

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 TOM DWORKIN ASSOCIATES) Account Number: SR AC 99-186763
 6) Case ID 341727
 7 Petitioner) Canoga Park, Los Angeles County

8 Type of Business: Fabric retailer

9 Audit Period: 10/1/01 – 9/30/04

10 <u>Items</u>	<u>Amounts in Dispute</u>	
11 Disallowed netted sales in interstate commerce	\$65,657	
12 Negligence penalty	\$3,360	
13 Amnesty double negligence penalty	\$1,066	
14 Amnesty interest penalty	\$1,280	
	<u>Tax</u>	<u>Penalties</u>
15 As determined	\$42,291.12	\$5,556.84
16 Adjustment: Sales and Use Tax Department	-6,431.51	-877.05
Appeals Division	<u>-2,262.67</u>	<u>-253.94</u>
17 Proposed redetermination	\$33,596.94	\$4,425.85
Amount concurred in	<u>-28,222.88</u>	
18 Protested	<u>\$ 5,374.06</u>	<u>\$4,425.85</u>
19 Proposed tax redetermination	\$33,596.94	
Interest through 6/30/09	17,691.48	
20 Negligence penalty	3,359.73	
Amnesty double negligence penalty	1,066.12	
Amnesty interest penalty	<u>1,279.74</u>	
21 Total tax, interest, and penalties	<u>\$56,994.01</u>	
22 Monthly interest beginning 7/1/09	<u>\$223.98</u>	

23 UNRESOLVED ISSUES

24 **Issue 1:** Whether petitioner has established that additional adjustments are warranted for
 25 disallowed netted interstate commerce sales. We recommend no further adjustments.

26 Petitioner, a corporation, sells fabric at retail and wholesale to various hotels or their
 27 purchasing agents. The fabric is used to manufacture bed spreads, upholstery, and drapes. It is not
 28 uncommon for an out-of-state customer to direct that petitioner deliver the fabric to a fabricator for

1 final delivery to the customer outside of California.

2 During the audit, the Sales and Use Tax Department (Department) examined all sales invoices
3 for the audit period on an actual basis and found that petitioner did not collect sales tax reimbursement
4 or report sales tax on sales with final out-of-state destinations, without considering whether title
5 transferred to the customer or its purchasing agent in California, and instead petitioner netted such
6 sales from its reported gross receipts. The Department also noted that a portion of these netted sales in
7 interstate commerce were actually delivered to California fabricators, as directed by the customers'
8 purchase orders, prior to shipment out of state. The Department found that title transferred to the
9 customers upon delivery of the fabric to the California fabricators in these sales and that sales tax
10 applied because the sales were not exempt interstate sales.

11 The Department also noticed recorded sales in interstate commerce to Indian tribes located in
12 California for which petitioner delivered the fabric directly to California fabricators pursuant to the
13 tribes' purchase orders. According to Mr. J. Caleb Donner, petitioner's representative, the fabric was
14 thereafter shipped to the Indian reservations by common carriers chosen and paid for by the tribes.
15 Since the sales of fabric to Indian tribes were delivered to fabricators, the Department again found that
16 title transferred to the tribes off the reservation upon delivery to the fabricators in California.
17 Therefore, the Department found that these sales did not qualify for the exemption for sales to Indians
18 on reservations and concluded that the transactions were subject to sales tax.

19 Four transactions with an Indian Tribe, the Morongo Band of Mission Indians (Morongo),
20 totaling \$60,698, and a portion of the sale to the Oklahoma State University totaling \$4,958.64, remain
21 at issue.

22 With respect to the transactions with Morongo, petitioner notes that Morongo is a sovereign
23 Indian tribe not subject to sales and use tax. Petitioner asserts that Morongo's purchase orders contain
24 a clause specifying that Morongo does not take title to any purchased item until the property is actually
25 delivered on the reservation. Petitioner argues that Morongo was not at risk for damaged goods prior to
26 their reaching the reservation, and thus title to the property did not transfer to Morongo prior to delivery
27 on the reservation. Petitioner also contends that various purchase orders with FOB East Coast and FOB
28 Los Angeles title clauses were actually exempt sales in interstate commerce and not subject to tax.

1 California Code of Regulations, title 18, section (Regulation) 1616, subdivision (d)(4)(A),
2 provides that sales tax does not apply to sales of tangible personal property made to Indians negotiated
3 at places of business located outside Indian reservations if, and only if, the property is delivered to the
4 purchaser on the reservation and ownership of the property transfers to the purchaser on the
5 reservation. Subdivision (b)(3)(D) of Regulation 1628 explains that, unless explicitly agreed that title
6 is to pass at a *prior* time, the sale occurs when and where the retailer completes its obligations
7 regarding delivery. Petitioner relies on the provision in the Morongo purchase orders that states that
8 “title to the property transfers to the tribe upon delivery on the reservation and not before.” However,
9 the provision fails to specify who was supposed to make the delivery. In order to be an exempt sale,
10 delivery to the reservation must have been made by the seller or pursuant to a specific FOB reservation
11 provision.

12 The available evidence indicates that petitioner delivered the fabric only to the California
13 fabricator, and the purchase order contains no provision that required petitioner to deliver the fabric to
14 Morongo on the reservation. In fact, petitioner had no part in delivering the property to the
15 reservation. Instead, Morongo arranged and paid for delivery by common carrier of the fabric from the
16 California fabricator to the tribe on the reservation. As such, petitioner’s sales to Morongo occurred
17 when it completed its responsibilities with respect to physical delivery of the products *to the California*
18 *fabricator*. Thus, the sales did not did satisfy the conditions for the exemption.

19 With respect to petitioner’s claims that Morongo did not bear the risk of loss prior to delivery
20 on the reservation, petitioner has not shown any instances in which petitioner, and not Morongo, bore
21 the risk of loss at any time after the delivery of the product to the fabricator, and based on the
22 documentation presented, we conclude that petitioner did not bear such risk.

23 With respect to disallowed purchase order number OSU-404 for \$31,376, for which a reduction
24 of \$22,253 had been allowed resulting in revised disallowed measure of \$9,123, petitioner argues that
25 an additional \$4,958.64 should be allowed for this sale. Petitioner contends that it was merely a sales
26 representative of Northeast Textile, Inc. for this transaction. In support, petitioner provided a copy of
27 its sales representative agreement with Northeast and a copy of Northeast invoice number 40705 dated
28 March 31, 2003. The invoice refers to purchase order number OSU-404 and shows that Northeast

1 made an ex-tax sale of fabric to Rausch Purchasing Management/Oklahoma State University
2 Foundation totaling \$22,253.22 (\$21,336 fabric + \$917.22 freight charges). The invoice also shows
3 that the purchase was prepaid and the fabric was shipped from Clover, South Carolina, to a fabricator
4 in Vernon, California.

5 We note that petitioner's purchase order number OSU-404 contains specific references to
6 Northeast and invoice number 40705 that total \$22,253.22 (\$20,994 + \$342 + \$917.22), which agrees
7 with the amount of the Northeast invoice and the amount of allowed reduction. However, purchase
8 order number OSU-404 also includes additional sales of fabric to Rausch totaling \$9,122.64
9 (\$4,958.64 + \$4,164) that was shipped to Phoenix Draperies in Vernon, California. Petitioner has not
10 provided any corresponding Northeast invoice to show that Northeast also sold the \$9,122.64 in
11 additional fabric to Rausch or that petitioner was a Northeast sales representative for these particular
12 sales as well. In addition, the purchase order makes no reference to Northeast or any Northeast invoice
13 numbers for these sales. Thus, petitioner has failed to produce evidence that shows it was acting as a
14 sales representative on behalf of Northeast for the additional fabric sales on purchase order number
15 OSU-404. Absent such evidence, we find no basis for removing any of the remaining \$9,123 from the
16 disallowed taxable measure for purchase order number OSU-404.

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

18 Section 6484 provides that if any part of the deficiency for which a deficiency determination is
19 made was due to negligence or intentional disregard of the law or authorized rules and regulations, a
20 penalty of 10 percent of the amount of the determination shall be added thereto. In determining
21 negligence, the test is whether the taxpayer's conduct met the standard of care of a reasonably prudent
22 businessperson in the attendant circumstances, and imposing a negligence penalty is justified where the
23 same types of errors found in a prior audit are continued in a subsequent audit period (*Independent*
24 *Iron Works, Inc. v. State Board of Equalization* (1959) 167 Cal.App.2d 318, 323).

25 Here, the same type of error found in the prior audit was repeated in the current audit period.
26 Additionally, in the prior audit, the Department sent petitioner a letter dated June 18, 2001, granting
27 relief under Revenue and Taxation Code section 6596 for the errors found in the prior audit, but
28 explaining the proper application of tax and advising petitioner that its failure to report sales properly

1 in the future would result in assessments of additional tax, interest, and possible penalties, particularly
2 for reporting periods commencing after July 1, 2001 (which includes all the reporting periods at issue
3 here). However, petitioner continued to not report as taxable transactions in which the fabric was
4 delivered to in-state fabricators.

5 Petitioner claims that it did not intend to report its tax liability in a negligent manner and
6 therefore lacked the “requisite intent.” The penalty is applicable when a taxpayer *is* negligent, not
7 merely where it *intends* to be negligent. The evidence here shows that petitioner was made aware of
8 its reporting problems and failed to take appropriate action to correct them. A reasonably prudent
9 person under the same or similar circumstances would have taken corrective action to alleviate the
10 problems after being advised that it was reporting incorrectly, and certainly not allowed them to
11 continue. Also, even after the allowed reduction of \$27,426, disallowed netted sales still result in a
12 sizable understatement of \$410,467 (or 28.18 percent). The large amount and percentage of
13 understatement also indicates a standard of conduct below that of a reasonably prudent businessperson
14 and constitutes evidence of negligence. We conclude that petitioner was negligent and the penalty is
15 appropriate.

16 AMNESTY

17 Two amnesty penalties apply in this case. An amnesty interest penalty of \$1,279.74 will be
18 applicable when the liability is final because, although petitioner submitted a timely amnesty
19 application, petitioner failed to pay the amnesty-eligible tax and interest due, or enter into a qualifying
20 installment payment agreement to do so, by May 31, 2005. (Rev. & Tax. Code, §§ 7073, subd. (a)(3),
21 7074, subd. (a).) An amnesty double negligence penalty of \$1,066.12 will also be imposed, pursuant
22 to section 7073, subdivision (c), because the determination was issued after the amnesty period.

23 Mr. Scott Dworkin, petitioner’s president, submitted a statement under penalty of perjury
24 contending that the penalty is not applicable because petitioner filed a timely application and received
25 written confirmation on May 28, 2005, that its amnesty application had been accepted. As noted
26 above, it is true that petitioner submitted a timely application for amnesty.

27 Evidence indicates that petitioner was made aware of the audit liability on December 22, 2004,
28 and that, on January 4, 2005, the Department discussed the taxability of questioned sales in detail and

1 the amnesty program. On May 28, 2005, petitioner was also advised that it had to file amended sales
2 and use tax returns and pay all amnesty-eligible tax and interest, or enter into an installment payment
3 agreement to do so, by May 31, 2005. However, petitioner chose not to file amended returns to report
4 its understatement or fulfill the payment requirements of the amnesty program as a means of satisfying
5 its liability. Had petitioner complied with the requirements of the amnesty program, it could have
6 been relieved of the amnesty penalties and negligence penalty imposed on the tax for the amnesty-
7 eligible periods.

8 We conclude that petitioner's failure to satisfy its amnesty-eligible liability as required by the
9 amnesty program was not due to reasonable cause and petitioner is not entitled to relief from the
10 amnesty penalties.

11 **RESOLVED ISSUE**

12 In our D&R, we recommended adjustments totaling \$36,576. In the reaudit, the Department
13 found that, with respect to the reduction of \$12,504 we recommended, only \$3,354 had actually been
14 disallowed. Thus, this was the maximum adjustment that was available for that transaction. The total
15 adjustment allowed totaled \$27,426. We recommend no further adjustments.

16 **OTHER DEVELOPMENTS**

17 None.

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19 Summary prepared by Rey Obligacion, Business Taxes Specialist III
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