

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
JAX LOGISTICS, INC.

) OTA Case No. 18011926
) CDTFA Account No. 101-034938
) CDTFA Case ID: 836399
)
) Date Issued: May 13, 2019
)

OPINION

Representing the Parties:

For Appellant: Manuel A. Almeida, Representative
Jeff Palmer, Accountant

For Respondent: Mengjun He, Tax Counsel III
Scott Claremon, Tax Counsel IV
Lisa Renati, Supervising Tax Auditor III

For Office of Tax Appeals: Tom Hudson, Tax Counsel III

M. GEARY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Jax Logistics, Inc. (appellant) appeals from the October 5, 2017 Decision and Recommendation (D&R) issued by respondent California Department of Tax and Fee Administration (Department), which recommended removal of a negligence penalty but otherwise recommended that appellant’s liability for \$205,994.75 in tax, plus accrued interest, for the period from July 1, 2010, through June 30, 2013, be redetermined without adjustment in accordance with the Notice of Determination (NOD) issued by the Department on June 20, 2014.

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Andrew J. Kwee, and Daniel K. Cho, held an oral hearing for this matter in Los Angeles, California, on February 20, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Is appellant entitled to a reduction in the measure of unreported taxable rental receipts?

FACTUAL FINDINGS

1. Appellant is a California retailer, wholesaler and lessor of tangible personal property (TPP), which consisted of trusses, stages, rigging, steel decks and related accessories.¹ It has held a California seller's permit since March 1, 2007. During the audit period, appellant purchased TPP ex-tax.² Appellant also did not report or pay use tax measured by its cost directly to the Department or its predecessor, the Board of Equalization (BOE). Appellant sold and leased the TPP in California. It paid sales tax in connection with some of its sales but did not pay any tax in connection with its leases.
2. The BOE audited appellant for the period July 1, 2010, through June 30, 2013, determining an aggregate deficiency measure of \$2,229,684, consisting of the following three audit items: (1) unreported rental receipts measuring \$2,204,514; (2) ex-tax small tool purchases subject to use tax measuring \$6,648; and (3) disallowed claimed sales in interstate commerce measuring \$18,552. Based on this audit, the BOE issued an NOD on June 20, 2014, for \$205,994.75 in tax, plus applicable interest, and a negligence penalty of \$20,559.49.³
3. On July 16, 2014, appellant filed a petition for redetermination contesting the first and third audit issues (unreported rental receipts and unreported sales in interstate commerce) and the negligence penalty. According to the D&R, appellant conceded the second audit issue (underreported ex-tax purchases subject to use tax) at the appeals conference on May 11, 2017.

¹ Appellant's customers used the TPP to construct stages and related appurtenances for concerts or other performances.

² By "ex-tax" we mean that appellant purchased the TPP without paying sales or use tax.

³ Appellant made payments toward its liability totaling \$110.41 between July 7, 2014, and July 19, 2017. In addition, the BOE applied a credit of \$5,869 to offset part of the liability at issue in this appeal. Appellant has not filed a claim for refund for these payments. However, appellant will have six months from the date the NOD becomes final (after the conclusion of this appeal), to file a claim for refund for these amounts, in accordance with R&TC section 6902.

4. The D&R also recommended deleting the negligence penalty, but otherwise recommended that the liability be redetermined without adjustment.⁴ This timely appeal followed.
5. Appellant concedes that it purchased TPP ex-tax and did not timely elect to pay use tax to the state measured by the purchase price. Appellant further concedes that it rented or leased that same TPP in this state, and that it did not remit use tax to the state measured by the rental or lease payments that accrued during the audit period.

DISCUSSION

A retailer owes sales tax on its gross receipts from the retail sale of tangible personal property in California. (R&TC, § 6051.) When sales tax does not apply, use tax applies to the storage, use, or other consumption of TPP purchased from any retailer for storage, use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (Rev. & Tax. Code, §§ 6201, 6401.) A “lease” or “rental” is a granting of possession of TPP by a lessor to a lessee for a consideration. (R&TC, §§ 6006.1, 6006.3.) Generally, a lease of TPP is a continuing sale and purchase for the duration of the lease, and tax is due on the rentals payable. (R&TC, §§ 6006.1, 6010.1; Cal. Code Regs., tit. 18, § 1660(b)(2), (c)(1).) However, a lease of TPP is not a continuing sale and purchase, and therefore is not subject to tax, if the lessor leases it in substantially the same form as acquired and the lessor made a timely election to pay California sales tax reimbursement or use tax measured by the lessor’s purchase price of the property. (R&TC, §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1; Cal. Code Regs., tit. 18, § 1660(b)(1)(E), (c)(2).) If a lessor did not pay sales tax reimbursement or use tax to its vendor when it purchased the tangible personal property and the lessor does not want to pay use tax measured by its rental charges, the lessor must timely report and pay tax measured by the full purchase price with its return for the period during which the property is first placed into rental service. (Cal. Code Regs., tit. 18, § 1660(c)(2).) If the lessor does not make a timely election to pay tax on the purchase price, the lessor may not retroactively do so. (*Action Trailer Sales, Inc. v. State Bd. of Equalization* (1975) 54 Cal.App.3d 125, 131-132.)

In this appeal, appellant concedes it did not pay sales tax reimbursement or use tax to its vendor or make a timely election to pay tax measured by the purchase price with the returns for

⁴The D&R indicates that the Department agreed to delete the negligence penalty because this was appellant’s first audit.

the periods during which appellant first placed the TPP in rental service. Its sole argument is that it misunderstood the law. It further concedes that it rented or leased that same TPP in the state, and that it did not remit use tax to the state measured by the rental or lease payments that accrued during the audit period. Appellant asserts that it was always its intent to pay tax measured by the price it paid for the TPP, and that it never made a “conscious election” to pay use tax measured by rental charges. It contends that, due to management’s lack of knowledge and experience, and to California’s complex sales and use tax laws regarding leases of TPP, it was unable to implement a process to accurately compute and timely pay tax measured by its cost. It also argued that it was possible that some of the vendors from whom appellant purchased the TPP, or some of the lessees to whom appellant rented the TPP may have remitted sales or use tax to the BOE, and it at least implied that the Department should have done something to learn whether they did.

The Department established a reasonable basis for its determination that appellant failed to report use tax due measured by taxable rental receipts of \$2,204,514 for the period from July 1, 2010, through June 30, 2013. Appellant concedes all of the elements required to establish its liability with the exception of the determined measure, and it offered no explanation or evidence to dispute the measure determined by the Department. Based on the evidence, we find that appellant is not entitled to a reduction in the measure of unreported taxable rental receipts. This finding is dispositive. Nevertheless, we will address some of the arguments raised by appellant.

We have no evidence to establish what appellant intended to do. Regardless, the liability under these circumstances is not determined by what the taxpayer intended to do. It is determined by what the taxpayer did, and a conscious election is exactly what the law requires. Absent a timely election, tax is owed measured by the rental income stream. Appellant did not timely elect to pay tax measured by its cost, and it cannot do so now.

The law that governs a lessor’s election to pay tax measured by purchase price is not especially complex: if the lessor fails to pay tax to its vendor, it must report and pay that tax, measured by the purchase price, on its return for the period during which the TPP is first placed in service. Furthermore, even if there was evidence to show that appellant was not aware of the requirements for an effective election, the result would be the same. The law clearly states what is required, and appellant failed to familiarize itself with those requirements at its own risk.

Ignorance or a misunderstanding of California’s tax law does not excuse a failure to follow the law. (*Appeal of LaVonne A. Hodgson* (02-SBE-001) 2002 WL 245667.)

Finally, appellant’s suggestions that the Department should have determined whether appellant’s vendors or lessees may have paid the tax ignores the fact that the Department carried its burden by establishing a reasonable basis for the determination. (See *Schuman Aviation Co. Ltd. v. U.S.* (2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Michael E. Myers* (2001- SBE- 001) 2019 WL 1187160.) The Department met its burden, and the burden of proof shifted to appellant to establish that a result different from the Department’s determination is warranted. (*Riley B’s, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Appellant did not carry that burden.

HOLDING

Appellant is not entitled to a reduction in the measure of unreported taxable rental receipts.

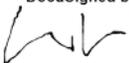
DISPOSITION

We sustain the Department’s action agreeing to delete the negligence penalty but otherwise redetermining the liability without adjustment.

DocuSigned by:

1A9B52EF88AC4C7
Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:

3CADA62FB4884CB
Andrew J. Kwee
Administrative Law Judge

DocuSigned by:

7B28A07A7E0A43D
Daniel K. Cho
Administrative Law Judge