OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011950) CDTFA Case IDs: 869833 & 876220) CDTFA Acct No. SR Y KH 102-136512
ABDUL SALAM AND ZAHIDA PERVEEN, dba Salam U.S. Wireless	) Date Issued: April 16, 2019

OPINION

Representing the Parties:

For Appellant:	Rohail Islam, representative
For Respondent:	Mengjun He, Tax Counsel III
For Office of Tax Appeals:	Richard Zellmer Business Tax Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, the partnership of Abdul Salam and Zahida Perveen (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] on a timely petition for redetermination of a Notice of Determination (NOD) assessing a tax deficiency of $4,814.78, plus applicable interest, for the period January 1, 2012, through December 31, 2014.[2]

Office of Tax Appeals (OTA) Administrative Law Judges Jeffrey G. Angeja, Neil Robinson, and Jeffrey I. Margolis, held an oral hearing for this matter in Sacramento, California,

[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of the BOE relevant to this case were transferred to the California Department of Tax and Fee Administration (CDTFA). (Gov. Code, § 15570.22; 2017 Stats. 2017, ch. 16, § 5.) For ease of reference, the term "CDTFA" shall refer to both, depending on the context and timing. When referring to acts or events that occurred before January 1, 2018, "CDTFA" shall refer to the BOE; and when referring to acts or events that occurred on or after January 1, 2018, "CDTFA" shall refer to CDTFA.

[2] Appellant also filed a claim for refund of $794 for alleged over-payments made on its sales and use tax returns for the second and fourth quarters of 2013, all quarters of 2014, and the first quarter of 2015. Appellant concedes that this issue was resolved during the audit, and therefore, appellant no longer seeks a refund of the alleged $794 overpayment.

on February 27, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether appellant has established that it is entitled to relief from the tax and interest based on erroneous advice received during a prior audit.

FACTUAL FINDINGS

The Current Audit Liability

1. Appellant, a husband and wife partnership doing business as Salam U.S. Wireless, is an authorized Metro PCS retailer of cellular telephones and accessories.
2. CDTFA audited appellant for the period January 1, 2012, through December 31, 2014. In that audit, CDTFA found that appellant received rebates from Metro PCS as reimbursement when it sold cellular telephones to end-user customers at discounted prices. CDTFA considered these third-party rebates as taxable gross receipts. The audit included a measure of tax of $163,598 for unreported taxable third-party rebates.
3. CDTFA issued a Notice of Determination (NOD) to appellant for tax of $12,929.66, plus applicable interest, based on the audit.
4. Appellant filed a timely petition for redetermination, protesting the NOD.
5. In a re-audit, CDTFA reduced the measure of tax for third-party rebates from $163,598 to $60,486 based on new documentation furnished by appellant. This reduced the tax liability to $4,814.78. Appellant agreed that $60,486 is the correct amount of third-party rebates, but continued to seek relief from the tax based on appellant's alleged reliance on erroneous advice received during a prior audit.
6. In a Decision and Recommendation issued August 17, 2017, CDTFA's Appeals Bureau denied appellant's request to relieve the tax. This appeal followed.

The Prior Audit of the Related Predecessor Entity

7. A prior audit of a separate, but related, predecessor entity was conducted for the period January 1, 2007, through December 31, 2009. During the majority of the prior audit period (from January 1, 2007, through June 1, 2009) the predecessor business was owned by an unrelated taxpayer, but one of appellant's partners, Mr. Salam, acquired the

business in May 2009. From January 1, 2009, through June 1, 2009, the predecessor made retail sales of personal accessories (such as wallets, sunglasses, and purses) at flea markets. In May 2009, when Mr. Salam acquired the predecessor, Mr. Salam also acquired a second business selling cellular phones at retail. Mr. Salam operated both businesses as a sole proprietor.

8. The workpapers and other information from the prior audit contain no indication that the auditor was aware of third-party rebates. Further, they contain no evidence that the auditor performed an examination or analysis that would have disclosed that rebates were involved.

9. It is undisputed that the prior audit of the predecessor qualifies as prior written advice with respect to appellant. Specifically, there is common ownership between appellant and the predecessor since Mr. Salam wholly owned the sole proprietorship and is a 50-percent owner of petitioner. Also, appellant is a legal, statutory successor to the predecessor because the predecessor changed from a sole proprietorship to a partnership. Therefore, appellant has standing to seek relief based on the written advice received by the predecessor. (See Cal. Code Regs., tit. 18, § 1705(c).)

DISCUSSION

California imposes sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) Gross receipts are not solely limited to amounts that the retailer collects from the purchaser, but may also include amounts the retailer receives from other sources. (R&TC, § 6012(b).) California Code of Regulations, title 18, section (Regulation) 1671.1, which became effective October 1, 2007, provides in subdivision (c)(3)(A) that when a retailer enters into an oral or written contract with a manufacturer or other third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products in exchange for a certain payment of a like amount from the contracting party (e.g., a payment that is not contingent upon selling a particular amount of the specified products), such payment is part of the taxable gross receipts or sales price of the sale. It is rebuttably presumed that any consideration received by

retailers from third parties related to promotions for sales of specified products is subject to tax until the contrary is established. (Cal. Code Regs., tit. 18, § 1671.1, subd. (c)(3)(A).)

Here, it is undisputed that appellant received rebates of $60,486 from Metro PCS in exchange for specific reductions in appellant's selling prices of its cellular phones, and as such, the rebates are taxable gross receipts. (Cal. Code Regs., tit. 18, § 1671.1, subd. (c)(3)(A).) Appellant concedes that tax applies to the rebates it received.

However, appellant asserts that it should be relieved of the tax because the business was previously audited, and in that prior audit CDTFA failed to explain that the third-party rebates are subject to tax. Appellant argues that the prior audit disclosed that cellular telephone purchases exceeded reported total sales, which should have alerted the auditor that rebates were involved. Appellant further adds that it should be relieved of the liability for the tax because appellant's failure to charge and report tax on the third-party rebates was an honest mistake, and prior to the current audit it was not aware that the third-party rebates were subject to tax. Appellant states (and there is no dispute) that once it was informed in April 2015 that tax was due on the rebate amounts, it immediately began charging and reporting tax on the rebates. Appellant also argues that it should be relieved of the tax because other cellular retailers were not charging tax on similar third-party rebates.

R&TC section 6596, subdivision (a), provides that if a person's failure to make a timely return or payment was due to that person's reasonable reliance on written advice from CDTFA, the person may be relieved of any sales or use taxes imposed. A taxpayer is eligible for relief if, in reliance on the written advice, the taxpayer failed to charge or collect sales tax reimbursement. (R&TC, § 6596(b)(3).) A person's failure to make a timely return or payment shall be considered to be due to reasonable reliance on written advice from CDTFA, only if *all* of the following conditions are satisfied:

> (1) the person requested in writing that CDTFA advise him or her whether a particular activity or transaction is subject to tax under this part. The specific facts and circumstances of the activity or transaction shall be fully described in the request.
> (2) CDTFA responded in writing to the person regarding the written request for advice, stating whether or not the described activity or transaction is subject to tax, or stating the conditions under which the activity or transaction is subject to tax.
> (3) In reasonable reliance on CDTFA's written advice, the person did not do either of the following:

> (A) Charge or collect from his or her customers amounts designated as sales tax reimbursement or use tax for the described activity or transaction.
> (B) Pay a use tax on the storage, use, or other consumption in this state of tangible personal property.
>
> (4) The liability for taxes applied to a particular activity or transaction which occurred before either of the following:
> (A) Before the board rescinded or modified the advice so given, by sending written notice to the person of the rescinded or modified advice.
> (B) Before a change in statutory or constitutional law, a change in the board's regulations, or a final decision of a court, which renders the board's earlier written advice no longer valid.

(R&TC, § 6596(b).)

A person seeking relief under section 6596 is required to file a statement signed under penalty of perjury setting forth the facts on which the claim for relief is based (R&TC, § 6596 (c)(2)), as appellant has done in this appeal.

If a previous audit of the person requesting relief contains written evidence demonstrating that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered written advice from CDTFA. (Cal. Code Regs., tit. 18, § 1705(c).) Audit comments, schedules, and other writings prepared by CDTFA that become part of the audit work papers which reflect that the activity or transaction in question was properly reported, and no tax amount was due, are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous. (*Ibid*.) Presentation of a person's books and records for examination by an auditor is deemed to be a written request for the audit report by the audited person and any person with shared accounting and common ownership with the audited person. (Cal. Code Regs., tit. 18, § 1705(c).) Also, written advice from CDTFA may be relied upon by the person to whom it was originally issued and a legal or statutory successor to that person. (Cal. Code Regs., tit. 18, § 1705(a).)

Here, it is undisputed that the auditor who performed the prior audit never examined any of the relevant documentation that appellant has attached to its opening brief (i.e., the screenshot from Brightpoint dated November 23, 2010, the list of transactions from May 2012 through December 2012, and the advertisement from Metro PCS involving the $30 rebate associated with purchases of Samsung Tint phones). We note that the prior audit report is dated September 20,

2010, and thus, the auditor who performed the prior audit could not have seen the screenshot from Brightpoint dated November 23, 2010, or the list of transactions from May 2012 through December 2012. For these reasons, we find that the foregoing documentation does not show that, at the time of the prior audit, CDTFA knew that Mr. Salam received rebates. Furthermore, appellant has not provided any other documentation that is sufficient to show that CDTFA knew about the third-party rebates in the prior audit. The parties agree (and our review confirms) that the workpapers and other information from the prior audit contain no indication that the auditor was aware of third-party rebates, nor have we found evidence that the auditor performed an examination or analysis that would have disclosed that rebates were involved.

Appellant argues that CDTFA should have known that third-party rebates were involved in the prior audit because Brightpoint was the vendor of cellular telephones in the prior audit, and if the auditor had compared the purchases from Brightpoint in the prior audit to the bank statements for that same period, the auditor would have seen a discrepancy, which would have led the auditor to conclude that third-party rebates were involved. In other words, appellant essentially argues that CDTFA failed to review documents that would have alerted it that rebates were involved, and therefore CDTFA failed to properly advise appellant about the taxability of the rebates. Unfortunately, the law only authorizes relief from tax based on a prior audit report when a taxpayer establishes that the audit report contains written evidence demonstrating that the issue in question was examined. (Cal. Code Regs., tit. 18, § 1705(c).) In other words, no relief is available based on an audit report that should have caught an error but did not.

We acknowledge that appellant's error was the result of an innocent mistake, and that appellant quickly corrected its error once it realized the proper application of sales tax to its cellular phone rebates. However, since there is no written evidence establishing that this issue was examined in appellant's prior audit, we are unable to recommend relief from the liability.

HOLDING

Appellant has failed to establish that it is entitled to relief of the liability.

DISPOSITION

CDTFA's action in reducing the measure of tax to $60,486 is sustained.

DocuSigned by:
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:
Jeffrey Margolis
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Jeffrey I. Margolis
Administrative Law Judge