OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18083545
	) CDTFA Case ID 940667
MOUNT DIABLO TILE AND STONE CO.	) CDTFA Account No. 101-720029
	)
	)
	) Date Issued: December 12, 2019

OPINION

Representing the Parties:

For Appellant:	Avi Nahmias, President
For Respondent:	Scott A. Lambert, 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 Mount Diablo Tile and Stone Co. (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 Notice of Determination (NOD), for $136,956.56 of additional tax, a failure-to-file penalty of $1,215.88, and applicable interest, for the period October 1, 2011, through February 7, 2015 (audit period).[2]

Office of Tax Appeals Administrative Law Judges Andrew J. Kwee, Amanda Vassigh, and Jeffrey G. Angeja held an oral hearing for this matter in Sacramento, California, on September 24, 2019. At the conclusion of the 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.

[2] The NOD also included a negligence penalty, which has been deleted by CDTFA.

ISSUES

1. Whether appellant has established that adjustments are warranted to the audited amount of unreported taxable sales.
2. Whether appellant has established that relief of the $1,215.88 penalty for failing to file a return for the fourth quarter of 2014 is warranted.

FACTUAL FINDINGS

1. Appellant operated a retail store in Walnut Creek, California from February 21, 2011, through February 7, 2015, selling tile, stone, and hardwood flooring.
2. For the audit period, appellant reported total and taxable sales of $382,191, claiming no deductions. Appellant did not file returns for the fourth quarter 2014 or the first quarter 2015 (January 1, 2015, through the February 7, 2015 closeout).
3. After CDTFA notified appellant of the upcoming audit, but before the audit began, appellant notified CDTFA that there had been a fire at the business location on February 7, 2015, which destroyed all the business records. However, appellant was able to provide partial records, which included invoices purportedly documenting sales for resale to approximately 17 customers, payment statements from subcontractors, and a bank statement for the month of January 2015. Also, CDTFA obtained federal income tax returns (FITR's) for 2011, 2012, and 2013 and 1099K,[3] and credit card deposit statements for January 1, 2011, through December 31, 2013.
4. CDTFA computed that gross receipts reported on the FITR's, net of sales tax reimbursement, exceeded total sales reported on sales and use tax returns (SUTR's) by $417,976 for 2011, $674,113 for 2012, and $865,032 for 2013.
5. CDTFA used the gross receipts reported on FITR's as audited total sales for the years 2012 and 2013. For the period January 1, 2014, through February 7, 2015, it used the average quarterly gross receipts reported on the 2013 FITR as audited quarterly total sales (computing a pro-rata portion of the quarterly amount for the partial first quarter 2015). CDTFA divided credit card deposits of $161,302 for the fourth quarter 2011 by the 79.79 percent ratio of credit card sales to reported gross receipts it had computed for

[3] Federal Form 1099-K, "Payment Card and Third-Party Network Transactions," is a form used by credit card companies and third-party processors (payment settlement agencies) to report the gross amount of reportable payments made to the taxpayer by the payment settlement agency.

the years 2012 and 2013 to establish audited total sales of $202,153 for that quarter.[4] After making the appropriate adjustments for sales tax included in gross receipts, CDTFA computed audited total sales of $3,083,615 ($202,153 for the fourth quarter 2011 + $788,548 for 2012 + $993,996 for 2013 + $993,996 for 2014 + $104,922 for the partial first quarter 2015).

6. CDTFA allowed sales for resale of $776,265 during the audit period for which appellant provided sales invoices, although appellant did not provide resale certificates. Of this amount, $657,801 represented sales allegedly made to three customers: Coliseum Tile, Inc., La Castellon, and Portofino Tiles and Floors.

7. CDTFA allowed a reduction for nontaxable installation labor of $300,893, based on appellant's representation that it sometimes acted as a prime contractor and hired subcontractors, who made charges for nontaxable installation labor.

8. CDTFA reduced audited total sales of $3,083,615 by $776,265 (sales for resale) and $300,893 (subcontracted installation labor) to compute audited taxable sales of $2,006,458. CDTFA then compared that amount to $382,191 reported taxable sales to compute the understatement of reported taxable sales of $1,624,268, which is at issue here.

9. On February 29, 2016, CDTFA issued the Notice of Determination, and on March 3, 2016, appellant filed a timely petition for redetermination, arguing that all taxable sales were reported, and that the entire difference of $1,624,268 represents nontaxable sales for resale for which it does not have documentation because the records were destroyed in a fire.

10. In support of its position that at least some of the deficiency results from nontaxable sales for resale, appellant provided sales invoices totaling $734,114 purportedly reflecting sales to three customers, Coliseum Tile, Inc., La Castellon, and Portofino Tiles and Floors. Notably, CDTFA had previously accepted $194,963 from these same sales invoices as nontaxable sales for resale in absence of a resale certificate (i.e., these transactions were already allowed in the $657,801 adjustment described above). In total, appellant claimed nontaxable sales for resale of $1,196,952 to these three customers ($657,801 + $734,114

[4] The slight difference between $202,158 ($161,302 ÷ .7979) and $202,153 is due to rounding. Other dollar amounts throughout this decision are slightly different from the result of the computations from which they are derived. In all cases, those minor differences are the result of rounding.

- $194,963). The new invoices request an additional adjustment of $539,151 (after subtracting the previously allowed transactions). The physical business address for all three customers was identical. CDTFA investigated these invoices and found no evidence that the sales were nontaxable sales for resale.[5]

11. On January 26, 2018, CDTFA issued its Decision and Recommendation recommending no changes to the audited understatement of reported taxable sales, deletion of the negligence penalty, and relief of the failure-to-file penalty for the partial first quarter 2015. This timely appeal followed.

DISCUSSION

Issue 1. Whether appellant has established that adjustments are warranted to the understatement of reported 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.)

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

[5] To verify whether the invoices represented nontaxable sales for resale, CDTFA attempted to contact the customers from whom appellant stated it had received copies of the invoices. According to CDTFA, the president of Coliseum Tile, Inc. stated that his company did not make the purchases, and he alleged that the invoices appeared to be fabricated. The manager of La Castellon (for which the seller's permit had been closed) stated that he had not received the sales invoices from appellant (i.e., the sales did not occur). Further, he asserted that La Castellon would not have made large volumes of purchases at the high selling prices reflected on the invoices. At the hearing, CDTFA contended that it should not have made the $194,963 adjustment for alleged nontaxable sales to these three customers.

610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *ibid*; see also *Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.)

Here the parties agree that the majority of the records were destroyed in a fire before the audit began. With the exception of the fourth quarter 2011, CDTFA used gross receipts reported on appellant's FITR's for 2012 and 2013 to establish audited total sales, with projections of amounts reported for 2013 into the remainder of the audit period. For the fourth quarter 2011, CDTFA concluded that reported gross receipts were understated because the gross receipts computed for that quarter (gross receipts reported on the 2011 FITR divided by four) were less than the credit card deposits for the same quarter. Accordingly, to establish audited total sales for that quarter only, CDTFA used a credit card projection of sales. We find that CDTFA used appellant's own available information to establish a reasonable and reliable amount of audited total sales, and appellant has not disputed that amount. Accordingly, the burden of proving that an adjustment to the deficiency is warranted shifts to appellant.

On appeal, appellant asserts that the entire deficiency represents nontaxable sales for resale and nontaxable charges for installation labor. In support of its position, appellant provided sales invoices totaling $734,114 to three customers, Coliseum Tile, Inc., La Castellon, and Portofino Tiles and Floors. According to appellant, the customers provided copies of these invoices, and appellant offered the invoices as evidence of additional nontaxable sales for resale.

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. (R&TC, § 6091.) If the seller does not timely obtain a valid and complete resale certificate, the seller will be relieved of liability for the tax only where the seller shows that the property was: 1) in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it forsale in the regular course of business; 2) is being held for resale by the purchaser and has not been used for any purpose other than retention, demonstration, or display, while being held for sale in the regular course of business; or 3) was consumed by the purchaser, with tax reported by the purchaser directly to CDTFA on the purchaser's returns or in an audit of the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).)

Here, appellant has not provided resale certificates in connection with the alleged sales for resale to Coliseum Tile, Inc., Portofino Tile and Floors, or La Castellon. Moreover, the

invoices appellant provided do not establish that these purchasers resold the property, still hold the property for resale, or paid tax in connection with the property (see Cal. Code Regs., tit. 18, § 1668(e).). Accordingly, appellant has failed to rebut the presumption that his gross receipts are retail sales subject to tax, and we conclude that no adjustment is warranted to the audited understatement of reported taxable sales.

Issue 2. Whether appellant has established that relief of the failure-to-file penalty for the fourth quarter 2014 is warranted.

When a taxpayer fails to file a return, a 10 percent failure-to-file penalty automatically applies to the liability. (R&TC, § 6511.) Under R&TC section 6592(a), relief from the failure-to-file penalty may be granted if it is found that a taxpayer's failure to file a return was due to reasonable cause and circumstances beyond its control and occurred notwithstanding the taxpayer's exercise of ordinary care and in the absence of willful neglect.

Here, appellant failed to file tax returns for the fourth quarter 2014 and the first quarter of 2015. As explained above, CDTFA relieved the failure-to-file penalty for the partial first quarter 2015 only, on the basis that a fire at its business location destroyed the majority of its business records.

Appellant continues to assert that its failure to file the fourth quarter 2014 return on time was due to an electrical fire at its business location that destroyed the majority of its business records. However, the return for the fourth quarter 2014 was due on January 31, 2015, and the fire did not occur until February 7, 2015. Accordingly, we find that the fire occurred after the due date of the return and could not have been the reason for appellant's failure to timely file a return for the fourth quarter 2014, and appellant has alleged no other basis for relief. Appellant also alleges that one of its co-owners, Ms. Lily Novoa, embezzled cash from the business during the fourth quarter of 2014, preventing appellant from paying its taxes; however, appellant provided no proof of this allegation, and in any event the allegation does not explain why appellant failed to file its tax return on time. Thus, there is no basis for relief of the failure-to-file penalty for that quarter.

HOLDINGS

1. Appellant has not established that adjustments are warranted to the audited amount of unreported taxable sales.
2. Appellant has not shown that its failure to file a return for the fourth quarter 2014 was due to reasonable cause, and there is no basis for relief of the failure-to-file penalty.

DISPOSITION

CDTFA's action in deleting the negligence penalty and relieving the failure-to-file penalty for the period January 1, 2015, through February 7, 2015, but otherwise denying appellant's petition for redetermination, is sustained.

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge