

CALIFORNIA 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:)
TRI-SIGNAL INTEGRATION, INC.) Account Number SR S AC 97-311287
Petitioner) Case ID 384478
Sylmar, Los Angeles County

Type of Business: Electrical sub-contractor

Audit period: 01/01/03 – 06/30/06

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Negligence penalty	\$106,006		
Failure-to-file penalty	\$ 15,934		
Relief of interest	unstated		
As determined and proposed to be redetermined		\$1,219,407.16	\$121,940.68
Less concurred		- 1,219,407.16	<u>00.00</u>
Balance, protested		<u>\$ 00.00</u>	<u>\$121,940.68</u>
Proposed tax redetermination		\$1,219,407.16	
Interest through 02/28/13		830,461.93	
Negligence penalty		106,006.29	
Failure-to-file penalty		<u>15,934.39</u>	
Total tax, interest, and penalty		\$2,171,809.77	
Payments		- 11,295.00	
Balance Due		<u>\$2,160,514.77</u>	
Monthly interest beginning 03/01/13		<u>\$ 6,040.56</u>	

This is an appeal that is covered by Revenue and Taxation Code section (Section) 40. Therefore, after the Board has made a determination in this matter, a written opinion that, among other things, sets forth the relevant factual findings and the legal analysis on which that determination is based must be published on the Board's website within 120 days from the date the Board renders a final decision in this matter. Accordingly, the Board may wish to consider the following two options:

- (A) The Board could follow its usual practice in business tax appeals, in which it typically votes to resolve the appeal on the day of the hearing. Under the usual practice, a notice of the Board's determination will be mailed within 45 days of the date of the Board's vote, and the 30-day period for the filing of a Petition for Rehearing (PFR) would begin on the date the

1 notice is mailed. If a PFR is not filed, the Board's determination will become final and its
2 decision will be rendered at the expiration of the 30-day PFR period. Unless the Board
3 specifically directs that it desires to issue a precedential (Memorandum Opinion) decision in
4 this matter, staff would then expeditiously bring back a proposed (nonprecedential) Summary
5 Decision that complies with Section 40 for the Board's approval on a later calendar. The
6 adopted decision will be published timely on the Board's website. If a PFR is filed, no decision
7 will be rendered until the conclusion of the petition for rehearing process.

8 (B) The Board could inform staff of its tentative determination and direct staff to prepare a
9 proposed Summary Decision (or Memorandum Opinion) that reflects the tentative
10 determination for Board approval as soon as practicable. Under this option, the Board would
11 hold any determination of the appeal in abeyance until it has the opportunity to consider the
12 proposed decision. The Board's later vote to adopt the decision would also constitute its vote
13 to resolve the appeal, and within 45 days a notice of decision would be mailed. The 30-day
14 PFR period would begin running when the notice of the Board's determination was mailed. If
15 no PFR is filed, the Summary Decision (or Memorandum Opinion) would then be timely
16 posted on the Board's website pursuant to Section 40.

17 We also note that petitioner could request during the oral hearing that the Board take Option B
18 above and defer its vote to determine the appeal until it adopts a Summary Decision (or Memorandum
19 Opinion). Such a request would, of course, defer resolution of the appeal and interest would continue
20 to accrue. On the other hand, petitioner may prefer that the Board follow its usual practice in business
21 tax appeals, which typically would result in a vote to resolve the appeal on the day of the hearing, thus
22 accelerating the resolution process, but potentially requiring petitioner to file a PFR before it sees the
23 content of the Summary Decision (or Memorandum Opinion) adopted by the Board.

24 UNRESOLVED ISSUES

25 **Issue 1:** Whether petitioner was negligent. We conclude that it was.

26 Petitioner is an electrical construction sub-contractor who enters into both lump sum and time-
27 and-material contracts and makes some retail sales. The Sales and Use Tax Department (Department)
28 found that petitioner purchased most materials and fixtures ex-tax from out-of-state vendors or from
California vendors to whom petitioner issued resale certificates. The Department also noted that
petitioner excluded lump-sum construction contracts from reported sales and did not report any
purchases subject to use tax on its sales and use tax returns prior to the second quarter 2006 (2Q06).
Using a cost accountability test, the Department computed an unreported cost of materials and fixtures
furnished and installed on lump-sum contracts of \$15,577,450. The Department also found an

1 unreported cost of self-consumed soft drinks of \$6,050 and a difference between recorded and reported
2 taxable sales of \$168,289.

3 The Department imposed a negligence penalty because the understatement is substantial, noting
4 that petitioner purchased over 80 percent of materials and fixtures without paying tax and issued resale
5 certificates, most of which were signed by petitioner's Chief Financial Officer (CFO). The
6 Department found that petitioner, through its CFO, knew it was not paying tax on purchases of
7 materials and fixtures but nevertheless failed to report or pay tax measured by the sales price of
8 fixtures or the cost of materials purchased for lump-sum construction contracts. The Department also
9 asserts that petitioner had initially asserted (erroneously) that it paid tax or tax reimbursement with
10 respect to its purchases of materials and fixtures.¹

11 Petitioner disputes the penalty on the basis that it believed it had properly reported the measure
12 of tax based on the Department's prior examinations of its records. Petitioner states that most of the
13 current liability is use tax related to Internet purchases from out-of-state vendors, rather than sales tax,
14 and alleges that it was not adequately informed about the application of tax to construction contracts.
15 Petitioner also states that it only issued resale certificates to suppliers because the vendors required that
16 they do so. Thus, petitioner argues that any understatement was related to misunderstanding, rather
17 than negligence. In addition, petitioner notes that its use tax liability is not related to amounts
18 collected from customers that it failed to remit.

19 We understand petitioner's primary argument against negligence to be that it relied on findings
20 of the Department's two prior examinations of its records, pursuant to which it was not advised that it
21 was dramatically understating its reported taxable measure.² Based on our review of the assignment
22 contract history document in the Department's Field Billing Order workpapers related to the prior
23 examinations, we conclude that petitioner's cooperation with the Department during those
24 examinations was severely limited. Accordingly, we find petitioner had no basis to conclude that the

25 _____
26 ¹ One argument raised by the Department at the conference was that petitioner must have been aware of the application of
27 tax since it computed tax in its estimated bids. However, petitioner disputed that assertion in its Request for
28 Reconsideration, and we found that the Department did not provide sufficient evidence to support its assertion.
Accordingly, this we do not consider this argument in our analysis.

² Although petitioner does not argue that it is entitled to relief based on Revenue and Taxation Code section 6596, we
address that question in the D&R and conclude that there would be no basis for relief under section 6596.

1 Department had thoroughly reviewed its records and drawn substantive conclusions about the accuracy
2 of those records. We reject petitioner's assertion that it issued resale certificates only because vendors
3 required that it do so. The most basic element of a resale certificate is the purchaser's certification that
4 it is purchasing tangible personal property for resale. Moreover, the resale certificate itself states that
5 the person issuing the certificate is liable for tax if he or she makes a use of the property other than
6 holding it for resale. We find that, even if petitioner were not aware of the exact application of tax, it
7 knew or reasonably should have known that it had purchased materials and fixtures without payment
8 of tax or tax reimbursement and that it was liable for tax either as a seller or consumer of the property.
9 Thus, we find that petitioner's failure to pay the applicable tax was a result of its failure to act with due
10 care and to do what a reasonably prudent business person would have done in similar circumstances.
11 We find that the amount of understatement, over \$15 million in measure (more than \$1 million per
12 quarter), and representing an error rate of more than 1,000 percent, is additional evidence of
13 negligence. We find that the petitioner was negligent and the penalty was properly applied.

14 **Issue 2:** Whether relief of the failure to file penalties for 3Q05 and 4Q05 is warranted. We find
15 relief is not warranted.

16 Petitioner has requested relief of the failure-to-file penalties on the basis that, at the beginning
17 of the audit, the auditor informed petitioner it had been filing returns incorrectly and instructed
18 petitioner not to file returns for 1Q06 and 2Q06. Petitioner alleges that the auditor stated he would file
19 the returns and then explain the correct procedure to petitioner. We first note that petitioner refers to
20 returns for 1Q06 and 2Q06 while the returns at issue are 3Q05 and 4Q05. The specific quarters at
21 issue are particularly significant since the Department did not begin the audit until January 17, 2006,
22 well after the due date for the 3Q05 return (October 31, 2005). Moreover, the auditor states that he did
23 not say he would file the returns but instead asked petitioner to advise him if it filed returns for either
24 3Q05 or 4Q05 so he could account for the returns in the audit workpapers. Based on our review of the
25 record, we find there was some discussion regarding the filing of returns for 3Q05 and 4Q05.

26 However, based on our belief that it would not be proper for an auditor to make the statements alleged
27 by petitioner, and based on the actual evidence, we find petitioner's failure to file returns for 3Q05 and
28

1 4Q05 was not caused by the Department or by other reasonable cause or circumstances beyond
2 petitioner's control. Accordingly, we find there is no basis for relief of the failure-to-file penalty.

3 **Issue 3:** Whether relief of interest is warranted. We find no basis for relief.

4 Petitioner protests the assessment of interest, essentially repeating the arguments it raised in its
5 request for relief of the failure-to-file penalty. The law provides for relief of interest only under very
6 narrow circumstances, and the only circumstance that could conceivably apply here is that there was an
7 unreasonable error or delay by an employee of the Board that resulted in accrual of all or part of the
8 interest. Further, while petitioner has filed a statement under penalty of perjury, that statement was
9 only filed to request for relief of the failure-to-file penalty, and it does not address petitioner's grounds
10 for requesting relief of interest. The request includes no evidence of, or even any description of,
11 unreasonable error or delay by a Board employee. In the absence of a statement under penalty of
12 perjury setting for the basis for petitioner's request for relief of interest, we find that relief of interest is
13 not warranted.

14 **RESOLVED ISSUE**

15 In the petition for redetermination, petitioner protested the entire determination. At the appeals
16 conference, although petitioner expressed some uncertainty regarding the audited understatement of
17 reported taxable measure, it stated that it did not wish to dispute the understatement of taxable measure
18 at the conference. Therefore, at the conference petitioner disputed only the two penalties and the
19 interest. While petitioner stated at the conference that it wished to reserve its right to dispute the
20 understatement of reported taxable measure in the future, it has not done so in its request for
21 reconsideration or in any other correspondence. Accordingly, we find that there is no unresolved
22 dispute regarding the audited understatement of reported taxable measure.

23 **OTHER MATTERS**

24 None.

25
26 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
27
28