

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
R. KHRAICH

) OTA Case No. 18012026
) CDTFA Account No. 101-219591
) CDTFA Case ID 888965
)
)
)

OPINION

Representing the Parties:

For Appellant:

R. Khraich

For Respondent:

Scott Lambert, Hearing Representative
Lisa Renati, Hearing Representative
Dana Flanagan-McBeth, Tax Counsel IV

For Office of Tax Appeals:

Deborah Cumins,
Business Tax Specialist III

D. CHO, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, R. Khraich (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s petition for redetermination of a Notice of Determination (NOD), which assessed a liability of \$147,234.45 of additional tax and applicable interest, for the period January 1, 2010, through September 30, 2014 (audit period).

Office of Tax Appeals Administrative Law Judges Nguyen Dang, Linda C. Cheng, and Daniel K. Cho held an oral hearing for this matter in Cerritos, California, on December 18, 2019. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of the BOE relevant to this case were 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 the BOE; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

ISSUE

Whether adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Appellant operated a used car dealership from May 2009 through September 2014. During the audit period, appellant sold vehicles for resale at auctions and made retail sales from two locations, in Riverside and San Bernardino.²
2. For the audit period, appellant reported total taxable sales of \$4,374,996, claiming no deductions.
3. With respect to the audit of the business, appellant provided Official Fee Reports (OFR)³ for the Riverside location for the period January 1, 2011, through September 30, 2013; sales tax worksheets (STW)⁴ for the San Bernardino location for the period April 1, 2011, through December 31, 2011; and federal income tax returns (FITR) for 2011 and 2012. Appellant did not provide sales journals for any portion of the audit period.
4. Based on the available documentation, CDTFA used a combination of appellant's OFR's for the Riverside location, appellant's STW's for the San Bernardino location, and information obtained from the California Department of Motor Vehicles (DMV), for the audit period,⁵ to compute unreported taxable sales of \$1,788,928. Appellant had not claimed deductions for bad debts on his FITR's or sales and use tax returns.
5. CDTFA made no adjustments for bad debts or buybacks⁶ because appellant did not provide any documentation to support such an adjustment.

² The San Bernardino location was open for the period April 1, 2011, through June 30, 2012.

³ The OFR's included the sales prices, taxes collected, Report of Sale numbers, vehicle identification numbers, and other information.

⁴ The STW's included customer names, sale dates, the counties where the customers resided, and the sales tax amounts. For some sales, the STW's also included the taxable amounts of the sales.

⁵ Although CDTFA obtained sales data from the DMV for the entire audit period, CDTFA only relied on the DMV data for the period consisting of the third quarter of 2011 through second quarter of 2012 and the fourth quarter of 2013 through the third quarter of 2014.

⁶ A "buyback" (also called a "roll back") occurs when a vehicle is purchased and operated on a Report of Sale and then returned to the dealer (because credit was unavailable, the customer changed his or her mind, etc.) prior to completion of the transaction and issuance of the title.

6. On June 10, 2015, CDTFA issued the NOD to appellant for additional tax owed of \$147,234.45 and applicable interest.
7. On July 6, 2015, appellant filed a timely petition for redetermination, arguing that adjustments should be made for bad debts and buybacks.
8. On November 7, 2017, CDTFA issued a Decision and Recommendation denying appellant's petition for redetermination.
9. This timely appeal followed.

DISCUSSION

California imposes a 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, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) 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).)

A retailer is relieved from liability for sales tax that became due and payable, insofar as the measure of tax is represented by accounts that have become worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. (R&TC, § 6055(a); Cal. Code Regs. tit. 18, § 1642(a).) If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as interest, insurance, repair, or installation labor and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. (Cal. Code Regs. tit. 18, § 1642(b)(1).) When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. (Cal. Code Regs. tit. 18, § 1642(f)(1).) This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, including the wholesale value of the repossessed article, is less than the purchase price. In support of deductions for bad debts, retailers must maintain adequate and complete records showing: (1) the date of original sale; (2) the name and address of purchaser; (3) the amount the purchaser contracted to pay; (4) the amount on which the retailer paid tax; (5) the jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated; (6) all payments or other credits applied to the

account of the purchaser; (7) 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 (8) 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).)

California Code of Regulations, title 18, section (Regulation) 1655(a), provides that the amount upon which tax is computed does not include the amount charged for merchandise returned by customers if, (1) the full sale price, including that portion designated as “sales tax,” is refunded either in cash or credit, and (2) the customer, in order to obtain the refund or credit, is not required to purchase other property at a price greater than the amount charged for the property that is returned.

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.)

Here, CDTFA used appellant’s records (OFR’s and STW’s) along with information obtained from the DMV to determine a deficiency measure. In other words, CDTFA used reliable evidence to determine a deficiency against appellant. Thus, we find that CDTFA’s audit was both reasonable and rational, and the burden of proof shifts to appellant to demonstrate that CDTFA’s determination is erroneous or overstated.

Appellant’s primary contention is that CDTFA’s audit fails to account for appellant’s bad debt and buybacks for the audit period. In support of this argument, appellant provided very limited documentation to show that a sale may have been cancelled and a repossession of a

vehicle may have occurred. However, appellant states that all of the necessary documentation to establish that he is entitled to a bad debt deduction was lost when his trailer containing the documentation was stolen. Nonetheless, appellant argues that had CDTFA examined the documentation at the time of the audit, appellant's liability would be greatly reduced. Therefore, appellant believes that he should not be punished for CDTFA's failure to properly examine the documentation at the time of the audit.

There is no dispute that appellant is unable to provide the necessary documentation to establish that he is entitled to a bad debt deduction pursuant to Regulation 1642. Although appellant states that he had the supporting documentation prior to the completion of the audit, these arguments and statements are immaterial to the resolution of this appeal.⁷ Regardless of the reason for appellant's inability to provide such documentation, it is appellant's burden to demonstrate that he is entitled to a bad debt deduction, and there is no provision in the Sales and Use Tax Law that would entitle appellant to such a deduction without adequate supporting documentation. (See Cal. Code Regs., tit. 18, § 1642(e); see also *Burnet v. Houston* (1931) 283 U.S. 223, 228 ["impossibility of proving a material fact upon which the right to relief depends simply leaves the claimant upon whom the burden rests with an unenforceable claim ..."].) Without the necessary documentation, we have no basis in which to find that appellant would be entitled to a bad debt deduction. Therefore, appellant has failed to meet his burden of proof.

⁷ With respect to appellant's arguments that he had the necessary documentation at the time of the audit and CDTFA failed to examine the documentation, we note that there appear to be some inconsistent facts in the record because the comments in the audit indicate that appellant did not provide such documentation at the time of the audit of the business. However, we do not need to resolve the factual dispute in this appeal because even if we accepted appellant's statements as facts, appellant would not be entitled to a bad debt deduction for the reasons stated above. Therefore, these arguments and statements are immaterial to the conclusion of this appeal.

HOLDING

Appellant has failed to demonstrate that an adjustment to the determined measure of tax is warranted.

DISPOSITION

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

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Daniel Cho

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Daniel K. Cho
Administrative Law Judge

We concur:

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Linda C. Cheng

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Linda C. Cheng
Administrative Law Judge

DocuSigned by:

Nguyen Dang

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Nguyen Dang
Administrative Law Judge

Date Issued: 3/4/2020