OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20015719
	) CDTFA Account No. 101-102334
L. OLIVEIRA, JR.	) CDTFA Case IDs 975265;178-050; 222-901
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Susan Tomsha-Miguel, Representative

For Respondent: Jason Parker, Chief of Headquarters Operations

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, appellant L. Oliveira, Jr. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) that denied appellant's petitions for redetermination of two Notices of Determination (NODs).[1]

On July 28, 2016, CDTFA timely issued the first NOD for tax of $5,690.55, a negligence penalty of $569.06, plus applicable interest, for the period April 1, 2013, through December 31, 2013. As explained below, after issuing the first NOD, CDTFA completed its audit of appellant and timely increased the tax liability from $5,690.55 to $8,790.18, the measure of unreported taxable sales from $74,630 to $115,281, and the negligence penalty from $569.06 to $879.02.[2]

On April 13, 2018, CDTFA timely issued the second NOD for tax of $21,287.65, plus applicable interest, for the period January 1, 2014, through September 30, 2015. By audit,

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes, as well as other business taxes and fees. In 2017, BOE's functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

[2] R&TC section 6563 allows CDTFA to decrease or increase the amount of a determination before it becomes final.

CDTFA established a measure of $279,182 for unreported taxable sales for the second NOD. After issuing the second NOD, CDTFA timely added a negligence penalty of $2,128.76.

The tax liabilities totaled $30,077.83 ($8,790.18 + $21,287.65), the measures of unreported taxable sales totaled $394,463 ($115,281 + $279,182), and the negligence penalties totaled $3,007.78 ($879.02 + $2,128.76) for the combined period of April 1, 2013, through September 30, 2015 (audit period).

Appellant waived his right to an oral hearing; therefore, we are deciding these matters based on the written record.

ISSUES

1. Whether any adjustments to the aggregate measure of unreported taxable sales are warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant has held a seller's permit to operate a furniture store and interior design center in Modesto, California, since June 30, 2008.
2. On October 13, 2013, appellant opened a second location in Livermore, California, but closed it on or about February 1, 2014.
3. For the audit period, appellant reported total/taxable sales of $84,589 on his sales and use tax returns (SUTRs) and claimed no deductions.
4. Upon audit, appellant failed to provide any books and records. On July 28, 2016, before completing its audit, CDTFA issued the first NOD, based on estimates, for the period April 1, 2013, through December 31, 2013.
5. CDTFA completed its audit and issued an audit report on March 9, 2018. Because appellant failed to provide books and records, CDTFA needed to use an indirect audit method to verify appellant's taxable sales. From its Data Analysis Section, CDTFA obtained appellant's credit card transaction data for the audit period as reported on Form 1099-K.[3] Using this data, CDTFA compiled credit card sales of $215,015 for the audit

[3] Form 1099-K (*Payment Card and Third Party Network Transactions*) is used to report a taxpayer's income received from electronic or online payment services (credit cards, debit cards, PayPal, etc.) to the IRS. (See Internal Revenue Code, § 6041(a).)

period. CDTFA noted that credit card sales alone exceeded reported taxable sales of $84,589 for the audit period. CDTFA concluded that the Form 1099-K data was the best evidence of appellant's sales and that, without evidence to the contrary, all sales were taxable. CDTFA decided to use the credit-card-sales-ratio method to compute audited taxable sales.

6. CDTFA noted that the Form 1099-K data showed credit card sales of only $138 for the first quarter of 2014 (1Q14). Because quarterly credit card sales ranged from $12,642 to $39,457 for the other quarters in the audit period, CDTFA concluded that the Form 1099-K data of credit card sales for 1Q14 were incomplete. CDTFA combined credit card sales of $25,956 for 4Q13 (the quarter before 1Q14) with credit card sales of $23,066 for 2Q14 (the quarter after 1Q14) and computed an average of $24,511 in credit card sales for 1Q14. CDTFA added $24,511 to credit card sales of $215,015 compiled from Form 1099-K data and computed audited credit card sales of $239,526 for the audit period.[4]

7. CDTFA estimated a 50 percent credit card sales ratio based on its experience auditing similar businesses. Thus, CDTFA divided audited credit card sales of $239,526 by the 50 percent credit card sales ratio and computed audited taxable sales of $479,052 for the audit period. Upon comparison to reported taxable sales of $84,589, CDTFA computed unreported taxable sales of $394,463 for the audit period.

8. Based on the completed audit, CDTFA increased the measure of tax for the first NOD, which was for April 1, 2013, through December 31, 2013, to $115,281.

9. On April 13, 2018, CDTFA issued the second NOD based on a measure of tax of $279,182 for the period January 1, 2014, through September 30, 2015.

10. Appellant disagreed with both NODs and timely filed petitions for redetermination. During CDTFA's internal appeals process, appellant provided bank statements and a bank deposits analysis for the audit period. In the analysis, appellant compiled total sales deposits of $580,726, which was composed of credit card sales deposits of $264,350 (45.52 percent of total sales deposits) and cash sales deposits of $316,376 (54.48 percent of total sales deposits).

[4] Audited credit card sales of $239,526 includes an extra $138 (relating to 1Q14). CDTFA did not net that amount out from the $215,015 in credit card sales for the audit period before adding $24,511 in credit card sales for 1Q14.

11. On December 19, 2019, CDTFA's Appeals Bureau issued a decision denying both petitions.

12. Appellant timely appealed these matters to the Office of Tax Appeals.

DISCUSSION

Issue 1. Whether any adjustments to the aggregate measure of unreported taxable sales are warranted.

California imposes a sales tax on a retailer for the 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.) The total amount of the sales price includes any services that are a part of the sale of tangible personal property. (R&TC, § 6011(b)(1).) Gross receipts do not include the price received for labor or services used in installing or applying the property sold. (R&TC, § 6012(c)(3).) 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).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, 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.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (Cf. *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.) 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.*; cf. *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Here, appellant failed to provide any books and records for CDTFA's examination upon audit, so CDTFA could not use a direct audit method to verify appellant's reported sales. Instead, CDTFA used an indirect audit method to compute and to determine appellant's sales:

the credit-card-sales-ratio method. The credit-card-sales-ratio method is one of CDTFA's generally accepted methods for determining sales. Thus, we find CDTFA has used a standard and recognized audit method to establish sales.

In the audit, CDTFA estimated a 50 percent credit card sales ratio based on its experience auditing similar businesses. Appellant's own bank deposits analysis indicates a credit card sales ratio of 45.52 percent, which is less than CDTFA's 50 percent estimate that resulted in unreported taxable sales of $394,463.[5] A credit card sales ratio of 45.52 percent would result in total/taxable sales of $580,726 (which would not reflect any cash payouts, i.e., cash sales proceeds that are not deposited but are used to pay for merchandise or operating expenses), unreported taxable sales of $496,137, and a larger tax liability for appellant. Thus, we find that CDTFA's determination was reasonable and rational, and the burden of proof shifts to appellant to show errors in the audit.

On appeal, appellant asserts that CDTFA made three errors in its audit; we address each alleged error below.

First, appellant asserts that a 50 percent credit card sales ratio is unreasonable and that a 95 percent credit card sales ratio is more reasonable for his type of business. Appellant's assertion is contradicted by his own bank deposits analysis, which, as noted above, indicates a credit card sales ratio of 45.52 percent. Hence, an adjustment based on a credit card sales ratio above 50 percent is unwarranted.

Second, appellant contends that credit card sales of $138 for 1Q14 per Form 1099-K is correct and that CDTFA erroneously added credit card sales of $24,511 for 1Q14. However, from his bank statements, appellant compiled credit card sales deposits of $30,416 for 1Q14. By appellant's own calculation, CDTFA's audited credit card sales of $24,649 for 1Q14 are *understated*. Further, appellant compiled credit card sales deposits of $264,350, which exceeds audited credit card sales of $239,526 for the audit period. Thus, we reject appellant's contention that credit card sales of $138 for 1Q14 per Form 1099-K is correct.

[5] Bank deposits are not gross receipts. (See R&TC, § 6012(a).) However, where, as here, a retailer is engaged in the business of making retail sales of tangible personal property, the retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, may be evidence of gross receipts from the retail sale of tangible personal property. In his bank deposits analysis, appellant alleged that there were deposits from non-sale or nontaxable transactions (e.g., deposits from relatives' businesses or rental property, tax refunds, etc.), but failed to provide us with substantiating documentation despite claiming otherwise in his opening brief.

Third, appellant argues that not all his sales were taxable. Appellant alleges he only reported retail sales of tangible personal property on the SUTRs and the difference between reported taxable sales and Form 1099-K data are services-related income not subject to sales tax. However, appellant acknowledges that he cannot document his nontaxable service income. Rather, appellant asserts that industry statistics reflect an average ratio of taxable to total sales of 40 percent, and that CDTFA Publication 35 advises a 20 percent taxable labor ratio for taxable labor and services.[6] We disagree. All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) A party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (See *Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) Appellant admits not having documentation to support his taxable and nontaxable sales; thus, appellant has failed to establish an adjustment to audited taxable sales is warranted.

Based on our finding that appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made, we conclude that appellant has failed to meet his burden of establishing that a reduction to the measure of unreported taxable sales is warranted.

Issue 2. Whether appellant was negligent.

CDTFA imposed negligence penalties pursuant to R&TC section 6484 because appellant failed to provide books and records for the audit period and the understatements were large in relation to reported taxable sales.

On appeal, appellant asserts that the negligence penalties should be abated because he was unable to properly manage the business while caring for his parents and their businesses when they became ill during the audit period.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto.

[6] The reference to a 20 percent taxable labor ratio in Publication 35 (*Interior Designers and Decorators*) is found in a discussion of furniture reupholsters' allocation of total labor charges between taxable fabrication labor and nontaxable repair labor. As such, the referenced 20 percent taxable labor ratio is inapplicable here and appellant's reliance on it is misplaced; thus, we do not address this particular ratio further.

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

In analyzing the issue of negligence, one of the factors that must be considered is whether the taxpayer has been previously audited. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Generally, a negligence penalty should not be recommended when the taxpayer has not been previously audited, but there are circumstances where a penalty in a first audit would be appropriate. (*Ibid*.) A negligence penalty can be upheld in a first audit if there is evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (*Ibid*.).

Here, appellant failed to provide any books and records for audit. Appellant concedes that he is unable to provide records for the audit period reflecting his taxable sales or nontaxable sales. We find that appellant's failure to maintain and provide the normal books of account, such as sales journals, purchase journals, general ledgers, or sales tax worksheets, and source documents, such as sales invoices, cash register tapes, service contracts, or merchandise purchase invoices, is evidence of negligence.

Regarding the deficiencies, we note that the unreported taxable sales of $394,463 found in the audit represents an error ratio of 466.33 percent when compared to reported taxable sales of $84,589.[7] Viewed from another perspective, appellant reported only $0.18 for every $1 in taxable sales. This large reporting error is also evidence of negligence. (See *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323 [evidence of numerous unreported sales that were unrelated to accounting system is evidence of negligence].)

[7] That is, the "error ratio" is the percentage of unreported sales to reported sales.

Further, the amounts appellant compiled from his own bank statements establish that he could not have held a good faith and reasonable belief that he was reporting his sales tax liabilities accurately or in substantial compliance with the requirements of the law. From his bank statements, appellant compiled total sales deposits of $580,726, which exceeded audited sales of $479,052, and credit card sales deposits of $264,350, which exceeded reported taxable sales of $84,589.[8] Although appellant did not provide any evidence of nontaxable sales, he asserted an industry average of 60 percent nontaxable sales. If we found that 60 percent of appellant's sales were nontaxable (which we have not), appellant's taxable sales would have been $232,290 ($580,726 × 40 percent taxable ratio), which, when compared to reported taxable sales of $84,589, would still have resulted in an understatement of $147,701 and an error ratio of 174.61 percent.

We find that the understatement cannot be attributed to appellant's bona fide and reasonable belief that his bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Therefore, we find that appellant was negligent, and the negligence penalties are warranted.

[8] As noted in Issue 1, appellant alleged that most of his sales were services-related income not subject to sales tax, but has not produced substantiating evidence.

HOLDINGS

1. No adjustments to the aggregate measure of unreported taxable sales are warranted.
2. Appellant was negligent.

DISPOSITION

Sustain CDTFA's action in denying appellant's petitions.

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
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Nguyen Dang
Administrative Law Judge

Date Issued: 8/31/2020