OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	
ALFREDO J. TALAVERA	) OTA Case No. 18011825) CDTFA Case ID: 713047) CDTFA Acct. No. 53-011069)))

OPINION

Representing the Parties:

For Appellant: Alfredo J. Talavera, Taxpayer

For Respondent: Kevin B. Smith, Tax Counsel III

A. KWEE, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, appellant Alfredo J. Talavera timely appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA), on a petition for redetermination of a January 25, 2013 Notice of Determination (NOD).[1] The NOD is for $59,381.07 in tax, plus applicable interest, for the period October 1, 2005, through May 31, 2009 (liability period). The NOD reflects CDTFA's determination that appellant is personally liable as a responsible person for the unpaid tax liabilities of Rico Alta, Inc., dba Rico Auto Sales (RAI). This matter is being decided based on the written record because appellant waived the right to an oral hearing.

ISSUE

Whether appellant established a basis to reduce RAI's unpaid sales tax audit liability.

FACTUAL FINDINGS

1. RAI, a California corporation, operated as a used car dealership in California.
2. On November 21, 2008, CDTFA notified RAI that its account was selected for an audit. Upon audit, CDTFA discovered that appellant treated vehicle repossession losses as fully

[1] Sales taxes were formerly administered by the 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, the term "CDTFA" shall refer to its predecessor, the board.

deductible in the amount of the original sale price, notwithstanding down payments or monthly payments paid by the customer, the wholesale value of repossessed vehicles, or payments allocable to nontaxable amounts. CDTFA discussed with the taxpayer that California Code of Regulations, title 18, section (Regulation) 1642(f), "Allowable methods of computing loss," requires that these items be taken into consideration when determining the allowable deduction for repossession losses.

3. During the course of the audit, on May 31, 2009, RAI terminated its business operations.
4. Subsequently, on October 28, 2009, RAI informed CDTFA that it had terminated its business operations.
5. On July 6, 2010, CDTFA issued a closeout audit report for RAI, disclosing an audit liability of $59,381.07 in tax, plus applicable interest, and consisting of two audit items: (1) a disallowed claimed bad debt deduction of $642,739; and (2) differences between recorded and reported taxable sales of $113,336. Thereafter, CDTFA issued a July 22, 2010 NOD to RAI for the liabilities disclosed by audit for the period October 1, 2005, through the May 31, 2009 closeout date.
6. Upon further investigation, CDTFA concluded that appellant was personally liable as a responsible person for the unpaid liabilities of RAI. On January 25, 2013, CDTFA issued an NOD to appellant, holding him personally liable for RAI's unpaid taxes.
7. Appellant timely petitioned his responsible person NOD, and CDTFA denied the petition.
8. On appeal, appellant only makes two contentions: (1) CDTFA incorrectly calculated his responsible person liability because the correct amount of "the liability excluding penalties and interests amount[s] to $59,375.45," and (2) subdivision (f) of Regulation 1642, which specifies the allowable methods of computing repossession losses, is invalid because CDTFA lacks statutory authority to specify the method in which a bad debt deduction must be calculated.[2]
9. In response, CDTFA filed a brief with OTA contending that Regulation 1642 is consistent with its authorizing statute. CDTFA further cites *Newco Leasing, Inc. v. State Bd. of Equalization* (1983) 143 Cal.App.3d 120, for the proposition that CDTFA is

[2] Appellant does not dispute that he is personally responsible for the unpaid liabilities of RAI within the meaning of Revenue and Taxation Code section 6829, so we do not discuss responsible person liability further.

legally required to follow its own regulations. CDTFA further contends that OTA is bound by the applicable statutes.

DISCUSSION

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, § 6012.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 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) 2001 WL 37126924.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *ibid*; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Here, CDTFA met its initial burden because it established, through audit, a discrepancy between RAI's recorded and reported taxable sales, and because it is undisputed that RAI's disallowed bad debt deductions did not meet the requirements set forth in Regulation 1642 to claim a deduction. Therefore, the law presumes that RAI's gross receipts are subject to tax and the burden is on RAI (and, by extension, appellant) to establish otherwise.

Whether CDTFA correctly calculated appellant's responsible person NOD

Appellant submitted an audit schedule dated June 30, 2010, titled "taxable measure understated by districts," which shows that RAI's tax liability is $59,375.45. Appellant contends that this amount should be the amount of his responsible person liability. RAI's liability was

based on the July 6, 2010 audit report, disclosing a tax liability of $59,381.07, plus interest and penalties. As relevant, cities and counties may generally impose a transaction and use tax (district tax) pursuant to the Transactions and Use Tax Law. (See Part 1.6, Division 2, of the Revenue and Taxation Code.) Not all districts in this state impose a district tax. The schedule was also an estimate, prepared prior to the final audit report. Therefore, the audit schedule listing the breakdown of the taxes for each district is not necessarily the total tax liability owed by RAI. The billed amount is the amount disclosed in the NOD. RAI's audit liability was based on the understated taxable measure of $756,075, and we find no evidence that CDTFA erred in calculating tax on this measure. As such, we find that appellant failed to establish that RAI's liability was overstated.

Whether appellant established a basis for a bad debt deduction

Appellant contends he is entitled to a bad debt deduction for the full amount of the sales price of repossessed vehicles. As relevant here, retailers may generally take a bad debt deduction for amounts reported as taxable and thereafter found worthless and charged off for income tax purposes. (R&TC, §§ 6055(a), 6203.5(a).) The statute authorizing a bad debt deduction specifically delegates quasi-legislative authority to CDTFA and provides that a "retailer that has previously paid the tax may, *under rules and regulations prescribed by [CDTFA]*, take as a deduction the amount found worthless and charged off by the retailer." (R&TC, § 6055(a) [emphasis added].) Revenue and Taxation Code section 7051 grants CDTFA the authority to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law.[3]

CDTFA exercised its delegated lawmaking authority as set forth in Revenue and Taxation Code sections 6055 and 7051, and promulgated Regulation 1642, which provides, in pertinent part, that:

> When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, *including the wholesale value of the repossessed article*, is less than that price.

[3] The courts have concluded that the legislative delegation in Revenue and Taxation Code section 7051 is proper even though it confers some degree of discretion on CDTFA. (*Henry's Restaurants of Pomona, Inc. v. State Bd. of Equalization* (1973) 30 Cal.App.3d 1009, 1020.)

(Cal. Code. Regs., tit. 18, § 1642(f)(1) [emphasis added].) Regulation 1642 goes on to specify allowable methods for computing deductible repossession losses, both of which take into account the wholesale value of the repossessed vehicle. The legislature implicitly approved CDTFA's promulgated methods for calculating losses by amending subdivision (b), pertaining to agreements between retailers and lenders, without changing any of the other provisions of Revenue and Taxation Code section 6055. (Stats. 2011, ch. 727 (A.B. 242), § 3; Stats. 2012, ch. 362 (A.B. 2688), § 2.)

On appeal, appellant contends that CDTFA lacks statutory authority to require retailers to reduce the allowable deduction by the wholesale value of the repossessed vehicle. Instead, appellant contends that retailers are statutorily authorized to deduct the entire contract price.

As a preliminary matter, CDTFA is correct that it is required by law to follow Regulation 1642 and "must be faithful to its own announced regulations." (*Newco Leasing, Inc. v. State Bd. of Equalization, supra,* 143 Cal.App.3d at p. 124.) Furthermore, "[a] regulation adopted by an administrative agency pursuant to its delegated rulemaking authority has the force and effect of law." (*California Teachers Assn. v. California Com. On Teacher Credentialing* (2003) 111 Cal.App.4th 1001, 1008.)

Here, because CDTFA was exercising its substantive rulemaking power, it was "truly 'making law,' [and CDTFA's] quasi-legislative rules have the dignity of statutes." (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 6.) In reviewing the legality of such a regulation, an appellate court is limited to determining whether the regulation (1) is within the scope of the authority conferred and (2) is reasonably necessary to effectuate the purpose of the statute. (*Ibid*.) There is a strong presumption that the regulation is valid and the standard on review is confined to the question of whether the regulation is arbitrary, capricious, or without reasonable or rational basis. (*Ibid*.) The Office of Tax Appeals is not a court. (Gov. Code, § 15672.) OTA is an administrative agency and we are precluded by the Constitution of the State of California from declaring a statute unenforceable or refusing to enforce the clear and unambiguous provisions of a statute, unless an appellate court has determined that the statute is unconstitutional. (Cal. Const., Art. III, § 3.5.)

In California, only a court may declare a quasi-legislative regulation that has been formally promulgated by a state agency, such as Regulation 1642, to be invalid. (Gov. Code, § 11350(b).) Therefore, OTA does not have authority to declare Regulation 1642

invalid and refuse to follow it on that basis. Nevertheless, in the course of deciding an appeal, OTA may be required to interpret the Sales and Use Tax Law, including CDTFA's regulations. (See Gov. Code, §§ 15671, 15674.) Here, it appears that CDTFA was within the scope of its delegated authority by specifying, by regulation, the allowable methods for computing losses. The statute makes clear that a deduction is not allowable for amounts collected by a retailer and provides that tax must be paid on such amounts. (R&TC, § 6055(a).) Therefore, it is reasonable for Regulation 1642 to specify that the wholesale value of repossessed vehicles, plus any payments received from the purchaser, cannot be deducted from the taxable measure. Appellant's contention that it may deduct the entire purchase price, including amounts allocable to nontaxable charges, is contrary to a plain reading of the statute, which limits the deduction to relief "from liability for sales tax that became due and payable," and as a matter of law there is no sales tax liability to relieve with respect to nontaxable charges. (R&TC, §§ 6051, 6055(a).) Accordingly, there is no basis to conclude that Regulation 1642 is invalid. It is undisputed that appellant is not entitled to any further deductions under Regulation 1642. Therefore, we find appellant failed to establish a basis for any additional adjustments.

HOLDING

Appellant failed to establish that any additional adjustments are allowable.

DISPOSITION

CDTFA's action in denying the petition for redetermination is sustained, and the NOD shall be redetermined as provided in CDTFA's decision.

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
8A429481...
Andrew Wong
Administrative Law Judge

Date Issued: 1/14/2020