

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 UNION OUTLET, INC.) Account Number SR AS 100-507178
) Case ID 547465
 6 Petitioner) Los Angeles, Los Angeles County

7 Type of Business: Clothing wholesaler

8 Audit period: 1/1/06 – 12/31/08

9 <u>Item</u>	<u>Disputed Amount</u>
10 Disallowed claimed sales for resale	\$ 274,438
11 Disallowed claimed sales in interstate commerce	\$1,147,208
12 Unreported sales	\$ 10,149
13 Negligence penalty	\$ 11,812

	<u>Tax</u>	<u>Penalty</u>
14 As determined	\$157,819.48	\$15,781.96
15 Post-Hearing adjustment	- 39,696.38	- 3,969.64
16 Proposed redetermination, protested	<u>\$118,123.10</u>	<u>\$11,812.32</u>
17 Proposed tax redetermination	\$118,123.10	
18 Interest through 03/31/13	47,890.99	
19 Negligence penalty	<u>11,812.32</u>	
20 Total tax, interest, and penalty	<u>\$177,826.41</u>	
21 Monthly interest beginning 04/01/13	<u>\$ 590.62</u>	

22 The Board held a hearing regarding this matter on April 26, 2012, and voted to return the
 23 matter to the Sales and Use Tax Department (Department) to conduct a reaudit. The understatement of
 24 reported taxable measure established in the reaudit is \$1,431,795, a reduction of \$481,168 from the
 25 measure of \$1,912,963 established in the original audit. The adjustments are discussed below under
 26 Post Hearing Developments.

27 UNRESOLVED ISSUES

28 **Issue 1:** Whether petitioner has established that it made any sales for resale during the audit
 period. Prior to the Board hearing, we found that it had not.

Petitioner reported total sales of \$2,327,870, claiming \$676,498 as nontaxable sales for resale
 and \$1,651,372 as exempt sales in interstate commerce, thereby reporting no taxable sales for the audit

1 period. Petitioner provided partial sales invoices for 2007, customer purchase orders, and shipping
2 documents for audit, but did not provide any sales journals or summary records. No resale certificates
3 or other documentation were provided in support of petitioner's claimed sales for resale, so the
4 Department disallowed all \$676,498 of petitioner's claimed sales for resale. Petitioner contends that it
5 is a wholesaler, and does not make any retail sales. However, it is not sufficient to just assert all sales
6 were for resale; petitioner has the burden of establishing that its claimed sales for resale were in fact
7 sales for resale. Since petitioner had not done so, we concluded prior to the Board hearing that no
8 adjustment was warranted to this audit item.

9 **Issue 2:** Whether petitioner has established that any of the disallowed claimed exempt sales in
10 interstate commerce actually qualified for the exemption. Prior to the Board hearing, we found that it
11 had not.

12 The Department found that petitioner had shipping documents to support \$15,276 in exempt
13 interstate commerce sales for the June 2007 test period. Compared to petitioner's average monthly
14 claimed interstate commerce sales of \$59,348 for 2007, the Department computed disallowed claimed
15 interstate commerce sales of \$44,072, representing an error rate of 74.26 percent. The Department
16 applied the error rate to petitioner's claimed interstate commerce sales of \$1,651,372, and established
17 \$1,226,316 in disallowed claimed exempt sales in interstate commerce for the audit period. Petitioner
18 repeated its contention that it was a wholesaler and not a retailer, and asserted that these particular
19 sales qualified for the interstate commerce exemption. Petitioner has the burden of establishing that its
20 sales were for resale or exempt from tax. Since the Department used a valid method to compute
21 petitioner's allowable deductions for exempt sales in interstate commerce, we concluded prior to the
22 Board hearing that no adjustment was warranted to this audit item.

23 **Issue 3:** Whether petitioner has established that the amount of unreported sales is overstated or
24 for nontaxable sales. We find that it has not.

25 The Department compared petitioner's gross receipts from its federal income tax returns to the
26 total sales reported on its sales and use tax returns and found that the former exceeded the latter by
27 \$10,149 for the audit period. The Department determined that the \$10,149 difference was unreported
28 sales subject to sales tax.

1 compute the disallowed amount of claimed exempt sales in interstate commerce of \$1,147,208 (a
2 reduction of \$79,108 from the \$1,226,316 established in the audit). In addition, the Department made
3 a cursory review of the bank statements and found that the deposits reconciled with gross receipts
4 reported on the 2007 federal income tax return. As a result, the Department concluded that the
5 evidence supported the accuracy of the gross receipts reported on the federal income tax returns, and it
6 recommended no adjustment to the unreported taxable sales of \$10,149, which represented the
7 difference between gross receipts reported on federal returns and total sales reported on sales and use
8 tax returns. Further, the Department concluded that, even with the additional data provided after the
9 Board hearing, petitioner's records were incomplete and inadequate. Accordingly, the Department
10 retained the negligence penalty in the reaudit.

11 We have reviewed the reaudit workpapers and we concur with the Department's
12 recommendations to reduce the disallowed claimed nontaxable sales for resale and disallowed claimed
13 exempt sales in interstate commerce. With respect to the negligence penalty, we agree with the
14 Department's description of the records as incomplete and inadequate since, even after the Board
15 hearing, petitioner provided records for one year only. Moreover, petitioner reported zero taxable
16 sales. In contrast, the audited taxable sales, even after the post-Board hearing reaudit, exceeded
17 \$1.4 million, which constitutes over 60 percent of petitioner's reported total sales of \$2,327,870. Not
18 only is the understatement substantial in amount, but reporting zero taxable sales without
19 documentation to establish that over 60 percent of those sales are nontaxable is clearly negligent. We
20 conclude the penalty was properly imposed, even though petitioner had not been audited previously.

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