

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19054818
D. ASHIKIAN) CDTFA Account No. 011-766921
) CDTFA Case ID: 854739
)
)
)

OPINION

Representing the Parties:

For Appellant: D. Ashikian
For Respondent: Jason Parker, Chief
Headquarters Operations Division
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, D. Ashikian (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) for liability of \$21,149.78, a negligence penalty of \$2,115.03, and applicable interest, for the period July 1, 2010, through June 30, 2013 (audit period). Subsequently, CDTFA reduced the audit measure from \$382,831 to \$256,239, which will result in a reduction to the tax; deleted the negligence penalty; and denied the remainder of the petitioned amount.

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

ISSUES

1. Whether appellant has shown that adjustments are warranted to the disallowed claimed nontaxable labor charges.
2. Whether appellant has shown that further adjustments are warranted to the unreported taxable gasoline sales.

FACTUAL FINDINGS

1. In March 1988, appellant began operating a gas station with a convenience store and auto repair shop in Burbank.¹
2. During the audit period, appellant reported total sales of \$4,015,447 and claimed nontaxable sales of \$3,605,531, which included claimed nontaxable labor charges of \$211,877.² Appellant reported taxable sales of \$409,916.³
3. For audit, appellant provided federal income tax returns (FITR's) for 2011 and 2012; sales journals for the audit period; sales invoices for the auto repair shop for the year 2012; and gasoline and diesel purchase invoices for 2011.
4. Using total sales reported on the sales and use tax returns (SUTR's), net of tax, and costs of goods sold reported on the FITR's, CDTFA computed a book markup⁴ of 26.60 percent for 2011 and 2012 combined.⁵ CDTFA determined there were insufficient records to compute a book markup for taxable merchandise and decided to investigate further.
5. Regarding nontaxable labor, CDTFA reviewed the auto repair shop sales recorded in the sales journal for the period July 1, 2010, through December 31, 2012. CDTFA computed that recorded labor represented 89.83 percent of the recorded sales in the auto repair

¹ Appellant asserts that his business closed at some point after the audit but before CDTFA's appeals process occurred. Appellant contends that as a result he could not provide additional invoices to CDTFA. Despite appellant's contentions there is no evidence in the record to verify whether or when appellant closed his business.

² Appellant also claimed deductions of nontaxable sales of food, sales tax included in gross receipts, lottery ticket sales, cash discounts, and a state tax exemption on gasoline. These claims are not in dispute and will not be discussed further.

³ Appellant has been audited twice before. The first audit period was April 1, 1991, through September 30, 1993, which resulted in a deficit audit where audited taxable sales were estimated due to lack of records. The second audit period was October 1, 1993, through September 30, 1996, found no understatement or overstatement of reported taxable sales resulting in a "no change audit."

⁴ "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is \$.70 and it charges customers \$1.00, the markup is \$.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (.30 ÷ .70 = .42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (.30 ÷ 1.00 = .3).

⁵ CDTFA expected a markup in the range of 25 to 40 percent for this type of business. Although the 26.60 percent markup does fall within that range, CDTFA's April 17, 2019 Decision notes that the correct book markup, computed using total sales reported on the SUTR's, net of tax and lottery sales, is 9.69 percent.

- shop. CDTFA expected a labor sales ratio between 40 to 60 percent; it determined that further investigation was warranted.
6. CDTFA reviewed appellant's 2012 auto repair shop invoices and found sales totaling \$22,931, consisting of parts sales of \$10,402 and labor charges of \$12,529. In contrast, the total amounts recorded in the sales journal for 2012 were parts sales of \$6,549 and nontaxable labor of \$58,683. CDTFA then computed a labor-to-sales ratio of 54.64 percent ($\$12,529 \div \$22,931$).
 7. CDTFA determined that appellant recorded total auto repair shop sales of \$170,258 for the period July 1, 2010, through December 31, 2012. It applied the 54.64-percent labor-to-sales ratio to appellant's recorded auto repair shop sales to compute audited nontaxable labor sales of \$93,029, which is \$75,680 less than the claimed amount of \$168,709. Then CDTFA computed an error ratio in claimed nontaxable labor of 44.86 percent ($\$75,680 \div \$168,709$), which it applied to claimed nontaxable labor of \$43,168 for the period January 1, 2013, through June 30, 2013, to compute a disallowed amount of \$19,365. In total, CDTFA disallowed claimed nontaxable labor of \$95,045 ($\$75,680 + \$19,365$).
 8. Regarding reported taxable gasoline sales, CDTFA first noted that the amount recorded in appellant's sales journal of \$2,479,261 exceeded reported taxable gasoline sales of \$2,421,288 by \$57,973.
 9. CDTFA compared the taxable sales of gasoline that appellant recorded in its sales journals to the gallons of gasoline that appellant purchased (which it calculated by using the amount of prepaid sales tax per gallon),⁶ to calculate the per gallon sales price. CDTFA then compared the audited selling price to the average price per gallon during the audit period for the Los Angeles area as reported by the U.S. Department of Energy Information Administration (EIA).
 10. CDTFA then compared the EIA prices with appellant's selling prices, as posted on www.losangelesgasprices.com, for one Monday in January 2012, three Mondays in March 2012, and two Mondays in April 2012. Based on that comparison, CDTFA

⁶ For instance, for the third quarter 2010, appellant's prepaid sales tax on gasoline totaled \$3,528, and the prepayment rate was \$0.055 per gallon. Accordingly, appellant purchased 64,145 gallons of gasoline in that quarter ($\$3,528 \div \0.055).

computed that appellant's selling prices were only 2.4 cents less than the average for the Los Angeles area.

11. In the audit, CDTFA used selling prices reported by EIA, adjusted by the 2.4 cent differential, to compute audited taxable sales of gasoline of \$2,675,494, which exceeded reported gasoline sales of \$2,421,288 by \$254,206.
12. On October 15, 2014, CDTFA issued the NOD for tax of \$21,149.78, a negligence penalty of \$2,115.03, and applicable interest. Appellant filed a timely petition for redetermination disputing the disallowed claimed nontaxable labor and the unreported taxable sales of gasoline. CDTFA issued a decision dated April 17, 2019, which reduced the measure of unreported taxable sales of gasoline by \$126,592 from \$254,206 to \$127,614 based on *ad hoc* reports that appellant provided. CDTFA also deleted the negligence penalty. 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 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.)

Issue 1: Whether appellant has shown that adjustments are warranted to the disallowed claimed nontaxable labor charges.

The audited ratio of labor sales to total auto repair shop sales of 54.64 percent was computed by CDTFA based on its review of the sales invoices provided by appellant for the year 2012. The audited amount of auto repair shop sales for the period July 1, 2010, through December 31, 2012, is the amount recorded in appellant's sales journal. CDTFA used those figures, from appellant's own records, to compute the audited amount of nontaxable labor for the first 10 quarters of the audit period and to compute the percentage of overstatement in claimed amounts for those 10 quarters, which it then applied to the claimed nontaxable labor for the last two quarters of the audit period.

We find that a test period of one year is sufficiently long to establish a representative labor sales ratio for this three-year audit period. We further find that CDTFA used the best available information, appellant's own records, to establish auto repair sales for 10 of the 12 quarters of the audit period. We find that test period sufficiently long to establish a representative percentage of error in claimed nontaxable labor. Accordingly, we find that CDTFA has shown that its determination is rational and reasonable. Appellant, thus, has the burden of showing that adjustments are warranted.

Appellant argues that the auditor asked him to provide invoices for specific months of the audit period. Appellant states that, by the time he filed an appeal of the audit findings, he was unable to provide more invoices because the business had closed. We infer from appellant's statement that he believes the audited amount of disallowed claimed nontaxable labor would have been lower if he could have provided more invoices for CDTFA's review. We note that appellant raised the same argument during the appeals process with CDTFA, stating that many of the 2012 sales invoices for the auto repair shop were missing.

On the other hand, CDTFA argues that appellant's repair invoices did not include sequential invoice numbers or job numbers. Also, appellant did not maintain a listing of all invoices or other summary records that could be used to confirm that all invoices had been provided. CDTFA notes that, if additional invoices were provided, they might not support a reduction in the disallowed amount because additional invoices could reveal additional taxable sales of parts.

CDTFA has used the invoices appellant provided. Appellant's unsupported assertion that there were additional sales invoices in 2012 for the auto repair shop, which would support a higher percentage of labor charges to total sales, is not sufficient to satisfy appellant's burden of proof that adjustments are warranted. (See *Riley B's, Inc. v. State Bd. of Equalization, supra*; see also *Appeal of Magidow, supra*.) In the absence of evidence, we find no adjustment is warranted to the audited amount of disallowed claimed nontaxable labor.

Issue 2: Whether appellant has shown that further adjustments are warranted to the unreported taxable gasoline sales.

In the reaudit, CDTFA computed the audited selling prices of gasoline for each quarter by dividing recorded gasoline sales by the recorded number of gallons of gasoline sold, and then applying them to the number of gallons of gasoline purchased. In other words, CDTFA used selling prices computed from appellant's records and the number of gallons of gasoline appellant purchased, a verifiable figure based on the amounts of prepaid sales tax appellant paid on its purchases of gasoline. We, therefore, find that CDTFA has shown that its determination is rational and reasonable. Thus, appellant has the burden to show that adjustments are warranted.

Appellant has not made any arguments regarding the measure of unreported taxable sales of gasoline. However, appellant's stated amount in dispute, \$222,659, appears to include the understatement of reported gasoline sales.⁷

Appellant has not provided any evidence to dispute the audited selling prices or to dispute the audited number of gallons sold. Accordingly, appellant has failed to meet his burden. We, therefore, find that no adjustment is warranted to the audited amount of unreported gasoline sales.


HOLDINGS

1. Appellant has not shown that adjustments are warranted to the disallowed claimed nontaxable labor charges.
2. Appellant has not shown that further adjustments are warranted to the unreported taxable gasoline sales.


⁷ Disallowed claimed nontaxable labor of \$95,045 and unreported gasoline sales of \$127,614 (\$95,045 + \$127,614 = \$222,659).


DISPOSITION

We sustain CDTFA’s Decision to reduce the audited understatement of reported taxable sales from \$382,831 to \$256,239, delete the negligence penalty, and deny the remainder of the petition.

DocuSigned by:

48745BB806914B4...
Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:

DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

DocuSigned by:

JD390BC3CCB14A9...
Jeff Angeja
Administrative Law Judge

Date Issued: 4/22/2020