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:	
SUNKIST ENTERPRISES CORP., dba Goodyear Tire Center	Account Number: SR CH 19-753280 Case ID 469916
Petitioner	Burlingame, San Mateo County

Type of Business: Tire and auto center

Audit period: 07/01/05 – 06/30/06

Item	Disputed Amount
Unreported sales	$136,122
Negligence penalty	$ 1,123

	Tax	Penalty
As determined and protested:	$11,230.08	$1,123.02

Proposed tax redetermination	$11,230.08
Interest through 12/31/10	4,383.95
Negligence penalty	1,123.02
Total tax, interest, and penalty	$16,737.05
Payments	- 10,706.79
Balance Due	$ 6,030.26
Monthly interest beginning 1/1/11	$ 3.05

UNRESOLVED ISSUES

Issue 1: Whether petitioner is liable for the determined tax. We find it is.

Petitioner, a corporation, was issued seller's permit number SR CH 19-753280 in August 1989, for the operation of a Goodyear Tire Center. Mr. Syed Ali Husain was identified in the seller's permit application as petitioner's president. At Mr. Husain's request, this seller's permit was closed effective June 30, 2006, and petitioner obtained a new seller's permit to operate a similar business at the same business location, beginning July 1, 2006.

The Sales and Use Tax Department (Department) conducted an audit of petitioner in which it found a difference between recorded and reported taxable sales of $136,122. Petitioner does not dispute the amount of the audited understatement. Instead, petitioner contends that, for the period

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covered by the audit, it was not operating the Goodyear Tire Center because the tire center had been transferred to Irfan Mahmood prior to the audit period. At the appeals conference, Mr. Husain stated that, around 1997, he "walked away" from the Goodyear Tire Center, and that Mr. Mahmood, his nephew and an employee of the tire center, took over the business operations. Mr. Husain states that he was not involved in the operations of the business again until 2006.

The Board's records show that a seller's permit was issued to Irfan Automotive, Inc. to operate a Goodyear center at the same address where petitioner's business was located. That seller's permit was opened August 8, 1997, with a start date of July 1, 1997, and was closed on July 16, 1998, effective July 1, 1997, with a notation that it "did not operate." The fact that Irfan Automotive applied for a seller's permit indicates that it may have contemplated acquiring the business from petitioner. However, there is no other evidence of an actual or intended transfer of ownership. Further, petitioner did not close its seller's permit or otherwise report a change of ownership of the business until after the audit period.

Since there is some evidence that Mr. Mahmood was involved in the management of the business before the alleged transfer, it is not entirely clear whether there was a complete change of management when Mr. Husain states he made an "informal family transfer" of the business. However, the question of who managed the business is not the salient point. Petitioner is a corporation. Any internal changes in the management of the business do not affect petitioner's liability for the determined tax. We find that, although the management of the business apparently was substantially transferred from Mr. Husain to Mr. Mahmood before the audit period, ownership of the business remained with petitioner, and petitioner remains responsible for the audited tax liability. Consequently, we recommend no adjustment.

Issue 2: Whether petitioner was negligent. We find that it was.

The Department applied the negligence penalty because petitioner's recorded taxable sales of $307,187 exceeded its reported taxable sales of $171,065 by $136,122. Thus, petitioner reported only 56 percent ($171,065 ÷ $307,187) of its *recorded* taxable sales. Petitioner disputes the penalty on the basis that the understatement was the result of misconduct of its manager, Mr. Mahmood. Petitioner also notes that, after Mr. Husain regained control of the business, the returns filed for the first and second quarters of 2006 resulted in no audit liability.

It appears to be undisputed that Mr. Mahmood and his associate, Mr. Jabbar, did not exercise due care in reporting and thus were negligent, at a minimum. The amounts of recorded taxable sales were clear, the understatement represented almost half of those recorded amounts, and no non-negligent explanation of that error has been provided. The question, however, is whether the negligence of those individuals, who were agents or employees of petitioner, should be deemed negligence of petitioner. Generally, where an agent or employee of a taxpayer is guilty of negligence, with a resulting tax deficiency, the 10-percent penalty will still apply, even though the agent or employee acted without the taxpayer's knowledge or consent, or acted contrary to the express instructions of the taxpayer. However, situations may be encountered where the taxpayer has been defrauded by the employee, and as a result did not benefit from the understatement of tax. In such cases, whether the negligence penalty is imposed will depend upon whether circumstances made it difficult of impossible for the taxpayer to detect such fraud. (Sales and use Tax Audit Manual, § 0506.20.) In this case, Mr. Husain has stated that the understatement was not readily apparent because Mr. Mahmood kept a second set of books. As a result, petitioner alleges that it was defrauded by its employees. Even if we assume this to be true, there is no evidence that petitioner took any steps to monitor the activities of Mr. Mahmood and Mr. Jabbar. In fact, it appears likely that the mismanagement would have continued unabated if an employee had not contacted Mr. Husain directly. We find it likely that underreporting at this level would have been obvious if petitioner had made any effort to supervise the activities of Mr. Mahmood and Mr. Jabbar. Accordingly, we find that petitioner was negligent, and the negligence penalty was properly imposed.

OTHER DEVELOPMENTS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III