

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 LIVING SPACES FURNITURE LLC, dba)
6 Living Spaces Furniture)
7 Petitioner)

Account Number: SR Y AA 100-202947
Case ID 425660

Rancho Cucamonga, San Bernardino County

8 Type of Business: Furniture retailer

9 Audit period: 1/1/04 – 12/31/06

10 Item Disputed Amount

11 Additional taxable sales \$310,636

12 As determined: \$ 701,153.84
13 Adjustment - Sales and Use Tax Department + 218,162.69
14 - Appeals Division + 193,922.49¹
15 - Post Board Hearing - 457,307.12

14 Proposed redetermination \$ 655,931.90

15 Less concurred 631,525.70

16 Balance, protested \$ 24,406.20

16 Proposed tax redetermination \$ 655,931.90

17 Interest through 8/31/11 98,493.83

17 Total tax and interest \$754,425.73

18 Payments received 628,951.17

19 Balance Due \$125,474.56

20 Monthly interest beginning 9/01/11 \$ 134.90

21 The Board held the hearing in this appeal on April 27, 2011, to consider the disputed measure
22 of tax of \$6,170,485 (petitioner concurs in a deficiency measured by \$7,995,956) for the audit period
23 January 1, 2004, through December 31, 2006. The disputed measure considered by the Board
24 consisted of petitioner’s charges itemized as “Guardian 1 Plan Kit,” which, for fabric upholstered
25 furniture, included petitioner’s application of Guardian protection products on the furniture it sold.

26 _____
27 ¹ The Sales and Use Tax Department notified petitioner of both increases, pursuant to Revenue and Taxation Code section
28 6563, by letters dated July 18, 2008, and October 4, 2010.

1 The Board concluded that petitioner was providing the Guardian package as an optional warranty, but
2 returned the matter to staff to determine the taxable measure related to the fabrication of the fabric
3 upholstered furniture. The Sales and Use Tax Department (Department) has recommended that the
4 taxable measure related to the fabrication be established at \$700,000 while petitioner believes that the
5 taxable measure should be established at \$39,364.

6 UNRESOLVED ISSUE

7 **Issue:** Whether the taxable measure related to fabrication of fabric upholstered furniture
8 should be reduced to \$39,364. We find the measure should be established at \$350,000.

9 Petitioner sold Guardian packages as an option with its sales of furniture. The Guardian
10 package consists of an assortment of Guardian protection and cleaning products and a warranty for
11 repair or replacement of the applicable furniture if it were to suffer qualifying damage. Petitioner sold
12 the Guardian package for 10 percent of the sale price of the applicable furniture, with a minimum price
13 of \$70 and maximum price of \$1,500 (the maximum coverage was for invoices up to \$15,000).

14 The matter remaining in dispute is the portion of the sale price of the Guardian package that
15 represents taxable fabrication of fabric upholstered furniture. Resolution of this issue is complicated
16 by the fact that there is no readily available objective method for establishing the portion of the sale
17 price that represents charges for fabrication, such as would be the case if petitioner had offered the
18 fabrication alone (i.e., without the warranty portion of the package). Petitioner suggests that the
19 measure of the fabrication be established at 57 cents per unit based on its cost of labor plus a markup
20 of 50 percent. The Department does not believe that a retailer would provide such fabrication for less
21 than \$1.00, and believes that the proper measure is fair retail value, which the Department believes is
22 \$10.00 per unit.

23 We find it entirely unlikely that a seller of furniture, at prices in the hundreds or thousands of
24 dollars, would offer to apply a fabric protection product of this type for pennies, regardless of the cost
25 to do so. We believe that a retailer providing such fabrication would likely maximize its profits by
26 establishing a selling price of \$9.99. However, we believe that a retailer might also consider the
27 benefit of reducing customer complaints in setting its price (i.e., it seems likely that purchasers of
28 furniture with stain protection would make fewer complaints about stains than purchasers whose

1 furniture has no stain protection). We believe that a retailer who balanced these interests would charge
2 \$5.00 to apply fabric protector onto furniture it sold. Thus, in the absence of better hard data, we
3 conclude that the portion of the price paid for the Guardian package properly allocable to fabrication is
4 \$5.00 per unit, or \$350,000 for the audit period.

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