STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matters of the Petition for Redetermination under the Sales and Use Tax Law of:	)	
MELIKA, INC.	)	Account Number: SR AS 97-700998 Case ID 549416
Petitioner	)	Inglewood, Los Angeles County

Type of Business: Used car dealer

Audit period: 4/1/05 – 3/31/08

Item	Disputed Amount
Unreported taxable sales	$2,213,901
Negligence penalty	$18,322

	Tax	Penalty
As determined	$318,309.02	$31,830.90
Pre-D&R adjustment	+ 68,978.94	+6,897.90
Post-D&R adjustment	-204,066.73	-20,406.67
Proposed redetermination, protested	$183,221.23	$18,322.13

Proposed tax redetermination	$183,221.23
Interest through 10/31/12	88,531.50
Negligence penalty	18,322.13
Total tax, interest, and penalty	$290,074.86
Payments	- 8,250.00
Balance Due	$281,824.86
Monthly interest beginning 11/1/12	$874.86

UNRESOLVED ISSUES

Issue 1: Whether additional adjustments to the audited amount of unreported taxable sales are warranted. We conclude that no additional adjustments are warranted.

Petitioner operated this business from May 2000 through June 2010, and had been audited previously for the period October 2001 through September 2004. During the current audit period, petitioner reported total sales of $18,944,232 and claimed deductions of $2,398,707, for reported taxable sales of $16,545,525. Based on gross receipts and cost of goods sold reported on petitioner's federal income tax returns for 2004 through 2007, the Sales and Use Tax Department (Department)

computed book markups of 41.14 percent for 2004, 26.05 percent for 2005, 15.51 percent for 2006, and 10.13 percent for 2007. Since the Department expected the markup for this business to be in the 40-50 percent range, it found that the book markup for 2004 was reasonable, but concluded that the book markups for the other years were too low, and thus decided to compute petitioner's taxable sales using the markup method. Initially, the Department used a 45 percent markup established in the prior audit to compute audited taxable sales. At the appeals conference, petitioner noted that the Department computed a markup of 28.26 percent for the test period October 2005, which is in the current audit period. After additional analysis, the Department agreed with petitioner that the lower markup should be used, and, based on our review, we concur. In the post-conference reaudit, the Department used the audited cost of goods sold, as computed in the audit, and a markup of 28.26 percent to establish audited retail sales, which it reduced for documented exempt sales in interstate commerce to establish audited taxable sales for the period April 1, 2005, through December 31, 2007. It compared audited taxable sales to reported taxable sales (before reductions for claimed bad debts) to compute understatements of $793,567 for April 2005 through December 2007 and $577,542 for 2007, which represented percentages of error of 7.03 percent and 11.52 percent, respectively. The Department then added the understatement for the first quarter 2008, computed using an error ratio of 11.52 percent, to compute gross unreported taxable sales of $1,494,514. It disallowed petitioner's claimed bad debts of $834,388, but made an allowance for supportable bad debts of $115,001. In sum, the Department established a $2,213,901 understatement of taxable measure.

Petitioner indicated that it does not agree with the post-conference reaudit results, but did not provide any specific arguments other than the lower markup with which the Department now agrees. Since petitioner has not provided documentation to support additional adjustments to the audit or shown that there are errors in the audit calculations, we recommend no further adjustments.

Issue 2: Whether petitioner was negligent. We conclude that it was.

The Department imposed the negligence penalty because the understatement of tax was substantial, and because the same types of errors were noted in the prior audit. Petitioner argues that the errors were not intentional but instead were due to lack of knowledge in accounting.

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We note that in the current audit petitioner did not provide complete source documents (i.e., sales contracts, purchase invoices, sales journal, or purchase journal) for the period January 2007 through March 2008, or resale certificates. Since petitioner was informed of its recordkeeping requirements in the prior audit, we reject petitioner's argument that it lacked knowledge in accounting, and find petitioner's lack of records to be evidence of negligence in recordkeeping. Further, petitioner has not provided a non-negligent explanation for its failure to report $2,213,901, which is 13.38 percent of its taxable sales, and thus we find the deficiency resulted from petitioner's negligence in reporting.

OTHER MATTERS

None.

Summary prepared by Pete Lee, Business Taxes Specialist II

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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentages developed	28.26% retail 14.83% sales for resale
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None