**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 19064890 |
| | ) CDTFA Account No. 102-790070 |
| **THE PARTNERSHIP OF R. PERAZA ET AL.** | ) CDTFA Case ID 954453 |
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**OPINION**

Representing the Parties:

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| For Appellant: | R. Peraza, Partner<br>J. Peraza, Partner |
| For Respondent: | Mariflor Jimenez, Hearing Representative<br>Kevin Smith, Tax Counsel III<br>Jason Parker, Chief of Headquarters Operations |
| For Office of Tax Appeals: | Richard A. Zellmer<br>Business Taxes Specialist III |

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, the Partnership of R. Peraza & J. Peraza dba Peraza Concrete Transport (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition of a Notice of Determination (NOD) issued on May 19, 2016. The NOD is for $99,490.31 in tax, accrued interest, and failure to file penalties of $9,600.37 for the period October 1, 2008, through September 30, 2015 (liability period).

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Daniel K. Cho, and Natasha Ralston held an oral hearing for this matter in Cerritos, California, on June 16, 2020.[2] At the conclusion of the hearing, the record was held open to allow for

[1] Sales taxes were formerly administered by the State Board of Equalization (SBE). Effective July 1, 2017, functions of SBE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When this opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, SBE.

[2] Due to the COVID-19 pandemic, the oral hearing was conducted electronically with the agreement of the parties.

additional briefing and documentation from the parties. This matter was submitted for decision on August 17, 2020.

## ISSUES

1. Whether any further adjustments are warranted to the tax liability as determined by CDTFA.
2. Whether appellant established a basis for interest relief.

## FACTUAL FINDINGS

1. During the liability period, appellant sold ready-mix concrete. Appellant paid tax to its suppliers at the time of purchasing the cement and other mixing aggregates that it added to the concrete (ready-mix concrete).
2. Appellant delivered the ready-mix concrete to its customers' job sites using appellant's own concrete mixer trucks. Appellant delivered the concrete by pumping it out at a location specified by the customer. Appellant's customers were responsible for installing the concrete at the job site. Appellant did not install any concrete.
3. Appellant did not report or pay any tax to the state on its retail sales of concrete during the liability period.
4. On or about July 17, 2015, CDTFA notified appellant that CDTFA was investigating appellant's business to ensure compliance with the Sales and Use Tax Law including tax reporting requirements. Appellant did not have a seller's permit at this time and had never filed any sales and use tax returns with CDTFA.
5. On August 13, 2015, after the onset of the audit, appellant obtained a seller's permit for its business.
6. On or about February 11, 2016, appellant filed sales and use tax returns in person at CDTFA's office. Appellant's returns reported $0.00 in taxable sales for the period July 1, 2015, through December 31, 2015.
7. Upon audit, CDTFA obtained purchase and sales invoices from appellant for one-month test periods for 2010 through 2014.[3] According to appellant's sales invoices, beginning in 2011, appellant began collecting an amount itemized as "sales tax" from its customers

[3] The periods tested were January 2010, February 2011, May 2012, September 2013, and November 2014.

at a rate of approximately 8.75 percent or higher.[4] A number of the invoices have payment information and/or customer signatures on them. There are also unexplained gaps in the available invoice numbers.[5] The "sales tax" and selling prices in the invoices were all handwritten on a pre-printed form containing appellant's letterhead "Peraza Concrete Transport."

8. Appellant included separately stated charges for delivering the concrete but did not include any provision transferring title to the cement that it sold in its sales agreements. Appellant collected amounts for "sales tax" on the charges for the delivery and for the concrete. Appellant did not remit to the state any of the sales tax that appellant collected from its customers.

9. CDTFA determined that tax applies to appellant's separately stated charges for delivery, concrete, and "sales tax." In support for assessing sales tax on separately stated charges for "sales tax," the auditor concluded that it appears appellant recreated some missing records with incorrect information in "an attempt to defraud the State." As such, CDTFA concluded the invoices were insufficient to establish that appellant collected sales tax from its customers. Nevertheless, CDTFA accepted the invoiced amounts for delivery, concrete, and sales tax for purposes of calculating the audited taxable measure.

10. CDTFA calculated the taxable measure using the markup method.[6] To determine costs, CDTFA used purchase invoices. CDTFA obtained total purchases from only one of appellant's top three suppliers: Alpha Materials, Inc. (Alpha). Alpha reported to CDTFA that it sold $1,123,859 of cement and other mixing aggregates (materials) to appellant

[4] For example, for February 2011, appellant collected "sales tax" on 24 out of 26 of the invoices, as follows: #3319 ($39 tax), #3322 ($33 tax), #3325 ($70 tax), #3270 ($0 tax), #3331 ($59 tax), #3302 ($30 tax), #3334 ($130 tax), #3340 ($167 tax), #3306 ($132 tax), #3337 ($66 tax), #3350 ($38 tax), #3344 ($75 tax),#3309 ($50 tax), #3345 ($68 tax), #3346 ($103 tax), #3312 ($0 tax), #3347 ($70 tax), #3348 ($72 tax), #3349 ($98 tax), #3315 ($130 tax), #3330 ($66 tax), #3351 ($58 tax), #3355 ($139 tax), #3323 ($114 tax), #3359 ($58 tax),#3305 ($56 tax).

[5] For example, for February 2011, there were 26 invoices. The invoice numbers range from 3270 to 3350, which is a difference of 70. Appellant only submitted 26 invoices. It is unclear what happened to the remaining 44 invoice numbers for this period.

[6] "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 $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (.30 ÷ .70 = 0.42857). 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 = 0.3).

during the period January 1, 2010, through June 30, 2015. Appellant also purchased materials from Associated Ready-Mix Con, Inc. (ARM) and Robertson's Ready Mix (Robertson's). Appellant did not maintain or provide complete purchase information. ARM reported to CDTFA that it did not maintain any records for appellant's purchases because appellant made all its purchases in cash. Robertson's did not provide appellant's purchase information to CDTFA.

11. For periods in which purchase information was available for ARM and Robertson's, appellant's purchases from these suppliers combined totaled approximately 25 percent of appellant's purchases from Alpha. CDTFA multiplied the total purchases from Alpha by 25 percent to estimate total purchases from ARM and Robertson's, and thereafter, computed audited material purchases of $1,468,682 for the period January 1, 2010, through September 30, 2015. For the period October 1, 2008, through December 31, 2009, appellant's sales invoices recorded sales of $12,815 for January 2010, and $25,456 for February 2011. CDTFA multiplied the average of these two amounts ($19,135) by the number of remaining quarters in the liability period (15) to compute audited purchases of $287,031 for the period prior to 2010. In total, CDTFA computed audited purchases of $1,755,713 ($1,468,682 + $287,031).

12. CDTFA performed a shelf test[7] and computed an average audited markup of 68.75 percent for the years tested. CDTFA applied the average markup to the remaining years in the liability period (and the actual markup for the years tested) to compute audited taxable sales of $2,944,353 for the liability period. From this amount, CDTFA subtracted audited tax-paid purchases resold of $1,755,713, resulting in unreported taxable sales of $1,238,642 for the liability period.

13. CDTFA also allowed a bad debt deduction of $43,587.

14. On May 19, 2016, CDTFA issued an NOD to appellant for the liability disclosed by audit, which appellant petitioned.

15. On December 15, 2016, CDTFA issued a decision on appellant's petition. CDTFA's decision reduced unreported taxable sales from $1,238,642 to $1,188,012, because the auditor erroneously used sales invoices, instead of purchase invoices, to compute audited

[7] A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

purchases for the period October 1, 2008, through December 31, 2009. CDTFA also granted relief of the failure to file penalties due to reasonable cause, but otherwise denied the petition. This timely appeal followed.

16. By Notice dated May 15, 2020, OTA notified the parties that OTA was raising several questions and asked the parties to be prepared to address the questions at the oral hearing. One of the issues was "whether it was appropriate [for CDTFA] to include separately stated charges for 'sales tax' in the taxable measure."

17. At the oral hearing, R. and J. Peraza testified that appellant delivered ready-mix concrete directly to its customers using appellant's own cement trucks, and that appellant did not install the cement. R. and J. Peraza also confirmed that, as reflected in the invoices attached to CDTFA's audit workpapers, appellant did include separately stated charges for sales tax to its customers, and that the total amount identified on appellant's work orders (sales receipts) were the amounts paid by the customers. Aside from contending that the bad debt deduction should be greater than allowed by CDTFA, appellant does not specifically dispute the accuracy of the calculations made by CDTFA during the audit. Instead, appellant requests leniency due to an honest misunderstanding of the law, and because it paid sales tax to its suppliers based on its cost at the time of purchase.

18. During the oral hearing, CDTFA conceded that separately stated charges for sales tax were not taxable. CDTFA also conceded partial interest relief due to an unreasonable error or delay by CDTFA.

19. Following the oral hearing, the record was held open to allow CDTFA 30 days to identify the dollar amount of its concessions, and 30 days for appellant to provide documentation to support additional adjustments claimed during the oral hearing.

20. By letter dated July 7, 2020, CDTFA clarified the amount of its concession to be the following: (1) interest relief of $5,125.73 for the period June 3, 2016, through April 13, 2017; (2) interest relief of $1,025.14 for the period January 30, 2018, through February 28, 2018; and (3) reduction of tax of $7,323, due to adjusting the selling price to exclude separately stated charges for sales tax. Appellant did not provide any further documentation or argument during the additional briefing period.

## DISCUSSION

Issue 1: Whether any further adjustments are warranted to the tax liability as determined by CDTFA.

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, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

Charges for shipping and transportation are generally taxable when transportation is by facilities of the retailer. (R&TC, § 6012(a)(3); Cal. Code Regs., tit. 18, § 1628(b)(2).) As one exception, tax does not apply to separately stated transportation charges for transportation from the retailer's location directly to the purchaser, provided the property was sold before the retailer delivered the property. (R&TC, § 6012(c)(7); Cal. Code Regs., tit. 18, § 1628(b)(2).) Transportation charges are taxable when delivery of the property is made via facilities of the retailer unless there is an explicit written agreement executed prior to delivery that transfers title at some earlier time. (Cal. Code Regs., tit. 18, § 1628(b)(3)(D).)

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.)

It is undisputed that appellant reported $0 in taxable sales for the liability period and that appellant's retail sales of ready-mix concrete were taxable. Appellant's separately stated charges for concrete were taxable retail sales because it is undisputed that appellant sold directly to consumers (homeowners and construction contractors). In addition, appellant's separately stated transportation charges for concrete were also taxable because appellant did not include a written provision transferring title to the concrete prior to delivery. In other words, it is clear from these undisputed facts that there is a substantial understatement. Appellant's records were incomplete, and thus, we find it was reasonable and rational for CDTFA to compute appellant's sales using the markup method based on available records. The markups were based on appellant's own sales and purchase invoices, and purchase information from appellant's primary supplier. As such, we conclude CDTFA's determination was both reasonable and rational, and thus CDTFA has met its initial burden. Therefore, appellant has the burden of establishing error in CDTFA's determination.

Here, we believe the invoices are sufficient to establish that appellant charged and collected sales tax reimbursement from its customers, in the amounts specified on the invoices. Many of the invoices include payment information, special notes, and/or customer signatures. Furthermore, the tax rate charged on the invoices reflects that appellant charged tax on both the separately stated transportation charges and the concrete charges. Finally, appellant conceded that it collected the sales tax reimbursement from its customers, in the amounts reflected on appellant's invoices.

A retailer may collect sales tax reimbursement from its customer if the contract of sale so provides, and the measure of tax does not include any such separately stated charges for "sales tax." (R&TC, § 6051; Cal. Code Regs., tit. 18, § 1700(a)(1).) As such, we find that the audit liability was overstated to the extent CDTFA included separately stated charges for "sales tax" in the liability.[8] Therefore, an adjustment is warranted for separately stated charges for "sales tax" that appellant collected from its customers. At the oral hearing, CDTFA conceded that the separately stated charges for "sales tax" are nontaxable, and in a post-hearing submission CDTFA calculated that an adjustment of $7,323 is warranted for this item. Appellant was granted 30 days to offer evidence or argument in response to CDTFA's post-hearing calculation

[8] The R&TC imposes a 40-percent penalty for a failure to timely remit sales tax reimbursement under the circumstances at issue in this appeal. (R&TC, § 6597.) CDTFA has not asserted such a penalty in this appeal.

of the adjustment. Appellant failed to respond and, finding no evidence or argument to the contrary, we conclude that appellant failed to establish error in CDTFA's revised calculation of the liability, or that any further adjustment is otherwise warranted for this item.

Tax-Paid Purchases Resold Deduction

Appellant does not otherwise contend error in CDTFA's determination. Instead, appellant contends that it already paid tax to its suppliers when it purchased the cement, aggregate, and other mixing materials, and, as such, no additional tax is due. As a general matter, a retailer who resells tangible personal property before making any use thereof (other than retention, demonstration, or display while holding it for sale in the regular course of business) may take a deduction of the purchase price of the property if the retailer paid tax or tax reimbursement to its supplier at the time of purchase. (R&TC, § 6012(a)(1); Cal. Code Regs., tit. 18, § 1701(a).)

Here, CDTFA already allowed a tax-paid purchases resold deduction of $1,755,713, which was calculated based on appellant's own purchase invoices. The sales tax is not a tax imposed on cost, value added, or adjusted income. The measure of sales tax is the gross receipts, or the *total amount* of the sales price, from the retail sale of appellant's concrete. (R&TC, § 6051.) Although tax has been paid on appellant's cost, tax has not been paid on appellant's markup over cost (i.e., the selling price). Therefore, we find appellant's argument that it paid tax on cost unpersuasive because appellant has already been given an allowance for tax that it paid on cost to its suppliers.

Bad Debt Deduction

Appellant further contends that it is entitled to an additional bad debt deduction. There are very limited circumstances where a retailer may take a deduction due to an inability to collect tax or tax reimbursement from its customer. As relevant here, retailers may generally take a bad debt deduction for amounts reported as taxable and thereafter found worthless and charged off for income tax purposes. (R&TC, §§ 6055(a), 6203.5(a).) In support of a bad debt deduction, retailers must maintain adequate and complete records showing the date of original sale; the name and address of the purchaser; the amount the purchaser contracted to pay; the amount on which the retailer paid tax; the jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated; all payments or other credits applied to the account of the purchaser;

evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles; and the taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax. (Cal. Code Regs., tit. 18, § 1642(e).)

Appellant contends that it is entitled to an additional bad debt deduction to account for a bankruptcy filed by one of its customers, Rancho Pacific Telecommunications, Inc. (Rancho), and other miscellaneous bad debts. Appellant has not specified the amount of bad debt adjustment it seeks. CDTFA contends that it already accounted for these claimed bad debts when it allowed a bad debt deduction of $43,587. For audit, appellant provided income tax turns for 2013 and 2014, and appellant did not claim any bad debts on these returns. Appellant provided no other documentation to show that these debts were charged off for income tax purposes. As such, we find appellant's bad debt documentation, which consists of copies of filings of mechanic's liens that appellant filed on its customers' real property (residences), and copies of non-sufficient funds checks received from customers, to be legally insufficient to establish that it is entitled to a bad debt deduction. For example, appellant may have recovered payment from the customers after filing the mechanic's liens on their real property. This is why the law requires that the debt has been charged off for income tax purposes. (R&TC, § 6055(a).) Appellant has not provided any such evidence. As such, we conclude that appellant is not entitled to any additional bad debt deduction.[9] Therefore, no further adjustments are warranted on account of alleged bad debts.

Appellant also contends that it cannot afford to pay this liability, that COVID-19 (the current global pandemic) has impacted its concrete transport business substantially since March 2020, and requests an allowance due it its current financial position. The legislative power of this state is vested in the California Legislature, which consists of the Senate and Assembly. (Cal. Const., Art. 4, § 1.) OTA is bound to follow and enforce these laws and has no statutory or legal authority to exercise discretion or to make policy exceptions for individual

[9] A $43,587 bad debt deduction was already allowed by CDTFA and is not at issue; therefore, we do not address whether an offset is warranted for this erroneous allowance. (R&TC, § 6483.)

taxpayers on a case-by-case basis.[10] As such, the law requires us to conclude that no adjustments are allowable on account of appellant's financial circumstances.

In summary, we find that appellant is entitled to an adjustment to delete separately stated charges for "sales tax" from the taxable measure as conceded by CDTFA. Otherwise, we find that no additional adjustments are warranted.

Issue 2: Whether appellant established a basis for interest relief.

There is no statutory right to interest relief. The law allows the board,[11] in its discretion, to grant relief of all or any part of the interest imposed on a person under the Sales and Use Tax Law where the failure to pay the tax is due in whole or in part to an unreasonable error or delay by an employee of the board acting in his or her official capacity. (R&TC, §§ 20, 6593.5(a)(1).) Such an error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c); see Cal. Code Regs., tit. 18, § 1703(b)(1)(E).)

Appellant contends that it failed to report and pay sales tax due to an honest mistake and misunderstanding of the law. Appellant does not explain how its honest mistake in failing to remit to the state the tax that it collected was due to an unreasonable error or delay by CDTFA.[12]

[10] The California Legislature enacted R&TC section 7093.6, which authorizes CDTFA to accept an Offer in Compromise (OIC) on qualifying final tax liabilities. The OIC program is administered by CDTFA. OTA has no jurisdiction over this program.

[11] R&TC section 6593.5 states "board"; however, on and after July 1, 2017, the term "board," generally means CDTFA. As an exception, on and after January 1, 2018, the term "board," with respect to an appeal, means OTA. (R&TC, § 20(a), (b).)

[12] As noted above, CDTFA concedes that there was an unreasonable error or delay by CDTFA for some periods. CDTFA does not explain the basis for its conclusion. We offer no opinion with respect to periods conceded by CDTFA because they are no longer at issue in this appeal.

As such, we find that interest relief is inapplicable, and we decline to grant interest relief beyond the amount conceded by CDTFA.[13]

[13] Even if appellant was able to establish that its allegedly honest mistake in failing to pay the tax was caused by an employee of the board acting in his or her official capacity, in order to be eligible for interest relief, appellant would still have to show that no significant aspect of that error or delay was caused by appellant's own actions or failure to act. (R&TC, § 6593.5(b).) Here, appellant's own invoices document that it charged and collected an amount itemized as "sales tax" from its customers on its transportation charges and on its charges for ready-mix concrete. These invoices contain customer signatures, delivery notices, and payment information. The evidence that appellant collected "sales tax," even though it did not have a seller's permit with CDTFA, is not just limited to the invoices submitted for audit; it is also documented on appellant's lien filings that appellant filed in various counties within this state. For example, appellant recorded a mechanic's lien with the County of Riverside, for an unpaid invoice, 2652, on October 9, 2009. As supporting documentation, appellant included invoice 2652, dated September 11, 2009. The invoice includes a customer signature, plus a $40 charge for sales tax. The mechanic's lien was signed by J. Peraza, as owner of appellant, under penalty of perjury. Appellant only had two owners: R. and J. Peraza. Appellant also admitted during the oral hearing that it collected separately stated amounts for "sales tax" from its customers. These facts demonstrate that it is clear and undisputed that appellant knowingly collected the sales tax from its customers over a period of many years, while appellant was operating without a seller's permit, and did not timely remit the tax to the state. This is not an honest mistake and does not qualify for interest relief.

## HOLDINGS

1. Appellant is entitled to an adjustment to delete separately stated charges for "sales tax" from the liability, in the amount of $7,323, as conceded by CDTFA.
2. Appellant is not entitled to any further interest relief, beyond the amount conceded by CDTFA.

## DISPOSITION

CDTFA's action to deny the petition is sustained, subject to the adjustments made in CDTFA's decision, and to CDTFA's concessions of: (1) $6,150.87 in interest relief, and (2) $7,323 in tax.[14]

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Natasha Ralston
Administrative Law Judge

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 9/23/2020

[14] The details of the concession, including the periods of interest abatement, are set forth in CDTFA's letter dated July 7, 2020.