

1 \$14,556 to a high of \$148,196. Additionally, five of the quarterly periods in the prior audit showed
2 differences exceeding \$100,000. That is, large errors were recurring during the prior audit period, and
3 the errors fluctuated widely from one quarter to the next. Thus, the evidence indicates that the higher
4 percentage of error for the second quarter 2002 was not some sort of aberration. Furthermore, the error
5 ratio of 18.97 percent computed in the prior audit is greater than the error ratio of 14.7496 percent
6 computed for the audit period at issue here, and Mr. Symonds has not provided any basis for us to
7 conclude that he substantially improved his reporting from the prior audit period to the current period.
8 We find that the Department's test is valid and that no adjustment is warranted.

9 **Issue 2:** Whether the Department made a clerical error in computing the amount of
10 Mr. Symonds' unrecorded vehicle sales. We conclude that it did not.

11 During the audit of Mr. Symonds, the Department found that 52 Report of Sale (ROS) forms
12 did not have corresponding deal jackets during the test period January 1 through November 30, 2002.
13 Of the 52 ROS, 50 were available for examination, which resulted in taxable sales of \$389,575. The
14 Department combined this amount with the sales amounts recorded in the deal jackets for the test
15 period to compute the average sale price of a vehicle of \$8,021, which was applied to the two missing
16 ROS to compute taxable sales of \$16,042. Thus, the Department computed unrecorded taxable vehicle
17 sales of \$405,617 which, when compared with reported taxable sales for the test period, results in an
18 error ratio of 24.798 percent. The Department applied this error ratio to Mr. Symond's reported
19 taxable sales for the audit period to establish unrecorded taxable sales of \$959,935.

20 Mr. Symonds agrees that he had 52 unrecorded sales, but contends that the average selling
21 price should be computed using 52 unrecorded vehicle sales instead of 50. Mr. Symonds computed an
22 average selling price of \$7,826, and argues that making this correction will reduce the measure of tax
23 to \$959,011. The computational method suggested by Mr. Symonds is incorrect. The average selling
24 price of vehicles can only be computed using known selling prices, which is what the Department did.
25 We find that the Department used the correct methodology to calculate the average selling price, and
26 that no adjustment for this issue is warranted.

27 **Issue 3:** Whether the Department has properly computed the error ratio for disallowed sales
28 for resale. We conclude that it did.

1 The Department examined Mr. Symonds' claimed sales for resale for the period January 1
2 through November 30, 2002, and found 36 errors totaling \$213,224. This amount was divided by
3 \$431,138, the claimed sales for resale for that period, to compute an error ratio of 49.456 percent,
4 which was applied to claimed sales for resale for the audit period to compute disallowed sales for
5 resale of \$545,128.

6 Mr. Symonds does not dispute the errors found in the test but contends that the computation of
7 the error ratio is flawed, and that it should instead be computed by subtracting allowable nontaxable
8 sales found in the test of \$324,002 from claimed sales for resale for the test period of \$431,138 to
9 compute errors totaling \$107,137, and then divide errors of \$107,137 by the claimed sales for resale of
10 \$431,138 to compute an error ratio of 24.8498 percent.

11 This method is obviously flawed since it uses errors of \$107,137 when Mr. Symonds himself
12 admits that the errors in *claimed resales* total \$213,224. That is, the test found that Mr. Symonds
13 properly claimed \$217,914 resales and incorrectly claimed \$213,224 resales. It is true that the *total*
14 allowable resales found during the test period was \$324,002. However, the \$106,088 difference
15 between the allowable *claimed* resales and the total allowable resales resulted from Mr. Symonds'
16 failure to report or claim \$106,088 in allowable resales. Thus, although Mr. Symonds had not reported
17 these sales in its total gross sales, no tax was assessed for them because the Department concluded they
18 were for resale. Since the test was of *claimed* resales, to develop a percentage of such claimed resales
19 to apply to the *claimed* resales of the remainder of the audit period, the Department's method is valid.

20 Mr. Symonds also contends that the error ratio is flawed because the total amount of sales for
21 resale examined of \$537,226 (claimed resales of \$431,138 plus the \$106,088 of resales not reported as
22 gross receipts or deducted as claimed resales) does not match the amount of sales for resale for 2002
23 listed on audit schedule 12G (\$535,163). As explained in the D&R, this difference resulted from
24 certain sales not being included on this schedule, and did not result in any calculation errors.

25 **Issue 4:** Whether a greater allowance for bad debts is warranted. We recommend no
26 adjustment.

27 Petitioners contend that discount fees paid to Westlake Financial (Westlake), to whom they
28 sold their sales contracts, should be included in the amount of bad debt allowance. Petitioners are

1 mistaken. A retailer who sells receivables with recourse so that the retailer will bear any bad debt loss
2 on them is entitled to a bad debt deduction to the same extent as if the receivables had not been sold.
3 (Cal. Code Regs., tit. 18, § 1642, subd. (h)(1)(C).) However, the fact that a retailer sells receivables at
4 a discount, with or without recourse, does not in itself entitle the retailer to a bad debt deduction to the
5 extent of the discount. (Cal. Code Regs., tit. 18, § 1642, subd. (h)(1)(C).) Thus, we conclude that
6 petitioners are not entitled to a bad debt allowance for the amount of the discounts.

7 Petitioners contend that the Department did not account for all of the bad debts from down
8 payments as reflected in the deal jackets. In the D&R, we agreed that the deal jackets were petitioners'
9 account receivable records because the deal jackets were used to record the receipt of customer
10 payments and outstanding balance due from the customer. Thus, we found that the notations on the
11 deal jackets are evidence of non-payment by a customer. We recommended that the allowance for bad
12 debts associated with down payments be increased if, during the recommended reaudit, petitioners
13 provided deal jackets that show additional amounts of down payments that were not made by
14 customers, *and* that such amounts were written off for income tax purposes. (Cal. Code Regs., tit. 18,
15 § 1642, subd. (a).) Petitioners did not provide such records for reaudit, and we therefore conclude that
16 a greater allowance for bad debts is not warranted.

17 **Issue 5:** Whether petitioners were negligent. We conclude that they were.

18 Petitioners argue that the penalties should be deleted because petitioners trusted their outside
19 bookkeeper to report sales accurately. Mr. Symonds alternatively argues that the penalty should not be
20 projected into periods prior to 2002. HFAS argues that it made a good faith effort to report the correct
21 amount of tax and it did not attempt to defraud the State.

22 We conclude that the negligence penalty was properly imposed because: 1) the understatements
23 are large in relation to the amount of reported taxable sales, 2) petitioners failed to report a substantial
24 amount of taxable sales recorded in its records, and 3) similar errors occurred in the prior audit of
25 Mr. Symonds. Petitioners cannot escape the penalties by blaming their bookkeeper. (Audit Manual §
26 0504.20.) With respect to Mr. Symonds' argument that it is unfair to impose the negligence penalty on
27 periods prior to 2002 because the liability for those periods is based on a projection of error ratios, we
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1 find that this ignores the fact that the books and records for periods prior to 2002 were not made
2 available. We conclude that the negligence penalties were properly imposed.

3 **Issue 6:** Whether relief of the amnesty penalties is warranted. Relief is not warranted.

4 Although Mr. Symonds applied for amnesty, he did not file amnesty returns or enter into an
5 installment payment plan, and HFAS did not apply for amnesty. Since the determinations were issued
6 after the deadline for participating in the amnesty program, amnesty double negligence penalties were
7 added of \$15,752.53 for Mr. Symonds and \$390.68 for HFAS. In addition, when the liabilities become
8 final, amnesty interest penalties will be added of \$23,118.38 for Mr. Symonds and \$332.10 for HFAS.

9 Although we explained by letter that petitioners could file requests for relief of the amnesty
10 penalties and provided forms they could use to do so, neither petitioner has filed a request for relief.

11 We therefore have no basis to consider recommending relief.

12 **OTHER DEVELOPMENTS**

13 None.

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15 Summary prepared by Pete Lee, Business Taxes Specialist II
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