

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 AZIM SHAALEMI,) Account Number: SR AC 97-139882
 6 dba Yama Motors) Case ID 521073
 7 Petitioner) North Hollywood, Los Angeles County

8 Type of Business: Used car dealer

9 Liability period: 1/1/05 – 6/30/08

10 <u>Item</u>	<u>Disputed Amount</u>
11 Additional taxable sales	\$1,347,660
12 3 vehicles subject to use tax	\$48,755
12 Fraud penalty	\$27,815

	<u>Tax</u>	<u>Penalty</u>
14 As determined	\$178,388.27	\$44,597.15
14 Post-D&R adjustments	- 67,128.32	-16,782.09
15 Proposed redetermination, protested	<u>\$111,259.95¹</u>	<u>\$27,815.06</u>
16 Proposed tax redetermination	\$111,259.95	
17 Interest through 2/28/15	71,746.44 ²	
17 Fraud penalty	<u>27,815.06</u>	
18 Total tax, interest, and penalty	\$210,821.45	
18 Payments	- 1,308.00	
19 Balance Due	<u>\$209,513.45</u>	
20 Monthly interest beginning 3/1/15	<u>\$549.76</u>	

21 This matter was scheduled for Board hearing in October 2012, but was postponed at
 22 petitioner's request to allow additional time to hire a new representative. It was rescheduled for Board
 23 hearing in February 2013, but was deferred at the Appeals Division's request for additional time to
 24 issue a Supplemental D&R. It was rescheduled for Board hearing in June 2014 and again in August
 25 2014, but was postponed at petitioner's request each time due to scheduling conflicts. It then was

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 27 ¹ The proposed tax is net of a credit of \$1,174 for tax paid to another state pursuant to Revenue and Taxation Code section 6406.

28 ² In preparing this case for the hearing, we noted that the interest had been computed incorrectly and was substantially understated. The interest computations have since been corrected.

1 rescheduled for Board hearing in October 2014, but was postponed at the request of petitioner's new
2 representative.

3 UNRESOLVED ISSUES

4 **Issue 1:** Whether further adjustments to the amount of unreported taxable sales and unreported
5 purchases of vehicles subject to use tax are warranted. We conclude that no further adjustments are
6 warranted.

7 Petitioner operated a used car dealership from 1998 through 2007. Prior to its initial contact
8 with petitioner on January 6, 2009, the Sales and Use Tax Department (Department) gathered and
9 examined records provided by the Department of Motor Vehicles (DMV), vehicle purchase reports
10 from the Board's Investigation and Special Operations Division (ISOD), and income tax returns from
11 the Franchise Tax Board. Petitioner provided no books and records for examination, alleging that the
12 records were destroyed in a fire at his home where he stored his records after he closed the business.
13 While petitioner reported total sales of \$249,175 and \$312,795 on his sales and use tax returns for
14 2005 and 2007, respectively, reports from various auto auction houses showed purchases of vehicles of
15 \$1,017,400 and \$1,125,400 in 2005 and 2007, respectively.³ Based on a detailed examination of the
16 vehicles purchased in 2005, the Department determined that one purchase of a Ferrari for \$143,000
17 was a nonrecurring transaction, and reduced audited purchases by that amount. The Department then
18 computed that petitioner sold 76.63 percent of the vehicles he purchased in 2005 (excluding the
19 Ferrari) at retail and sold the rest for resale. Based on amounts reported on petitioner's federal returns,
20 the Department computed a book markup of 32.34 percent. The Department multiplied adjusted
21 purchases by the taxable sales ratio of 76.63 percent and then added a markup of 32.34 percent to
22 establish audited taxable sales of \$886,693 for 2005⁴ and \$1,141,292 for 2007. A comparison of
23 audited taxable sales with reported taxable sales for 2005 and 2007 showed an average reporting error
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26 ³ ISOD's vehicle purchase reports showed purchases of \$904,300 and \$937,300 for 2005 and 2007. The Department found
27 that petitioner also made purchases of \$113,100 and \$188,100 from Manheim Riverside Auto Auction in 2005 and 2007
28 that were not included in ISOD's vehicle purchases reports. However, we found that those amounts represented petitioner's
sales to the auto auctions, rather than purchases. Therefore, we recommended that those amounts be deducted from
purchases in the post-D&R reaudit.

⁴ $(\$1,017,400 - \$143,000) \times .7663 \times 1.3234 = \$886,748$. The difference is due to rounding differences.

1 rate of 267.32 percent, which the Department used to establish unreported taxable sales for 2006. The
2 Department also estimated that petitioner made retail sales of \$71,344 in 2008, based on purchase
3 information from auto auctions. In sum, the Department established unreported taxable sales of
4 \$2,220,138 for the liability period.

5 Petitioner contends that the audited markup of 32.34 percent is excessive, and argues that the
6 markup should be recomputed using vehicle sale prices reported to the DMV on form REG 262,
7 *Vehicle/Vessel Transfer and Reassignment Form*. However, the overall markup computed by the
8 Department using information obtained from the DMV, including forms REG 262, was -36.78 percent,
9 which we find to be unreasonable. Furthermore, the sale prices of \$7,795 and \$55,000 reported to the
10 DMV for two vehicles petitioner sold at retail not only were substantially lower than petitioner's costs
11 for the vehicles (\$15,500 and \$66,000), but also were substantially lower than the financed amounts
12 (\$17,760 and \$75,000) shown in contracts obtained from the finance company. Therefore, we find that
13 the vehicle sale prices reported to the DMV are unreliable, and conclude that no other evidence has
14 been provided to support an adjustment to the audited markup.

15 After the appeals conference, petitioner provided DMV documentation that confirmed he was
16 out of business before 2008, and shipping documents showing that he shipped at least three of the six
17 vehicles he purchased in 2008 outside of California. Based on this documentation, the Department
18 concluded that the audited amount of taxable sales for 2008 should be deleted. In the D&R, we agreed
19 with the Department and made that recommendation. Additionally, we recommended that the
20 purchase of the Ferrari be included with petitioner's other purchases of vehicles he sold for resale in
21 computing the taxable sales ratio, and recommended various other adjustments to audited purchases
22 and to reflect a payment of use tax directly to the DMV by one of petitioner's customers. As a result
23 of our recommended adjustments, the taxable sales ratio was reduced from 76.63 percent to
24 60.42 percent, and the amount of unreported taxable sales in the post-D&R adjusted Field Billing
25 Order was reduced to \$1,347,660.

26 However, in preparing the initial summary for Board hearing, we noted that petitioner had
27 registered two of the six vehicles he purchased during the first six months of 2008 in his own name in
28 Arizona as late as October 2008. Thus, the available evidence suggested that petitioner purchased

1 those two vehicles for his own use. Since petitioner provided no evidence showing that the vehicles
2 were delivered to him by the auto auctions at a point outside this state, it appeared that the purchases
3 occurred in California. Therefore, we requested further investigation to determine if petitioner was
4 liable for use tax on his purchases of vehicles in 2008 for use in California. In a Supplemental D&R,
5 we explained our finding that the certificates of title and registration information that petitioner had
6 provided were not sufficient to show that the disposition of three of the six vehicles purchased in 2008
7 qualified as exempt sales in interstate commerce.

8 Petitioner asserts that the three subject vehicles were shipped from California auction houses to
9 a point outside of this state, but admits that he is unable to locate any documentation to support that
10 assertion. Petitioner claims that he lived in Arizona in 2008 for least three months, and paid taxes to
11 Arizona for all three vehicles, but petitioner has not provided the exact dates of his move to Arizona
12 and his subsequent return to California, and has not provided any evidence of sales and use taxes paid
13 to the State of Arizona. In the Supplemental D&R, we concluded that petitioner had purchased three
14 of the vehicles for his own use in 2008, and since petitioner failed to provide sufficient documentation
15 to show that he purchased the vehicles for use outside of California, we concluded that petitioner is
16 liable for use tax on the purchase price of \$48,755 for the three vehicles. Accordingly, we
17 recommended that, after the amount originally determined for unreported taxable sales for the first two
18 quarters of 2008, \$71,344, was deleted, unreported purchases of vehicles subject to tax of \$48,755
19 should be added. Overall, our recommendations resulted in unreported measure of \$1,396,415
20 (\$1,347,660 + \$48,755).⁵

21 **Issue 2:** Whether the Department has established clear and convincing evidence to support an
22 assertion of the 25 percent penalty for fraud or intent to evade the tax. We conclude that it has.⁶

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24 ⁵ In preparing an adjusted Field Billing Order pursuant to our recommendations in the Supplemental D&R, the Department
25 also calculated a credit of \$1,174 for sales tax paid to Arizona for petitioner's use of one of the vehicles in that state.
26 Therefore, in spite of our finding that petitioner did not provide sufficient evidence that he paid sales tax in Arizona, the
27 Department has reduced the tax by \$1,174.

28 ⁶ On October 19, 2009, petitioner signed the most recent in a series of waivers of the otherwise applicable three-year statute
of limitations, which allowed the Department until January 31, 2010, to issue a Notice of Determination (NOD) for the
period October 1, 2005, through September 30, 2006. Thus, without regard to whether the finding of fraud is upheld, the
NOD dated December 9, 2009, was timely issued for the period October 1, 2005, through June 30, 2008, under the 3-year
statute of limitations (Rev. and Tax. Code §§ 6487, subd. (a); 6488). Absent a finding of fraud, the determination would
not have been timely for the period January 1, 2005, through September 30, 2005.

1 The Department asserted the 25 percent fraud penalty because 1) petitioner had knowledge
2 regarding his responsibility to report his sales, as evidenced by signed sales and use tax returns filed
3 during the liability period; 2) petitioner intentionally avoided paying his tax liability; 3) petitioner's
4 confirmed purchases of over \$1.8 million for 2005 and 2007 from an auction house are significantly
5 higher than total purchases of \$309,744 reported on petitioner's income tax returns and reported sales
6 of \$550,476 for the two years; 4) DMV Reports of Sale for 18 vehicles show that petitioner reported
7 selling prices to the DMV that were less than petitioner's costs for 16 of 18 vehicles identified as sold
8 at retail; and 5) petitioner consistently understated his actual sales by substantial amounts. Petitioner
9 contends that there was no intent to evade the tax, that the used car dealership was operated as a part-
10 time business, and that his main source of income was a travel agency that he owned and operated.

11 The record shows that petitioner charged his retail customers sales tax reimbursement and filed
12 quarterly sales and use tax returns. While petitioner had sufficient knowledge of his reporting
13 obligations, he consistently underreported his taxable sales. The auction house reports show that
14 petitioner's purchases were far in excess of his reported sales and costs of goods sold reported on his
15 federal income tax returns. Petitioner averaged 3.34 vehicle sales per month, which should not be
16 complicated to keep track of or difficult to report on quarterly sales tax returns. The understatement of
17 \$1,396,415 in the adjusted FBO represents an error rate of 174 percent in comparison to reported
18 taxable sales of \$801,591, which is strong evidence of fraud. We find that these facts constitute clear
19 and convincing evidence of petitioner's intent to evade the sales tax.

20 **OTHER MATTERS**

21 None.

22 Summary prepared by Lisa Burke, Business Taxes Specialist III
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MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100% taxable ⁷
Mark-up percentages developed	32.34%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None

⁷ Although some of the vehicles were sold in nontaxable transactions, all of the property sold by petitioner would have been subject to tax if sold at retail.