

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of: INNOVATIVE COIN LAUNDRIES, LLC <hr/>) OTA Case No. 18063253) CDTFA Case No. 921863) CDTFA Acct. No. 100-861755)) Date Issued: April 8, 2019))
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OPINION

Representing the Parties:

For Appellant: Harry-Todd Astrov, Esq.

For Respondent: Joseph Boniwell, Tax Counsel

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 6561,¹ Innovative Coin Laundries, LLC (appellant) appeals a 40-percent penalty of \$58,655.35 imposed by respondent California Department of Tax and Fee Administration (CDTFA) for sales tax reimbursement collected but not remitted. The 40-percent penalty is included in a Notice of Determination (NOD) issued by CDTFA on September 11, 2015, for the period April 1, 2011, through March 31, 2014.

Appellant waived its right to an oral hearing and, therefore, the matter is being decided based on the written record.

ISSUE

Whether the 40-percent penalty for unremitted sales tax reimbursement is warranted.

FACTUAL FINDINGS

1. Appellant is a retailer, wholesaler, and lessor of commercial laundry equipment. For the audit period April 1, 2011, through March 31, 2014, appellant used Quickbooks

¹ Unless otherwise indicated, all statutory references are to “sections” or “§” of the Revenue and Taxation Code.

accounting software to record its taxable sales and sales tax reimbursement that it collected.

2. Upon audit, CDTFA compared the taxable sales recorded in appellant's sales tax liability reports² for the audit period (\$2,701,128) with the amount of taxable sales reported on appellant's sales and use tax returns for the same period (\$978,306), and computed a difference of \$1,722,822 (\$2,701,128 - \$978,306).
3. CDTFA also compared the amount of sales tax reimbursement recorded in appellant's sales tax liability reports with the amount of tax reported on appellant's sales and use tax returns and found that the recorded sales tax reimbursement exceeded appellant's reported tax by \$146,638, representing sales tax reimbursement that appellant collected from its customers but did not remit.
4. In the September 11, 2015 NOD, CDTFA imposed a 40-percent penalty pursuant to section 6597, in the amount of \$58,655.35.
5. Appellant had knowledge of its sales and use tax reporting requirements, as evidenced by the facts that: appellant had maintained an active seller's permit since 2007, and had correctly calculated tax and properly charged sales tax reimbursement on its sales invoices; appellant had been audited previously for the period April 1, 2008, through March 31, 2011;³ appellant admits that when it was time to prepare appellant's sales and use tax returns, its office assistant informed appellant's managing member of the total tax liability for the quarter, and appellant's managing member then checked appellant's bank account and advised the office assistant to pay the tax liability based on the available funds in the bank account, thereby reporting less tax than was due.
6. Appellant agrees with the amounts established in the audit for unreported taxable sales and an allowance for taxable bad debts, but protests the imposition of the 40-percent penalty. Appellant asserts that the 10-percent negligence penalty is warranted, but not the 40-percent penalty. This timely appeal followed.

² We understand the "sales tax liability reports" to be sales journals.

³ CDTFA states that in the prior audit, it established unreported taxable sales of \$1,147,684 and imposed a 10-percent penalty for negligence.

DISCUSSION

Effective January 1, 2007, section 6597(a)(1), provides that any person who knowingly collects sales tax reimbursement or use tax and fails to timely remit that tax or tax reimbursement to CDTFA is liable for a penalty of 40 percent of the amount not timely remitted. The penalty does not apply if the person's liability for unremitted tax or tax reimbursement averages \$1,000 per month or less, or does not exceed 5 percent of the total amount of the tax liability for which the tax or tax reimbursement was collected for the period in which the tax was due, whichever is greater. (§ 6597(a)(2)(A).) However, if a person's failure to make a timely remittance of sales tax reimbursement, or use tax, is due to reasonable cause or circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person shall be relieved of the 40-percent penalty. (§ 6597(a)(2)(B).)

Preliminarily, we note that based on sections 0509.05 and 0509.15 of its Audit Manual, CDTFA has concluded that the penalty imposed by section 6597 is an evasion penalty, and therefore CDTFA asserts that it is required to prove fraud or intent to evade the payment of tax by clear and convincing evidence before the penalty may be imposed. However, CDTFA has not alerted us to any statute, regulation, or precedential opinion as authority to support a conclusion that the 40-percent penalty under section 6597 is an evasion penalty. We find no support in section 6597 for the proposition that it is a fraud penalty.⁴ Moreover, we are aware of no authority for the proposition that CDTFA's Audit Manual is a binding legal authority that the Office of Tax Appeals must follow. Accordingly, we conclude that the 40-percent penalty is not an evasion penalty, and that CDTFA may properly impose it when CDTFA satisfies the criteria of section 6597 by a preponderance of the evidence.⁵

Next, there is no dispute that appellant collected sales tax reimbursement of \$230,375 during the audit period, but only reported and remitted tax due of \$83,752 on its sales and use tax returns. Moreover, appellant was aware of the correct amounts of tax due when it decided to report and remit lower amounts. Specifically, while appellant maintained sales tax liability

⁴ We note that section 6597 contains no language stating that it is a fraud penalty, and furthermore, section 6597(b) provides that the penalty may be relieved based upon a showing of reasonable cause (i.e., non-negligent circumstances beyond a person's control). We find it implausible that the imposition of a "fraud" penalty under section 6597(a), established by clear and convincing evidence, could be relieved based upon a showing of the mere absence of negligence under section 6597(b).

⁵ As explained below, the facts of this case establish that the penalty was properly imposed even under the clear and convincing standard of proof applicable to evasion penalties.

reports that clearly showed its taxable sales and the amounts of sales tax reimbursement collected from its customers, appellant reported and remitted substantially lower amounts to CDTFA – and specifically instructed its office assistant to do so. Thus, appellant knowingly collected the tax reimbursement and failed to remit it to CDTFA. Furthermore, appellant’s unreported tax averaged more than \$1,000 per month and it is more than five percent of the total tax due for the periods at issue herein. Thus, we find that the requirements of section 6597 for imposing the 40-percent penalty have been satisfied, even if we were to apply the clear and convincing standard of proof applicable to an evasion penalty.

On appeal, appellant argues that its severe cash flow shortages constitute reasonable cause for failing to remit the tax reimbursement. Appellant also contends that its managing member experienced significant health issues that prevented appellant from timely remitting the tax reimbursement. Specifically, appellant asserts that its managing member was experiencing severe back pain in 2013 and was prescribed Oxycodone to relieve the pain, as a result of which he could not drive or “provide sustained focus on [appellant’s] business.” In addition, appellant asserts that in December 2013, the managing member suffered an aneurysm and was “laid up” for three months while he recovered from this incident.

We note first that there are no provisions in section 6597 that allow relief from the 40-percent penalty based on financial difficulties. Second, as to the alleged health issues of appellant’s managing member, section 6597(b)(1)(A) provides that the 40-percent penalty may be relieved based on a taxpayer’s illness, if that illness caused the person’s failure to timely remit the tax. Here, appellant has failed to establish that the managing member’s alleged illness caused appellant’s failure to remit \$146,638 in tax reimbursement. Specifically, appellant’s own records accurately reflected the correct amount of its taxable sales (\$2,701,128), and the full amount of tax reimbursement it collected (\$230,375), but appellant has failed to establish how the managing member’s alleged illnesses caused appellant to both substantially underreport its taxable sales and to pay significantly less tax reimbursement than the amounts recorded in its own records. Moreover, the alleged health issues in 2013 do not bear upon appellant’s failure to remit the tax reimbursement it collected in 2011 and 2012. Therefore, we conclude that relief of the 40-percent penalty is not warranted.

HOLDING

We conclude that the 40-percent penalty for sales tax reimbursement collected but not remitted was properly imposed, and no relief is warranted.

DISPOSITION

We sustain respondent's action in full.

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:
Neil Robinson
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Neil Robinson
Administrative Law Judge

DocuSigned by:
Daniel K. Cho
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Daniel K. Cho
Administrative Law Judge