

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

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4 In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
5)
6 TRI-SIGNAL INTEGRATION, INC.) Account Number SR S AC 97-311287
Case ID 384478
7)
8 Petitioner)
9)

10 **Representing the Parties:**

11 For Petitioner: Robert McKibben, Representative

12 Dennis Furden, Representative

13 For Sales and Use Tax Department: Marc Alviso, Hearing Representative

14 For Appeals Division: Jeffrey G. Angeja, Tax Counsel IV

15 **LEGAL ISSUE 1**

16 Whether adjustments are warranted to the understatement of reported taxable measure.

17 **FINDINGS OF FACT**

18 Petitioner is an electrical construction sub-contractor who enters into both lump-sum and time-
19 and-material contracts and makes some retail sales. The Sales and Use Tax Department (Department)
20 found that petitioner purchased most materials and fixtures without the payment of tax or tax
21 reimbursement from out-of-state vendors or from California vendors to whom petitioner issued resale
22 certificates. The Department also noted that petitioner excluded lump-sum construction contracts from
23 reported sales and did not report any purchases subject to use tax on its sales and use tax returns prior
24 to the second quarter of 2006 (2Q06). Using a cost accountability test, the Department computed an
25 unreported cost of materials and fixtures furnished and installed on lump-sum contracts of
26 \$15,577,450. The Department also found an unreported cost of self-consumed soft drinks of \$6,050
27 and a difference between recorded and reported taxable sales of \$168,289.

28 Petitioner asserts that the audited amount of purchases of materials, computed by applying

1 50 percent to total contracts, is excessive, and argues that adjustments are warranted for purchases of
2 materials that were installed in the performance of construction contracts outside California.

3 APPLICABLE LAW

4 Revenue and Taxation Code section 6481 states, in relevant part, if the Board is not satisfied
5 with the reported amount of tax required to be paid to the state, it may compute and determine the
6 amount required to be paid upon the basis of the facts contained in the return or returns or upon the
7 basis of any information within the Board's possession or that may come into its possession. The
8 Board is not required to accept as conclusive the taxpayer's books and records, where, in conducting
9 the audit, the Board used a recognized and standard accounting procedure and determined from its
10 audit that the books and records did not reflect all taxable sales or disclose the correct tax liability.
11 (*Riley B's, Inc. v. State Board of Equalization* (1976) 61 Cal.App.3d 610, 615-616.) The burden of
12 proof is on the taxpayer to explain the disparity between the taxpayer's books and records and the
13 results of the Board's audit. (*Id.*)

14 ANALYSIS & DISPOSITION

15 To establish audited taxable measure, the Department used a materials accountability test,
16 which is a recognized and standard audit procedure. In its computations, the Department used the best
17 available information. We note that the Department made an adjustment in the audit for materials used
18 outside California, and petitioner has not provided records to show that the audited amount of
19 purchases of materials is excessive or to show that there are other errors in the Department's findings.
20 In the absence of evidence of errors in the Department's findings, we find no adjustment is warranted.

21 LEGAL ISSUE 2

22 Whether petitioner was negligent.

23 FINDINGS OF FACT

24 Petitioner provided records for audit that were incomplete. The available records show that
25 petitioner purchased materials and fixtures without payment of tax to its vendors either because
26 petitioner issued resale certificates to the vendors or because the vendors were located out-of-state.
27 Petitioner then used the materials and sold the fixtures in the performance of construction contracts,
28 but did not report tax on its returns.

1 The Department imposed a negligence penalty because the understatement, over \$15 million
2 and representing an error rate of more than 1,000 percent, is substantial, noting that petitioner
3 purchased over 80 percent of its materials and fixtures without paying tax and issued resale certificates,
4 most of which were signed by petitioner's Chief Financial Officer (CFO). The Department found that
5 petitioner, through its CFO, knew it was not paying tax on purchases of materials and fixtures but
6 nevertheless failed to report or pay tax measured by the sales price of fixtures or the cost of materials
7 purchased for lump-sum construction contracts. The Department also asserts that petitioner had
8 initially asserted (erroneously) that it paid tax or tax reimbursement with respect to its purchases of
9 materials and fixtures.

10 Petitioner disputes the penalty on the basis that it believed it had properly reported the measure
11 of tax based on the Department's prior examinations of its records. Petitioner states that most of the
12 current liability is use tax related to Internet purchases from out-of-state vendors, rather than sales tax,
13 and alleges that it was not adequately informed about the application of tax to construction contracts.
14 Petitioner also states that it only issued resale certificates to suppliers because the vendors required that
15 it do so. Thus, petitioner argues that any understatement was related to misunderstanding, rather than
16 negligence. In addition, petitioner notes that its use tax liability is not related to amounts collected
17 from customers that it failed to remit.

18 APPLICABLE LAW

19 Revenue and Taxation Code section 6484 provides for the imposition of a 10-percent penalty if
20 any part of the deficiency for which a deficiency determination is made was due to negligence or
21 intentional disregard of the law or authorized rules and regulations. Negligence is the failure to act
22 with due care and to do what a reasonably prudent person would do under the same or similar
23 circumstances. (See Sales and Use Tax Audit Manual § 0506.10.)

24 ANALYSIS & DISPOSITION

25 The understatement, though significant, was the result of confusion regarding the application of
26 tax. Moreover, the state of confusion that existed during this audit period was aggravated by the fact
27 that prior audits failed to discover similar existing errors during the preparation of two Field Billing
28 Orders for prior periods. Accordingly, we find that petitioner was not negligent, and that the

1 negligence penalty should be deleted.

2 LEGAL ISSUE 3

3 Whether relief of the failure-to-file penalty for the third quarter and fourth quarters of 2005
4 (3Q05 and 4Q05, respectively), is warranted.

5 FINDINGS OF FACT

6 Petitioner did not file sales and use tax returns for 3Q05 and 4Q05. As a result, a penalty for
7 failure to file returns was added to the amounts of tax determined for those quarters. Petitioner
8 requested relief of the failure-to-file penalties on the basis that, at the beginning of the audit, the
9 auditor informed petitioner it had been filing returns incorrectly and instructed petitioner not to file
10 returns for 1Q06 and 2Q06. Petitioner alleges that the auditor stated he would file the returns and then
11 explain the correct procedure to petitioner. (It is unclear why petitioner refers to the returns for 1Q06
12 and 2Q06 while the returns at issue are 3Q05 and 4Q05, and the specific quarters at issue are
13 particularly significant since the Department did not begin the audit until January 17, 2006, well after
14 the due date for the 3Q05 return (October 31, 2005).) The auditor states that he did not say he would
15 file the returns but instead asked petitioner to advise him if it filed returns for either 3Q05 or 4Q05 so
16 he could account for the returns in the audit.

17 APPLICABLE LAW

18 The 10-percent penalty for failure to file returns automatically applied to the determination
19 pursuant to Revenue and Taxation Code sections 6511. Revenue and Taxation Code section 6592,
20 subdivision (a) provides that such penalty may be relieved if the Board finds that the failure to make a
21 return was due to reasonable cause and circumstances beyond the person's control and occurred
22 notwithstanding the exercise of ordinary care and in the absence of willful neglect. A person seeking
23 relief of a failure-to-file penalty must submit a declaration under penalty of perjury setting forth facts
24 establishing reasonable cause in order for us to consider relieving the penalty. (Rev. & Tax. Code, §
25 6592, subd. (b).)

26 ANALYSIS & DISPOSITION

27 We find that the record shows there was some discussion regarding the filing of returns for
28 3Q05 and 4Q05. However, we find petitioner's failure to file returns for 3Q05 and 4Q05 was not

1 caused by the Department or by other reasonable cause or circumstances beyond petitioner's control,
2 and there is thus no basis for relief of the failure to file penalty.

3 LEGAL ISSUE 4

4 Whether relief of interest is warranted.

5 FINDINGS OF FACT

6 Interest has been applied from the date the tax became due to the date of payment. Petitioner
7 argued at the appeals conference that interest should be relieved, although it did not specify the period
8 for which it believes relief is warranted. Petitioner has not argued a specific reason for the relief of
9 interest.

10 APPLICABLE LAW

11 Revenue and Taxation Code section 6482 provides that the amount of a deficiency
12 determination shall bear interest from the last day of the month following the quarterly period for
13 which the amount, or any portion thereof, should have been returned until the date of payment.
14 Interest charges represent the time value of money and are mandatory. The law provides for relief of
15 interest under only very narrow circumstances, including when the failure to make a timely return or
16 payment was due to a disaster, unreasonable error or delay by a Board employee (only if no significant
17 aspect of the error or delay is attributable to the taxpayer), or reasonable reliance on written advice
18 from the Board. (Rev. & Tax. Code, §§ 6593, 6593.5, subd. (a), 6596, subd. (a).) A person requesting
19 relief of interest must file with the Board a statement under penalty of perjury setting forth the facts
20 upon which he or she bases his or her claim for relief. (Rev. & Tax. Code, §§ 6593, 6593.5, subd. (c),
21 6596, subd. (c)(2).)

22 ANALYSIS & DISPOSITION

23 Of the three potential circumstances under which to consider relief, only unreasonable error or
24 delay by a Board employee is potentially relevant. Petitioner has not identified any unreasonable error
25 or delay by a Board employee, nor does our review of the record reveal any. Accordingly, we find no
26 basis on which to relieve interest.

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ORDER

It is hereby ordered that the negligence penalty be deleted, and that otherwise the matter be redetermined without further adjustment.

Adopted at Sacramento, California, on June 11, 2013.

Jerome E. Horton _____, Chairman

Michelle Steel _____, Member

Betty T. Yee* _____, Member

George Runner _____, Member

Marcy Jo Mandel* _____, Member**

*Except as to Issue 2.

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