

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

J. MELLO

) OTA Case No. 18053158
) CDTFA Acct. No. 53-001396
) CDTFA Case ID: 919660
)
)
)

OPINION

Representing the Parties:

For Appellant:

J. Mello
Terrence J. Moore, Attorney
Omar Reyes, witness
Lynn Gutierrez, witness

For Respondent:

Mengjun He, Tax Counsel III
Jason Parker, Headquarters Operations
Chief
Scott Claremon, Tax Counsel IV

For Office of Tax Appeals:

Josh Lambert, Tax Counsel

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, J. Mello (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s timely petition for redetermination of CDTFA’s Notice of Determination (NOD). The NOD is for personal liability against appellant as a responsible person under R&TC section 6829, for the unpaid liabilities of American Custom Coach, Inc. (American Custom) consisting of a \$156,881.29 tax liability, plus applicable interest, and penalties of \$35,484.42, for the period January 1, 2008, through

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.

April 30, 2013 (the liability period).² The NOD reflects CDTFA's determination that appellant is personally liable for the unpaid sales and use tax liabilities of American Custom.³

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Michael F. Geary, and Jeffrey G. Angeja, held an oral hearing for this matter in Cerritos, California, on January 23, 2020. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether appellant is personally liable under R&TC section 6829 for the unpaid tax liabilities of American Custom, for the liability period.

FACTUAL FINDINGS

1. American Custom, a California corporation located in Redlands, California, operated as a fabricator of specialized mobile facilities, such as mobile exam and dental clinics, mobile mammography, laboratories, and blood donation vehicles, mobile command centers, as well as simulation and emergency response units.
2. Appellant concedes that American Custom collected sales tax reimbursement on all of its taxable retail sales of tangible personal property during the liability period, and that American Custom terminated its business operations effective April 30, 2013.
3. Appellant also concedes that he was American Custom's president, Chief Executive Officer (CEO), the sole officer of the corporation, and the only person authorized to make financial decisions on behalf of American Custom during the liability period.

² Following the issuance of the NOD to appellant, CDTFA performed a reaudit of American Custom for the period ending April 30, 2013, based upon additional records provided by appellant, and by reaudit report dated December 28, 2015, CDTFA reduced the tax liability assessed against American Custom by \$10,346.62, from \$95,983.77 to \$85,637.15, and it deleted the negligence penalty. As a result, on March 24, 2016, CDTFA reduced the unpaid tax liability at issue by \$10,346.62, from \$156,881.29, to \$146,534.67. Thereafter, on February 24, 2017, CDTFA deleted the NOD issued to American Custom for the period January 1, 2013, through April 30, 2013, for \$5,876 tax, thereby further reducing the unpaid tax liability at issue from \$146,534.67 to \$140,658.67. Finally, on June 22, 2017, CDTFA applied a payment adjustment of \$51,304.14, which it collected by levy from one of American Custom's financial accounts, which thereby reduced the outstanding tax liabilities of American Custom for the first quarter of 2008 (1Q08) and 2Q08 to zero and 3Q09 to \$3,717.38, and further reduced the unpaid liability at issue from \$140,658.76 to \$89,354.53.

³ The penalties consist of late payment penalties of \$12,423.04 for 1Q08, 2Q08, 3Q11 and 4Q11, a failure to pay penalty of \$2,689.40 for 3Q09, and a finality penalty of \$8,563.72. Appellant has not specifically protested the penalties. Therefore, we decline to further address them.

4. An Automated Compliance Management System (ACMS)⁴ entry on April 1, 2015, documents a telephone call between CDTFA and “Ms. Meleka,” an accountant for American Custom, during which Ms. Meleka stated that she prepared sales and use tax returns and discussed each return in detail with appellant.
5. According to appellant’s testimony, during the liability period his accountants presented him with financial documents, such as profit-and-loss-statements, ledgers, and sales records, as well as quarterly sales and use tax returns, and explained them to him.
6. Appellant signed an Installment Payment Agreement, dated August 11, 2009, as American Custom’s president.
7. Various notes entered into ACMS during the period August 25, 2008, through February 25, 2015, show that appellant communicated with CDTFA on numerous occasions regarding American Custom’s unpaid liabilities, delinquent returns, payment arrangements, and a release of funds collected by levy.
8. Appellant signed, as CEO, American Custom’s sales and use tax returns for 2Q09, 3Q08 and 3Q09.
9. An Employment Development Department (EDD) Wage History report shows that American Custom paid wages to its employees totaling \$2,842,978 during 1Q08 through 3Q13.
10. A Southern California Edison payment history report shows that American Custom made payments totaling \$17,643.25, \$17,115.64, \$12,070.91, and \$2,966.46 during 2010, 2011, and 2012, and 1Q13, respectively.
11. Union Bank of California checking account statements show that American Custom made payments and withdrawals totaling \$617,495.46 and \$281,246.61, respectively, during 4Q08.
12. American Custom income statements for September 2008, March 2011, and December 2011, show cost of goods sold totaling \$51,970.31, \$113,245.95, and \$157,389.20, respectively.
13. Following the closure of American Custom’s seller’s permit and its failure to pay its outstanding tax liabilities, CDTFA conducted an investigation to determine whether

⁴ ACMS is a software program that is used by CDTFA to contemporaneously document communications between compliance staff and taxpayers or their representatives.

appellant was personally liable for the unpaid tax liabilities of American Custom, pursuant to R&TC section 6829.⁵ On August 21, 2015, CDTFA issued the NOD to appellant. By letter dated September 14, 2015, appellant filed a timely petition for redetermination, disputing CDTFA's finding that he is personally liable for the unpaid liabilities of American Custom. CDTFA reduced appellant's liability from \$156,881.29, to \$89,354.53, and removed the negligence penalty. Otherwise, CDTFA denied the petition.

14. During the oral hearing in this matter, appellant conceded that he had knowledge of and is liable for unpaid liabilities arising from American Custom's filing of non-remittance sales and use tax returns; however, appellant disputes that he had knowledge of American Custom's unpaid tax liabilities as determined by CDTFA's audit for the period April 1, 2010, through April 30, 2013.
15. American Custom's sales journals for the period October 1, 2010, through March 31, 2012, show recorded taxable sales of \$1,886,872. American Custom reported only \$915,920 in taxable sales on its sales and use tax returns during that period, resulting in an understated measure of tax of \$971,969. The recorded taxable sales during this period consist of seven sales.
16. Ms. Amber Bustamonte's resume establishes that she did not begin working at American Custom until 4Q12 at the earliest.
17. On June 5, 2017, appellant filed a police report with the Riverside Police Department, alleging that Ms. Bustamonte embezzled funds from Aleph Group, Inc. (Aleph), from December 14, 2014, through December 23, 2016.⁶

⁵ American Custom's unpaid liabilities at issue originate from the following: (1) non-remittance sales and use tax returns for the first quarter of 1Q08, 2Q08, and 3Q08 (amended); (2) an NOD issued to American Custom on January 17, 2014, for \$95,983.77 tax, plus accrued interest, for the period April 1, 2010, through April 30, 2013; and (3) an NOD issued to American Custom on October 4, 2013, for the period January 1, 2013, through April 30, 2013, based upon American Custom's failure to file returns for those periods.

⁶ Aleph is a separate corporation from American Custom and began operations after the termination of American Custom. Appellant is Aleph's principal officer. During the hearing the parties did not specifically address the type of business in which Aleph is engaged, but our understanding is that it is engaged in the same type of business operations that American Custom engaged in.

DISCUSSION

The law provides, in pertinent part, that any responsible person who willfully fails to pay or to cause to be paid the taxes due from a corporation shall be personally liable for unpaid taxes and interest and penalties not so paid upon termination of the business of the corporation. (R&TC, § 6829(a); Cal. Code Regs., tit. 18, § 1702.5(a).) Personal liability may only be imposed if CDTFA establishes that, while the person was a responsible person, the corporation collected sales tax reimbursement from customers (whether separately stated or included in the selling price) and failed to remit such tax when due. (R&TC, § 6829(c); Cal. Code Regs., tit. 18, § 1702.5(a).) In summary, there are four elements that must be met in order to impose responsible person liability: (1) that the corporation collected sales tax reimbursement (or incurred a use tax liability); (2) termination of the business; (3) that the person was responsible for the corporation's sales and use tax compliance during the liability period; and (4) the person willfully failed to pay the liability or cause it to be paid. CDTFA has the burden to prove these elements by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 1702.5(d).)

Here, appellant concedes that the first three elements are met. Thus, the only issue remaining as to the proposed tax liability is whether appellant willfully failed to pay, or to cause to be paid, American Custom's tax liability.

Element 4 - Willfulness

The term "willfully fails to pay or to cause to be paid" means that the failure was the result of a voluntary, conscious and intentional course of action. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).) A failure to pay or to cause to be paid may be willful even though such failure was not done with a bad purpose or motive. (*Ibid.*) In order to show willfulness, CDTFA must establish all of the following:

(A) On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.

(B) The responsible person had the authority to pay the taxes or to cause them to be paid (i) on the date that the taxes came due and (ii) when the responsible person had actual knowledge as defined in (A). A responsible person who was required to obtain approval from another person prior to paying the taxes at issue and was unable to act on his or her own in making the decision to pay the taxes does not have the authority to pay the taxes or to cause them to be paid.

(C) When the responsible person had actual knowledge as defined in (A), the responsible person had the ability to pay the taxes but chose not to do so.

(Cal. Code Regs., tit. 18, § 1702.5(b)(2).)

Turning to the first sub-element (actual knowledge), appellant admitted under oath that he reviewed the quarterly sales tax returns and all of American Custom's financial documents with his staff prior to the filing of each sales tax return. The testimony of each of appellant's witnesses was consistent with appellant's admission. Therefore, appellant's own admission establishes that he saw the substantial discrepancy between American Custom's recorded taxable sales and its sales tax returns during the audit period (i.e., American Custom underreported its taxable sales by \$971,969 during the period October 1, 2010, through March 31, 2012). With these facts, CDTFA has clearly established that appellant had actual knowledge of American Custom's unpaid tax liability.

On appeal, appellant stated that he is an engineer with no accounting background, and that he was primarily involved in the production and design aspects of the business. Appellant said that he had no specific knowledge of the Sales and Use Tax Law, and that as a result he hired and relied on various accountants and/or bookkeepers, including Ms. Amber Bustamonte, to oversee American Custom's sales and use tax matters. Appellant then alleged that Ms. Bustamonte embezzled funds from American Custom, and she altered the company's internal bookkeeping records to change recorded taxable sales into recorded nontaxable sales. Appellant alleged that he had no knowledge of the audit liability until the audit was completed, by which time American Custom was defunct and lacked the funds with which to pay the liability. As a result of his lack of knowledge, appellant argued that he is not liable under R&TC section 6829. We disagree.

First, we find the evidence of Ms. Bustamonte's alleged conduct to be unpersuasive. Appellant adduced no documentary evidence showing the alleged embezzlement, or the altering of taxable sales invoices in the bookkeeping records. Appellant provided the first page of a police report *alleging* embezzlement, but appellant has not stated or established any factual findings or results from the police report. In other words, the first page of the police report alone does not establish that Ms. Bustamonte engaged in the conduct alleged therein. Absent such evidence, we are not persuaded that Ms. Bustamonte committed such acts. Moreover, when questioned by the panel of judges, appellant's witnesses stated that they had not seen books and

records indicating that Ms. Bustamonte committed those acts at American Custom, only at Aleph.

Even if the allegations against Ms. Bustamonte are true, they are immaterial, because the primary portion of the disputed audit liability (i.e., for the period October 1, 2010, through March 31, 2012, during which American Custom recorded taxable sales of \$1,886,872 but only reported taxable sales of \$915,920 on its sales and use tax returns) occurred *prior* to Ms. Bustamonte's employment at American Custom. Moreover, that liability arises from a failure to report sales that were recorded as taxable, which would have been unaffected by any sales that Ms. Bustamonte allegedly altered to show as nontaxable. Accordingly, we conclude that the allegations against Ms. Bustamonte lack merit, and they do not alter our conclusion that CDTFA has established appellant's actual knowledge of American Custom's unpaid audit liability.

As for appellant's authority to pay taxes or to cause them to be paid, appellant did not dispute that he had such authority. Further, we find that as American Custom's president, CEO, and sole shareholder, appellant had authority to direct affairs of the corporation throughout the audit period, which included the authority to pay taxes. Nothing in the record indicates that his authority was limited.

Finally, as for the availability of funds for the payment of taxes, we note that American Custom collected sales tax reimbursement on all of its taxable sales, and therefore it had those funds available to pay the tax liability during each reporting period of the audit. Further, American Custom had the funds available to pay its sales and use tax liabilities, based on the EDD Wage History report showing that American Custom paid wages to its employees totaling \$2,842,978 during 1Q08 through 3Q13, and a Southern California Edison payment history report, showing that American Custom made payments totaling \$17,643.25, \$17,115.64, \$12,070.91, and \$2,966.46 during 2010, 2011, and 2012, and 1Q13, respectively. Furthermore, various checking accounts show withdrawals for large sums of money, as described above. American Custom's income statements, cost of goods sold, and general ledger also corroborate that there was substantial income from which to pay the liabilities. Therefore, American Custom had the funds available to pay its sales and use tax liabilities during the liability period.

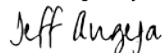
On the basis of the foregoing, all elements have been met to hold appellant personally liable under R&TC section 6829 for American Custom's unpaid sales tax liabilities.

HOLDING

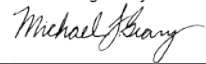
Appellant is personally liable for the unpaid tax liabilities of American Custom, for the period January 1, 2008, through April 30, 2013.


DISPOSITION

CDTFA’s actions in reducing appellant’s liability from \$156,881.29, to \$89,354.53, and removing the negligence penalty, but otherwise denying the petition, are sustained.

DocuSigned by:

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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:

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Michael F. Geary
Administrative Law Judge

DocuSigned by:

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 3/10/2020