

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
SARRTORI, LLC

) OTA Case No. 18113999
) CDTFA Case ID: 848443
) CDTFA Acct. No. 102-481448
)
) Date Issued: August 26, 2019
)

OPINION

Representing the Parties:

For Appellant: Sugu Aria, CPA

For Respondent: Joseph Boniwell, Tax Counsel

For Office of Tax Appeals: Sarah Fassett, Tax Counsel

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Sarrtori, LLC (appellant) appeals a 40-percent penalty of \$30,965.52¹ imposed by respondent California Department of Tax and Fee Administration (CDTFA)² for sales tax reimbursement collected but not remitted. The 40-percent penalty is included in a Notice of Determination (NOD) issued by CDTFA on October 2, 2014, for the period, October 1, 2010, through September 30, 2013.

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

¹ Respondent, in its opening brief, agreed with the Decision dated October 24, 2018, to adjust the penalty from \$30,965.52 to \$29,802.40.

² Sales taxes were formerly administered by the State Board of Equalization. In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code § 15570.22; Stats. 2017, ch. 16, § 5.) For ease of reference, when referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to the board; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

ISSUES

1. Whether the R&TC section 6597 penalty (40-percent penalty) for failure to timely remit collected sales tax reimbursement was properly imposed.
2. Whether appellant has established that relief of the 40-percent penalty is warranted.

FACTUAL FINDINGS

1. Appellant is a retailer of men's clothing and performs alterations on new and used clothing. For the audit period October 1, 2010, through September 30, 2013, appellant used a point of sale (POS) system to record its taxable sales and the sales tax reimbursement that it collected from customers.
2. Upon audit, CDTFA compared the taxable sales recorded in appellant's POS system for the audit period (\$1,232,448) with the amount of taxable sales reported on appellant's sales and use tax returns for the same period (\$337,098) and computed a difference of \$895,350 (\$1,232,448 - \$337,098). Respondent also discovered \$57,195 of alterations that were recorded in appellant's POS system that were not reported on its sales and use tax returns. Respondent determined that appellant's charges for the alterations of new clothing items were taxable. During the audit, appellant indicated that 75-percent of the alterations performed were on new clothing items. Respondent regarded this as a reasonable estimate and applied the 75-percent ratio to appellant's total alteration charges to compute taxable alterations of \$42,897 ($\$57,195 \times .75$), along with the unreported taxable sales of \$895,350, which brought appellant's total measure of unreported tax to \$938,247 ($\$895,350 + \$42,897$).
3. CDTFA also compared the amount of sales tax reimbursement recorded in appellant's POS system and sales invoices (\$106,214) with the amount of tax reported on appellant's sales and use tax reports returns (\$29,177) and found that the recorded sales tax reimbursement exceeded appellant's reported tax by \$77,037 ($\$106,214 - \$29,177$), representing sales tax reimbursement that appellant collected from its customers but did not remit.
4. In the October 2, 2014 Notice of Determination, CDTFA imposed a 40-percent penalty, pursuant to R&TC section 6597, in the amount of \$30,965.52. Appellant protested the penalty, and in a Decision dated October 24, 2018, CDTFA reduced the penalty from

\$30,965.52 to \$29,802.40, but otherwise sustained the penalty. This timely appeal followed.

DISCUSSION

Issue 1 – Whether the R&TC section 6597 penalty (40-percent penalty) for failure to timely remit collected sales tax reimbursement was properly imposed.

Effective January 1, 2007, R&TC 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. (R&TC, § 6597(a)(2)(A).)

As a preliminary matter, we find it necessary to address CDTFA’s argument regarding the requirements for imposing the 40-percent penalty. In its briefs, CDTFA asserts that according to R&TC section 6597, California Code of Regulations, title 18, section (Regulation) 1703, and section 0509.65 of its Audit Manual, imposition of the 40-percent penalty requires a showing, by clear and convincing evidence, of fraud or intent to evade the payment of tax.

However, neither R&TC section 6597 or Regulation 1703 supports this position. The terms “fraud” or “evasion” are conspicuously absent here, and there is no requirement that the person “knowingly” or “willfully” fail to timely remit tax or tax reimbursement. In contrast, the inclusion of a relief provision based upon reasonable cause under R&TC section 6597(a)(2)(B), a mutually exclusive condition to fraud, suggests that imposition of the 40-percent penalty does not require a showing of fraud. Thus, it should be clear from the plain and unambiguous language of R&TC section 6597 that a showing of “fraud” is not required in order to impose the 40 percent penalty. And where the statutory language is clear and unambiguous, our inquiry is complete.³ (*Desert Palace, Inc. v. Costa* (2003) 539 U.S. 90, 98.)

Moreover, we are not persuaded by any of the legal interpretations contained in CDTFA’s Audit Manual, which are merely conclusory statements regarding the imposition of

³ While the foregoing is dispositive, we note that the legislative history supports a plain reading of the statute. (Analysis of Sen. Bill No. 1449 (2005-2005 Reg. Sess.) 3/29/2006, “This bill would not require [CDTFA] to demonstrate fraud or an intent to evade taxes”)

the 40-percent penalty. Accordingly, for purposes of imposing the 40-percent penalty, we find that it is immaterial whether the failure to timely remit tax or tax reimbursement was due to fraud or intent to evade the payment of tax.

Next, the information contained in appellant's sales records (i.e., appellant's own POS records) and sales tax returns indicate that it knowingly collected sales tax reimbursement, but failed to timely remit that tax reimbursement. Moreover, it is undisputed that the threshold amounts specified in R&TC section 6597(a)(2)(A) have been met.

Appellant does not dispute these facts. The only explanation offered by appellant for its failure to report and remit more than two-thirds of the tax reimbursement it collected is that, during the three-year period, appellant's bookkeeper was entirely at fault for the mistaken understatements reported to CDTFA. Appellant asserts that at the end of each calendar year, it provided its cash register Z tapes to an outside accountant, who correctly reported appellant's sales for income tax purposes. Appellant asserts that this shows it had no intention of failing to accurately report its sales to all agencies.

We find appellant's contention to be unpersuasive. The evidence clearly establishes that while appellant maintained POS 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. Thus, appellant knowingly collected tax reimbursement and failed to remit it to CDTFA. Appellant's alleged intention to accurately report its sales is irrelevant in light of our analysis above that intent to evade is immaterial for purposes of this penalty. It is sufficient that appellant knowingly collected tax reimbursement, and failed to remit it, in amount in excess of the thresholds specified in the statute. Therefore, we find that the 40-percent penalty was properly imposed.

Issue 2 – Whether appellant has established that relief of the 40-percent penalty is warranted.

If a person's failure to make a timely remittance of sales tax reimbursement 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. (R&TC, § 6597(a)(2)(B).)

“Reasonable cause or circumstances beyond the person's control” includes, but is not limited to, any of the following: (1) the occurrence of a death or serious illness of the person or the person's next of kin that caused the person's failure to make a timely remittance; (2) the

occurrence of an emergency, as defined in Government Code section 8558, that caused the person's failure to make a timely remittance; (3) a natural disaster or other catastrophe directly affected the business operations of the person that caused the person's failure to make a timely remittance; (4) CDTFA's failure to send returns or other information to the correct address of record caused the person's failure to make a timely remittance; (5) the person's failure to make a timely remittance occurred only once over a three-year period, or once during the period in which the person was engaged in business, whichever time period is shorter; or (6) the person voluntarily corrected errors in remitting tax or tax reimbursement that were made in previous reporting periods and remitted payment of the liability owed as a result of those errors prior to being contacted by CDTFA regarding possible errors or discrepancies. (R&TC, § 6597(b)(1)(A) – (F).)

The standard for penalty relief requires that appellant provide a non-negligent reason for its failure to timely remit the sales tax reimbursement it collected. However, appellant's contention does not demonstrate that it exercised ordinary care in this regard, because as explained above, appellant had actual knowledge of its underreporting. At a minimum, appellant could not reasonably or in good faith have relied on its bookkeeper's reporting in light of its actual knowledge of the severely understated reported amounts. Based on the foregoing, we find that appellant acted at least negligently in failing to timely remit the sales tax reimbursement it collected. Accordingly, we find that relief of the 40-percent penalty is not warranted.

HOLDINGS

1. The 40-percent penalty was properly imposed.
2. Appellant has not established that relief of the 40-percent penalty is warranted.

DISPOSITION

CDTFA's imposition of the 40-percent penalty, as reduced from \$30,965.52 to \$29,802.40, is sustained.

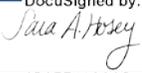
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

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Josh Lambert
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge