

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:) NCMG, INC.) dba New Century Marble & Granite) Petitioner)	Account Number: SR S CH 97-264777 Case ID 386871 San Leandro, Alameda County
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Type of Business: Construction contractor
 Audit Period: 1/1/03 – 12/31/05

<u>Items</u>	<u>Disputed Amounts</u>
Unreported cost of materials and sales of fixtures	\$229,409
Unreported cost of items used in petitioner’s showroom	\$ 69,047
Tax as determined and protested	<u>\$23,385.68¹</u>
Proposed tax redetermination	\$23,385.68
Interest through 7/31/10	<u>14,156.77</u>
Total tax and interest	\$37,542.45
Payments	<u>-107.00</u>
Balance due	<u>\$37,435.45</u>
Monthly interest beginning 8/1/10	<u>\$135.79</u>

This matter was previously scheduled for Board hearing on April 15, 2009, but was postponed at the request of the Appeals Division so it could issue a Supplemental Decision and Recommendation to provide additional information and clarification. It was then scheduled for Board hearing on April 13, 2010, but was postponed because petitioner wanted more time to gather additional information, and petitioner’s representative had a scheduling conflict.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted for remnants and for an increase in ending inventory. We recommend no adjustment.

¹ The amount of determined tax is net of a concurred in credit of \$913.52. Thus, the total amount of tax protested is \$24,299.20 (\$23,385.68 + \$913.52).

1 Petitioner installs marble and granite countertops (materials) under lump sum contracts, and
2 also makes retail over-the-counter sales of kitchen and bathroom fixtures (fixtures). Petitioner
3 purchased the materials and fixtures without payment of tax or tax reimbursement to its vendors by
4 issuing them resale certificates, and reported tax on the cost of materials installed in construction
5 contracts and on the sale price of fixtures.

6 During the audit, the Sales and Use Tax Department (Department) noted that for the year 2003,
7 petitioner's merchandise purchases exceeded the reported taxable measure. The Department also noted
8 that petitioner instituted better internal controls in early 2004 and that the reported taxable measure for
9 the years 2004 and 2005 significantly exceeded the merchandise purchases. Accordingly, the
10 Department concluded the reported taxable measure for the years 2004 and 2005 was substantially
11 accurate, but the reported taxable measure for 2003 was understated. The Department performed a
12 cost accountability test for the year 2003. The Department reduced the material and fixture purchases
13 for 2003 to account for the cost of items used in its showroom and for freight-in, which it computed at
14 one percent. The Department then added a 31.07 percent markup, which had been computed in a shelf
15 test, to the amount of fixture purchases to compute retail sales of fixtures. To establish audited taxable
16 measure, the Department added the material purchases, the retail sales of fixtures, and the cost of items
17 displayed in petitioner's showroom. Upon comparison to the reported taxable measure, the
18 Department concluded that petitioner had underreported a measure of \$298,456 (\$229,409 with respect
19 to items consumed in the performance of lump sum construction contracts or sold at retail, and \$69,047
20 with respect to property displayed in its showroom).

21 Petitioner contends that an adjustment should be made to account for changes in inventory.
22 Although petitioner has not specified the amount of adjustment, we note that its federal income tax
23 return for the year 2003 shows an increase in ending inventory of \$154,632.

24 Petitioner is the consumer of materials that it furnished and installed in the performance of
25 construction contracts, and it purchased marble and granite for use in performing construction
26 contracts, not for resale. Thus, petitioner was not entitled to issue resale certificates for its purchases
27 of marble and granite slabs, and when it did issue a resale certificate to a California vendor with
28 knowledge that the property would not be resold, petitioner owed the tax the vendor would have owed

1 but for having been relieved of it by petitioner's issuance of a resale certificate. (Rev. & Tax. Code, §
2 6094.5, subd. (a).) That is, petitioner owed tax measured by the full purchase price of the slabs, with
3 no reduction for the prorated value of the remnants, and that tax became due when petitioner purchased
4 the slabs.² However, even if petitioner for some reason thought it would resell the slabs, petitioner
5 would have owed use tax measured by the full purchase price of the slabs, without any reduction for
6 the prorated value of remnants, and the tax would have become due when petitioner made its first use
7 of the slabs. For purchases from out-of-state vendors, whether it issued a resale certificate or not,
8 petitioner owed use tax, and the use tax was due with the return for the period during which its
9 purchase occurred. Accordingly, we conclude that no adjustment is allowable for remnants that remain
10 in inventory. We also concluded in the D&R that an inventory adjustment could be warranted for
11 fixtures. However, petitioner did not provide any documentation to support an inventory adjustment
12 for fixtures. Further, based on its observation, the Department stated that marble and granite remnants
13 represent the majority of the inventory. Accordingly, we believe any adjustment for an increase in the
14 inventory of fixtures would have been minor. In any event, in the absence of documentation, we have
15 no basis upon which to recommend an adjustment for ending inventory.

16 **Issue 2:** Whether petitioner is liable for the use tax on the cost of fixtures and marble and
17 granite displayed in the showroom. We find petitioner consumed those items and is liable for use tax.

18 Petitioner moved materials and fixtures from its extax inventory into its showroom for display
19 without reporting and paying use tax on the cost of those items. Petitioner contends that it is not liable
20 for the tax because those items were held for sale in the regular course of business, and were in fact
21 sold. Petitioner argues that the tax was not due until the materials and fixtures were sold. The
22 Department noted that the fixtures at issue were cemented or otherwise permanently affixed to realty.
23 Also, according to the Department, petitioner stated that the fixtures are rarely removed from the
24 showroom, except when older models are replaced, and that the fixtures are usually scratched or
25 otherwise damaged in the process of removal and are generally discarded.

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28 ² Since the Department assessed use tax as of the date the marble and granite was allocated to a construction job, petitioner has received a timing benefit in situations where the slabs were purchased in one quarter and allocated to a job in a later quarter.

1 If a person gives a resale certificate or purchases property from out of state without paying tax
2 to a retailer registered in California for collection of such tax, the purchaser owes use tax on its use of
3 such property except when its use is limited to demonstration or display while holding the property for
4 sale in the regular course of business. That is, in such circumstances, the purchaser owes use tax
5 unless the property was used for no purpose other than demonstration and display while being held for
6 sale in the regular course of business. Petitioner clearly did not hold the materials displayed in its
7 showroom for resale since it did not sell materials in the regular course of business (only consuming
8 the materials in the performance of construction contracts). With respect to the fixtures, we find that
9 the installation of the fixtures rendered them no longer held for resale in the regular course of business.
10 Consequently, we conclude that petitioner owed use tax on the cost of the materials and fixtures when
11 they were removed from extax inventory for installation in the showroom.

12 **Issue 3:** Whether petitioner should be relieved of the tax on remnants that were not installed in
13 construction contracts because it relied on advice from a prior audit of its predecessor. We conclude
14 that no relief is warranted.

15 Petitioner contends it should be relieved from the liability for use tax on remnants consumed
16 during the current audit period because, in the prior audit of petitioner's predecessor, the Department
17 treated remnants as non-taxable until the remnants were installed in a construction contract.

18 We have examined the workpapers for the audit of petitioner's predecessor for the period
19 October 1, 1993, through September 30, 1996. In that audit, the Department performed a material
20 accountability test and computed cost of goods sold of \$125,446. The Department accepted the
21 predecessor's reported taxable measure because the amount of cost of goods sold was very close to the
22 reported taxable measure of \$127,282. Thus, the Department prepared a no-change audit report for the
23 audit of the predecessor.

24 Petitioner asserts that, in the prior audit of its predecessor, the beginning and ending inventories
25 included substantial amounts of remnants. Thus, petitioner argues that the inventory adjustments made
26 in the cost accountability test in the prior audit of its predecessor are evidence that the Department
27 treated remnants as non-taxable until they were installed in construction contracts. However, the audit
28 of petitioner's predecessor does not mention remnants at all. We conclude that the auditor who

1 performed the audit of petitioner's predecessor was not aware that the beginning and ending
2 inventories included remnants. Therefore, we find that the prior audit does not contain advice on the
3 application of tax with respect to petitioner's remnants. Furthermore, we find that the cost
4 accountability test in the prior audit is not written advice for purposes of Revenue and Taxation Code
5 section 6596. In order to qualify for relief under section 6596, the written advice must state whether or
6 not a particular activity or transaction is subject to tax. In this instance, the cost accountability test
7 does not state whether a particular activity or transaction is subject to tax, and thus, the cost
8 accountability test cannot be used as written advice on which petitioner may rely. We conclude that
9 petitioner is not eligible for relief under section 6596.

10 **OTHER DEVELOPMENTS**

11 None.

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13 Summary prepared by Rey Obligacion, Retired Annuitant
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