STATE OF CALIFORNIA

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition	)	
for Redetermination Under the	)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:	)	
	)	
--- COMPUTER SYSTEMS, INC.	)	No. SY -- XX XXXXXX-010
[now --- COMPUTER SOLUTIONS,	)	
INC.]	)	
	)	
Petitioner	)	

   The Appeals conference in the above-referenced matter was held by Staff Counsel Lucian Khan on September 7, 1993 in ---, California.

Appearing for Petitioner: --- -. ---
                 Senior Vice President
                 Operations

Appearing for the
Sales and Use Tax Department
(SUTD):   --- -. ---
                 Senior Tax Auditor -
                 CPA

                 -. --- ---
                 Supervising Tax Auditor

Protested Items

   1. Petitioner protests tax liability included in Audit Item A measured by $556,442.

   2. Petitioner protests the claimed overpayment not allowed in the audit measured by $487,016.

Contentions

   1. The sale to DEF's in the third quarter of 1990 should not be recognized until the final acceptance by the customer.

2.   Interest on the DEF's transaction should have only been assessed from the date of delivery (February 1991).

3.   Petitioner is entitled to an offset for an overpayment made during the second quarter 1987, which was measured by $487,016.

4.   The negligence penalty should not apply.

Summary

Petitioner is a corporation engaged in the business of retail sales of computer hardware and software, with service, repairs, and consultation.

In April of 1992, SUTD completed an audit of petitioner's account which covered the period January 1, 1988 through December 31, 1990. The issues raised by petitioner, and arguments supporting the issues, are as follows:

1.   Sale to DEF - This transaction involves a contract signed by petitioner for the development of computer hardware and software. Although physical delivery to DEF occurred in February of 1991, both petitioner and SUTD agree the customer was invoiced, title transferred, and payment was received all during the third quarter of 1990.

According to the terms of the contract, DEF had until March of 1992 to make final acceptance. As of the current date, final acceptance has not yet occurred.

Petitioner argues tax is not due on the transaction until final acceptance was to occur (March 1992).

SUTD argues Revenue and Taxation Code Section 6006 defines a sale to include a transfer of title or possession, conditional or otherwise. Since transfer of title, invoicing, and payment all occurred during the third quarter of 1990, tax should have been paid on the return covering that period.

2.   Interest Assessed on DEF's Transaction - Interest was assessed in the audit starting November 1, 1990 based on SUTD's finding that the DEF transaction should have been reported on the third quarter 1990 return.

Petitioner argues interest should not be assessed until after the due date for the first quarter 1991 return (May 1, 1991), because the computer was not delivered until February 1991.

3.   Offset for Second Quarter 1987 Overpayment - In May of 1987, petitioner was in negotiations with the Los Angeles ---'s Department for the furnishing and installation of a

computer system. Although a final agreement was never reached, petitioner's records mistakenly showed the transaction was complete. As a consequence, petitioner mistakenly reported tax on the second quarter 1987 return.

During the fourth quarter of 1988, petitioner discovered the previous mistake. To recapture the prior overpayment, petitioner subtracted that amount, from tax due for the quarter, and paid the remainder. The deduction did not show on the face of the return nor was there any explanation which accompanied the return. Therefore, SUTD was unaware the deduction was taken, and only became aware of this fact while auditing petitioner's records. The audit was conducted between November 1991 and February 1992.

The deduction was disallowed by the auditor, and on January 8, 1992, petitioner filed an official claim for refund.   Petitioner did not provide a waiver for the second quarter of 1987.

Petitioner argues an offset should be allowed under Revenue and Taxation Code Section 6483. SUTD argues the offset cannot be made because petitioner did not file a timely claim for refund; thus, the statute of limitations now bars the claim.

4.   Negligence Penalty - SUTD assessed a negligence penalty because it felt the records were not organized in a manner so one could easily determine the amount of tax due for each quarter. There was no smooth audit trail between invoices, worksheets, and returns. Sometimes an invoice showing a transaction which occurred during one quarter would be included in a worksheet for another quarter, or included in a different quarterly return, not corresponding with the date of the transaction.   There was a large dollar volume of underpayment, and in a prior audit, petitioner also underpaid the tax due. Petitioner encountered some difficulty in determining and explaining the reason for the fourth quarter 1988 underpayment. The problem was directly related to petitioner's inadequate records.

Petitioner admits there were some problems accounting for certain transactions (such as DEF); however, this large amount of underpayment is really attributable only to three major transactions, and thus should not be a major factor in deciding whether the penalty should be assessed.

Analysis and Conclusions

1.   Sale to DEF - "Sale" means and includes any transfer of title or possession, conditional or otherwise, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006.) This definition coincides with the common law definition of a "sale" and parallels the Commercial Code definition. (Cal-Metal Corp. v. State Board of Equalization (1984) 161 Cal.App.3d 759, 764.)

The total amount of tax on the entire sales price is due and payable on the due date of the return to be filed after the close of the reporting period in which the sale is made (Sales and Use Tax Regulation 1641(c)). All retailers must report sales tax liability on an accrual basis. (Reg. 1642(c).)

Here, although physical delivery did not occur until February of 1991, title transferred and payment was received during the third quarter of 1990. Since the physical delivery of the computer hardware and software is not required for a sale to occur, tax was due, and should have been reported on the third quarter 1990 return. Therefore, I agree with SUTD's argument on this issue.

2.   <u>Interest Assessed on DEF's Transaction</u> - Interest applies to all determinations from the date on which the amount of tax becomes due and payable until the date of payment. (Rev. & Tax. Code § 6482, Reg. 1703(b)(3).)

The return covering the third quarter of 1990 was due on or before October 31, 1990. Therefore, interest started to accrue as of November 1, 1990, not May 1, 1991 as petitioner argues.

3.   <u>Offset for Second Quarter 1987 Overpayment</u> - For purposes of sales tax, the tax return shall show the gross receipts of the seller during the preceding reporting period and shall also show the amount of taxes for this period, and any other information which the Board deems necessary. (Rev. & Tax. Code § 6453.) Every seller of tangible personal property shall keep adequate and complete records showing all deductions allowed by law and claimed in filing returns. (Rev. & Tax. Code §§ 7053 and 7054; Reg. 1698(a)(2).) Where one fails to comply with the requirements for taking a deduction, he or she may only seek reimbursement for sales tax allegedly overpaid by filing a claim for refund. (<u>Philips & Ober Electric Company</u> v. <u>State Board of Equalization</u> (1991) 231 Cal.App.3d 723.)

Revenue and Taxation Code Section 6487 provides for a three-year statute of limitations period for taxpayers filing on other than an annual basis, and when there is no evidence of fraud or intent to evade the tax.

Revenue and Taxation Code Section 6488 allows the statute of limitations period to be extended, providing the taxpayer consents in writing before the expiration of the three-year period.

Revenue and Taxation Code Section 6902 provides that for persons required to file returns on other than an annual basis (e.g., quarterly), no refund shall be approved by the Board after three years from the last day of the month following the close of the quarterly period for which the overpayment was made. <u>A refund may be approved by the Board, however, for any period for which a waiver is given under Section 6488 if a claim is filed with the Board before the expiration of the period agreed upon.</u>

Every claim shall be in writing and state the specific grounds upon which the claim is founded (Rev. & Tax. Code § 6904), and failure to file a claim within the time prescribed will constitute a waiver of any demand against the state on account of the overpayment. (Rev. & Tax. Code § 6905.)

In making the determination, the Board may offset overpayments for a period or periods against underpayments for another period or periods. (Rev. & Tax. Code § 6483.)

In order that the overpayment made during the second quarter 1987 may offset against any underpayments assessed in the audit, petitioner must show that the deduction taken on the fourth quarter 1988 return properly complied with the requirements for taking a deduction, or in the alternative, a timely claim for refund was filed within the required three-year period, or the three-year period was extended under Section 6488.

According to the facts, petitioner deducted the second quarter 1987 overpayment from the fourth quarter 1988 sales figures before the return was prepared. Since no deduction was taken on the return, SUTD had no knowledge of it, or reason to question whether it was appropriate. The only way the deduction could have been detected was by reviewing petitioner's records; however, when this occurred, even petitioner encountered problems trying to determine why the sales figures did not match the figures on the return. Therefore, because the deduction was not properly taken on the face of the return, petitioner must show that a timely claim for refund was made.

Here, the overpayment was included with the second quarter 1987 return. The due date for this return was July 31, 1987; therefore, petitioner was required under Section 6902 to file the claim within three years of this date (July 31, 1990) unless a waiver was given under Section 6488 to further extend this period. The claim for refund was made on January 8, 1992, and no waiver was provided; therefore, I conclude the claim was not timely.

4.   Negligence Penalty.

Petitioner was assessed a 10 percent negligence penalty for failure to maintain adequate and complete records. Revenue and Taxation Code Section 6484 provides for the imposition of the 10 percent penalty if any part of the deficiency for which the determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations. In determining whether petitioner is negligent, the test is whether or not the petitioner's conduct met the standard of care of a reasonable prudent businessperson in the attendant circumstances. (Southeastern Finance Company v. Commissioner, 115 F.2d 205 (1946).) A substandard degree of care is not to be imputed in a case based solely on a reasonable error in interpreting the applicable law. Negligence is defined in the American Heritage Dictionary (2nd college ed.) as the omission or neglect of any reasonable precaution, concern, care or action.

I agree with SUTD that the negligence penalty should apply. This is the second audit in which it has been determined that petitioner has underpaid its taxes. There was no smooth audit trail between invoices, worksheets, and tax returns. Transactions which should have been reported in one quarter were in fact reported in another. When questioned about the discrepancy between the figures on the fourth quarter 1988 return as compared to the books and records, even petitioner encountered difficulty providing an explanation. Petitioner admits having trouble accounting for certain transactions (DEF's) which resulted in confusion and inaccurate reporting. As a result of these record-keeping problems, a large volume of sales were not properly reported.

<u>Recommendation</u>

Deny the petition.

_____   _____
Lucian Khan, Staff Counsel   Date