

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petition for Redetermination)
4 Under the Sales and Use Tax Law of:)

5 D & H SERVICE STATION)

6 Petitioner)

Account Number: SR EA 97-858582

Case ID 435924

Westminster, Orange County

7 Type of Business: Gas station with mini-mart

8 Audit period: 04/01/04 – 03/31/07

9 Item Disputed Amount

10 Unreported taxable sales \$335,454

11 Disallowed nontaxable sales \$193,093

Negligence penalty \$ 17,695

TaxPenalty

13 As determined:

\$251,142.62

\$25,114.26

14 Adjustment – Post Board hearing

- 74,196.71

- 7,419.63

14 Proposed redetermination

\$176,945.91

\$17,694.63

15 Less concurred

- 135,983.52

00.00

15 Balance, protested

\$ 40,962.39\$17,694.63

16 Proposed tax redetermination

\$176,945.91

17 Interest through 11/30/10

95,375.57

17 Negligence penalty

17,694.63

18 Total tax, interest, and penalty

\$290,016.11

18 Payments

- 1,134.08

19 Balance Due

\$288,882.03

20 Monthly interest beginning 12/1/10

\$ 1,025.5721 The Board held a hearing regarding this matter on June 17, 2010, granting petitioners 30 days
22 to provide additional records and the Sales and Use Tax Department (Department) 30 days to respond.

23 UNRESOLVED ISSUES

24 **Issue 1:** Whether adjustments are warranted to the amount of unreported taxable sales based on
25 an examination of daily sales reports. Based on the evidence provided after the Board hearing, we
26 recommend a reduction of the understatement of reported taxable sales of \$979,727, from \$4,708,658
27 to \$3,728,931.

1 Petitioner has operated a gasoline station with a mini-mart since May 2001. Using petitioner's
2 daily sales reports for the period January 1, 2005, through December 31, 2006, the Sales and Use Tax
3 Department (Department) compiled recorded taxable sales of \$14,531,402 (including estimated
4 amounts for six days in 2005 and three days in 2006, for which daily sales reports were not available).
5 That amount exceeded reported taxable sales for the years 2005 and 2006 by \$3,049,515, which
6 represented a percentage of error of 26.56 percent. To establish the understatement for the remainder
7 of the audit period, the Department applied 26.56 percent to reported taxable sales for the last three
8 quarters of 2004 and the first quarter of 2007.

9 Petitioner does not dispute that reported taxable sales were understated by \$3,049,515 for the
10 years 2005 and 2006. However, petitioner protests the application of the 26.56 percent of error to the
11 remainder of the audit period. During the appeals conference, petitioner provided schedules of
12 recorded taxable sales for the fourth quarter 2004 (4Q04) and 1Q07. Using those schedules, petitioner
13 computed an understatement of 21.7 percent, which it contended should be used to compute the
14 audited understatement for the last three quarters of 2004 and 1Q07.

15 For the reasons explained in the D&R, we recommended that the Department investigate
16 further in a reaudit, expanding its comparison of recorded and reported taxable sales, but only if
17 petitioner provided daily sales reports for 4Q04 and 1Q07. Petitioner did not provide the sales reports
18 and we thus did not recommend any further adjustments prior to the Board hearing.

19 After the Board hearing, petitioner provided daily sales reports for 2Q04 and 3Q04. The
20 Department used the additional records to compute a percentage of understatement of 23.46 percent,
21 and in its reaudit report dated August 9, 2010, the Department applied the revised percentage of error
22 to reported taxable sales to compute a \$549,580 reduction in the understatement, from \$4,708,658 to
23 \$4,159,078.

24 In a letter dated August 18, 2010, petitioner disputes the Department's application of the
25 percentage of error to reported taxable sales for 4Q04 and 1Q07. Petitioner asserts there should be no
26 understatement established for 4Q04 because reported taxable measure for that quarter exceeds the
27 recorded amount by approximately \$300,000. For 1Q07, petitioner states the understatement should be
28 \$311, the difference between recorded and reported taxable sales. The Department declined to make

1 those adjustments because petitioner had not provided source documents to support the recorded
2 figures for those two quarters.

3 For 1Q07, we disagree with this position since the amount of recorded taxable sales of
4 \$1,835,170 for 1Q07 is well within the range of amounts recorded for the remainder of the period,
5 excluding 4Q04 (\$1,560,416 to \$2,135,822). Accordingly, even without complete source documents,
6 we find it likely that the amount of recorded taxable sales for 1Q07 is substantially accurate. Upon
7 further review in light of our views, the Department concurred and prepared another reaudit on
8 October 8, 2010, reducing the audited understatement of taxable sales for 1Q07 to \$311, thereby
9 further reducing the understatement of reported taxable sales for the audit period by \$430,147, from
10 \$4,159,078 to \$3,728,931.

11 For 4Q04, we agree with the Department's conclusion that no further adjustment is warranted.
12 For that quarter, the amount of recorded taxable sales was \$1,117,423, which is much less than the
13 amount recorded for any other quarter (the next lowest amount is \$1,560,416, for 1Q05). In the
14 absence of detailed records for 4Q04, we are not convinced that the amount of recorded taxable sales is
15 accurate, and we find the available evidence is not sufficient to support an adjustment.

16 In summary, we recommend a reduction of the understatement of reported taxable sales of
17 \$979,727 (\$549,580 + \$430,147).

18 **Issue 2:** Whether adjustments are warranted to the audited amount of disallowed recorded
19 nontaxable sales¹ related to repair labor and referral fees. Based on the evidence provided after the
20 Board hearing, we recommend an increase of \$22,350 in the disallowed recorded nontaxable labor
21 from \$170,743 to \$193,093.

22 Petitioner did not provide any sales invoices for auto repairs. For the period October 1, 2004,
23 through December 31, 2006, the Department noted that the amount of recorded sales of auto parts was
24 \$1,687, which it found much lower than expected in relation to recorded nontaxable labor of \$225,701
25 for the same period. Also, the Department noted that, on the daily sales reports printed from the
26 computer, there were handwritten amounts next to the amounts of recorded nontaxable labor, which
27 _____

28 ¹ Some recorded amounts were claimed as deductions on returns, and the remainder were netted from reported total sales.

1 the Department concluded were additional charges associated with auto repairs. The Department used
2 the handwritten amounts on the available daily sales reports to establish additional garage sales of
3 \$119,157 and to establish total garage sales of \$344,858 (\$225,701 + \$119,157) for the audit period.
4 The Department estimated, based on its experience auditing similar businesses, that 50 percent of this
5 amount, \$172,429, represented taxable sales of parts, and it established an understatement of \$170,743
6 (\$172,429 - \$1,687). Based on its review of the daily sales reports provided after the Board hearing,
7 the Department found that the audited amount of total garage sales had been understated. Accordingly,
8 the Department concluded that the amount of disallowed recorded nontaxable labor should be
9 increased from \$170,743 to \$193,093. We concur with the Department and recommend that increase.

10 Petitioner contends that all recorded labor represented nontaxable repair labor, rather than
11 taxable sales of parts. Petitioner asserted at the conference that it does not perform major repairs, and
12 most of its auto repairs involve smog checks and oil changes, which require minimal parts. Petitioner
13 further stated at the conference that the handwritten amounts represent nontaxable referral fees.
14 Petitioner asserted that, when asked to perform major auto repairs, it refers customers to other repair
15 shops, and petitioner receives a referral fee from those repair shops.

16 The D&R notes that the handwritten amounts at issue are written on petitioner's daily sales
17 reports, which petitioner used to record gross receipts. Furthermore, petitioner acknowledges that the
18 handwritten amounts represent business revenue. Thus, both the handwritten amounts and the
19 recorded amounts of nontaxable labor represent gross receipts, and petitioner has the burden of proving
20 those amounts are not subject to tax. (Rev. & Tax. Code, § 6091.) The D&R found the Department's
21 estimate that 50 percent of these amounts represent nontaxable labor to be reasonable. However, the
22 D&R recommended that petitioner be given the opportunity in the reaudit to provide invoices for the
23 auto repairs showing recorded labor and sales of auto parts and to provide documentation, such as
24 cancelled checks from other repair shops, showing that the handwritten amounts represent referral fees.
25 Since petitioner did not provide invoices or other documentation for reaudit, there is no basis for
26 adjustment.

27 **Issue 3:** Whether petitioner was negligent. We conclude that it was.
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