

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Credits, Cancellations and)
 Refunds Under the Sales and Use Tax Law of:)

SEL RETAIL OPERATIONS, dba)
 Sony Style)

Account Number SR Z OHB 100-043683
 Case ID 735345

Taxpayer)

Type of Business: Retailer of electronics

Audit Period: 07/01/02 – 06/30/05

Cancellation Amount: \$5,296,062.94

PROCEDURAL BACKGROUND

This cancellation of tax, interest and penalties came before the Board on the nonappearance adjudicatory calendar at its April 22, 2014, meeting. At this meeting, the Board unanimously approved the cancellation of tax, interest and penalties as recommended by staff.

LEGAL ISSUE 1

Whether SEL Retail Operations (Taxpayer) is entitled to a cancellation of tax, interest and penalties.

FINDINGS OF FACT

Taxpayer is a retailer of audiovisual electronics, computers, electronic components and accessories. Upon audit of the period from July 1, 2002, through June 30, 2005, the Sales and Use Tax Department (Department) determined a liability against Taxpayer based on differences between recorded and reported taxable sales, ex-tax purchases of fixed assets from out-of-state vendors subject to use tax examined on an actual basis, and ex-tax purchases of consumable supply items from out-of-state vendors subject to use tax examined on a test basis. On April 2, 2009, the Department issued to Taxpayer a Notice of Determination for tax of \$6,109,905.67 plus applicable interest, a negligence penalty of \$610,990.68, and an amnesty negligence penalty for amnesty eligible periods of \$41,784.69.

1 On May 1, 2009, Taxpayer filed a timely petition for redetermination and presented additional
2 documentation to support adjustments to the determined audit liability. Upon reaudit, the Department
3 reduced the amount of tax to \$4,508,952.12, the negligence penalty to \$450,895.32, and removed the
4 amnesty negligence penalty entirely¹. At the April 27, 2011, meeting of the Board, the Board
5 approved the adjustments. On May 9, 2011, the Department issued a Notice of Redetermination for
6 tax of \$4,508,952.12 plus applicable interest and a negligence penalty of \$450,895.32. On June 9,
7 2011, the determination became final and a 10-percent penalty (finality penalty) of \$450,895.21 was
8 added for failure to timely pay the determination.

9 Taxpayer subsequently provided additional documentation supporting further adjustments for
10 sales included in the determination for which the tax on those transactions had been reported and paid
11 under the account of Sony Electronics, a related entity. Upon a second reaudit, the Department
12 examined the additional documentation and allowed an adjustment of \$2,689,772.81 for tax reported
13 and paid under Sony Electronics' account. Based on the audit report dated April 18, 2013, the
14 Department reduced the amount of tax owed to \$1,819,179.31 (\$4,508,952.12 - \$2,689,772.81) and the
15 finality penalty to \$181,917.93. The Department also concluded that the negligence penalty was not
16 warranted because Taxpayer's underpayment was not the result of negligence.

17 At the April 22, 2014, meeting of the Board, the Board unanimously approved an adjustment of
18 \$5,296,062.94. The adjustment included a reduction in tax of \$2,689,772.81, a reduction in interest of
19 \$1,886,417.53, and a reduction in penalties of \$719,872.60 (removal of the negligence penalty of
20 \$450,895.32 and reduction of the finality penalty of \$268,977.28).

21 APPLICABLE LAW

22 California imposes sales tax on a retailer's gross receipts from the retail sale of tangible
23 personal property in California unless the sale is specifically exempt from taxation by statute. (Rev. &
24 Tax. Code, §§ 6012, 6051.) When the sales tax is inapplicable, use tax may be imposed measured by
25 the sales price of tangible personal property purchased from a retailer for storage, use or consumption
26 in California. (Rev. & Tax. Code, §§ 6011, 6201, 6401.) The use tax is imposed on the person
27 actually storing, using or otherwise consuming the property. (Rev. & Tax. Code, § 6202.)

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¹ The amnesty negligence penalty was removed in its entirety because there was no longer any amnesty eligible liability.

If the Board is not satisfied with the return or returns of the tax or the amount of tax, or other amount required to be paid to the state by any person, it may compute and determine the amount required to be paid and issue a deficiency determination, including interest. (Rev. & Tax Code, §§ 6481, 6482.) A 10-percent penalty (finality penalty) shall be added to the amount of any determination, exclusive of interest and penalties, that is not paid at the time it becomes final. (Rev. & Tax. Code, § 6565.) If any amount has been illegally determined either by the person filing the return or by the Board, the Board shall set forth that fact in its records, certify the amount determined to be in excess of the amount legally due and the person against whom the determination was made, and authorize the cancellation of the amount upon the records of the Board. (Rev. & Tax. Code, § 6981.)

ANALYSIS & DISPOSITION

Taxpayer and its related entity, Sony Electronics, provided documents establishing that Sony Electronics recorded sales and accrued sales tax on behalf of Taxpayer during the period at issue and that the tax owed by Taxpayer was reported and paid by Sony Electronics. Therefore, adjustments were appropriate for the tax reported and paid under the Sony Electronics' account, as well as for the finality penalty and interest amounts attributable to that tax. Based on these adjustments, we find it appropriate to cancel that portion of the liability assessed against Taxpayer.

LEGAL ISSUE 2

Whether the Taxpayer was negligent.

FINDINGS OF FACT

During the initial audit, the Department found that the taxable measure was significantly understated throughout the audit period. Audited taxable sales and purchases exceeded reported taxable sales and purchases by \$76,379,496, resulting in a tax liability of \$6,109,905.67. The Department, therefore, imposed a 10-percent negligence penalty for Taxpayer's failure to exercise the degree of care exercised by an ordinary prudent businessperson.

APPLICABLE LAW

Revenue and Taxation Code section 6484 provides for the imposition of a 10-percent penalty if any part of the deficiency for which a deficiency determination is made was due to negligence or intentional disregard of the law or authorized rules and regulations. Negligence is the failure to

1 exercise the care that a person of ordinary prudence would exercise under the circumstances. (See
2 *Howard v. Commissioner* (9th Cir. 1991) 931 F.2d 578, 581-582; see Sales and Use Tax Audit
3 Manual, § 0506.10.)

4 ANALYSIS & DISPOSITION

5 Based on the adjustments recommended in the reaudit and second reaudit that included tax
6 erroneously reported and paid by Sony Electronics, Taxpayer's tax liability was substantially reduced,
7 from \$6,109,905.67 to \$1,819,179.31. Taxpayer's underpayment was found to be substantially due to
8 legitimate confusion regarding which entity in the corporate family should be reporting the tax at issue.
9 Therefore, after all of the adjustments are taken into account, we find that the remaining differences in
10 unreported tax were not the result of a failure to exercise due care by the Taxpayer. Accordingly,
11 Taxpayer was not negligent and is entitled to the cancellation of the negligence penalty.

12 ORDER

13 It is hereby ordered that the cancellation of tax, interest and penalties as recommended by staff
14 be approved.

15 Adopted at Culver City, California, on June 25, 2014.

17 Jerome E. Horton, Chairman

19 Michelle Steel, Member

21 Betty T. Yee, Member

23 George Runner, Member

25 Marcy Jo Mandel, Member*

27 * For John Chiang, pursuant to Government Code section 7.9.
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