STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination	)	
Under the Sales and Use Tax Law of:	)	
	)	
GLENN ALAN OLSON and SHEILA OLSON,	)	Account Number: SR KHO 99-857221
dba Olson Automotive Machine Shop and Repair	)	Case ID 475832
	)	
Petitioner	)	Hanford, Kings County

Type of Business: Automotive repair and machine shop

Audit period: 7/1/04 – 6/30/07

Item	Disputed Amount
Unreported taxable sales	$560,177

	Tax	Penalty
As determined:	$46,177.67	$4,617.77
Adjustment - Sales and Use Tax Department	- 5,555.96	-4,617.77
Proposed redetermination	$40,621.71	$ 0.00
Less concurred	8.88	
Balance, protested	$40,612.83	
Proposed tax redetermination	$40,621.71	
Interest through 2/29/12	21,014.35	
Total tax and interest	$61,636.06	
Payments	555.65	
Balance Due	$61,080.41	
Monthly interest beginning 3/1/12	$233.72	

This matter was previously scheduled for Board hearing on October 28, 2011, but was postponed at petitioner's request to allow it additional time to prepare for the hearing.

UNRESOLVED ISSUES

Issue 1: Whether further adjustments are warranted. We conclude that no further adjustments are warranted.

Petitioner, a mother and son partnership, makes retail sales and installs custom hi-performance engines and parts for race cars and other vehicles. The Sales and Use Tax Department (Department) found that the gross receipts reported on federal income tax returns exceeded the total sales reported on the sales and use tax returns for 2004 through 2006 by $266,564, and *cost of goods sold* reported on the federal returns ($972,839) was almost double *sales* reported for sales tax purposes ($513,711). Total and taxable sales recorded in the general ledger exceeded the total and taxable sales reported on sales tax returns for the audit period by $278,556 and $134,753, respectively.

The Department established petitioner's sales using the markup method. It reduced the merchandise purchases reported on federal returns of $329,055 for 2005 and $388,598 for 2006 by the cost of three damaged engines that could not be resold, and for self-consumption. Petitioner stated that the inventory amounts reported on the 2005 and 2006 federal returns were wrong, and that a physical inventory taken in May 2008 established inventory of $452,374, which petitioner considered representative of the inventory on hand at the end of the audit period (no other documentary evidence of inventories was provided). The Department accepted petitioner's inventory figure as a reasonable ending inventory valuation, but assumed the business commenced with no inventory in March 1996 and that inventory increased by a constant $37,698 each year for the next 12 years ($452,374 ÷ 12). It calculated petitioner's inventory to be $339,282, $376,980, and $414,678 on January 1st of 2005, 2006, and 2007, respectively.

After adjusting for inventories, the Department computed audited cost of merchandise sold of $261,268 for 2005 and $311,782 for 2006. It conducted a shelf test using 33 randomly selected sales invoices, computed a shelf test markup of 44.96 percent, and applied the audited markup to the audited cost of merchandise sold to compute audited merchandise sales of $378,734 for 2005 and $451,959 for 2006. It reduced the audited merchandise sales by audited sales for resale to compute audited taxable sales of $368,839 for 2005 and $429,148 for 2006, resulting in understated taxable sales of $203,830 for 2005 and $231,119 for 2006 and an error rate of 123.53 percent for 2005 and an error rate of 116.71 percent for 2006. The Department applied the 123.53 percent error rate to petitioner's reported taxable sales for the period July 1, 2004, through December 31, 2005, and applied the 116.71 percent error rate to petitioner's reported taxable sales for the period January 1, 2006, through June 30, 2007, to compute unreported taxable sales of $560,177 for the audit period.

Petitioner contends that the inventory amounts used in the audit calculations are incorrect since a new store was built in 2002 that included more shelf space, and that it began to increase inventory in

2003 to fill that additional space. Petitioner provided a handwritten summary indicating that its inventory was $35,000 in January 2004, $86,000 in January 2005, $245,650 in January 2006, $339,400 in January 2007, and $450,000 in January 2008. However, petitioner has not provided any evidence indicating that the new store was larger and allowed for an increased inventory capacity. Nor has it provided, other than the physical inventory taken after the end of the audit period, any physical counts of inventory to support its handwritten summary of inventories. We find that the Department was generous in allowing a $37,698 adjustment for inventory increases each year without documentation, and in the absence of such supporting documentation, we conclude that no further inventory adjustment is warranted.

Issue 2: Whether petitioner is entitled to a reduction in taxable measure for exempt sales to Indians on Indian reservations. We conclude no adjustment is warranted.

Petitioner provided copies of 12 sales invoices for engine parts totaling over $12,000 and three resale certificates (apparently taken as generic exemption certificates and alleging that the purchasers are members of federally recognized tribes), and asserts that they represent sales delivered by petitioner's truck to three Indian purchasers on Indian reservations. The Department stated that the sales invoices do not indicate that a shipment was made, and that title to the parts transferred to the purchasers at petitioner's retail location. We find that the evidence provided does not establish that title to the property transferred to Indians on a reservation, or that the property was delivered by petitioner's truck to the reservation. Therefore, we conclude that the sales do not qualify as exempt sales to Indians.

OTHER DEVELOPMENTS

None.

Summary prepared by Pete Lee, Business Taxes Specialist II

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100% taxable
Mark-up percentages developed	44.96%
Self-consumption allowed in dollars	$9,324 (2005) $4,504 (2006)
Self-consumption allowed as a percent of taxable purchases	3.2% (2005) 1.3% (2006)
Pilferage allowed in dollars	$0
Pilferage allowed as a percent of taxable purchases	0%