

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 18011867
IRVINE CABINETS SHOWROOM, INC.)	CDTFA Account No. 100-920530
dba Irvine Cabinets)	CDTFA Case ID 858653
)	
)	
)	

OPINION

Representing the Parties:

For Appellant: Farhad Kalvakhi, Representative

For Respondent: Jarrett Noble, Tax Counsel III

K. LONG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Irvine Cabinets Showroom, Inc. (appellant) appeals a Decision and Recommendation (D&R) issued by respondent California Department of Tax and Fee Administration (CDTFA),¹ denying appellant's petition for redetermination of the Notice of Determination (NOD) for a tax liability of \$239,324.99, a negligence penalty of \$23,932.53, and applicable interest, for the period July 1, 2010, through June 30, 2013 (audit period).

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

ISSUE

Whether appellant has shown that adjustments to the deficiency measure are warranted.

FACTUAL FINDINGS

1. Appellant is a manufacturer of kitchen cabinets, countertops, and flooring. The majority of appellant's sales are kitchen cabinets.

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.

2. For the third quarter of 2010 (3Q10), appellant reported total sales of \$371,249, and claimed nontaxable sales of \$358,629, including the following: tax-paid purchases resold of \$114,996; sales for resale of \$122,259; and nontaxable labor charges of \$121,374. For 4Q10, appellant reported total sales of \$324,419 and claimed nontaxable sales of \$324,419, consisting of the following: tax-paid purchases resold of \$30,339; sales for resale of \$179,824; and nontaxable labor charges of \$114,256. For 1Q11 through 2Q13, appellant claimed deductions for “other” in amounts equal to the total sales reported for each quarter.
3. CDTFA audited appellant for the period July 1, 2010, through June 30, 2013. Appellant did not provide a complete set of books and records for the audit. Instead, appellant provided federal income tax returns for 2010, 2011, and 2012, a general ledger, and purchase and sales invoices for 1Q13 and 2Q13.
4. Upon audit, appellant told CDTFA that it did not install cabinets and that all of its sales were to outside contractors that installed the cabinets. Appellant told CDTFA that the “other” deductions that it claimed on its returns for 1Q11 through 2Q13 were actually nontaxable sales for resale. Appellant also told CDTFA that it mistakenly claimed nontaxable sales for resale as nontaxable labor charges on its returns for 3Q10 and 4Q10. Appellant did not provide resale certificates or other evidence, such as XYZ letters, to support its claimed nontaxable sales for resale. Appellant did not explain its reporting method to CDTFA during the audit.
5. During the audit, appellant told CDTFA that it made retail sales throughout the audit period but stopped collecting sales tax reimbursement after 3Q10. In response to this admission, CDTFA calculated a deficiency measure for “estimated retail sales subject to tax”² for the period 4Q10 through 2Q13. CDTFA divided appellant’s reported taxable sales of \$12,620 for 3Q10 by appellant’s reported total sales of \$371,249 for that quarter to establish a taxable sales ratio of .0339934. CDTFA applied the taxable sales ratio of

²The audit working papers refer to this audit item as “estimated retail sales subject to sales tax based on reported taxable ratio 3Q10” and the D&R refers to this audit item as “estimated additional taxable sales.” However, this audit item is more accurately characterized as disallowed claimed nontaxable sales because appellant claimed all of its sales as nontaxable for every quarter but 3Q10.

- .0339934 to appellant's reported total sales of \$4,301,209 for the period 4Q10 through 2Q13 to calculate "estimated retail sales subject to tax" of \$146,212 (audit item 2).³
6. To verify appellant's claimed deductions, CDTFA reviewed appellant's purchase invoices for 1Q13 and 2Q13 and found that appellant was entitled to claim deductions for tax-paid purchases resold totaling \$345,993 for those quarters. However, appellant did not provide evidence to support its deduction of claimed nontaxable sales for resale, labor, and other.⁴
 7. CDTFA disallowed appellant's claimed deductions of nontaxable sales for resale, labor and other, based on an error percentage of disallowed claimed nontaxable sales for 1Q13 and 2Q13. CDTFA calculated the error percentage as follows. First, CDTFA reduced total recorded sales of \$919,287 for 1Q13 and 2Q13 by the measure of "estimated retail sales subject to tax" identified in audit item 2 of \$31,263 for 1Q13 and 2Q13. CDTFA then further reduced this figure by \$345,993 to account for audited tax paid purchases resold during 1Q13 and 2Q13. Thus, CDTFA estimated audited taxable sales of \$542,031 which, when compared to recorded total sales of \$919,287, represents an error ratio of 58.962085. CDTFA applied the error ratio to recorded total sales of \$4,765,575⁵ for the audit period to establish disallowed claimed nontaxable sales of \$2,809,882 (audit item 1).
 8. Based on these audit findings, CDTFA issued an NOD to appellant for a deficiency of \$239,324.99 tax, plus applicable interest, and a negligence penalty of \$23,932.53.
 9. Appellant filed a timely petition for redetermination with CDTFA. During CDTFA's appeals process, appellant asserted that it is not liable for tax because it is a construction contractor that installs cabinets pursuant to lump-sum contracts using tax-paid materials and incurring less than 90 percent of its direct labor and material costs for fabrication and

³ Audit item 2 consists of the sum of "estimated retail sales subject to tax" for the quarters 4Q10 through 2Q13. As relevant here to the remainder of this opinion the measure of "estimated retail sales subject to tax" is \$15,902 for 1Q13 and \$15,361 for 2Q13. For clarity, we use the term "estimated retail sales subject to tax" in reference to audit item 2, in order to avoid confusion with the disallowed claimed nontaxable sales included in audit item 1.

⁴ As noted above, appellant told CDTFA that its deductions for labor and other were actually deductions for sales for resale.

⁵ Although appellant reported total sales of \$4,672,458 for the audit period, appellant recorded total sales of \$4,765,575 for the audit period.

installation prior to its attachment of the cabinets to the realty. However, by email sent July 24, 2017, appellant provided figures indicating that 90.7 percent of the total direct cost of labor and material in fabricating and installing the cabinets is incurred prior to affixation to the realty.⁶ CDTFA issued a D&R on October 30, 2017, in which it recommended deleting the negligence penalty but otherwise denying appellant's petition for redetermination.

10. This timely appeal followed.

DISCUSSION

California imposes a 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 from taxation by statute. (R&TC, § 6051.) A retail sale is a sale for a purpose other than resale in the regular course of business in the form of tangible personal property. (R&TC, § 6007.) All gross receipts are presumed subject to tax, and the seller has the burden of proving that a sale of tangible personal property is not a sale at retail unless it timely and in good faith takes from the purchaser a certificate that the property is purchased for resale. (R&TC, §§ 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).)

A construction contract means a contract to erect, construct, alter, or repair any building or other structure or other improvement to real property. (Cal. Code Regs., tit. 18, § 1521(a)(1)(A)1.) However, "construction contract" does not include a furnishing of tangible personal property under what would otherwise be considered a construction contract if the person furnishing the property is not responsible under the construction contract for final affixation or installation of the furnished property. (Cal. Code Regs., tit. 18, § 1521(a)(1)(B)2.) Construction contractors are generally the consumers of the materials they furnish and install and are the retailers of fixtures they furnish and install. (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)1.) Construction contractors are generally the retailers of fixtures they furnish and install. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)1.) A cabinet will be considered to be prefabricated and a fixture when 90 percent of the total direct cost of labor and material in fabricating and installing

⁶ Appellant's July 24, 2017 email asserts that its installation costs represent 10.30 percent of the total cost. To come to this figure, appellant compared its alleged installation costs for 2013 of \$105,376 to its alleged total cost before installation for 2013 of \$1,028,246. However as discussed in greater detail below, appellant's calculation is incorrect and according to the figures provided by appellant 90.7 percent of the total direct cost of labor and material in fabricating and installing the cabinets is incurred prior to their attachment to realty.

the cabinet is incurred prior to affixation to the realty. (Cal. Code Regs., tit. 18, § 1521(c)(3).) In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. (*Ibid.*) If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated. (*Ibid.*)

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 admitted during the audit that it made taxable sales. Appellant did not report any taxable sales on its returns during the period 4Q10 through 2Q13. Based on this information, CDTFA found that appellant underreported its taxable sales. In computing the taxable measure, CDTFA used appellant's returns, as well as appellant's purchase and sales invoices to determine the measures of unreported taxable sales. During the audit, CDTFA found that appellant was entitled to a deduction for tax paid purchases resold and calculated an error ratio, which reduces appellant's total sales by tax paid purchases resold. Accordingly, we find that CDTFA used the best available evidence (appellant's own books and records) to calculate appellant's deficiency and CDTFA's determination is reasonable. Therefore, the burden shifts to appellant to demonstrate that reductions are warranted.

Appellant contends that less than 90 percent of the direct cost of labor and materials in fabricating and installing cabinets is incurred prior to attaching them to realty. However, appellant has not provided any credible evidence in support of its contention. By contrast in an email to CDTFA's Appeals Bureau dated July 24, 2017, appellant provided figures indicating

that 90.7 percent of its direct cost of labor and materials was incurred prior to attaching the cabinets to realty. Specifically, appellant's July 24, 2017 email states that its total costs were \$1,133,622 and its installation costs were \$105,376. Appellant's email also states that its costs before installation were \$1,028,246. When compared to the total costs of \$1,133,622, appellant's costs before installation of \$1,028,246 represents 90.7 percent of appellant's total costs. Thus, even if we accept appellant's figures as accurate, we find that the cabinets are fixtures because 90 percent of the total direct cost of labor and material in fabricating and installing the cabinets are incurred prior to affixation to realty. (Cal. Code Regs., tit. 18, § 1521(c)(3).) As such, appellant's sales of cabinets are subject to the sales tax.


With respect to appellant's contention that it is entitled to an allowance for tax paid purchases resold, we again note that CDTFA provided such a deduction in its determination of the deficiency measure. Appellant has not provided any evidence that the deduction for tax paid purchases resold should be increased. Appellant's unsupported assertions are insufficient to satisfy its burden of proof. Thus, based on the foregoing, we find that no adjustments are warranted.

HOLDING

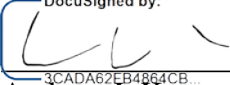
Appellant has not shown that adjustments to the deficiency measures are warranted.

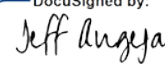
DISPOSITION

CDTFA's action in denying the petition for redetermination is sustained.

DocuSigned by:

DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

We concur:

DocuSigned by:

3CAD62EB4864CB...
Andrew J. Kwee
Administrative Law Judge

DocuSigned by:

DD390BC3CCB14A9...
Jeffrey G. Angeja
Administrative Law Judge

Date Issued: 4/7/2020