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: Y & S ENTERPRISES, Inc., dba Y & S Auto Body Shop Petitioner	Account Number: SR Y EA 14-775127 Case ID 492513 San Pedro, Los Angeles County

Type of Business: Auto body shop

Audit period: 10/01/04 – 12/31/07

Item	Disputed Amount
Understatement of reported taxable sales	$3,896,821
Negligence penalty	$ 38,609

	Tax	Penalty
As determined and proposed to be redetermined	$386,086.64	$38,608.70
Less concurred	- 64,598.75	00.00
Balance, protested	$321,487.89	$38,608.70

Proposed tax redetermination	$386,086.64
Interest through 10/31/13	214,482.94
Negligence penalty	38,608.70
Total tax, interest, and penalty	$639,178.28
Payments	- 35,845.58
Balance Due	$603,332.70
Monthly interest beginning 11/1/13	$ 1,751.21

This matter was scheduled for Board hearing in October 2011, but was deferred for settlement consideration. The hearing was rescheduled for July 2013, but was postponed at petitioner's request due to a scheduling conflict.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the audited understatement of reported taxable sales. We find no adjustment is warranted.

Petitioner has operated auto body shops since January 1989, and it operated at three locations during the audit period. For audit, petitioner provided federal income tax returns for 2004, 2005, 2006,

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and 2007; sales tax return worksheets for the fourth quarter of 2006 (4Q06) through 4Q07; job folders; and purchase invoices for fixed assets and self-consumed supplies.

The Sales and Use Tax Department (Department) noted substantial differences between the gross receipts reported on petitioner's federal returns and the total sales reported on sales and use tax returns. Also, the Department reviewed the available sales tax return worksheets and discovered computational errors. The Department recalculated the taxable sales shown on the available worksheets and found that its recalculated taxable sales for 4Q06 through 4Q07 exceeded reported taxable sales by $977,998, which represented an error ratio of 41.68 percent. The Department applied that percentage to reported taxable sales for the remainder of the audit period to establish an understatement of reported taxable sales caused by computation errors in the sales tax worksheets of $2,508,670. The Department then traced information from 31 job folders, randomly selected by petitioner from all job folders for 2007, to the sales tax return worksheets. It found understatements in the recorded taxable sales for *each* of the 31 jobs. Based on a discussion with petitioner's in-house accountant, the Department determined that petitioner had erroneously posted an amount on the worksheets based on the cost of auto parts rather than their selling price. Using the information for those 31 transactions, the Department computed a percentage of error of 27.61 percent in the amounts recorded on the worksheets for individual transactions. The Department applied that percentage to the adjusted recorded taxable sales to compute an understatement of reported taxable sales due to posting errors of $2,171,166. In other words, the Department used a two-step process. It first re-calculated the amounts of taxable sales recorded on the sales tax return worksheets and found a difference between the re-calculated figures and reported amounts of $2,508,670 (computational errors). The Department then found that the amounts recorded on the worksheets for individual transactions were understated by $2,171,167 (posting errors). Thus, the understatement of reported taxable sales is the total of those amounts, $4,679,837.

Petitioner provided a sales summary at the appeals conference that shows an understatement of $783,015, and it disputes the balance of $3,896,822 ($4,679,837 - $783,015). With respect to the computation errors, petitioner concedes that there were errors on the worksheets reviewed by the

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Department, but argues that the errors for those five quarters should not be projected to the remainder of the audit period. Petitioner states that its former controller passed away at the end of 2006, and the new bookkeeper made errors in formatting the reports that caused the computer system to generate incorrect totals for the worksheets, but only starting with the fourth quarter of 2006. As support, petitioner has provided re-constructed sales tax return worksheets for the audit period.

Regarding the posting errors, petitioner contends that the percentage of error computed by the Department based on its review of 31 job folders should not be projected to all transactions. Although petitioner concedes that there were errors in the posting of sales data from the job folders to the sales tax return worksheets for each of the folders reviewed by the Department, it asserts that it did not make the same types of mistakes in posting other jobs. As support, petitioner has provided its own test of the posting of sales data for 77 jobs, asserting that the only posting errors it found were minimal and resulted in overstatements, rather than understatements of taxable sales.

With respect to the computation errors, we have reviewed the reconstructed worksheets provided by petitioner at the conference. We find that many repair orders are missing from the worksheets, and, for some of the repair orders recorded on the reconstructed worksheets, there is missing information for individual sales categories. As an explanation for these discrepancies, petitioner states that the repair orders are out of sequence because of the differing lengths of time it takes to complete various jobs and that some repair orders have missing details because those repair orders did not result in sales. However, petitioner has provided no documentation to support these assertions. Further, the amount of taxable sales recorded on the reconstructed worksheets for the period 4Q04 through 3Q06 total $2,878,142, compared to the $3,203,890 of reported taxable sales for the same quarters. The amounts of total sales recorded on the reconstructed worksheets are also substantially less than the amounts of gross receipts reported on federal returns for 2005, 2006, and 2007, and petitioner's only explanation is its unsupported assertion that the amounts reported on federal returns were incorrect.

We find that the amounts recorded on the reconstructed worksheets do not represent all of petitioner's sales, and that no adjustments are warranted to the understatement of $2,508,670 resulting

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from computation errors on the worksheets. Regarding the posting errors, we find it simply inconceivable that there would be posting errors for each of 31 jobs which were *randomly selected by petitioner*, and that there would be no other posting errors for any other job performed during the audit period except for minimal errors resulting in overstatements. Thus, we find that no adjustment is warranted to the understatement of $2,171,167 related to errors in posting individual sales to the sales tax return worksheets.

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

The Department imposed the negligence penalty because petitioner failed to maintain adequate records for sales and use tax purposes and because the understatement represented amounts for which petitioner had collected the correct amount of sales tax reimbursement from its customers. Petitioner disputes the penalty on the basis that the understatement was due to computer system errors which began in 4Q06, after a change in accounting personnel, and because it was unaware of those errors.

The understatement of reported taxable sales of $4,679,837 represents an understatement of 87 percent of reported taxable sales of $5,355,060. Petitioner provided no sales and use tax worksheets for periods before October 2006, and in the available worksheets, there were substantial computation and posting errors. There are also substantial differences between the amounts reported on federal returns and on sales and use tax returns. We find that the magnitude of the understatement, the lack of supporting records, and the discrepancies in the records are evidence that petitioner did not exercise due care in reporting or in recordkeeping. Accordingly, we find that the understatement was the result of negligence, and the penalty was properly applied.

OTHER MATTERS

None.

Summary prepared by Lisa Burke, Business Taxes Specialist III

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