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:

JERRY PENA, dba Ontario Tire & Accessories Zone

Petitioner

Account Number SR EH 97-843498
Case ID 478061

Ontario, San Bernardino County

Type of Business: Tire shop

Audit period: 01/01/05 – 09/30/08

Item	Disputed Amount
Unreported taxable sales	$666,749
Negligence penalty	$ 5,167

	Tax	Penalty
As determined	$57,147.93	$5,714.81
Pre-D&R adjustment	- 5,474.82	- 547.50
Proposed redetermination, protested	$51,673.11	$5,167.31

Proposed tax redetermination	$51,673.11
Interest through 07/31/12	20,669.13
Negligence penalty	5,167.31
Total tax, interest, and penalty	$77,509.55
Payments	- 14,139.89
Balance Due	$63,369.66
Monthly interest beginning 08/01/12	$ 187.67

A Notice of Appeals Conference was mailed to petitioner's address of record, and the notice was not returned by the Post Office. Petitioner did not respond to the notice or appear at the appeals conference, which was held as scheduled. We thereafter sent petitioner a letter offering him the opportunity to provide any additional arguments and evidence in writing he wished us to consider, but he did not respond.

UNRESOLVED ISSUES

Issue 1: Whether adjustments are warranted to the unreported taxable sales. We find no further adjustment is warranted.

Petitioner operated a retail automotive tire and wheel shop. For audit, petitioner provided federal income tax returns, purchase invoices, sales invoices, and a limited number of daily sales summaries and cash register tapes. The Sales and Use Tax Department (Department) found various discrepancies in its review of the records, and it decided to establish audited sales on a markup basis.

Using information provided by petitioner's suppliers and purchase invoices petitioner provided, the Department compiled merchandise purchases of $972,232 for the years 2005, 2006, and 2007, which significantly exceeded reported taxable sales of $726,418. The Department conducted shelf tests, computing markups for four merchandise categories, and it computed a weighted average markup of 42.68 percent. The Department added the audited markup to audited purchases to establish audited total sales of $1,352,248, which it reduced by audited nontaxable sales for resale of $58,392 to establish audited taxable sales of $1,293,856, which exceeded reported taxable sales of $726,418 by $567,438. It then computed a percentage of error of 78.12 percent which it applied to reported taxable sales to compute an understatement of $46,403 for the first six months of 2008, and established an understatement for the period January 1, 2005, through June 30, 2008, of $613,844. Since petitioner did not file a return for the third quarter 2008 (3Q08), the Department established taxable sales for that quarter of $52,905, which represented an average of the audited amounts of taxable sales for 1Q08 and 2Q08. The Department established two separate audit items, for $613,844 and $52,905, which total $666,749 in unreported taxable sales.

Petitioner contends that the Department has incorrectly computed the understatement. Petitioner also asserts that the audited cost of goods sold should be adjusted for the cost of merchandise sold in nontaxable sales for resale and for the cost of merchandise sold with the business.

Petitioner has provided no evidence of errors in the Department's computations, and we have identified no errors in our review of the audit workpapers. Further, petitioner has provided no evidence to support adjustments in the audited markup, and we find the markup of 43 percent reasonable for this type of business. Accordingly, we reject petitioner's general contention that the Department has incorrectly computed the understatement. Regarding petitioner's assertion that the audited cost of goods sold should be adjusted for the cost of merchandise sold in nontaxable sales for resale, we note that the Department computed the total sales of tangible personal property on a markup

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

basis and then deducted all nontaxable sales for resale for which petitioner provided adequate documentation. We find that the Department has properly adjusted for nontaxable sales for resale, and no further adjustment is warranted. Further, we find no inventory adjustment is warranted because petitioner has not provided evidence of his inventory at the beginning or the ending of the audit period.

Issue 2: Whether petitioner was negligent. We find that he was.

The Department applied the negligence penalty because the records were not adequate and the understatement was significant. Petitioner protests the penalty on the basis that reported sales were accurate.

We find that petitioner's failure to provide adequate records and the substantial understatement of $666,749, which represented an understatement in excess of 78 percent of reported taxable sales, are strong evidence of negligence. Further, petitioner was audited previously, and the errors found in this audit were similar to the errors found in the prior audit. We reject petitioner's assertion that reported taxable sales were accurate, and note in particular that petitioner's purchases of merchandise of $972,232 far exceeded his reported taxable sales of $726,418 for the years 2005, 2006, and 2007. We find that petitioner was negligent, and the penalty was properly applied.

OTHER MATTERS

None.

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

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100%
Mark-up percentages developed	42.68%
Self-consumption allowed in dollars	None
Pilferage allowed in dollars	None