

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
) OTA Case No. 18083591
KATZIR’S FLOOR & HOME DESIGN, INC.) CDTFA Case ID: 254332
) CDTFA Acct. No. 013-763190
)
) Date Issued: October 21, 2019
)

OPINION

Representing the Parties:

For Appellant: Omer Katzir
Jeannette Katzir

For Respondent: Scott A. Lambert, Hearing Representative
Stephen Smith, Tax Counsel IV
Lisa Renati, Hearing Representative

For Office of Tax Appeals: Deborah Cumins,
Business Taxes Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, appellant Katzir’s Floor & Home Design, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ in response to appellant’s timely petition for redetermination of a Notice of Determination (NOD) which proposed a liability of \$133,274.32 of additional tax and applicable interest, for the period January 1, 1999, through December 31, 2001. In its subsequent decision, CDTFA reduced the tax liability from \$133,274.32 to \$111,868.06, relieved the interest for the period June 30, 2014, through May 5, 2016, and denied the remainder of the petitioned amount.²

¹ Sales taxes were formerly administered by the State Board of Equalization (Board). In 2017, functions of the Board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) 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.

² As of the date of CDTFA’s Decision, appellant had also filed a claim for refund of \$1,000.00. Further, as of November 7, 2008 (the date of the most recent reaudit), appellant had paid \$41,354.28; we are unaware of additional claims for refund filed with respect to those additional payments. Since CDTFA is holding all claims for refund in abeyance until the liability is paid in full, and therefore has taken no action on the them, claims for refund will not be addressed herein.

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

ISSUES

1. Whether reductions are warranted to the measure of unreported taxable sales.
2. Whether additional relief of interest is warranted.

FACTUAL FINDINGS

1. Appellant has operated the business known as “Natural Hardwood Flooring & Moulding” in Van Nuys since June 1982, selling flooring materials, with no installation.
2. For the audit period, appellant did not provide a sales journal or other summary record of sales. In addition, the amounts appellant reported on its sales and use tax returns did not reconcile with the amounts reported on appellant’s federal income tax returns (FITR’s) or its bank deposits.
3. In conducting the audit, CDTFA examined appellant’s Invoice Summary Report (a list of sales that were invoiced in that quarter) for the third quarter of 2001 (3Q01). The report separately recorded amounts of sales tax reimbursement, which CDTFA totaled and then divided by the applicable sales tax rate to establish recorded taxable sales for 3Q01. CDTFA then reduced that figure by documented amounts of returned merchandise, sales that were not consummated, and other errors made in recording sales. It compared audited taxable sales to reported taxable sales for 3Q01 and used the difference to compute a percentage of error of 12.72 percent, which it applied to reported taxable sales for the audit period to establish the audited understatement of reported taxable sales, which was \$1,631,727 in the audit.
4. In the course of this appeal, CDTFA issued a Decision and Recommendation (D&R), issued four Supplemental D&R’s (SD&R’s), and conducted an audit and four reaudits.³
5. CDTFA originally scheduled an appeals conference in this matter for January 18, 2005, but appellant requested a postponement. CDTFA then held an appeals conference in this

³ In light of Issue 2 (appellant’s request for interest relief), it is necessary to provide relevant details and dates of the lengthy procedural history of this appeal.

matter on November 29, 2005, at which appellant contended that additional adjustments to the test of 3Q01 are warranted for sales that were not consummated, bad debts, late fees, freight charges, and other errors. Appellant did not provide any documentation to support its allegations at this time. Instead, appellant advised that it had the necessary documentation and would provide it on request.

6. The February 2, 2006 D&R recommended a reaudit to give appellant the opportunity to:
1) provide documentation to support various adjustments, and 2) show that an adjustment for timing differences is warranted. Regarding Issue 2, appellant requested a reduction of audited taxable sales for 3Q01 for the amount of sales commenced, but not completed in that quarter. The D&R recommended that an adjustment be made only if appellant also established the amount of sales that were commenced in prior quarters but were completed in 3Q01.
7. Pursuant to the D&R, CDTFA conducted two reaudits, on May 9, 2006, and on July 24, 2006. During the reaudits, appellant provided documentation to support adjustments which reduced the measure of tax to \$709,367, rather than the \$1,631,727 established in the audit.
8. Appellant filed a Request for Reconsideration (RFR) of the D&R on August 24, 2006, asserting that it had additional documentation to support further adjustments. The adjustments requested by appellant included adjustments for: 1) late fees and bad check fees; 2) duplicated sales invoices resulting from bad checks; and 3) bad debts. Appellant's RFR also advised that its president would be out of the country for an extended period of time, and thus appellant requested a delay until November 15, 2006 to provide additional information.
9. CDTFA issued the first SD&R on May 23, 2007, recommending a reaudit to make any supported adjustments. However, in the SD&R, CDTFA noted the possibility that the bad debt deduction may have been erroneously allowed in the earlier reaudits. The SD&R recommended that CDTFA's audit staff, during the recommended reaudit, determine if appellant is entitled to a bad debt allowance.
10. On January 15, 2008, CDTFA issued a third reaudit report in which the allowance for bad debts was deleted from the audit computations, because appellant had filed its FITR's on

- the accrual basis and had not claimed any bad debt deductions. As a result, the audited amount of unreported taxable sales increased from \$709,367 to \$1,534,443.
11. Appellant filed a second RFR on April 21, 2008, arguing that: 1) it is entitled to an allowance for bad debts; 2) an adjustment for duplicate sales invoices should be made; and 3) an adjustment should be made for sales that were completed after 3Q01.
 12. CDTFA issued the second SD&R on August 13, 2008, recommending a reaudit to make an allowance for the actual amount of bad debts found worthless during the third and fourth quarters of 2001, noting that appellant had provided a copy of its FITR for fiscal year ending April 30, 2002, on which it claimed a bad debt deduction of \$171,571.
 13. In the fourth reaudit report dated November 7, 2008, CDTFA included a credit amount of \$163,255 (\$171,571 bad debt deduction claimed on appellant's FITR for fiscal year ending April 30, 2002, less sales tax reimbursement). However, it did not make an adjustment to the audited percentage of error computed for 3Q01, because there was no evidence that appellant had written off the bad debts for income tax purposes during the remaining periods of the audit. The fourth reaudit reduced the tax deficiency to \$111,868.06.
 14. Appellant filed a third RFR on December 22, 2008, contending that: 1) the allowance for bad debts provided in the fourth reaudit should be increased; 2) adjustments should be made that were recommended by the auditor but rejected by the supervisor; and 3) the schedules provided by appellant should be used to compute taxable sales. CDTFA asked appellant to provide documentation establishing that the claimed bad debt deduction was warranted, but appellant did not do so.
 15. CDTFA issued a third SD&R on May 29, 2009, recommending that the tax be redetermined in accordance with the fourth reaudit dated November 7, 2008.
 16. This matter was scheduled for a Board hearing on October 6, 2009, but appellant filed a settlement proposal on September 9, 2009, and the matter was removed from the Board's calendar.
 17. On March 18, 2010, CDTFA informed appellant that a mutually agreeable settlement could not be reached.

18. This matter was scheduled for a Board hearing on July 13, 2010, but appellant filed a second settlement proposal on June 28, 2010, and the matter was removed from the Board's calendar.
19. On March 12, 2013, CDTFA informed appellant that a mutually agreeable settlement could not be reached.
20. This matter was scheduled for a Board hearing on October 30, 2013, but on August 5, 2013, the matter was postponed because appellant submitted additional documentation to CDTFA's Appeals Bureau (at the time, Appeals Division) arguing that the documentation supports further adjustments. CDTFA concluded that no adjustments were warranted.
21. Appellant filed two requests for relief of penalties, collection cost recovery fees, and interest, on December 15, 2012, and February 27, 2013.
22. CDTFA issued a fourth SD&R on May 5, 2016, recommending relief of interest for the period June 30, 2014, through May 5, 2016, and recommending that the tax be redetermined in accordance with the reaudit dated November 7, 2008.
23. This timely appeal followed.

DISCUSSION

Issue 1. Whether reductions are warranted to the measure of unreported taxable sales.

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.) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698, subd. (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 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, appellant did not keep a written record of how it established the amounts reported on its sales and use tax returns. Therefore, CDTFA was not able to determine how taxable sales were reported. CDTFA attempted to reconcile amounts reported on appellant's sales tax returns with amounts reported on FITR's and with bank deposits, and noted significant differences that CDTFA was unable to reconcile. Thus, CDTFA was justified in concluding that additional investigation was warranted. (R&TC, § 6481.)

As explained above, CDTFA performed an audit and four reaudits, based on appellant's own records and information. Therefore, we find that CDTFA has established that its determination is reasonable and rational. Thus, the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

On appeal, appellant raises three primary unresolved arguments, which we shall address separately. First, appellant contends that the audited taxable sales for 3Q01 should be reduced for the sales that were commenced in that quarter but not completed until after the quarter. According to appellant, the total of such sales is \$33,869.

We acknowledge that appellant made sales that were commenced in 3Q01 and not completed until after the quarter. We agree that it was correct for appellant to remit tax on those sales when they were completed and that the amount of sales represented by invoices in 3Q01 should be reduced for sales that were completed after the quarter. However, appellant also made sales that commenced prior to 3Q01 but were completed during that quarter, and those sales must be added to the total sales represented by invoices in 3Q01 in order to have a complete amount of sales for which tax was due for 3Q01.

Appellant has declined to provide a schedule showing the amount of sales that commenced prior to 3Q01 but were completed in that quarter. However, in the binders of information appellant has provided, there is a document included under tab 4 of the "Computer Report Summary Sales Tax September 2001." The document is entitled "Special Order May-September 2001," and it lists invoices, by date, showing the amount of each special order and the

month in which the special-order sale was completed. On that document, there are 28 sales listed for which the invoices are dated in April, May or June 2001, and the special-order sales are completed in July, August, or September 2001. The total of the 28 sales that commenced before 3Q01 but were completed during 3Q01 is \$112,200.34. Accordingly, the correct adjustment for timing differences would be an *increase* to the total amount of sales invoices for 3Q01 of \$78,331 (\$112,200 commenced prior to 3Q01 and completed in the quarter - \$33,869 commenced in 3Q01 and completed after the quarter). Thus, we find there is no basis for reducing the audited amount of taxable sales for 3Q01 on the basis that \$33,869 of those sales were completed after 3Q01.

Second, appellant contends that the audited amount of taxable sales for 3Q01 should be reduced by an amount of bad debts, such that the percentage of error applied to the remainder of the audit period is reduced. As relevant here, in order to be entitled to a bad debt deduction, a retailer must charge off the bad debts for income tax purposes. (R&TC, § 6055, subd. (a); Cal. Code Regs., tit. 18, § 1642, subd. (a).)⁴

Here, appellant filed accrual-basis FITR's for fiscal years ended April 30, 2000, 2001, and 2002. On the FITR for fiscal year ending April 30, 2002, appellant claimed a bad debt deduction of \$171,571. CDTFA therefore correctly allowed a bad debt deduction for sales tax purposes by the amount of that deduction (net of tax included therein) in the amount of \$163,255, for the period May 1, 2001, through December 31, 2001. In contrast, on its FITR's for fiscal years ending April 30, 2000 and 2001, appellant claimed no bad debt deduction. Accordingly, appellant was not entitled to an adjustment for bad debts for the period May 1, 1999, through April 30, 2001. In its discussion of the third reaudit with the CDTFA audit staff and in its RFR dated December 22, 2008, appellant asserted that, although its FITR's were prepared on an accrual basis, it netted bad debts from the amounts of gross receipts reported on FITR's for the two fiscal years May 1, 1999, through April 30, 2001. However, appellant has not provided documentation, such as tax worksheets, to support this assertion. Thus, we

⁴ A retailer is relieved from liability for sales tax insofar as the measure of tax is represented by accounts that have found to be worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. If a taxpayer reports income tax on a cash basis and therefore does not take a specific bad debt deduction on his or her FITR's, a bad debt deduction will not be disallowed solely for that reason. (R&TC, § 6055(a); Cal. Code Regs., tit. 18, § 1642, subd. (a).)

conclude that, for periods prior to May 1, 2001, appellant has not shown that bad debts were charged off for income tax purposes, and therefore no additional allowance for bad debts is warranted.

Third, appellant contends that the binders of paperwork appellant presented for 3Q01 support an overpayment, rather than an understatement, of reported taxable sales. In support, appellant has provided voluminous documents that represent its records for the months of July, August, and September 2001. For each month, appellant has provided a schedule with various totals. The schedules include figures that are largely similar to the figures scheduled on Exhibit 3, page 3, of the fourth SD&R. However, appellant has scheduled an amount of taxable sales of \$1,392,584 for 3Q01, which is less than the \$1,404,220 computed by CDTFA using compiled amounts of recorded sales tax reimbursement, and appellant has not explained this discrepancy. We also note that appellant has reduced its scheduled amount of taxable sales by amounts such as late fees and credit card fees, which are not subject to tax and would not have been included in CDTFA's audited taxable sales, since there would have been no sales tax reimbursement charged on those fees. Since the fees were not included in taxable sales, there is no basis for these adjustments. However, the most significant issues with appellant's worksheets are that they make adjustments for special order sales commenced, but not completed, in 3Q01 and for bad debts, which adjustment we analyzed and rejected above. As a result, those adjustments are not warranted. Therefore, we find that appellant's schedules and records do not support further adjustments.

Issue 2. Whether further relief of interest is warranted.

The amount of the determination shall bear interest from the last day of the month following the quarterly period for which the amount should have been paid to the date of payment. (R&TC, § 6482.) Interest may be relieved only under narrow circumstances: 1) where the failure to pay the tax was due to a disaster (R&TC, § 6593); 2) where the failure to pay the tax was due to an unreasonable delay or error on the part of a Board employee (R&TC, § 6593.5); and 3) where the failure to pay the tax was due to erroneous, written advice received from the Board (R&TC, § 6596). A taxpayer seeking relief from the interest must file with the Board a statement under penalty of perjury setting forth the facts upon which the request for relief is based. (R&TC, §§ 6593, 6593.5, subd. (c).) An error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or a failure

to act by, the taxpayer. (Cal. Code Regs., tit. 18, § 1703, subd. (b)(1).)

Appellant made two separate requests for relief of penalties, collection cost recovery fees, and interest, on December 15, 2012, and April 17, 2013. Since there are no penalties or collection cost recovery fees at issue here, there is no relief to consider on those bases. In its second request for relief of interest, appellant requested relief on the basis that the economic downturn in the construction industry represented a disaster; however, R&TC section 6593 does not identify an economic downturn as a basis for relief, and thus we reject this contention.

In appellant's first request for relief of interest, it asserts that the process has continued too long. This matter has been in the appeals process since the petition for redetermination was filed on February 9, 2004. As detailed above, there have been many delays, several of which have related to appellant's requests for time to provide additional documentation, an extended trip out of the country for appellant's corporate president, multiple RFR's, and settlement proposals. We find that a significant portion of these delays is attributable to appellant, and therefore these delays do not warrant relief. (See Cal. Code Regs., tit. 18, § 1703, subd. (b)(1).)


However, CDTFA noted that there was an unreasonable delay in its preparation of the fourth SD&R, and it recommended relief of interest for the period June 30, 2014, through May 5, 2016. We have reviewed the record regarding the various delays and find there was an unreasonable error or delay caused by CDTFA for the period June 30, 2014, through May 5, 2016. Appellant has failed to submit evidence establishing any other period of delay to which it did not contribute, and therefore we conclude that no further relief of interest is warranted.

HOLDINGS

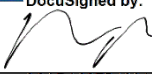
1. No further reductions are warranted to the measure of underreported taxable sales.
2. No further relief of interest is warranted.


DISPOSITION

CDTFA’s action in reducing the understatement of tax to \$111,868.06, relieving interest for the period June 30, 2014 through May 5, 2016, and otherwise denying the petition for redetermination, is sustained.

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 Jeffrey G. Angeja
 Administrative Law Judge

We concur:

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 Andrew J. Kwee
 Administrative Law Judge

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 Teresa A. Stanley
 Administrative Law Judge