

**CALIFORNIA STATE BOARD OF EQUALIZATION**

**APPEALS DIVISION FINAL ACTION SUMMARY**

In the Matter of the Petition for Redetermination )  
 Under the Sales and Use Tax Law of: )  
 NCMG, INC. ) Account Number: SR S CH 97-264777  
 dba New Century Marble & Granite ) Case ID 386871  
 Petitioner ) San Leandro, Alameda County

Type of Business: Construction contractor

Audit Period: 1/1/03 – 12/31/05

<u>Items</u>	<u>Disputed Amounts</u>
Unreported cost of materials and sales of fixtures	\$229,409
Unreported cost of items used in petitioner’s showroom	\$69,047
Tax as determined and protested	<u>\$23,385.68<sup>1</sup></u>
Proposed tax redetermination	\$23,385.68
Interest through 2/28/11	<u>15,107.30</u>
Total tax and interest	\$38,492.98
Payments	<u>-107.00</u>
Balance due	<u>\$38,385.98</u>
Monthly interest beginning 3/1/11	<u>\$135.79</u>

The Board held a hearing regarding this matter on July 14, 2010, granting petitioner additional time to present further records so that the Sales and Use Tax Department (Department) could review and address petitioner’s contentions. Subsequently, the Department reviewed petitioner’s records and concluded that no adjustments are warranted, as discussed below in Post Hearing Developments, and we agree.

**UNRESOLVED ISSUES**

**Issue 1:** Whether adjustments are warranted for remnants and for an increase in ending inventory. We recommend no adjustment.

<sup>1</sup> The amount of determined tax is net of a concurred in credit of \$913.52. Thus, the total amount of tax protested is \$24,299.20 (\$23,385.68 + \$913.52).

1           Petitioner installs marble and granite countertops (materials) under lump sum contracts, and  
2 also makes retail over-the-counter sales of kitchen and bathroom fixtures (fixtures). Petitioner  
3 purchased the materials and fixtures without payment of tax or tax reimbursement to its vendors by  
4 issuing them resale certificates, and reported tax on the cost of materials installed in construction  
5 contracts and on the sale price of fixtures.

6           During the audit, the Sales and Use Tax Department (Department) noted that for the year 2003,  
7 petitioner's merchandise purchases exceeded the reported taxable measure. The Department also noted  
8 that petitioner instituted better internal controls in early 2004 and that the reported taxable measure for  
9 the years 2004 and 2005 significantly exceeded the merchandise purchases. Accordingly, the  
10 Department concluded the reported taxable measure for the years 2004 and 2005 was substantially  
11 accurate, but the reported taxable measure for 2003 was understated. The Department performed a  
12 cost accountability test for the year 2003. The Department reduced the material and fixture purchases  
13 for 2003 to account for the cost of items used in its showroom and for freight-in, which it computed at  
14 one percent. The Department then added a 31.07 percent markup, which had been computed in a shelf  
15 test, to the amount of fixture purchases to compute retail sales of fixtures. To establish audited taxable  
16 measure, the Department added the material purchases, the retail sales of fixtures, and the cost of items  
17 displayed in petitioner's showroom. Upon comparison to the reported taxable measure, the  
18 Department concluded that petitioner had underreported a measure of \$298,456 (\$229,409 with respect  
19 to items consumed in the performance of lump sum construction contracts or sold at retail, and \$69,047  
20 with respect to property displayed in its showroom).

21           Petitioner contends that an adjustment should be made to account for changes in inventory.  
22 Although petitioner has not specified the amount of adjustment, we note that its federal income tax  
23 return for the year 2003 shows an increase in ending inventory of \$154,632.

24           Petitioner is the consumer of materials that it furnished and installed in the performance of  
25 construction contracts, and it purchased marble and granite for use in performing construction  
26 contracts, not for resale. Thus, petitioner was not entitled to issue resale certificates for its purchases  
27 of marble and granite slabs, and when it did issue a resale certificate to a California vendor with  
28 knowledge that the property would not be resold, petitioner owed the tax the vendor would have owed

1 but for having been relieved of it by petitioner's issuance of a resale certificate. (Rev. & Tax. Code, §  
2 6094.5, subd. (a).) That is, petitioner owed tax measured by the full purchase price of the slabs, with  
3 no reduction for the prorated value of the remnants, and that tax became due when petitioner purchased  
4 the slabs.<sup>2</sup> However, even if petitioner for some reason thought it would resell the slabs, petitioner  
5 would have owed use tax measured by the full purchase price of the slabs, without any reduction for  
6 the prorated value of remnants, and the tax would have become due when petitioner made its first use  
7 of the slabs. For purchases from out-of-state vendors, whether it issued a resale certificate or not,  
8 petitioner owed use tax, and the use tax was due with the return for the period during which its  
9 purchase occurred. Accordingly, we conclude that no adjustment is allowable for remnants that remain  
10 in inventory. We also concluded in the D&R that an inventory adjustment could be warranted for  
11 fixtures. However, petitioner did not provide any documentation to support an inventory adjustment  
12 for fixtures. Further, based on its observation, the Department stated that marble and granite remnants  
13 represent the majority of the inventory. Accordingly, we believe any adjustment for an increase in the  
14 inventory of fixtures would have been minor. In any event, in the absence of documentation, we have  
15 no basis upon which to recommend an adjustment for ending inventory.

16 **Issue 2:** Whether petitioner is liable for the use tax on the cost of fixtures and marble and  
17 granite displayed in the showroom. We find petitioner consumed those items and is liable for use tax.

18 Petitioner moved materials and fixtures from its extax inventory into its showroom for display  
19 without reporting and paying use tax on the cost of those items. Petitioner contends that it is not liable  
20 for the tax because those items were held for sale in the regular course of business, and were in fact  
21 sold. Petitioner argues that the tax was not due until the materials and fixtures were sold. The  
22 Department noted that the fixtures at issue were cemented or otherwise permanently affixed to realty.  
23 Also, according to the Department, petitioner stated that the fixtures are rarely removed from the  
24 showroom, except when older models are replaced, and that the fixtures are usually scratched or  
25 otherwise damaged in the process of removal and are generally discarded.

26  
27 \_\_\_\_\_  
28 <sup>2</sup> Since the Department assessed use tax as of the date the marble and granite was allocated to a construction job, petitioner has received a timing benefit in situations where the slabs were purchased in one quarter and allocated to a job in a later quarter.

1 If a person gives a resale certificate or purchases property from out of state without paying tax  
2 to a retailer registered in California for collection of such tax, the purchaser owes use tax on its use of  
3 such property except when its use is limited to demonstration or display while holding the property for  
4 sale in the regular course of business. That is, in such circumstances, the purchaser owes use tax  
5 unless the property was used for no purpose other than demonstration and display while being held for  
6 sale in the regular course of business. Petitioner clearly did not hold the materials displayed in its  
7 showroom for resale since it did not sell materials in the regular course of business (only consuming  
8 the materials in the performance of construction contracts). With respect to the fixtures, we find that  
9 the installation of the fixtures rendered them no longer held for resale in the regular course of business.  
10 Consequently, we conclude that petitioner owed use tax on the cost of the materials and fixtures when  
11 they were removed from extax inventory for installation in the showroom.

12 **Issue 3:** Whether petitioner should be relieved of the tax on remnants that were not installed in  
13 construction contracts because it relied on advice from a prior audit of its predecessor. We conclude  
14 that no relief is warranted.

15 Petitioner contends it should be relieved from the liability for use tax on remnants consumed  
16 during the current audit period because, in the prior audit of petitioner's predecessor, the Department  
17 treated remnants as non-taxable until the remnants were installed in a construction contract. We have  
18 examined the workpapers for the audit of petitioner's predecessor for the period October 1, 1993,  
19 through September 30, 1996. In that audit, the Department performed a material accountability test  
20 and computed cost of goods sold of \$125,446. The Department accepted the predecessor's reported  
21 taxable measure because the amount of cost of goods sold was very close to the reported taxable  
22 measure of \$127,282. Thus, the Department prepared a no-change audit report for the audit of the  
23 predecessor.

24 Petitioner asserts that, in the prior audit of its predecessor, the beginning and ending inventories  
25 included substantial amounts of remnants. Thus, petitioner argues that the inventory adjustments made  
26 in the cost accountability test in the prior audit of its predecessor are evidence that the Department  
27 treated remnants as non-taxable until they were installed in construction contracts. However, the audit  
28 of petitioner's predecessor does not mention remnants at all. We conclude that the auditor who

1 performed the audit of petitioner's predecessor was not aware that the beginning and ending  
2 inventories included remnants. Therefore, we find that the prior audit does not contain advice on the  
3 application of tax with respect to petitioner's remnants. Furthermore, we find that the cost  
4 accountability test in the prior audit is not written advice for purposes of Revenue and Taxation Code  
5 section 6596. In order to qualify for relief under section 6596, the written advice must state whether or  
6 not a particular activity or transaction is subject to tax. In this instance, the cost accountability test  
7 does not state whether a particular activity or transaction is subject to tax, and thus, the cost  
8 accountability test cannot be used as written advice on which petitioner may rely. We conclude that  
9 petitioner is not eligible for relief under section 6596.

### 10 POST HEARING DEVELOPMENTS

11 At the Board hearing, petitioner claimed that it reported use tax on materials removed from its  
12 inventory, and when the job was completed, returned the remnants to its inventory. Petitioner claimed  
13 that when the remnants were later removed from inventory and sold at retail, it reported tax on such  
14 retail sales. Thus, petitioner claims that it is entitled to a tax-paid purchases resold deduction on  
15 subsequent retail sales of tax-paid remnants.

16 The Department's review of petitioner's records disclosed documents showing that use tax had  
17 been accrued on the cost of the entire slab and some invoices showing retail sales of remnants on  
18 which sales tax reimbursement was charged and sales tax reported. However, the deficiency calculated  
19 by the Department did not include any amount for sales of the remnants, but rather imposed tax only  
20 on the cost of the materials. Accordingly, there are no gross receipts from the retail sale of remnants  
21 included in the deficiency against which to offset a tax-paid purchases resold deduction, and we  
22 conclude no adjustment is warranted for this argument. (In fact, in order to allow the deduction, the  
23 Department would have to *add* the gross receipts from the retail sale of remnants to the deficiency, and  
24 that might well *increase* the deficiency.)

25 Petitioner also argued that the materials accountability test for 2003 on which the deficiency is  
26 based includes the cost of materials purchased in 2003 which were removed from inventory for use in  
27 subsequent years. The Department found that petitioner was unable to document that it had reported  
28 use tax for any such use of property in later years that had been purchased in 2003. Additionally, the

1 Department notes that any materials purchased in 2003 that were used in subsequent years would have  
2 been offset by similar use of materials in 2003 that had been purchased prior to 2003. We agree.  
3 Petitioner does not argue, and has not established, that its practices in this context were any different  
4 for the relevant periods, and we conclude that if it removed property from inventory after 2003 that it  
5 had purchased in 2003, it is likely to have also removed property from inventory in 2003 that it had  
6 purchased prior to 2003, and barring evidence to the contrary, we believe that the amounts would have  
7 been roughly equivalent. Thus, we recommend no adjustment for this contention.

8 Finally, petitioner claims that it made no use of showroom items prior to their sales. The  
9 Department found that petitioner withdrew materials from resale inventory for use in revamping its  
10 showroom. The Department noted that petitioner treated such improvements as assets and it claimed  
11 depreciation for the assets for income tax purposes. We find that such attachment to realty and  
12 depreciation for income tax purposes establishes that petitioner did consume the subject materials, and  
13 we thus conclude that no adjustments are warranted for this contention.

14  
15 Summary prepared by Rey Obligacion, Retired Annuitant  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28