

**CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY**

In the Matter of the Petition for Redetermination)
 Under the Sales and Use Tax Law of:)
 BRIAN SCOTT GERSTEIN) Account Number SR EA 100-251828
 Petitioner) Case ID 606328
) Costa Mesa, Orange County

Type of Business: Sales of jewelry
 Audit period: 07/01/07 – 06/30/11

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Disallowed claimed nontaxable sales ¹	\$280,531		
As determined		\$23,026.47	\$2,302.65
Post-D&R adjustment			<u>- 2,302.65</u>
Proposed redetermination, protested		<u>\$23,026.47</u>	<u>\$ 00.00</u>
Proposed tax redetermination		\$23,026.47	
Interest through 02/29/16		<u>9,379.39</u>	
Total tax and interest		<u>\$32,405.86</u>	
Monthly interest beginning 03/01/16		<u>\$ 115.13</u>	

This matter was scheduled for Board hearing in June 2014, but was deferred at the Appeals Division’s request, in order to issue an SD&R. It was rescheduled for Board hearing in February 2015 but was postponed for settlement consideration.

UNRESOLVED ISSUE

Issue: Whether adjustments are warranted to the amount of disallowed claimed nontaxable sales. We find no adjustment is warranted.

Petitioner has sold high-end watches and jewelry out of his residential apartment since August 2003. He does not have a store open to the public, and he maintains a mailing address through a UPS

¹ Petitioner claimed all of his reported total sales as nontaxable sales for resale, but the claimed amount included exempt sales in interstate commerce. For simplicity, we will refer to all the claimed amounts as “claimed nontaxable sales.”

1 store. For the audit period, petitioner reported total sales of \$10,925,123, all of which he claimed as
2 nontaxable sales for resale. For audit, petitioner provided federal income tax returns; sales and use tax
3 returns and worksheets; sales invoices for 2009, for sales to California customers only; and bank
4 statements for 2009, along with handwritten deposit summaries.

5 The Sales and Use Tax Department (Department) noted that the amount of gross receipts of
6 \$11,766,943 reported on federal income tax returns exceeded petitioner's reported total sales. Since
7 petitioner was unable to explain the difference, the Department used \$11,766,943 as audited total sales.
8 To establish the audited percentage of nontaxable sales, the Department reviewed the invoices for
9 2009. After reviewing responses to XYZ letters sent by petitioner and researching the names of
10 petitioner's customers on the Board's records, the Department computed a percentage of nontaxable to
11 total sales of 10.56 percent. It applied that percentage to audited total sales of \$11,766,943 to compute
12 audited nontaxable sales of \$1,242,589, and disallowed the remaining claimed amount of \$10,524,354.
13 Petitioner disagreed and provided sales invoices for the first six months of 2011. The Department
14 examined those invoices, which totaled \$752,917, and disallowed six claimed nontaxable sales, which
15 totaled \$17,950. Thus, the Department computed an overstatement of 2.384 percent (rounded)
16 ($\$17,950 \div \$752,917$) in the claimed amounts, and it applied that percentage to audited total sales of
17 \$11,766,943 to compute the disallowed amount of nontaxable sales (either claimed as nontaxable sales
18 or netted from reported total sales) of \$280,531.

19 The six sales remaining in dispute are a sale of a NASCAR-logo² watch to Muscle Motors
20 Performance, Inc. (MMP) for \$7,450; a sale of a TAG-Heuer watch and a Rolex watch to out-of-state
21 retailer Elegant Timepieces, Inc. (ET), a Florida retailer that does not hold (and is not required to hold)
22 a California seller's permit; and a sale of \$150 and three sales of \$100 each, based on declared values
23 listed on shipping invoices for which the Department could not find the relevant sales invoices.

24 Petitioner contends that: the sale to MMP was a nontaxable sale for resale; the sale to ET was a
25 nontaxable sale for resale and an exempt sale in interstate commerce; and the remaining four amounts
26 established as sales (of \$100 or \$150) were not sales at all, but were simply declared values for
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28 ² NASCAR is an acronym for national Association for Stock Car Auto Racing.

1 shipments of small items. Regarding the sale to MMP, petitioner asserts that MMP was in the business
2 of selling NASCAR equipment, and petitioner had no reason to believe that MMP was not going to
3 resell the watch in the regular course of business. As support, petitioner provided a resale certificate
4 that he stated MMP had provided, but that certificate contained the seller's permit number of an
5 unrelated company, L.U.C. Trading, Inc. (L.U.C.). After the D&R was issued, petitioner also provided
6 an email string between him and an unnamed person from MMP. In one of the emails, in response to
7 petitioner's request, the person from MMP provided MMP's seller's permit number and a link to the
8 Board of Equalization permit verification webpage. As for the sale to ET, petitioner did make a sale to
9 an out-of-state retailer, but he delivered the merchandise to that retailer's customer, who was located in
10 California. Petitioner now agrees that he is liable for tax on this transaction, for which he drop-shipped
11 merchandise to a California customer of an out-of-state retailer. (See Cal. Code Regs., tit. 18, § 1706.)
12 However, petitioner contends that the sale to ET was an isolated incident and should not be included in
13 the amount used to compute the percentage of error in claimed nontaxable sales for the remainder of
14 the audit period. With respect to the four amounts established as sales based on the declared values on
15 shipping invoices, petitioner asserts that the amounts were far too low to represent sales of jewelry,
16 since his sales of jewelry are each \$1,000 or more. Petitioner surmises that the shipping invoices were
17 probably for free shipments of small items, such as watch links for watches previously purchased,
18 small items or paperwork omitted from the original shipment to the purchaser, or repaired jewelry.

19 We find that petitioner has not presented adequate documentation to support his claim that the
20 sale to MMP was a nontaxable sale for resale. The L.U.C. seller's permit has no relevance to the
21 disputed sale, and, the emails presented do not identify the name of the person from MMP, indicate
22 that the sale was for resale, or state that the sale was nontaxable. Further, the Department's records
23 show that MMP was in the business of selling aftermarket automotive parts, not watches or jewelry.
24 Moreover, when the Department contacted the purchaser, MMP stated it did not issue a resale
25 certificate with respect to the purchase of the watch and confirmed it has not paid use tax to the Board.
26 Accordingly, we find that the evidence does not support petitioner's assertion that the watch was sold
27 to MMP for resale.

1 Also, we find that there is no evidence to show that the sale to ET, for which petitioner drop-
2 shipped the merchandise to a California purchaser, was an isolated incident. Although no other drop-
3 shipments were found during the six-month test period, we find it unlikely that no other drop shipment
4 orders occurred in the remaining sales, totaling almost \$10 million, especially since most of
5 petitioner's sales were to other retailers for resale, and petitioner sold to both in-state and out-of-state
6 retailers. Accordingly, we find there is no basis for regarding the sale to ET as a nonrecurring error
7 and excluding it from the amount used to compute the percentage of error applied to claimed amounts
8 for the remainder of the audit period.

9 Regarding the three amounts of \$100 and the amount of \$150, scheduled from declared values
10 on shipping invoices and regarded by the Department as sales amounts, we note that petitioner himself
11 identified the values of the items shipped. Since petitioner is in the business of selling jewelry, and he
12 has not presented any evidence that any other items were being shipped in these four shipments to
13 California residents, we find that the shipping invoices are evidence of sales by petitioner totaling
14 \$450. While the declared values do appear low in comparison to the typical selling prices for
15 petitioner's merchandise, it is unclear why the value of items being returned after shipment would be
16 so much lower than petitioner's selling prices. Thus, although it is possible that these shipments
17 included items for which petitioner made no charge to his customers, as petitioner asserts, we find it is
18 equally likely (or more probable) that the four shipping invoices represented shipments of jewelry sold
19 at prices in excess of the declared values. In any event, we find that the Department's conclusion that
20 the shipping invoices related to sales of merchandise at the declared values is reasonable and based on
21 the best-available information. Petitioner has not provided evidence to the contrary, and we find no
22 adjustment is warranted.

23 **RESOLVED ISSUE**

24 The Department imposed a negligence penalty because it found an understatement of reported
25 taxable measure of \$10,524,354 in the audit, which was reduced in a revised audit to \$280,531. At the
26 appeals conference, the Department stated that it no longer concludes that the understatement was due
27 to negligence, since the understatement established in the revised audit represents only about
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1 2.4 percent of claimed nontaxable sales, and petitioner had not been audited previously. We concur,
2 and we recommend that the negligence penalty be deleted.

3 **OTHER MATTERS**

4 None.

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