

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
S. PITSLEY

) OTA Case No. 18114001
) CDTFA Case ID 971018
) CDTFA Acct. No. 101-540717
)
)
)

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

For Respondent: Scott A. Lambert,
Business Taxes Specialist III

For Office of Tax Appeals: Deborah Cumins,
Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, S. Pitsley (appellant) appeals a Notice of Determination (NOD) issued by respondent California Department of Tax and Fee Administration proposing \$61,911.63 of additional tax and applicable interest for the period January 1, 2013 through March 31, 2016 (liability period).

This matter is being decided based on the written record because appellant waived her right to an oral hearing.

ISSUE

Is appellant entitled to a reduction of the audited measure of unreported taxable sales?

FACTUAL FINDINGS

1. Appellant operated a retail clothing store in Riverside, selling used children’s clothing, furniture, and accessories, from March 15, 2010, through December 31, 2016.
2. For the liability period, appellant reported total sales of \$100,513 and taxable sales of \$62,799. Appellant’s claimed deductions consisted of \$2,621 for returned taxable

- merchandise, \$2,492 for cash discounts, and \$32,601 for “Other” (i.e. unspecified) deductions.
3. Appellant provided no records for, and did not cooperate in, the audit.
 4. Respondent obtained through its Data Analysis Unit appellant’s federal income tax returns (FITRs) for 2013, 2014, and 2015 and 1099-K¹ forms for the period January 1, 2013 through December 31, 2014.
 5. On sales and use tax returns (SUTRs), appellant reported total sales that were \$291,823 less than gross receipts reported on FITRs for the years 2013, 2014 and 2015. Appellant reported taxable sales on SUTRs for each of the years 2013, 2014, and 2015 that were less than the costs of goods sold (COGS) claimed by appellant on FITRs. These findings are strongly indicative of an understatement of taxable sales.
 6. Respondent used the 1099-Ks to schedule appellant’s electronic payment transactions for the period January 1, 2013, through December 31, 2014, which totaled \$256,285. It used the quarterly average for that period (\$32,036) to estimate the electronic or online payment transactions² for the period January 1, 2015, through March 31, 2016 totaling \$160,180. Respondent thus determined credit card sales during the liability period totaling \$416,463.
 7. In the absence of records, such as cash register z-tapes³, to establish cash or total sales, and based upon its experience auditing similar businesses, respondent estimated that 50 percent of appellant’s sales were credit card sales. Accordingly, it divided audited credit

¹ Form 1099-K is used by electronic payment processing companies to report a taxpayer’s income from electronic or online payment services, such as credit cards, debit cards, and PayPal, to the Internal Revenue Service. A copy of the Form 1099-K is also sent to the payee/taxpayer.

² Because respondent refers to such transactions as “credit card” sales, we will also use that reference.

³ Z tapes are point-of-sale terminal (register) summaries of sales transactions and can include sales tax reimbursement collected and payment methods.

- card sales by 0.50 to establish audited total sales of \$832,926, which exceeded reported taxable sales of \$62,799⁴ by \$770,127.⁵
8. On July 14, 2016,⁶ respondent issued an NOD for a tax deficiency of \$61,911.63, measured by unreported taxable sales of \$770,127, plus applicable interest.
 9. On July 25, 2016, appellant filed a timely petition for redetermination.
 10. On October 22, 2018, respondent issued a Decision denying the petition.
 11. Appellant filed this timely appeal.
 12. In a November 14, 2019 letter, respondent acknowledged an error in its calculation of credit card deposits for the fourth quarter of 2013. Instead of total deposits of \$56,567, such deposits actually totaled \$33,006. After adjusting for the error, the measure of unreported sales was reduced by \$76,573, from \$770,127 to \$693,554, the measure now at issue.⁷

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).)

Respondent may determine a tax deficiency on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) When a taxpayer challenges an NOD, respondent has a minimal, initial burden of showing that its determination is

⁴ Appellant provided no documentation to support the deductions claimed on sales and use tax returns. Therefore, respondent concluded that all of her sales are subject to tax. Appellant has not specifically disputed respondent's decision to disallow the claimed deductions.

⁵ The audit report refers to the \$201,738 measure of unreported sales for the period for which Forms 1099-K were available as the unreported taxable measure based on book differences, and the remainder, \$568,389, as unreported taxable sales based on a credit card ratio (i.e. the ratio of credit card sales to total sales). The distinction has no real significance to our analysis.

⁶ The NOD was timely because appellant filed her SUTR for the first quarter 2013 late. The SUTR was due on April 30, 2013, but appellant filed it on July 31, 2013. Accordingly, the period during which respondent could issue a timely NOD would have expired on July 31, 2016, three years after the return for the first quarter 2013 was filed. (See R&TC, section 6487, subd. (a).)

⁷ Respondent's November 14, 2019 letter states that the measure has been reduced by \$75,598, from \$770,127 to \$694,529. However, the attached schedule shows the reduction we refer to in this finding of fact.

reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawai'i 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.) If respondent carries that burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.)

The applicable burden of proof is by a preponderance of the evidence. (*Appeal of Estate of Gillespie*, 2018-OTA-052P, at p. 4.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) 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.) To satisfy the burden of proof, a taxpayer must prove that (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

Appellant contends the 50-percent ratio of credit card sales to total sales (credit card ratio) is too low and the resulting audited measure of unreported taxable sales is too high. She has provided no evidence to support her contention.

There was ample evidence during the audit to support respondent's conclusion that appellant had underreported taxable sales and that use of an alternative, indirect audit methodology was warranted. Gross receipts reported on appellant's FITRs exceeded total sales reported on SUTRs for the years 2013, 2014, and 2015 by \$291,823. Although there is no evidence the auditor computed book markups, the COGS claimed on appellant's FITRs for 2013, 2014, and 2015 exceed reported taxable sales for the same years, which would mean that appellant was selling goods for less than she paid for them.⁸ Appellant provided no records for the audit, but respondent had access to SUTRs, and was able to obtain appellant's FITRs and Forms 1099-K. With the available evidence indicating a probable understatement of taxable sales, and with the only available records being FITRs, SUTRs, and Forms 1099-K, respondent's decision to use a credit card ratio to establish taxable sales was rational and reasonable.

⁸The claimed amounts of COGS and reported taxable sales, respectively, were \$36,769 and \$24,431 for 2013, \$34,800 and \$33,483 for 2014, and \$50,580 and \$30,225 for 2015.

According to the Forms 1099-K, appellant's credit card sales exceeded reported taxable sales by \$197,177 for the years 2013 and 2014, which was further evidence of an understatement of at least that amount. A more detailed analysis revealed quarterly average credit card sales of \$29,091, which respondent reasonably used to estimate credit card sales for the five quarters of the liability period for which no Forms 1099-K were available. Respondent thereby established credit card sales of \$378,177 for the liability period. Based on its experience auditing similar businesses, respondent estimated that credit card sales would represent 50 percent of appellant's total sales. Accordingly, respondent divided \$378,177 by 0.50 to establish audited taxable sales of \$756,353. That amount exceeded reported taxable sales of \$62,799 by \$693,554, the amount at issue here.

Since there was strong evidence that appellant's reported taxable sales were understated, and appellant did not provide records, we find it was appropriate for respondent to utilize an alternative audit method to establish taxable sales. Respondent used the credit card ratio method, which involves computations based on verifiable information (the credit card transactions reported for income tax purposes). Since appellant did not provide any records or information to show the ratio of credit card sales to her total sales, respondent's only option was to estimate the ratio using its experience auditing similar businesses. That is what respondent did and we find that its determination is reasonable and rational. The burden of proving a more accurate measure falls on appellant.

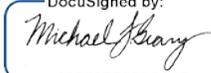
Appellant has provided no evidence to support her argument that the 50-percent credit card ratio is too low, and her unsupported assertion is not sufficient to meet her burden of proof. Consequently, based on the evidence, we find that that an adjustment to the audited understatement of reported taxable sales is not warranted.

HOLDING

Appellant is not entitled to a reduction of the audited measure of unreported taxable sales.

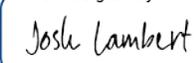
DISPOSITION

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

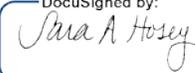
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Michael F. Geary
Administrative Law Judge

We concur:

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Josh Lambert
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge

Date Issued: 6/3/2020