

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 19034544  
**OMAG AUTOMOTIVE MACHINE, INC.** ) CDTFA Account No. 103-046561  
 ) CDTFA Case ID: 1029150  
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**OPINION**

Representing the Parties:

For Appellant: Bruce J. Legawiec, CPA  
For Respondent: Jason Parker  
Chief, Headquarters Operations Bureau  
For Office of Tax Appeals: Deborah Cumins,  
Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, OMAG Automotive Machine, Inc. (appellant) appeals a decision issued by the respondent California Department of Tax and Fee Administration (CDTFA) denying appellant’s timely petition for redetermination of the Notice of Determination (NOD) which assessed a liability of \$12,850.98 of additional tax and applicable interest for the period April 1, 2014, through March 31, 2017 (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 are warranted to the audited understatement of reported taxable sales.

**FACTUAL FINDINGS**

1. Appellant operates an automobile restoration and repair facility in Palm Springs. It provides services on modern-day vehicles, installing parts related to repairs that are

typically completed within a short time period. Appellant also restores vintage vehicles. The restoration projects are not typically completed within the same quarter as the date of purchase of repair parts; those projects can take several years. Appellant has held a seller's permit since April 1, 2014.

2. During the audit period, appellant reported total sales of \$3,355,975, claimed deductions totaling \$2,530,909,<sup>1</sup> and reported taxable sales of \$825,066. Appellant also reported purchases subject to use tax of \$193.
3. For audit, appellant provided profit and loss statements (P&Ls) for 2014, 2015 and 2016; sales and purchase invoices for January 2017; bank statements for 2016; and Internal Revenue Service Form 1099-K<sup>2</sup> merchant data for 2011 through 2015.<sup>3</sup>
4. In the absence of sales journals (or similar summary records) and complete source documents, CDTFA decided to establish audited sales using the markup method.
5. CDTFA conducted a short shelf test, using sales invoices and purchase invoices dated in January 2017, to compute an audited markup of 55.59 percent.
6. To establish audited purchases of parts, CDTFA used a multi-faceted approach. It identified appellant's three primary vendors and obtained information from them regarding their sales to appellant.<sup>4</sup> CDTFA then asked appellant to identify the entries in the purchase detail records that represented purchases of parts from other vendors. CDTFA scheduled those entries as purchases of parts from vendors other than the three primary vendors.
7. To evaluate the reasonableness of the audited amount of purchases, CDTFA compiled the total purchases represented by purchase invoices provided by appellant for January 2017 and computed a total of \$20,330.82. It multiplied that figure by 12 to compute an annual amount of purchases of \$243,969.84. Since that figure moderately exceeded the audited

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<sup>1</sup> The deductions were for nontaxable sales for resale (\$31,043), nontaxable labor (\$2,417,401), sales tax included (\$74,831), cash discounts (\$2,534), and "other" (\$5,100).

<sup>2</sup> The Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (e.g., credit cards, debit cards, PayPal, etc.).

<sup>3</sup> The appellant denied the auditor's request for federal income tax returns. Also, CDTFA requested invoices for all work-in-progress as of April 1, 2014 (i.e., beginning inventory). Appellant was unable or unwilling to provide the requested invoices.

<sup>4</sup> The three primary vendors that were surveyed are Auto Zone, IMC, and SFF Imported Auto Parts.

- purchases of \$229,678.70 for 2016, CDTFA concluded that its audited purchase amounts were reliable and not overstated.
8. To establish the audited cost of taxable sales, CDTFA first reduced audited purchases of parts by estimated amounts of loss due to shrinkage and self-consumption,<sup>5</sup> each computed at 1 percent. It then deducted the audited cost of sales to other retailers for resale. To compute that cost, CDTFA reduced the \$31,043 of sales for resale claimed by appellant on sales and use tax returns, by an estimated markup of 35 percent.
  9. For each year,<sup>6</sup> CDTFA computed audited taxable sales by adding a markup of 55.59 percent to the audited cost of taxable sales. It compared the amounts of taxable sales to reported taxable measure<sup>7</sup> to compute understatements that represented error rates of 21.45 percent for 2014, 15.01 percent for 2015, 17.57 percent for 2016, and 15.46 percent for the first quarter 2017.
  10. CDTFA applied the error rates to reported taxable sales for each quarter of the audit period to compute an understatement of reported taxable sales of \$143,117, the amount in dispute here.
  11. On July 27, 2017, CDTFA issued the NOD for tax of \$12,850.98 and applicable interest.
  12. On August 8, 2017, appellant filed a petition for redetermination.
  13. On February 25, 2019, CDTFA issued a Decision in which it denied appellant's petition.
  14. This timely appeal followed.

### DISCUSSION

The California sales tax is imposed on a retailer's retail sales in this state of tangible personal property, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) 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(b)(1).) When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or

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<sup>5</sup> CDTFA did not establish an audited cost of self-consumed merchandise subject to use tax because it found that appellant paid tax to the vendor when it purchased parts for its own use.

<sup>6</sup> For 2014, CDTFA used information for the entire year in these computations, even though the audit period did not begin until April 1, 2014. For the first quarter 2017, CDTFA used information for that quarter only.

<sup>7</sup> In its comparison, CDTFA used audited taxable measure, including reported purchases subject to use tax of \$193, rather than reported taxable sales. This minor error is in appellant's favor and will not be discussed further.

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.)

On 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.)

Since appellant did not provide complete records, CDTFA utilized an alternative audit method, specifically the markup method, to establish audited taxable sales. We note that appellant did not provide summary sales records or complete source documents. Its purchase records did not represent solely purchases of parts.<sup>8</sup> We find that the records provided by appellant were inadequate and unreliable. We, therefore, find it was appropriate for CDTFA to use the markup method as an alternate audit method in this case. We have reviewed CDTFA's audit and find no errors in its processes or computations. Thus, we find that CDTFA has shown that its determination is reasonable and rational. Appellant has the burden of establishing that adjustments are warranted.

Appellant argues that the audited amounts of taxable sales of parts are overstated because many of the parts purchased during the audit period were purchased for restoration projects that were not completed during the audit period. Appellant argues that the sales of many of the parts purchased during the audit period, and logically the imposition of tax thereon, did not occur until after the audit period. Appellant estimates that the cost of parts purchased but not sold during the audit period is \$176,312.50. As evidence, appellant provided its work orders for several restoration projects together with purchase invoices attached for parts related to those projects. Appellant notes that it has only been able to gather invoices for purchases totaling \$132,958.10, rather than \$176,312.50. Nevertheless, appellant asserts that the \$10,159 difference between

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<sup>8</sup> CDTFA reviewed the purchase detail provided by appellant and found that it included payments to a subcontractor, expenses for uniforms, and various payments to credit cards.

\$132,958 and the audited understatement of \$143,117 is *de minimis*. Appellant asserts that the available documentation is sufficient to conclude that there is no understatement.

In response, CDTFA acknowledges that appellant purchases parts for restoration projects that may take years to complete. During the appeals process with CDTFA, the Business Tax and Fee Division (BTFD) found it probable that there were parts purchased during the audit period for which the sale was not completed until after the audit period. At the same time, BTFD noted, there would have been sales that occurred during the audit period for which the parts had been purchased prior to the audit period. Thus, the total amount of purchases of parts sold during the audit period would represent: 1) purchases of parts prior to the audit period that were sold during the audit period, plus 2) purchases during the audit period, less 3) the cost of parts that remained with ongoing projects at the end of the audit period. Therefore, BTFD requested appellant's records of work-in-progress at the beginning of the audit period to determine the cost of parts purchased prior to the audit period and sold during the audit period.

Appellant found CDTFA's request unreasonable and stated that the records of work-in-progress as of April 1, 2014, no longer exist. Appellant claims CDTFA did not request those records until 2018. In its opening brief, appellant argues that the request, even if complied with, would not produce any information that was relevant or admissible.

Appellant's assertion, that the information regarding work-in-progress as of April 1, 2014, is irrelevant, is incorrect. Appellant is correct that its taxable sales for the audit period exclude sales of parts purchased during the audit period, but not sold until after the audit period. However, appellant's taxable sales of parts for the audit period include 1) its sales of parts purchased prior to the audit period but sold during the audit period and 2) its sales of parts that were purchased and sold during the audit period. The records BTFD requested are required to establish the first of those components.

In the absence of information regarding the cost of parts that were purchased before the audit period, it is impossible to complete the pertinent three-part computation. As such, it was appropriate for CDTFA to assume that the cost of parts assigned to work-in-progress remains relatively constant; as some projects are completed, other projects are started. Thus, we find there is no basis to reduce the audited cost of taxable sales for parts purchased during the audit period but not sold until after the audit period.

We find that the evidence appellant provided to support an adjustment tends to show that the audited amount of purchases may have been understated, rather than overstated as appellant claims.<sup>9</sup> In sum, appellant has not met its burden of establishing that adjustments are warranted.

HOLDING

Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.

DISPOSITION

We sustain CDTFA’s decision to deny the petition for redetermination.

DocuSigned by:  
*Joshua Aldrich*  
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Josh Aldrich  
Administrative Law Judge

We concur:

DocuSigned by:  
*Andrew Wong*  
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Andrew Wong  
Administrative Law Judge

DocuSigned by:  
*Sara A. Hosey*  
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Sara A. Hosey  
Administrative Law Judge

Date Issued: 4/6/2020

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<sup>9</sup> Of the purchase invoices attached to work orders in appellant’s opening brief, 1.29 percent of the invoices were dated before the audit period and 35.62 percent were dated after the audit period. Those purchases were not included in audited purchases. 83 percent of the purchase invoices attached to work orders in appellant’s opening brief were not included on the purchase detail provided during the audit. The purchase invoices appellant provided as support for an adjustment, instead support our finding that the records of purchases appellant provided during the audit were incomplete or, at least, misrepresentative (i.e., items characterized as credit card payments when they were purchases of parts).