

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matters of the Administrative Protest)
 and Petition for Redetermination Under the)
 4 Sales and Use Tax Law of:)
 5 CALDRON'S JEWELERS, INC.,) Account Number: SR KH 28-712563
 dba Caldron's Jewelers) Case ID 418580
 6 RICHARD CALDRON) Account Number: SR KH 53-002849
) Case ID 422927
 7 Petitioners) Tracy, San Joaquin County
 8)

9 Type of Business: Jeweler
 10 Liability Period: 07/01/01 – 09/30/05

11 <u>Item</u>	<u>Disputed Amount</u>	
12 Unreported taxable sales	\$239,245	
13 Negligence penalty	\$4,196	
14 Finality penalty	\$4,196	
	<u>Tax</u>	<u>Penalty¹</u>
15 As determined:	\$106,204.99	\$42,402.00
16 Adjustments: Tax	-45,069.74	
	<u>- 19,173.83</u>	
17 Fraud penalty		-26,551.36
18 Amnesty double fraud penalty		-15,850.64
19 Negligence penalty		+4,196.17
20 Finality penalty		<u>+4,196.14</u>
21 Tax and Penalty	\$41,961.42	
22 Less concurred	<u>23,628.92</u>	
23 Protested	<u>\$18,332.50</u>	<u>\$ 8,392.31</u>
24 Tax	\$41,961.42	
25 Interest through 7/31/11	24,197.69	
26 Penalties	<u>8,392.31</u>	
27 Total tax, interest, and penalties	\$74,551.42	
28 Payments	<u>-23,559.67</u>	
Balance Due	<u>\$50,991.75</u>	
Monthly interest beginning 8/1/11	<u>\$ 92.01</u>	

1 As explained below, certain amnesty penalties were imposed after the determinations were issued, and we now recommend that they be relieved (subject to the usual payment conditions). The addition and the offsetting adjustment for these penalties are not reflected in the table.

1 After the Board hearing in this matter on February 23, 2011, the Board granted petitioners 30
2 days to provide additional records and the Sales and Use Tax Department (Department) 30 days to
3 respond. Based on the post-hearing submissions, we recommend relief of the amnesty penalties,
4 subject to the standard payment conditions, and recommend no other adjustments, as discussed below
5 under Post Hearing Developments.

6 BACKGROUND

7 Caldron's Jewelers, Inc., (Caldron's) was incorporated in 1981, but its corporate status was
8 suspended by the Franchise Tax Board effective March 1, 1985. Mr. Richard Caldron, the sole
9 corporate officer of Caldron's Jewelers, Inc., did not notify the Board of this suspension, and continued
10 to operate the business under the corporate name. The Department concluded that Mr. Caldron is
11 personally liable for the tax debts of Caldron's as a responsible person pursuant to California Code of
12 Regulations, title 18, section 1702.6, which he does not dispute. The Department audited Caldron's
13 records and concluded that Caldron's was fraudulent in preparing its sales and use tax returns. The
14 Department issued a Notice of Determination (NOD) to Caldron's on July 12, 2007, for tax of
15 \$106,204.99 for the period January 1, 1996, through September 30, 2005, plus a fraud penalty of
16 \$26,551.36 pursuant to Revenue and Taxation Code section 6485 and an amnesty double fraud penalty
17 of \$15,850.64 (only a portion of the fraud penalty was imposed for the amnesty-eligible period). Since
18 Caldron's did not file a timely petition for redetermination, the NOD became final and a finality
19 penalty was imposed along with an amnesty double finality penalty and amnesty interest penalty. On
20 August 28, 2007, the Department issued a NOD to Mr. Caldron as a responsible person for the same
21 liability, except that the finality penalty, amnesty double finality penalty, and amnesty interest penalty
22 were not assessed against Mr. Caldron because these penalties had not been assessed against Caldron's
23 at the time the NOD was issued to him. Mr. Caldron filed a timely petition for redetermination.

24 Based on additional documentation Mr. Caldron provided at the appeals conference, the
25 Department recommended that the fraud penalty be replaced with a negligence penalty. Since the
26 NOD to Caldron's was timely for the period October 1, 1996, through June 30, 2001, only if the fraud
27 penalty were sustained, the Department agrees the liability for that period should be deleted, resulting
28 in a reduction for both NOD's in the tax due from \$106,204.99 to \$61,135.25 for the period July 1,

1 2001, through September 30, 2005, with the applicable negligence, finality, and amnesty penalties.²
2 Mr. Caldron and Caldron's (petitioners) argue that the statute of limitations has expired for the liability
3 assessed for the period July 1, 2001, through March 31, 2004.

4 UNRESOLVED ISSUES

5 **Issue 1:** Whether the NOD's were timely issued for the period July 1, 2001, through
6 December 31, 2002. We conclude that they were.

7 Caldron's issued waivers of limitation which expired on January 31, 2007, prior to the
8 Department's July 12, 2007 issuance of the NOD to Caldron's (which was timely under the general
9 three-year statute of limitations for the period beginning April 1, 2004). Thus, since the Department
10 no longer asserts fraud, the NOD was not timely for the period prior to April 1, 2004, absent the
11 application of the 10-year amnesty statute of limitations under Revenue and Taxation Code section
12 7073. We conclude that the 10-year amnesty statute of limitations does apply for the amnesty-eligible
13 period, that is, through December 31, 2002, because all five conditions for its application have been
14 met: Caldron's did not participate in the amnesty program or report the amnesty-eligible
15 understatement; the Department did not previously audit the periods in question; the periods in
16 question are contiguous with the normal three-year audit period; and the Department has found direct
17 evidence of a deficiency in the quarters at issue. We thus find that the NOD issued to Caldron's was
18 timely for the period July 1, 2001, through December 31, 2002.³

19 **Issue 2:** Whether Caldron's was negligent. We conclude that it was.

20 The Department imposed the negligence penalty because there was a large percentage of error
21 in reporting taxable sales, and because Caldron's maintained two sets of sales journals, the first journal
22 to record taxable sales and the second journal to record only nontaxable repair labor. The Department
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24 ² The Statement of Account dated April 16, 2010, issued to Mr. Caldron replaced the fraud and amnesty double fraud
25 penalties with negligence and amnesty double negligence penalties, and also included the applicable finality, amnesty
26 double finality, and amnesty interest penalties that had not been included in the NOD issued to him. Since the total of the
penalties imposed in the Statement of Account are less than the total of the penalties imposed in the NOD issued to Mr.
Caldron for the remaining liability period, the Department is not required to assert the additional penalties pursuant to
section 6563.

27 ³ The Board has concluded that the 10-year amnesty statute of limitations applies only to periods that were still open as of
28 the date the amnesty legislation was passed on August 16, 2004. On August 16, 2004, the otherwise applicable three-year
statute of limitations had expired for periods before July 1, 2001. Thus, the 10-year amnesty statute of limitations is not
applicable to such periods.

1 found that Mr. Caldron assumed the second journal only contained nontaxable sales. However, the
2 Department found that the second journal included large sales of jewelry on which sales tax
3 reimbursement was collected, but Caldron's failed to report such taxable sales.

4 Petitioners argue that this was Caldron's first audit since the business started in the 1940's,
5 there has not been any change in the manner in which the business was operated, Mr. Caldron believed
6 he maintained the proper records and correctly reported taxable sales, and Caldron's hired an outside
7 bookkeeper to prepare the business tax returns. In sum, petitioners assert the underreporting occurred
8 due to Mr. Caldron's lack of knowledge, not negligence.

9 We believe that Caldron's should have known that the high dollar sales recorded in the second
10 journal were taxable sales that should have been recorded in the first journal, rather than charges for
11 nontaxable repair labor. Petitioners had no explanation for such recording error. We find that such
12 unexplained failure to properly record these taxable sales indicates negligence. Additionally, since
13 these journals were Caldron's own records, it could have performed a cursory review for reporting
14 purposes. We find that Caldron's was negligent in failing to review its records. Further, Caldron's
15 collection of sales tax reimbursement indicates that it knew of its reporting obligation, but petitioners
16 could not explain why these taxes were not reported. We find that Caldron's unexplained failure to
17 remit the reimbursement on these sales is below the standard of care of a reasonably prudent person.
18 Finally, we note that for the remaining liability period, Caldron's had a deficiency measured by
19 \$544,134 while reporting tax measured by \$124,410, a 437 percent error ratio. We find that this very
20 large percentage of reporting error indicates negligence. Based on the foregoing, we conclude that
21 Caldron's was negligent, and the negligence penalty was properly applied.

22 **Issue 3:** Whether relief from the penalty for failure to timely pay the NOD is warranted. We
23 conclude that relief is not warranted.

24 Caldron's submitted a request for relief of this penalty, signed under penalty of perjury. To
25 consider relief of the finality penalties, the Board has provided specific direction to us in the
26 *Memorandum Opinion of Davinder Singh Pabla* (9/1/05). First, we must consider whether the
27 taxpayer has established a reasonable, non-negligent basis for his or her failure to timely pay or
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1 petition the tax due. Second, we must consider whether it is reasonable for the taxpayer to have
2 withheld payment of the tax until the resolution of the administrative protest.

3 With respect to the first condition, we conclude petitioners have established that there was a
4 reasonable, non-negligent basis for Caldron's failure to timely pay or petition the NOD. That is,
5 Caldron's relied upon its representative to respond to the NOD, and the representative expressly asked
6 the Department to send him a copy when the NOD was issued to Caldron's. Although the NOD was
7 mailed to the representative, it was mailed to an incorrect address, and the representative did not
8 become aware of the NOD until a Demand for Immediate Payment was issued, after the NOD was
9 final.

10 With respect to the second factor, based on the unique circumstances of this case, we concluded
11 in the Decision and Recommendation (D&R) that Caldron's could satisfy the second factor if the
12 undisputed portion of the determined tax, which, herein, covers the tax for the period April 1, 2004,
13 through September 30, 2005, were paid within 30 days of the issuance of the D&R. That is, petitioners
14 concede tax of \$23,628.92, and by the time we issued the D&R, \$17,000 in payments had been
15 applied. Thus, the initial condition for our recommendation that the penalty be relieved was that
16 petitioners pay the remaining \$6,628.92 in conceded tax within 30 days of the D&R. If it had done so,
17 our recommendation would have been to grant relief of this penalty subject to the standard condition
18 that the remaining tax be paid within 30 days of the mailing of notice of the Board's final decision.
19 However, only \$800 in additional payments have been made (\$500 within 30 days of the issuance of
20 the D&R, and \$300 over four months later). Since petitioners have not paid the undisputed amount in
21 full in the required time, we conclude that relief of the finality penalty is not warranted.

22 **RESOLVED ISSUE**

23 In preparing this matter for hearing, the Department observed to the Appeals Division that in
24 applying the 10-year statute of limitation, the D&R applied it to the period January 1, 2003, through
25 March 31, 2004, which is not a period of liability that was covered by the amnesty program. Since the
26 10-year statute of limitations is *not* applicable to any period not covered by the amnesty program, and
27 the NOD was not issued within the three-year limitations period applicable to the liability incurred
28 during the period January 1, 2003, through March 31, 2004, the NOD for that period is barred. The

1 table above reflects the adjustments to remove this liability, reducing the tax by \$19,173.83, from
2 \$61,135.25 to \$41,961.42, and reducing the applicable penalties accordingly.

3 POST HEARING DEVELOPMENTS

4 The Board Members directed the Department to conduct a further review to determine whether
5 the repair sales journals included any taxable sales with sales tax reimbursement recorded and, based
6 on that review, to reconsider whether it believes relief is warranted for the amnesty-related penalties.
7 The Members also directed that the Department determine whether adjustments should be made for
8 non-sales bank deposits or for non-taxable labor in excess of the claimed labor deduction.

9 An amnesty double negligence penalty of \$1,833.26, an amnesty double finality penalty of
10 \$1,833.25, and an amnesty interest penalty of \$2,038.45 were imposed because Caldron's did not
11 participate in the amnesty program. Petitioners submitted a statement signed under penalty of perjury
12 arguing they did not participate in the amnesty program because they had no knowledge or reason to
13 suspect that Caldron's had underreported its taxable sales until the audit was conducted, beginning in
14 December 2005, after the amnesty period had expired. Based on its further review, the Department
15 concluded that the journal Caldron's used to record repair sales did not list any sales tax
16 reimbursement during the amnesty period, and the Department thus accepted that Caldron's had a good
17 faith belief that no taxable sales had been recorded in that sales journal and that it did not have a
18 pending tax liability prior to March 31, 2005, the deadline for filing for amnesty. The Department now
19 recommends that the amnesty penalties be relieved if certain payment conditions are met. Based on
20 our review of the available information, we concur with the Department's conclusion. Accordingly,
21 we recommend that the amnesty double negligence penalty, the amnesty double finality penalty, and
22 the amnesty interest penalty be relieved, provided that, within 30 days of notice of the Board's action,
23 petitioners either pay the amnesty-eligible tax and interest due or enter into an installment payment
24 plan to pay the amnesty-eligible tax and interest due over a period not to exceed 13 months and then
25 successfully complete that agreement.

26 The Department states that petitioners have provided no evidence to support an adjustment for
27 non-sale amounts included in bank deposits or to support an adjustment for nontaxable repair labor.
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1 Accordingly, in the absence of supporting documentation, we recommend no further adjustment to the
2 audited understatement of reported taxable sales.

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