**CALIFORNIA STATE BOARD OF EQUALIZATION**

**APPEALS DIVISION FINAL ACTION SUMMARY**

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| In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: | |
| NNADI LINUS UDENGWU, dba Ude Auto Sales | Account Number: SR AP 97-031177 Case ID 515515 |
| Petitioner | Diamond Bar, Los Angeles County |

Type of Business: Used car dealer

Audit period: 4/1/05 – 6/30/08

| Item | Disputed Amounts |
|---|---|
| Understatement of reported taxable measure | $2,037,041 |
| Negligence penalty | $ 16,806 |

| | Tax | Penalty |
|---|---|---|
| As determined | $264,349.22 | $26,434.96 |
| Pre-D&R adjustment | - 66,371.84 | - 6,637.17 |
| Post-Board hearing adjustment | - 29,921.43 | - 2,992.15 |
| Proposed redetermination, protested | $168,055.95 | $16,805.64 |

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| Proposed tax redetermination | $168,055.95 |
| Interest through 08/31/13 | 84,677.10 |
| Negligence penalty | 16,805.64 |
| Total tax, interest, and penalty | $269,538.69 |
| Monthly interest beginning 09/01/13 | $ 840.28 |

The Board held a hearing regarding this matter on February 1, 2012, and ordered a reaudit. Based on the findings of two post-Board hearing reaudits, we recommend a reduction in the understatement of reported taxable measure of $362,684, as explained under Post Hearing Developments.

## UNRESOLVED ISSUES

**Issue 1:** Whether adjustments are warranted to the audited understatement of reported taxable measure. We conclude that no adjustment is warranted other than those explained under Post Hearing Developments.

Petitioner is a used car dealer who does not maintain a car lot to display his inventory. He purchases his cars from local auto auctions and usually sells them within days. Upon audit, petitioner only provided federal income tax returns for 2006 and 2007. He did not maintain sales journals, contracts, or summary worksheets, and his Department of Motor Vehicle (DMV) report of sale forms and purchase invoices were grossly incomplete. The Sales and Use Tax Department (Department) was unable to reconcile the sales reported on the sales and use tax returns with the gross receipts reported on the federal returns and thus concluded that the reported sales were unreliable. The Department established petitioner's sales by the markup method. It conducted a shelf test using 17 cars from the audit period for which there was sufficient information, and compared Kelly Blue Book selling prices to the purchase prices to calculate a 33.38 percent average markup. The Department applied the markup to $2,732,590, which represented the sales to petitioner reported by petitioner's vendors during the audit period. The Department computed total sales of $3,644,727, resulting in $2,317,144 unreported sales, all of which the Department regarded as taxable. Petitioner had reported total sales of $1,327,583, all of which he claimed as nontaxable sales for resale. The Department reviewed the bills of lading provided in support of these claimed nontaxable sales, and determined that sales of $1,245,002 (78 sales of cars) qualified as exempt sales (they had been shipped to Nigeria) and that $82,581 of the claimed amount was not supported as nontaxable. Petitioner contends that all of his sales were nontaxable sales for resale or exempt sales in foreign commerce.

We note that the claimed sales for resale to Clem's Auto Sales are not supported by a valid resale certificate or a signed XYZ letter confirming sales for resale, and that the dates of shipment on 12 bills of lading precede the dates that the vendors reported selling those cars to petitioner. Therefore, we find the Department correctly disallowed the claimed deductions as to those sales. Further, the vehicle identification numbers on three bills of lading could not be traced to purchase information in the audit, and therefore do not support exemption for any of the assessed sales. We thus find that no further adjustment is warranted.

**Issue 2:** Whether petitioner was negligent. We conclude that he was.

The Department found petitioner to be negligent because it considered petitioner's books and records inadequate for sales and use tax purposes, petitioner failed to maintain resale certificates or bills of lading to support his claimed nontaxable sales, and there is a substantial deficiency. Petitioner contends that he did not make any taxable retail sales and disagrees with the negligence penalty.

Petitioner's belief that all of his sales were nontaxable or exempt is not a sufficient reason for failing to report his sales. The understatement of reported taxable sales, after the post-Board hearing adjustments, of $2,037,041 represents a 153 percent error rate in comparison to reported total sales of $1,327,583. We find that such a substantial amount of unreported sales is evidence of negligence in reporting. Petitioner's failure to maintain sales journals, contracts, summary worksheets, and documentation to support his claimed nontaxable and exempt sales, are actions contrary to what we expect from a reasonably prudent businessperson. In addition, we find that the incomplete condition of petitioner's report of sale forms and purchase invoices is compelling evidence of negligence in recordkeeping. Accordingly, we conclude that petitioner was negligent.

**POST HEARING DEVELOPMENTS**

At the Board hearing, the Board directed the Department to conduct a reaudit, and, in particular, to review a listing of all verifiable information against the DMV database records. In two post-Board hearing reaudits, the Department found that: 1) petitioner had reported sales totaling $77,200 to DMV using report of sale forms issued to other retailers, 2) use tax had been reported to DMV for sales totaling $26,497, 3) the disallowed claimed exempt sales of $82,581 should be deleted, and 4) an adjustment was warranted for additional nontaxable sales of $176,406. Thus, the Department concluded that the understatement of reported taxable sales should be reduced by $362,684, from $2,399,725 ($2,317,144 unreported sales + $82,581 disallowed claimed exempt sales) to $2,037,041. We concur, and we recommend those adjustments.

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

**MARKUP TABLE**

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| Percentage of taxable vs. nontaxable purchases | 66% taxable<br>34% nontaxable |
| Mark-up percentages developed | 33.38% |
| Self-consumption allowed in dollars | $0 |
| Self-consumption allowed as a percent of taxable purchases | 0% |
| Pilferage allowed in dollars | $0 |
| Pilferage allowed as a percent of taxable purchases | 0% |