

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 STEFANO JEAN LOUIGI RASPI) Account Number SR AS 100-366424
 6) Case ID 309546
 7 Petitioner) Beverly Hills, Los Angeles County

8 Type of Business: Retailer of artwork designs

9 Audit period: 1/1/02 – 4/15/04

10 Item Disputed Amount

11 Unreported taxable sales \$1,276,520
 12 Bad debts \$ 25,063

	<u>Tax</u>	<u>Penalties</u>
13 As determined	\$129,414.69	\$17,269.61
14 Pre-D&R adjustment	- 35,730.36	<u>-17,269.61</u>
15 Post-D&R adjustment	- 2,803.66	
16 Proposed redetermination, protested	<u>\$ 90,880.67</u>	<u>\$ 0.00</u>
17 Proposed tax redetermination	\$ 90,880.67	
18 Interest through 4/30/12	<u>46,592.13</u>	
19 Total tax and interest	\$137,472.80	
20 Payments	<u>- 23,732.81</u>	
21 Balance Due	<u>\$113,739.99</u>	
22 Monthly interest beginning 5/1/12	<u>\$391.70</u>	

21 UNRESOLVED ISSUES

22 **Issue 1:** Whether further adjustments to the unreported taxable sales are warranted. We find no
 23 further adjustments are warranted.

24 Petitioner sold artwork designs to textile and garment manufacturers who used them as printing
 25 aids. The third-party artwork designers shipped the designs on CDs to petitioner or to the purchasers.
 26 Petitioner started this business in January 2002 but did not obtain a seller's permit until March 2004.
 27 He incorporated the business, SR European Design, Inc., on April 16, 2004, and applied for a seller's
 28

1 permit for SR European effective July 1, 2003. However, he only filed a second quarter 2004 tax
2 return for this account, but later filed returns for 2002 under the amnesty program.

3 The Department accepted petitioner's recorded total sales of \$1,590,989 for the audit period
4 and conducted a statistical sample test during which XYZ letters were sent to the purchasers of 415
5 randomly selected sales invoices out of 1,792 transactions. It determined that over 98 percent of
6 petitioner's sales were taxable retail sales. Petitioner stated that he made interstate commerce sales,
7 and sales over the Internet in which he transmitted designs via electronic mail without transferring any
8 tangible personal property. Thus, the Department allowed \$114,278 as exempt sales in interstate
9 commerce (which is 10 percent of recorded total sales, net of the 2002 and 2003 allowable bad debts)
10 and the same amount, \$114,278, for nontaxable design sales transmitted electronically, which reduced
11 sales to \$1,300,979, and it then applied the 98 percent taxable ratio to establish taxable retail sales.

12 Petitioner contends that the audit period should be January 1, 2002, through June 30, 2003, that
13 the audit should be conducted on an actual basis, that some of the XYZ responses indicated that the
14 artwork was purchased for resale, and that some of the transactions involve interstate commerce sales
15 and electronically transmitted designs. More specifically, petitioner contends that total sales for the
16 audit period were \$997,725, nontaxable sales for resale and exempt sales in interstate commerce were
17 \$772,649, and taxable sales were \$225,076.

18 We find that petitioner operated the business as a sole proprietor through April 15, 2004, since
19 the successor entity, SR European, did not exist until April 16, 2004. Petitioner has not shown that the
20 audit test is flawed or the sample is unrepresentative, nor has petition submitted documentation from
21 which a more accurate determination may be made. The statistical sample evaluation indicates that the
22 errors found in the audit test are representative of the errors in the population. We find that petitioner
23 had not shown that the audit conducted by the Department should be rejected in favor of an actual
24 basis examination. Regarding the XYZ responses, the Department allowed the transactions as sales for
25 resale when they were supported by the XYZ responses, and when the information gathered in follow-
26 up telephone calls corroborated the XYZ responses. The remaining XYZ responses do not establish
27 that the physical media containing the artwork was actually resold to a purchaser who physically
28 incorporated the media into the garment or textile being manufactured for sale or that the purchaser

1 otherwise resold it prior to use. Rather, information from petitioner himself shows that his customers
2 purchased the tangible personal property with the designs from petitioner for use in producing
3 garments and textiles and not for the purpose of incorporating the tangible personal property acquired
4 from petitioner into the garment or textile to be sold. We thus find that the subject sales were not sales
5 for resale but were taxable sales of manufacturing aids to textile manufacturers. Regarding other
6 claimed nontaxable sales, petitioner has not shown that his exempt sales in interstate commerce or his
7 nontaxable sales of electronically delivered designs were greater than the amounts allowed by the
8 Department.

9 **Issue 2:** Whether petitioner has established that further adjustments for unclaimed bad debts
10 are warranted. We conclude no further adjustments are warranted.

11 The Department accepted as allowable bad debts the \$140,899 difference between sales
12 recorded in petitioner's sales journal and the sales reported on his 2002 and 2003 federal income tax
13 returns, and an additional \$33,974 for the first three and one-half months in 2004, even though
14 petitioner provided the supporting documentation required by California Code of Regulations, section
15 1642, subdivision (e) for only \$5,145 of the claimed amounts. Petitioner asserts he is entitled to an
16 additional bad debt allowance of \$25,063. We find that the Department has been generous in allowing
17 a bad debt allowance greater than the \$5,145 supported by petitioner, and that petitioner is certainly not
18 entitled to any greater amount than the Department has already allowed.

19 **Issue 3:** Whether petitioner is entitled to an adjustment for his sales made in the second quarter
20 of 2004 by an amount that was allegedly reported by SR European. We find that he is not.

21 On August 30, 2004, petitioner filed his only return for this account for the second quarter
22 2004, reporting total sales of \$78,580, nontaxable transactions of \$68,677, and taxable sales of \$9,903.
23 On that same date, SR European filed a return for the fiscal year July 1, 2003, through June 30, 2004,
24 reporting total sales of \$64,735, nontaxable transactions of \$51,099, and taxable sales of \$13,636. On
25 November 30, 2004, SR European filed an additional return for the second quarter 2004, reporting total
26 sales of \$133,837, nontaxable transactions of \$100,762, and taxable sales of \$33,075. Petitioner
27 contends that SR European's return for the fiscal year July 1, 2003, through June 30, 2004, included
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1 taxable sales made by petitioner for periods through April 15, 2004, and thus petitioner is entitled to an
2 adjustment for the taxable sales reported by SR European.

3 We conclude no adjustment is warranted. Petitioner has not provided any records that identify
4 which of his sales were reported by SR European. For the January 1, 2002, through April 15, 2004
5 audit period, the Department calculated that petitioner made average quarterly taxable sales of
6 \$127,000. However, SR European reported a combined \$46,711 in taxable sales on the two tax returns
7 covering the second quarter 2004, substantially lower than petitioner's \$127,000 audited average
8 taxable sales per quarter. Based on this comparison, we find that the taxable sales reported by SR
9 European did not include any taxable sales made by petitioner through April 15, 2004.

10 **RESOLVED ISSUE**

11 We agree with the Department's recommendation to relieve petitioner of the failure-to-file
12 penalty of \$12,090.78 and the amnesty double failure-to-file penalty of \$5,178.83.

13 **OTHER MATTERS**

14 None.

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16 Summary prepared by Pete Lee, Business Taxes Specialist II
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Statistical Sample

Transactions Examined	Sales for resale
Confidence level	80%
Confidence interval	43.4241
Total number of items in the population	1,792
Number of items randomly selected for the test	415
Number of errors found	384
Whether stratification was used, and if so what was stratified	No stratification
Average dollar value of population	\$829.39
Dollar value of remaining errors	\$335,794
Dollar value of sample	\$342,239
Percentage of error	98.12%
Were XYZ letters sent	yes
Number of XYZ letters sent	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**

* The audit did not list or indicate the number of XYZ letters sent to petitioner’s purchasers, and, while we know that XYZ letters were sent regarding 415 transactions, it is not clear whether more than one sale had been made to any one purchaser.

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