It deducted reported total sales of parts (both
7 taxable and nontaxable) of \$180,433 to compute an understatement of reported taxable sales of parts of
8 \$315,693, which represents a percentage of error of 258 percent ($\$315,693 \div \$122,355$).³

9 Petitioner does not protest the audited markup, but contends that the audited cost of parts sold
10 should be reduced to account for defective parts returned to vendors, defective parts thrown away,
11 purchases of supplies and tools included in the recorded purchases of merchandise, and excessive
12 spillage of motor oil and lubricants.

13 In this type of business, we would expect petitioner's vendors to issue credits to petitioner for
14 defective parts it returned, and petitioner acknowledged at the conference that this is the case. Further,
15 we would expect such credits to be reflected on purchase invoices or credit memos issued to petitioner,
16 and we would expect petitioner to record the net amount of purchases in its records. Petitioner does
17 not concede that those credits were accounted for in its recorded merchandise purchases. Petitioner
18 also asserted that defective small parts were not returned to vendors for credit, but were instead
19 discarded.

20 Petitioner has not provided documentation, such as purchase invoices and the details of
21 recorded amounts of merchandise purchases, to show that the credits from vendors have not been
22 accounted for in petitioner's records. In addition, petitioner has provided no documentation of
23 _____

24 ² The audited cost of parts used for this calculation was based on the cost of parts beginning January 1, 2004. Since the
25 audit period commences April 1, 2004, the Department deducted 25 percent of audited parts sales for 2004 to account for
26 this. That is, marking up audit parts cost of \$416,595 for January 1, 2004, through March 31, 2007, by 28.44 percent
27 results in audited parts sales for that period of \$535,075. The Department regarded \$38,948, which is 25 percent of the
28 audited sales for 2004 of \$155,791, as having occurred during the first quarter of 2004, prior to the audit period. Thus, the
Department deducted that amount from audited sales of \$535,075 for the period beginning January 1, 2004, to calculate the
audited sales for the audit period. (We assume the \$1 discrepancy is the result of rounding.)

³ That is, the Department accepted petitioner's claimed resales of \$58,078 as valid. The audit workpapers do not include a
comment addressing whether the Department actually verified the claimed resales. We note also that, despite the
significant percentage of error, the Department did not impose a penalty for negligence.

1 defective small parts that were discarded rather than returned to the vendors. Furthermore, since
2 petitioner routinely returned defective parts to vendors for credit (as it concedes), we find it
3 implausible that petitioner would have thrown away a material amount of small defective parts rather
4 than returning them along with its other returns. In the absence of documentation, we recommend no
5 adjustment for alleged unrecorded credits from vendors or alleged discarding of small defective parts.
6 Similarly, petitioner has not provided documentation that purchases of supplies and tools were
7 inadvertently included in its recorded merchandise purchases. In the absence of documentation, we
8 recommend no adjustment.

9 Nor has petitioner provided documentation that it had significant spillage of oil and lubricants.
10 Petitioner opened this business in August 2000, more than three years before the beginning of the audit
11 period. Thus, petitioner was experienced in this business by the time the audit period began.
12 Accordingly, we would expect it to have implemented procedures to prevent excessive spillage of oil
13 and lubricants. We find that petitioner has not established that it had significant spillage of oil and
14 lubricants, and we recommend no adjustment for this claim.

15 Petitioner did not raise the issues of self-consumption and pilferage. Those issues are not
16 directly addressed in the D&R, but we address them here. The types of merchandise withdrawn from
17 inventory for self-consumption for which an adjustment might be warranted would be parts used by the
18 owners for repairing their own cars. We would expect that type of self-consumption to be nominal.
19 Also, since petitioner would still owe tax on the cost of the parts, any adjustment for self-consumption,
20 at approximately 28 percent of the cost (using the audited markup), would be minimal. With respect to
21 pilferage, we note that taxpayer ordered parts for each job on an as-needed basis and did not keep an
22 inventory of parts other than nuts, bolts, washers, and other similar items. Thus, any losses due to
23 pilferage of those small items would be minimal. Accordingly, since petitioner did not raise these
24 issues and we would expect the amounts, if any, to be minimal, we do not recommend any adjustments
25 for self-consumption or pilferage.

26 **OTHER DEVELOPMENTS**

27 None.

28 Summary prepared by Rey Obligacion, Retired Annuitant

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MARKUP TABLE

Percentage of purchases whose resale was taxable (if at retail)	100%
Mark-up percentages developed	28.44%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None