

## 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 ORACLE CORPORATION ) Account Number: SR BHA 99-727541  
 6 Petitioner ) Case ID 217113  
 Belmont, San Mateo County

7 Type of Business: Manufacture and sale of business software

8 Audit period: 01/01/96 – 12/31/98

9 <u>Item</u>	<u>Disputed Amount</u>
10 Disallowed claimed nontaxable sales	\$2,512,392
Purchases subject to use tax (other than Propeller)	\$ 129,365
11 Purchases from Propeller Portable Computer Prod.	\$3,635,904
Negligence penalty	\$ 342,041
12 Relief of interest	Not specified
13 Amnesty interest penalty	\$ 67,356

14	<u>Tax</u>	<u>Penalty</u>
15 As determined:	\$4,966,489.61	\$496,649.10
Adjustment - Sales and Use Tax Department	+ 299,948.66	-26,005.11 <sup>1</sup>
16 - Appeals Division	<u>-1,286,029.48</u>	<u>-128,603.02</u>
Proposed redetermination	\$3,980,408.79	\$342,040.97
17 Less concurred	<u>-3,458,099.65</u>	<u>00.00</u>
18 Balance, protested	<u>\$ 522,309.14</u>	<u>\$342,040.97</u>
Proposed tax redetermination	\$3,980,408.79	
19 Interest through 7/31/10	2,644,830.26	
20 Penalty for negligence	342,040.97	
Amnesty interest penalty	<u>67,355.67</u>	
21 Total tax, interest, and penalty	\$7,034,635.69	
Payments	<u>-3,327,459.37</u>	
22 Balance Due	<u>\$3,707,176.32</u>	
23 Monthly interest beginning 8/1/10	<u>\$3,808.87</u>	

24 This matter was previously scheduled for Board hearing on October 6, 2009, but was postponed  
 25 at petitioner's request because of a scheduling conflict. It was rescheduled for hearing on March 24,  
 26 2010, but was postponed at petitioner's request in order that the representative would have additional

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 28 <sup>1</sup> This is the difference between \$56,000 negligence penalty waived in connection with payments under the amnesty program and the \$29,994.89 increase in connection with the increase in the tax assessment.

1 time to work with the Sales and Use Tax Department (Department) and to submit an opening brief. It  
2 was rescheduled for Board hearing on May 26, 2010, but was again postponed to allow additional time  
3 for Propeller Portable Computer Products, Inc. (Propeller) (the petitioner in a related case) to file an  
4 opening brief.

### 5 UNRESOLVED ISSUES

6 **Issue 1:** Whether further adjustments are warranted to the disallowed claimed nontaxable sales.

7 We recommend no further adjustment.

8 Petitioner is a manufacturer and retailer of business software, and also sells maintenance  
9 contracts and training services. The Department used statistical sampling to test the accuracy of  
10 petitioner's claimed nontaxable sales, separating the population into three strata: 1) less than  
11 \$5,000.00, 2) \$5,000.00 through \$49,999.99, and 3) \$50,000.00 and more. The Department reviewed  
12 all claimed nontaxable sales in stratum 3 and reviewed random samples chosen from the other two  
13 strata. The Department identified several sales, claimed as nontaxable, for which petitioner did not  
14 present sufficient supporting documentation. Of the disallowed claimed nontaxable transactions that  
15 remained in dispute at the time of the appeals conference, petitioner and the Department agreed that  
16 certain of them were valid nontaxable sales and that one was subject to tax, and in the D&R and  
17 SD&R, we recommend that some of the previously disputed transactions be allowed as nontaxable.  
18 The remaining disputed transactions are discussed below.

19 Petitioner contends that the disputed sales to CalTech, Raytheon-Range Systems Engineering  
20 (Raytheon), Space Systems Loral (Loral), and TransCore, an SAIC Company (TransCore) were  
21 nontaxable sales for resale to those businesses, who resold the items in question to the U. S.  
22 Government before any use.<sup>2</sup> To support its claim that the sales to CalTech were nontaxable,  
23 petitioner provided: 1) a resale certificate that, under "description of property to be purchased" stated  
24 "Refer to purchase order on this and all future purchases"; 2) a purchase order from CalTech for the  
25 purchase of a technical services agreement for five years of technical support, not to exceed

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27 <sup>2</sup> With respect to the sales to CalTech, petitioner also contended that \$195,000 of the disputed transactions represented  
28 nontaxable training fees. During the reaudit we recommended, the Department concluded that the \$195,000 represented  
charges for nontaxable services and deleted that amount from the disallowed claimed nontaxable sales.

1 \$2,000,000; and 3) a fixed price contract between CalTech and petitioner (but it is not entirely clear if  
2 the sales at issue were made under that contract). Where, as here, a purchaser issues a “qualified resale  
3 certificate” indicating it wants to designate on each purchase order whether the purchase is for resale,  
4 each purchase order must then specify whether the property covered by the order is purchased for  
5 resale in order for the purchase to be covered by the resale certificate. (Cal. Code Regs., tit. 18, §  
6 1668, subd. (b)(4).) Here, despite the qualified resale certificate’s instruction to check the purchase  
7 order, the purchase order petitioner submitted for the disputed transaction does not state that the  
8 purchase was for resale. Therefore, we find that petitioner did not make the disputed sale pursuant to  
9 the resale certificate it proffered.

10 To support its claim that the sale to Raytheon was nontaxable, petitioner provided a “blanket  
11 exemption certificate” dated April 13, 1995. However, the seller’s permit number listed on that  
12 certificate was closed out six months earlier, on November 15, 1994, so at the time the certificate was  
13 issued, and in 1998 when the disputed sale was made, the certificate was not supported by a valid  
14 seller’s permit number (there are also other reasons the certificate does not support the disputed sale as  
15 nontaxable, as discussed in the D&R). Petitioner also provided a purchase order in support. While  
16 that purchase order references a seller’s permit number that was in effect when the purchase order was  
17 issued, the purchase order does not state that the purchase was made “for resale” and thus does not  
18 constitute a resale certificate.

19 To support its claim that the sale to Loral was nontaxable, petitioner provided a resale  
20 certificate dated April 15, 1995, indicating that Loral was in the business of selling electronic  
21 equipment to the U. S. Government. The certificate states “See Purchase order” under the  
22 “Description of Property to be Purchased.” However, despite the instruction in the qualified resale  
23 certificate to see the purchase order to determine if that particular purchase is for resale, petitioner did  
24 not provide a copy of the applicable purchase order, and instead submitted a “Purchase Order  
25 Exception Form” stating that Loral could not provide a purchase order because it “does not issue  
26 purchase orders.” In other words, petitioner is unable to provide a purchase order for this transaction  
27 including the statement “for resale” or the like. As such, there is no valid resale certificate as to the  
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1 disputed sale and petitioner has not otherwise established that the sale was for resale. We thus find  
2 that tax applies.

3 To support its claim that the sale to TransCore was nontaxable, petitioner submitted a resale  
4 certificate from Science Applications International Corporation (SAIC), which states that SAIC is  
5 engaged in the business of selling property and services to the U. S. Government, any tangible personal  
6 property purchased (except property ordered “For Resale-No”) will be resold, and the description of  
7 property to be purchased is “see purchase order.” The purchase order petitioner submitted for this  
8 transaction does not include a statement that the property purchased is for resale, and includes an  
9 unmarked box next to the statement “This order is exempt from sales/use tax in the state to which the  
10 material is to be shipped.” Also, the Department notes that the resale certificate was issued by SAIC,  
11 while the sale was made to TransCore. We find that, even if the resale certificate had been issued by  
12 the actual purchaser (which it was not), that certificate together with the purchase order do not  
13 establish that the sale was a nontaxable sale for resale.

14 We note that, even if petitioner had taken valid resale certificates for these transactions, there  
15 would still be the issue of whether they were taken in good faith as to the disputed sales because it is  
16 not clear that petitioner’s license agreements even permitted its customers to resell the subject  
17 software. We are unable to resolve this issue in favor of petitioner since it has not provided copies of  
18 the licensing agreements for the software, but for the reasons explained above, this issue is moot  
19 because petitioner has not established that it took valid resale certificates for these sales.

20 **Issue 2:** Whether further adjustments are warranted to the audited amount of purchases subject  
21 to use tax. We recommend no further adjustment.

22 Petitioner did not report any use tax liability on its purchases of assets, supplies, and other  
23 consumed items. The Department used statistical sampling to examine petitioner’s expense, supply,  
24 and capital asset accounts, separating the population into four strata, purchases that were: 1) less than  
25 \$1,000.00, 2) \$1,000.00 through \$9,999.99, and 3) \$10,000.00 through \$99,999.99 and 4) \$100,000.00  
26 and more. The Department examined all purchases in stratum four and reviewed random samples  
27 chosen from the other three strata and identified purchases that it concluded were subject to use tax.  
28 At the appeals conference, petitioner and the Department agreed on the application of tax for some of

1 the transactions, and the D&R recommends additional adjustments. The remaining disputed  
2 transactions are discussed below.

3         Petitioner contends that its purchases from Gilmore Global Logistics Services (Gilmore) were  
4 not subject to use tax because none of the materials it purchased from this vendor were shipped to  
5 California. The D&R recommends removing purchases through October 31, 1997. For purchases  
6 beginning November 1, 1997, we agreed that only a portion of those purchases delivered outside  
7 California were for use in California, and we adopted the 2.15 percent ratio the Department established  
8 based on its test of purchases from other vendors in relatively similar circumstances combined with a  
9 test performed by petitioner. Thus, the D&R recommends that 97.85 percent of the purchases from  
10 Gilmore removed from the deficiency and tax apply to 2.15 percent of purchases from Gilmore on and  
11 after November 1, 1997. Petitioner has not provided any additional documentation, and we  
12 recommend no further adjustment.

13         Petitioner contends that only \$2,715 of the purchase price paid to Noel Allum, Photographer,  
14 should be included as taxable measure in the sample because the remainder of the transaction, \$2,050,  
15 was a deposit that was paid prior to the sample period. We conclude that the full purchase price for the  
16 purchase, \$4,765 (\$2,715 + \$2,050) must be included as taxable for purposes of the test because the  
17 purchase invoice was selected as a sample item, the sale of the prints occurred at or about the time that  
18 the invoice was issued, and it is the purchase price that is taxable at that time, not the amount of the  
19 purchase price that remained due when the sale occurred.<sup>3</sup> This recommendation is in accord with the  
20 guidelines stated in the Sales and Use Tax Department Audit Manual, section 1302.25, subdivision (d).

21         **Issue 3:** Whether petitioner is liable for use tax with respect to its purchases from Propeller  
22 during the second quarter of 1997. We conclude that it is.

23         The audited amount of purchases subject to use tax includes purchases of \$13,045,668 from  
24 Propeller during the period January 1, 1996, through March 31, 1997, and purchases of \$3,635,904  
25 from Propeller during the second quarter 1997 (2Q97). Petitioner protests the application of use tax  
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27 <sup>3</sup> If the deposit had been selected in the sample rather than the actual purchase invoice, we would recommend that no  
28 portion of the purchase price be included in the taxable measure because the sample item in that case would represent  
merely a deposit, and not a taxable purchase.

1 only with respect to the purchases made in 2Q97. Propeller had previously operated in California, but  
2 it moved out of state in October 1994 and closed out its California seller's permit. At that time, it  
3 stopped billing petitioner for sales tax reimbursement. Beginning no later than April 1997, Propeller  
4 had representatives in California on petitioner's premises for the purpose of soliciting or processing  
5 sales orders. Also, beginning April 1, 1997, Propeller added a line item titled "Sales Tax" to its sales  
6 invoices and began charging sales tax reimbursement on its retail sales to petitioner. Propeller  
7 obtained a seller's permit from the Board with an initial start date of July 1, 1997. That date was later  
8 changed to April 1, 1997, after the Department discovered Propeller had been billing "sales tax" to  
9 petitioner and had representatives soliciting sales in California during the 2Q97. Although petitioner  
10 did pay to Propeller the amounts billed as "sales tax" on invoices during the 2Q97, neither petitioner  
11 nor Propeller has reported tax on the transactions at issue to the Board. In order to protect the state, the  
12 Department has asserted tax for those transactions against both Propeller and petitioner.

13         Petitioner contends that it is not liable for use tax on these transactions because petitioner did  
14 not issue a resale certificate to Propeller and the applicable tax is sales tax because: 1) Propeller's sales  
15 invoices show "sales tax" as a line item; 2) Propeller's sales invoices are labeled as drop shipments,  
16 which implies that the vendor supplying the property is located in California; 3) the requisition and  
17 purchase order numbers indicated on Propeller's sales invoices do not correspond to petitioner's  
18 purchase order numbers, which petitioner regards as an indication that the property sold was drop-  
19 shipped to petitioner; and 4) there are indications that none of the equipment petitioner purchased from  
20 Propeller was manufactured by Propeller. Further, petitioner asserts that the Department should bear  
21 the burden of proving that the transactions in question are use tax transactions. Petitioner also  
22 contends that, if use tax were applicable, it should be relieved from liability for that tax because it has  
23 valid receipts for payment of tax (Propeller's sales invoices).

24         We conclude that use tax is the applicable tax, and petitioner is liable for that use tax. Even if  
25 products sold by Propeller were drop shipped by vendors to petitioner, the available evidence does not  
26 show that any such drop shipments originated from locations in California. Accordingly, the evidence  
27 does not show that sales tax is applicable. We recognize that Propeller's sales invoices did include a  
28 line item for "sales tax," but mere terminology on sales invoices obviously does not determine whether

1 sales tax or use tax applies. Propeller's sales invoices are not valid receipts for payment of use tax  
2 because they do not include the number of the Propeller's permit to engage in business as a seller or  
3 the retailer's Certificate of Registration - Use Tax. (Cal. Code Regs., tit. 18, § 1686, subd. (a)(2).)  
4 Accordingly, petitioner is not relieved from liability for the use tax it owes with respect to these  
5 purchases (Rev. & Tax. Code, § 6202), and remains liable for use tax on the purchases in question.  
6 However, although petitioner's payments of amounts as "sales tax" to Propeller do not relieve  
7 petitioner of liability for tax, we believe those payments justify the Department's attempts to collect  
8 the tax due in connection with sales by Propeller to petitioner from Propeller. Accordingly, the D&R  
9 recommends that the Department withhold collection action against petitioner until Propeller's appeal  
10 is final, and if our recommendation in that appeal is sustained, pursue collection actions against  
11 petitioner only to the extent that collection efforts against Propeller are not successful.

12 **Issue 4:** Whether petitioner was negligent. We conclude that it was, and the negligence penalty  
13 was properly applied.

14 The Department added a ten percent penalty for negligence because petitioner made no effort to  
15 report use tax on purchases of tangible property that it consumed even though previous audits had  
16 resulted in use tax assessments, and petitioner's records were incomplete and inconsistent. The  
17 Department concluded that petitioner had not made good faith attempts to comply with California sales  
18 and use tax reporting requirements. Petitioner protests the negligence penalty on the basis that the use  
19 tax liability disclosed by audit is minor in comparison to the amount of tax petitioner reported on  
20 returns. Petitioner states that the audited measure subject to use tax is only 4.5 percent of reported  
21 taxable measure, including purchases from Propeller, and 3 percent without them (we calculate slightly  
22 higher percentages). . Petitioner admits that during the audit period it did not have the ability in its  
23 accounting system to properly accrue use tax, but asserts that this occurred because the business was  
24 growing rapidly and its personnel and resources were constrained. Further, petitioner states that during  
25 1999, after the appealed audit period, it took corrective action by installing systems to accrue use tax.  
26 Petitioner also disputes the Department's description of its records as inconsistent and incomplete,  
27 stating the liability would be much greater if that were true. Moreover, petitioner asserts that the  
28 majority of the audit adjustments are attributable to differences between petitioner's and the

1 Department's legal interpretation of certain transactions, and are not due to a lack of information or  
2 missing documents.

3 We note that petitioner was alerted to the requirement to report use tax by at least two previous  
4 Board audits and by numerous *Tax Information Bulletins* it received from the Board, but petitioner still  
5 reported *no* use tax during the entire audit period on its taxable purchases of fixed assets and other  
6 items for consumption. Furthermore, petitioner's records were deficient because several untaxed sales  
7 were not adequately documented. Petitioner's failure to accrue and report its use tax liability, its  
8 failure to properly document claimed nontaxable sales, and its failure to maintain the records necessary  
9 to determine its correct tax liability, resulted in an overall understatement of \$47,840,742, which  
10 represents 7.3 percent of reported taxable measure of \$651,295,777. For all these reasons, we  
11 conclude that petitioner was negligent and that the penalty was properly applied.

12 **Issue 5:** Whether relief of interest is warranted. We find there is no basis for relief.

13 Petitioner requests relief of the interest that accrued while this appeal was pending. The Notice  
14 of Determination in this matter was issued on April 1, 2003. Subsequently, petitioner filed a timely  
15 petition for redetermination, and the first appeals conference was held on February 18, 2004.  
16 Petitioner asserts the Board should grant relief due to its own avoidable delays and asserts the delays in  
17 the case have been caused by the substitution of two appeals attorneys, the need for at least three  
18 separate appeals conferences due to personnel turnover in the Board's Appeals Division, and the fact  
19 that none of the foregoing is attributable to petitioner's acts. Petitioner first contends that relief can be  
20 granted under Revenue and Taxation Code section 6593.5. Alternatively, petitioner contends that,  
21 even if section 6593.5 does not apply, relief of interest should be allowed under the general principles  
22 of equitable estoppel. Further, petitioner contends that relief of interest which accrued after the first  
23 appeals conference is warranted under Revenue and Taxation Code section 6596.

24 Section 6593.5 allows the Board to grant relief of interest if specified conditions are satisfied,  
25 but *only* as to interest accrued on tax liabilities arising during taxable periods commencing on and after  
26 July 1, 1999. Petitioner asserts there is a latent ambiguity in section 6593.5, and the section should be  
27 interpreted as enabling the Board to grant relief from interest accruing on and after July 1, 1999, as to  
28 liabilities arising in any period. Petitioner is mistaken: section 6593.5 is very clear on this point. Since

1 the entire audit period is prior to July 1, 1999, the Board has no authority to grant relief of interest  
2 pursuant to section 6593.5. Further, even if we did have discretion to consider relief of interest in this  
3 case, we find that significant aspects of the delays at the appeals level are attributable to acts of, or  
4 failures to act by, petitioner.<sup>4</sup> Many of the delays are attributable to the lengthy periods of time it took  
5 for petitioner's staff to recover records and other evidence. Also, petitioner requested several delays,  
6 and, on at least two occasions, the Appeals Division offered to issue a D&R based on a review of the  
7 petition file, but instead petitioner requested additional conferences. Furthermore, this is a complex  
8 case which required substantial, time-consuming efforts by all involved parties. Even if relief of  
9 interest under section 6593.5 were available in this mater, we would recommend no such relief because  
10 the parties were working on this case during the entire time that it was under the Appeals Division's  
11 jurisdiction, without substantial unreasonable delays under the circumstances.

12 With respect to petitioner's contention that relief from the interest should be allowed under the  
13 general principles of equitable estoppel, we find that equitable estoppel is simply not applicable under  
14 these circumstances. For example, one requirement is that the person seeking relief under equitable  
15 estoppel must be ignorant of the facts. Petitioner was certainly not ignorant of the facts relevant to its  
16 claim of equitable estoppel. Furthermore, a person seeking relief under equitable estoppel must show  
17 that the application of estoppel is necessary to prevent manifest injustice, and that it ignorantly relied  
18 on actions of the other party, as intended by that party, and that such reliance led to the injury for  
19 which relief is sought. Here, petitioner certainly cannot show any injury in connection with interest  
20 accruing on portions of the liability it concedes. Any interest that accrued did so because petitioner  
21 had use of the funds rather than remitting such funds to the Board. That is, petitioner had the ability to  
22 use those funds to earn interest, and certainly cannot show that the interest it owes the Board for  
23 having retained those funds for its own use has resulted in an injury constituting a manifest injustice.  
24 We note also that the parties were working on this appeal during the entire time that it was under the  
25 Appeals Division's jurisdiction.

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28 <sup>4</sup> A chronology of the events that occurred during the course of this appeal is attached as exhibit 4 of the D&R.



1 25, 2003, or enter into an installment payment agreement. Petitioner has not shown that its failure to  
2 do so was due to reasonable cause and circumstances beyond its control. Accordingly, we find there is  
3 no basis upon which to recommend relief of the amnesty interest penalty.

4 **OTHER DEVELOPMENTS**

5 None.

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7 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III  
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**Statistical Sample –Sales for Resale**  
**Evaluation of Results of Combined Samples for Strata 1 and 2**

Confidence level	80%
Confidence interval	6.4386%
Total number of items in the population	14,263 in stratum 1 6,161 in stratum 2
Number of items randomly selected for the test	450 each, strata 1 and 2
Number of errors found	29 in stratum 1 18 in stratum 2
Whether stratification was used, and if so what was stratified	Stratum 1: \$0.01 - \$4,999.99 Stratum 2: \$5,000.00 - \$49,999.99 Stratum 3: \$50,000 or more, reviewed on an actual basis
Average dollar value of population	\$ 1,127 – stratum 1 \$13,033 – stratum 2
Dollar value of remaining errors	\$ 22,157 – stratum 1 \$207,911 – stratum 2
Dollar value of sample	\$ 523,242 – stratum 1 \$5,751,408 – stratum 2
Percentage of error	4.235% - stratum 1 3.615% - stratum 2
Were XYZ letters sent	Yes
Number of XYZ letters sent	Unknown*
Percentage of XYZ letters sent in relation to number of questioned items	Unknown*
Number of responses to XYZ letters received	Unknown**
Percentage of responses to XYZ letters received in relation to the number of XYZ letters sent	Unknown**
Number of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	Unknown**
Percentage of responses to XYZ letters received accepted as proof of valid exempt/nontaxable sales	Unknown**
Number of responses to XYZ letters treated as taxable	1
Percentage of responses to XYZ letters treated as taxable	Unknown**

\* The audit did not list or indicate the number of XYZ letters sent to petitioner’s customers.

\*\* The audit did not list or indicate the number of responses to XYZ letters received.

**Statistical Sample – Purchases Subject to Use Tax**  
**Evaluation of Results of Combined Samples for Strata 1, 2, and 3**

Transactions Examined	Paid bills
Confidence level	80%
Confidence interval	14.4634%
Total number of items in the population	32,778 – stratum 1 25,705 – stratum 2 8,077 – stratum 3
Number of items randomly selected for the test	700 – stratum 1 600 – stratum 2 500 – stratum 3
Number of errors found	34 – stratum 1 34 – stratum 2 26 – stratum 3
Whether stratification was used, and if so what was stratified	Stratum 1 – \$0.01 - \$999.99 Stratum 2 - \$1,000 - \$9,999.99 Stratum 3 - \$10,000 - \$99,999.99
Average dollar value of population	\$ 385 – stratum 1 \$ 3,442 – stratum 2 \$27,982 – stratum 3
Dollar value of remaining errors	\$ 13,921 – stratum 1 \$ 99,994 – stratum 2 \$437,187 – stratum 3
Dollar value of sample	\$ 279,013 – stratum 1 \$ 2,006,406 – stratum 2 \$13,933,098 – stratum 3
Percentage of error	4.989% – stratum 1 4.984% – stratum 2 3.138% - stratum 3