

1 Subsequently, petitioner Sana Sadeddin contacted BPD and indicated she would like to have an oral
2 hearing before the Board.

3 The Sales and Use Tax Department (Department) concurrently audited the records of both
4 petitioners because their records were commingled. Ms. Sadeddin, who was the wife of Mr. Abdul
5 Jawad, president of The Auto Store of Merced, Inc. (ASMI), did not obtain a Department of Motor
6 Vehicle (DMV) dealer license for her location. Instead, she sent records of her sales to DMV on
7 reports of sale (ROS) that had been issued to ASMI. Additionally, the Department was uncertain of
8 the true ownership of Ms. Sadeddin's business operations and thus issued a dual determination against
9 ASMI for the same liability apparently incurred by Ms. Sadeddin (less a payment of \$1,152.00 applied
10 to that liability before the determination was issued to ASMI).

11 UNRESOLVED ISSUES

12 **Issue 1:** Whether adjustments are warranted to the unreported taxable sales. We recommend
13 no adjustment.

14 During the audit, petitioners informed the Department they had hired a new accountant in the
15 fall of 2005. Petitioners indicated that the prior accountant was unwilling to release financial
16 information or records to them or to the new accountant. The Department asked petitioners to
17 reconstruct their sales records for the entire audit period for each location, and petitioners did so.

18 The Department's analysis of the records and the ROS issued to petitioners disclosed that there
19 was no understatement of taxable sales for the period from the fourth quarter 2002 (4Q02) through
20 3Q03 and that the database provided for the period 4Q03 through 2Q06 was relatively complete. Since
21 the Department concluded that the amounts of sales tax reimbursement petitioners charged on their
22 contracts were substantially accurate, it decided to conduct the audits based on a reconciliation of
23 accrued and reported sales tax. The Department compared recorded amounts of sales tax
24 reimbursement from the reconstructed records with reported sales tax and found that ASMI and
25 Ms. Sadeddin understated their reported tax liability by \$332,277 and \$34,280, measured by
26 \$4,497,958 and \$462,923, respectively.

27 Petitioners contend that the reconstructed sales database contains duplications, and that all sales
28 of vehicles with the same VIN, except the last sale in the series, represent unwinds or rollbacks.

1 Petitioners state that DMV ROS were prepared for each transaction and that sales sometimes were
2 canceled after the DMV ROS were prepared. Petitioners assert that adjustments of approximately
3 \$700,000 are warranted for these uncompleted sales.

4 The Department indicated it was not aware of any duplicate sales in the reconstructed records,
5 and it asked petitioners to identify any sales for which the very same vehicle was resold within a month
6 or two after a prior sale and to provide records showing the vehicle was in fact returned to inventory
7 and resold. Although we allowed 30 days from the conference date to provide the requested
8 information, petitioners have not provided any evidence supporting the claimed duplicate sales.

9 We also have examined the audit workpapers and found no obvious duplications or other
10 inherent errors in the audit methodology or in the audit computations. In the absence of evidence to
11 support petitioners' contentions, we conclude that no adjustment is warranted.

12 **Issue 2:** Whether adjustments are warranted to the audited amount of bad debts. We
13 recommend no adjustment.

14 The Department found that petitioners had maintained loss reserve accounts with finance
15 companies, had recorded bad debts related to dealer-financed transactions, and had claimed bad debts
16 on income tax returns with respect to bad debts for which they had not claimed deductions on sales and
17 use tax returns. Based on its analysis of recorded repossession losses for 62 transactions, the
18 Department computed that the percentage of recorded losses related to taxable sales was 89.72 percent.
19 The Department applied this percentage to the amounts charged against the reserve loss account and to
20 recorded losses related to dealer-financed transactions and established allowable bad debt deductions
21 for ASMI and Ms. Sadeddin of \$1,739,592 and \$64,685, respectively.

22 Petitioners contend that the amounts of bad debts allowed should be increased. Petitioners
23 claim they sold contracts to financial institutions at a 10 to 15 percent discount, and these discounts,
24 which were separate from the reserve amounts, should be included as additional bad debts because
25 they were never received by petitioners. The Department responds that the discount amounts are a cost
26 of doing business for financing transactions that are paid in full and are not deductible. However, the
27 Department opined at the conference that, for defaulted financing transactions, petitioners may be
28 entitled to include the discount amounts in the bad debt computation. Although we allowed petitioners

1 30 days from the conference date to provide us with evidence of discounts related to sales for which
2 the purchasers defaulted on the financing contracts, they have not done so. In any event, the D&R
3 concludes that discounts allowed when petitioners sold contracts to financial institutions, which are
4 separate from the reserve amounts specified in the recourse contracts, are more in the nature of interest
5 on a loan. On that basis, the D&R finds that those discounts are not allowable as a bad debt deduction
6 regardless of whether the purchasers completed their payments or defaulted on their loans.
7 Accordingly, we conclude that no adjustment is warranted to the amount of unclaimed bad debts the
8 Department has already allowed.

9 **Issue 3:** Whether petitioners were negligent. We conclude that they were.

10 The Department asserted penalties for negligence because of the large understatements found in
11 petitioners' audits. The Department noted that, although ASMI hired several accountants and
12 converted to a software accounting system which resulted in accurate reporting of sales for the early
13 part of the audit period (4Q02 through the 3Q03), petitioners did not provide worksheets to support the
14 amounts reported on sales and use tax returns for ASMI and Ms. Sadeddin. Also, since the records for
15 the two petitioners were commingled, it was difficult for them to correctly report sales made under the
16 individual permits.

17 Petitioners dispute the negligence penalties on the basis that they hired and relied on CPA firms
18 to maintain their records and prepare financial statements. Also, they assert that the lack of records is
19 the result of the prior accountant's refusal to produce summary records.

20 As previously noted, summary records were not initially available for audit, and there were no
21 sales tax worksheets to support the reported amounts. Petitioners subsequently provided reconstructed
22 sales records from a download of the accounting software, and the understatement is based on a
23 reconciliation of the sales tax accrual account in those reconstructed records and reported sales tax.
24 Although petitioners allege that the audit deficiencies include \$700,000 in duplicate sales, they have
25 not provided supporting documentation. Further, even if that adjustment were supported, it would not
26 fully explain the audited understatements of taxable sales of \$4,497,958 for ASMI and \$462,923 for
27 Ms. Sadeddin. Accordingly, the available records support a finding that petitioners' reported taxable
28 sales were substantially less than recorded amounts. Additionally, petitioners recorded substantial

1 amounts of bad debt losses, but they neglected to claim deductions for the amounts to which they were
2 entitled. We find that the significant differences between recorded and reported taxable sales and the
3 failure to claim bad debt deductions are evidence that petitioners did not exercise due care in reporting.

4 With respect to their argument that they were not negligent because they relied on accountants,
5 we note that taxpayers are ultimately responsible for recording, reporting and paying their proper tax
6 liability. That petitioners hired and relied on CPA firms to maintain their records and prepare financial
7 statements does not absolve them of that responsibility. Petitioners were responsible for ensuring that
8 their CPA's received the correct sales amounts to report on the tax returns, and the evidence suggests
9 that they did not do so.

10 Finally, we note that the errors identified in this audit are the same types of errors found in a
11 prior audit of ASMI. Although the percentage of error was approximately 47 percent in the prior audit
12 and 11 percent in the current audit, which is an improvement, the dollar amount is still substantial and
13 the repeated audit error is additional evidence of negligence.

14 For all these reasons, we conclude that petitioners were negligent and the negligence penalty
15 was properly imposed.

16 **OTHER DEVELOPMENTS**

17 None.

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