

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
V.A. AUTO SALES, INC.

) OTA Case No. 18073394
) CDTFA Account No. 101-067633
) CDTFA Case ID 994205
)
) Date Issued: October 14, 2019
)

OPINION

Representing the Parties:

For Appellant: Marc Brandeis, CPA
Eric Sien, Corporate Officer

For Respondent: Scott Claremon, Attorney
Sunny Paley, Attorney
Lisa Renati, Representative

For Office of Tax Appeals: Josh Lambert, Tax Counsel

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, V.A. Auto Sales, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s timely petition for redetermination of a January 4, 2017, Notice of Determination (NOD). The NOD is for \$223,816.93 in tax, plus accrued interest, for the period January 1, 2011, through December 31, 2013.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Jeffrey G. Angeja, and Teresa A. Stanley held an oral hearing for this matter in Los Angeles, California, on August 21, 2019. At the conclusion of the oral hearing, the record was closed, and this matter was submitted for decision.

¹ Sales taxes were formerly administered by the State Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to its predecessor; the board.

ISSUES

1. Whether appellant is liable for sales or use tax in connection with the transfer of salvage title vehicles.
2. Whether appellant made a taxable use of any salvage title vehicles prior to resale.

FACTUAL FINDINGS

1. Appellant, a California corporation, is licensed with the California Department of Motor Vehicles (DMV) as a wholesale dealer of motor vehicles.
2. Appellant registered as a bidder at several auction houses, including Insurance Auto Auctions (IAA) and Copart Auctions (Copart). These auction houses sell salvage title vehicles at auction in this state to DMV licensed dealers.
3. During the period January 1, 2011, through December 31, 2013 (audit period), salvage title vehicles were purchased at auction using appellant's account number with these auction houses. These purchases were made with appellant's knowledge and permission. The total amount of consideration that appellant received for the salvage title vehicles was the auction selling price (paid to the auction house) plus a fee of approximately \$70 per transaction (retained by appellant).
4. Appellant maintained a purchase journal for its purchases, which CDTFA scheduled on CDTFA Audit Schedule 12A-2. During the audit period appellant recorded vehicle purchases totaling \$2,408,856 for 2011, \$2,110,652 for 2012, and \$1,500,026 for 2013. These amounts do not include the \$70 per vehicle commission income.
5. Appellant filed sales and use tax returns reporting total sales of \$931,898 for 2011, \$25,600 for 2012, and \$55,982, for 2013. Appellant deducted all sales as nontaxable, and reported \$0 in taxable sales for the audit period.
6. On November 14, 2014, CDTFA notified appellant that appellant had been selected for an audit. During the audit, CDTFA examined appellant's vehicle purchases for third quarter 2013 (the test period) on an actual basis.
7. Appellant purchased 74 salvage title vehicles during the test period, representing 7 purchases from Copart and 67 purchases from IAA. Of these transactions, appellant resold 7 vehicles to a purchaser identified as "Kim," 4 vehicles to "Can," and the remaining 63 to "Sovey."

- **Sales to Can.** Appellant provided waybills to show that all 4 of the vehicles sold to Can were shipped to Cambodia, and CDTFA accepted these as exempt sales in foreign commerce.
 - **Sales to Kim.** Appellant provided a waybill to show that 1 of the vehicles sold to “Kim” was shipped to Cambodia, which CDTFA accepted. CDTFA disallowed the remaining 6 vehicles sold to Kim for lack of documentation.
 - **Sales to Sovey.** Appellant provided waybills to document that 40 of the vehicles sold to Sovey were shipped to Cambodia, and CDTFA allowed these transactions. CDTFA disallowed the remaining 23 vehicles sold to Sovey for lack of documentation.
8. According to appellant’s 46-page handwritten purchase journal, Kim and Sovey consistently purchased vehicles from appellant throughout the entire three-year audit period. Appellant also sold vehicles to a small number of additional purchasers.
9. For the test period, CDTFA disallowed 29 of the salvage title vehicle transactions due to lack of supporting documentation (representing 6 sales to Kim, and 23 sales to Sovey). CDTFA computed the vehicle commission as 1.54 percent of appellant’s purchase price of salvage title vehicles during the test period. CDTFA treated this as a markup and applied the markup to appellant’s recorded cost of vehicles for the audit period to determine audited total sales. CDTFA then determined an error rate of 39.51 percent based on the 29 disallowed transactions, and applied the error rate to total sales, to determine audited taxable sales for the audit period.
10. In addition, CDTFA determined that appellant withdrew three vehicles from resale inventory for self-consumption. Appellant purchased all three vehicles from Copart and resold them to Kim as follows:
- A 2003 Mercedes Benz SL500 sold to Kim on March 3, 2011 for \$7,704, and shipped to Cambodia on September 2, 2013.
 - A 2003 BMW 745 sold to Kim on September 7, 2012 for \$5,280, and shipped to Cambodia on September 2, 2013.
 - A 2004 Porsche Boxter sold to Kim on December 3, 2012, for \$2,490, and shipped to Cambodia on September 2, 2013.

11. CDTFA disallowed these three vehicle purchases from Copart, representing one purchase in 2011 and two purchases in 2012 (\$15,474). CDTFA then concluded that appellant must have made similar taxable uses throughout the audit period, and estimated appellant's self-consumption of salvage title vehicles for the entire audit period by multiplying the disallowed transactions by three and allocating the measure for this audit item as \$15,474 per year.
12. On January 4, 2017, CDTFA issued the NOD to appellant for the liability disclosed by audit, which appellant timely petitioned.
13. CDTFA denied the petition in a Decision dated June 19, 2018. This timely appeal followed.
14. On appeal, appellant furnished 244 pages of bank statements for two bank accounts for the period January 2011 through December 2013. Appellant also scheduled all deposit transactions for 2011. Substantially all of the deposits into the corporate checking accounts during 2011 were wire transfers sourced from two purchasers: Khiev Narin and Loung Kokkim.² The deposits appellant scheduled for 2011 track the deposits that CDTFA scheduled for 2011 dollar-for-dollar. As relevant, during 2011, substantially all of appellant's recorded sales were to "Kim" and "Sovey," the same two purchasers at issue for the test period. Appellant's deposits for 2013 were minimal, and the bank ceased identifying the payor for wire transfers starting July 1, 2013.

DISCUSSION

Issue 1: Whether appellant is liable for sales or use tax in connection with the transfer of salvage title vehicles.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state 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 until the contrary is established. (R&TC, § 6091.) A retail sale means a sale for any purpose other than resale in the regular course of business. (R&TC, § 6007.)

Sales for purposes of resale are excluded from the measure of tax. (R&TC, § 6012; Cal.

² \$549,931 out of \$578,554 of the deposits to the first account during 2011 were wires from Khiev Narin (the remainder are unspecified cash/check deposits). \$354,223 out of \$356,023 of the deposits to the second account during 2011 were wires from Loung Kokkim (the remainder are unspecified cash/check deposits).

Code Regs., tit. 18, § 1668(e).) The burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a certificate from the purchaser that the property is purchased for resale (resale certificate). (Cal. Code Regs., tit. 18, § 1668(a).) As relevant here, if a seller does not timely obtain a valid resale certificate, the seller will be relieved of liability for the tax only where the seller establishes that the property was in fact resold by the purchaser, and the purchaser did not make a taxable use of the property, or is being held for resale by the purchaser and the purchaser has not made a taxable use of the property.³ (Cal. Code Regs., tit. 18, § 1668(e).) One method that CDTFA authorizes to establish a sale for resale in fact is the use of XYZ letters, which are sent to the purchasers, inquiring as to the disposition of the property. (Cal. Code Regs., tit. 18, § 1668(f).) CDTFA may consider alternative methods to ascertain whether the transaction qualifies as a sale for resale in fact in the absence of XYZ letters from the purchasers. (Cal. Code Regs., tit. 18, § 1668(f)(2)(F)(4).)

In the instant case, it is undisputed that appellant did not obtain resale certificates or XYZ letters from the purchasers. Nevertheless, appellant appeals to common sense. First, appellant contends that it held a *wholesale* dealer's license, and was not registered or authorized to make retail sales of vehicles. Second, appellant contends that the vehicles were salvage title vehicles which could not legally be driven in this state. Finally, appellant emphasizes that it resold all of the vehicles to the same buyers.

We believe appellant has provided sufficient evidence to conclude that, more likely than not, the disputed transactions were nontaxable sales for resale in fact. During the audit period appellant purchased 674 vehicles from IAA alone, and virtually all of the vehicles were resold to the same group of approximately five purchasers. In fact, for 2011, substantially all of the vehicles were sold to just two purchasers: Kim and Sovey. These were two of appellant's primary purchasers. Collectively, Sovey and Kim purchased hundreds of vehicles from appellant during the audit period. According to CDTFA's Audit Schedule 1R-12A-4, during the test period, Kim purchased 7 vehicles, of which 6 were disallowed, and Sovey purchased 63 vehicles, of which 23 were disallowed. Thus, the sheer volume of sales to Kim and Sovey weighs against these being retail sales.

³ For these purposes, a taxable use is any use other than retention, demonstration, or display while holding it for sale in the regular course of business. (R&TC, § 6009.)

We also take into consideration the fact that the vehicles at issue were wrecked vehicles purchased from an insurance auction house and written off for insurance purposes.⁴ In other words, this is not the type of property to be sold at retail, and considering the sheer number of vehicles purchased by the two customers at issue (Kim and Sovey), we do not believe these were retail sales. Consistent with this finding, appellant established that substantially all of its bank deposits during 2011 came from only two individuals, which is consistent with the fact that all of appellant's recorded sales during 2011 were made to two individuals: Kim and Sovey. In conclusion, we believe appellant has sufficiently tied the sales and payments at issue to volume wholesale purchasers. In further consideration of the fact that appellant was a licensed vehicle wholesaler, and not a retailer, we find that appellant in fact sold the 29 disallowed vehicles to these two customers for the nontaxable purpose of resale in the regular course of business.

Issue 2: Whether appellant made a taxable use of any salvage title vehicles prior to resale.

A person who purchases property for resale and who subsequently uses the property owes tax on that use. (R&TC, §§ 6094(a), 6244(a); Cal. Code Regs., tit. 18, § 1668(e).) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (R&TC, § 6202.)

We previously concluded that the sales to Kim and Sovey were nontaxable sales for resale in fact. The three disallowed transactions were sales to Kim, which CDTFA disallowed because appellant failed to substantiate why it took up to 2 years to sell the vehicles and that no use occurred during this timeframe. In situations such as these, the law imposes no time limits within which property purchased for resale must be resold. (See R&TC, §§ 6094, 6244; Cal. Code Regs., tit. 18, § 1668.) Thus, for example, under similar circumstances CDTFA has concluded “[t]here are no time limits for the subsequent resale of [an aircraft purchased for resale] which would trigger a use tax liability against the purchaser so long as it is actually being held for resale and there is no intervening use of the [aircraft], other than testing, demonstration, or display.” (Sales and Use Tax Annotation 475.0220 (6/30/97).)⁵ Here, appellant contends that

⁴ As relevant, a total loss salvage vehicle is a vehicle that has been wrecked, destroyed, or damaged to such extent that the insurance company considers it uneconomical to make repairs to the vehicle and the vehicle is not repaired by or for the person who owned the vehicle when the damage occurred. (Vehicle Code, § 544(a).)

⁵ CDTFA's annotations do not have the force or effect of law. (See *Yamaha Corp. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25 [discussing the proper weight to give an annotation].)

the property was stored for shipment to Cambodia. For purposes of imposition of the use tax, the terms “storage” and “use” do not include the keeping, retaining or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside this state. (R&TC, § 6009.1.) It is undisputed that the property was ultimately transported to Cambodia on September 2, 2013, and there is no evidence of use in this state other than storage for shipment to Cambodia. Therefore, we conclude that the sales to Kim were nontaxable sales for resale in fact, and we find no basis to conclude that appellant made a taxable use of the salvage title vehicles prior to shipment on September 2, 2013.⁶


⁶ At the oral hearing, CDTFA questioned whether appellant’s personal use vehicle was registered in non-operational status because the amount paid was only \$21. On review of the DMV document at issue, it clearly states it is a “VALIDATED REGISTRATION CARD” which must be kept with the vehicle, and also specifies the “registered owner information” and effective dates for the “registration card.” We note that DMV issues a separate document, called an “Annual Non-Operated Vehicle Notice,” for vehicles placed in non-operational status. (See: < https://www.dmv.ca.gov/portal/dmv/detail/pubs/brochures/fast_facts/ffvr01 >). Although CDTFA questioned why appellant only paid \$21, we note that during 2018 (when the document was issued), the fee charged by DMV for a *duplicate* registration card was \$21. (See: < <https://www.dmv.ca.gov/portal/wcm/connect/1709af94-8b66-4ffd-ad26-27ab12efa0ed/18vin21.pdf?MOD=AJPERES&CVID> >). We further note that payment was made in “cash” and the issue date was *after* the effective date, which is consistent with this card being issued in person at a DMV office, as a replacement DMV registration card. Therefore, we conclude appellant furnished a valid DMV registration card for his vehicle, and do not address CDTFA’s contention further.

HOLDINGS

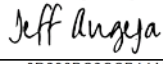
1. Appellant established that all of the disputed transactions qualify as nontaxable sales for resale in fact.
2. Appellant did not make any taxable use of the vehicles prior to reselling them in the regular course of business.


DISPOSITION

CDTFA's action is reversed. Appellant's liability is hereby reduced to \$0.

DocuSigned by:

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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:

0D390BC3CCB14A9
Jeffrey G. Angeja
Administrative Law Judge

DocuSigned by:

0CC6CEACCCBA44D
Teresa A. Stanley
Administrative Law Judge