

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petitions for Redetermination)
4 Under the Sales and Use Tax Law of:)5 JASON H. WALKER and)
6 STEPHEN W. SUNDES,)
7 dba Walker Mattress)Account Number: SR EH 52-035819
Case ID's 445416, 462500

8 Petitioner)

Hemet, Riverside County

9 Type of Business: Mattress and furniture retailer

10 Audit period: 1/1/04 – 12/31/06

11 Item Disputed Amount

12 Unreported taxable sales \$3,188,447

13 Negligence penalty \$24,710

14 44541646250015 1/1/04 – 9/30/0510/1/05 – 12/31/0616 Tax PenaltyTax Penalty

17 As determined \$128,627.56 \$12,862.77 \$118,477.14 \$ 0.00

18 Adjustment – Sales and Use Tax Department 0.00 0.00 0.00 +11,847.7319 Proposed redetermination, protested \$128,627.56 \$12,862.77 \$118,477.14 \$11,847.73

20 Proposed tax redetermination \$128,627.56 \$118,477.14

21 Interest through 8/31/11 71,358.70 54,425.43

22 Negligence penalty 12,862.77 11,847.7323 Total tax, interest, and penalty \$212,849.03 \$184,750.0324 Monthly interest beginning 9/1/11 \$643.14 \$592.3925 A Notice of Appeals Conference was mailed to petitioner's address of record, and the notice
26 was not returned by the Post Office. Petitioner did not respond to the notice or appear at the appeals

27 conference, which was held as scheduled. We thereafter sent petitioner a letter offering it the

28 opportunity to provide any additional arguments and evidence in writing it wished us to consider.

Petitioner submitted a letter dated October 13, 2009. The Sales and Use Tax Department (Department)

submitted a memorandum in response. The Decision and Recommendation was prepared based on the

information in the Board's files, the presentation made by the Department at the conference, and the

parties' post-conference submissions.

1 taxable sales of \$1,111,088 or 41 percent ($\$3,798,964 - \$2,687,876 = \$1,111,088$; $\$1,111,088 \div$
2 $\$2,687,876 = 41$ percent). The Department also compared bank deposits, after excluding sales tax
3 reimbursement, with recorded taxable sales and found that net bank deposits exceeded recorded
4 taxable sales by \$268,409. Because of these discrepancies, the Department concluded that further
5 investigation was necessary. It decided to establish audited taxable sales on a markup basis.

6 The Department used shelf tests to calculate a markup of 105.84 percent for sales of mattresses
7 and a markup of 79.48 percent for sales of furniture. To establish the audited amount of merchandise
8 purchases, the Department contacted petitioner's vendors. The Department compiled mattress
9 purchases of \$1,627,895 and furniture purchases of \$1,407,107. Applying the markup to these
10 purchases, the Department computed audited taxable sales of mattresses of \$3,350,859 and audited
11 taxable sales of furniture of \$2,525,478, for total audited taxable sales of \$5,876,337. Since petitioner
12 reported taxable sales of \$2,687,876, this resulted in unreported taxable sales of \$3,188,461 (the
13 measure of the NOD was slightly less, \$3,188,447, because of rounding).

14 Petitioner argues that the amounts of unreported taxable sales are overstated. Petitioner states
15 that the business only sold mattresses, and another business, Cozy Home Furniture & Mattress (Cozy
16 Home) sold furniture. Petitioner states that it previously owned Cozy Home and subsequently
17 transferred it to an unrelated partnership. Petitioner asserts that purchases for Cozy Home had been
18 included with the audited purchases for the business under audit, Walker Mattress. Petitioner claims
19 that it had made "thousands and thousands of dollars" in purchases for the Cozy Home store using
20 Walker Mattress' seller's permit number, and thus, the audited purchases should be reduced for
21 purchases made for Cozy Home. Petitioner also contends that the deficiency is overstated because the
22 audited markups were too high, asserting that its profit on a mattress sale was approximately 43 to 44
23 percent. Petitioner asserts that the Department compared the sales price of a mattress/box spring set to
24 the cost of the mattress only, thus computing an excessive markup.¹

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27 ¹ Petitioner offers an example of a mattress/box spring set that sold for \$699.99. It states that the cost of the mattress and
28 box springs was \$390, and it computes a profit margin of 44.2 percent [$(\$699.99 - \$390) \div \$699.99$]. It asserts that the
Department used the cost of the mattress only, \$290, to compute a profit margin of 58.5 percent [$(\$699.99 - \$290) \div$
 $\$699.99$].

1 Regarding cost of goods sold, the Department noted that from July 1, 2003, through 2004,
2 audited purchases of furniture totaled \$352,925.² In 2005, after Cozy Home had been transferred to an
3 unrelated partnership, audited purchases of furniture for Walker Mattress did not decrease, as would be
4 expected if purchases for Cozy Home had been included with petitioner's purchases prior to 2005.
5 Instead, audited purchases of furniture for Walker Mattress increased substantially to \$588,325 for
6 2005, and \$581,179 for 2006, after petitioner no longer operated Cozy Home. Additionally, we
7 examined reports of purchases from petitioner's four vendors and noted that two did not sell to
8 petitioner before the transfer of Cozy Home to the unrelated partnership. The two other vendors
9 showed no decrease in petitioner's purchases of furniture after the transfer of Cozy Home to the
10 unrelated partnership. Finally, petitioner claimed that "thousands and thousands of dollars" in
11 purchases were made for Cozy Home using a resale certificate with the Walker Mattress seller's permit
12 number, but provided no documentation whatsoever to support that claim.

13 Regarding markup, we note that petitioner has computed a gross profit margin (gross profit ÷
14 sales price) rather than a markup (gross profit ÷ cost), so it starts the discussion with a comparison of
15 different figures. (The figures in its example results in a markup of 79.5 percent as compared to a
16 gross profit margin of 44.2 percent.) In any event, petitioner has not identified any particular
17 transactions for which the Department used the incorrect cost, and comparing the costs of mattresses
18 sold separately and in sets, we have not found the cost of any mattress/box spring set in the shelf test
19 that appears too low. Further, we have found no computation errors. Accordingly, we find no basis
20 for reducing the audited markups.

21 **Issue 2:** Whether petitioner was negligent. We conclude that it was.

22 Petitioner disputes the negligence penalty on the basis that any understatement was the result of
23 clerical reporting errors and a misunderstanding of the applicable laws and regulations.

24 Petitioner provided incomplete records, with recorded purchases understated by 58 percent.
25 The understatement of taxable sales was \$3,188,461, a 119 percent of error ($\$3,188,461 \div \$2,687,876$).

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28 ² Petitioner operated Cozy Home, seller's permit number SR EH 100-172481, from April 1, 2003, through July 14, 2004,
when the Cozy Home business was transferred to an unrelated partnership.

1 This understatement is substantial both in absolute value and in relation to reported figures. Even
2 more persuasive is the fact that petitioner had *recorded* taxable sales in excess of reported taxable sales
3 of \$1,111,088, which represented a percentage of error in reported taxable sales of 41 percent
4 ($\$1,111,088 \div \$2,687,876$). We find that the absence of adequate records, the significant amount of
5 understatement, and the fact that petitioner's reported taxable sales were significantly less than the
6 amounts *in petitioner's own records* are all evidence that petitioner did not exercise due care in
7 recording and reporting. We find that petitioner's explanation that the understatement was due to
8 clerical reporting errors and a misunderstanding of the applicable laws and regulations is without
9 merit, and that the penalties have been properly imposed.

10 **OTHER DEVELOPMENTS**

11 None.

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13 Summary prepared by Pete Lee, Business Taxes Specialist II
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MARKUP TABLE

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| Percentage of taxable vs. nontaxable purchases | 100 percent taxable |
| Mark-up percentages developed | 105.84% mattresses 79.48% furniture |
| Self-consumption allowed in dollars | \$0 |
| Self-consumption allowed as a percent of total purchases | 0% |
| Pilferage allowed in dollars | \$0 |
| Pilferage allowed as a percent of total purchases | 0% |