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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18063345
	) CDTFA Account No. 017-778128
AUTO CELLULAR SYSTEMS, INC.	) CDTFA Case ID 777640
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	David Parker, Secretary Elaine Serrao, Attorney
For Respondent:	Randy Suazo, Hearing Representative Kevin Smith, Tax Counsel III Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Richard A. Zellmer, Business Taxes Specialist III

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Auto Cellular Systems, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] granting in part and denying in part appellant's petition for redetermination of a Notice of Determination (NOD) dated October 17, 2013. The NOD is for $352,276.58 in tax, plus applicable interest, for the period July 1, 2009, through June 30, 2012 (liability period). Based on its decision, CDTFA reduced the understated measure of tax from $3,816,309 to $3,239,870 but otherwise denied the petition for redetermination.

[1] Sales and use taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall also refer to BOE.

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Office of Tax Appeals Administrative Law Judges Daniel K. Cho, Andrew Wong, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on July 23, 2020.[2] At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether further adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Appellant operated as a retailer of cellular phones and related accessories. Appellant was an authorized dealer for Verizon Wireless. During the liability period, appellant operated 34 locations in California, although not all 34 locations operated throughout the entire liability period. Appellant sold phones in "bundled" transactions, meaning that a customer who purchased the phone was contractually obligated with a service provider for utility service for a period greater than one month as a condition of the sale.
2. CDTFA audited appellant for the liability period. Appellant explained to CDTFA that information from its Point of Sale system was exported to Excel spreadsheets, and the Excel spreadsheets were used to prepare the sales and use tax returns. However, appellant did not provide the Excel spreadsheets for audit. CDTFA was unable to determine how reported total sales or the claimed deductions were computed. CDTFA compiled sales tax reimbursement recorded in appellant's sales tax payable account, which totaled $4,037,562 for the liability period. Upon comparison to sales tax reimbursement of $3,735,785 reported on appellant's sales and use tax returns, CDTFA determined a tax understatement of $301,777. The tax understatement was divided by the applicable sales tax rate to compute unreported taxable sales of $3,239,870 for the liability period. CDTFA also included separate taxable measures of $514,549 for disallowed claimed bad debt deductions, and $61,890 for disallowed claimed "other" deductions.
3. Based on this audit, CDTFA issued an NOD to appellant on October 17, 2013, in the amount of $352,276.58 tax, plus accrued interest.
4. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.

[2] The oral hearing was originally noticed for Cerritos, California, but conducted electronically by video conference due to COVID-19.

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5. In a Decision and Recommendation issued on September 29, 2016, CDTFA concluded that the separate measures of tax for disallowed claimed bad debts and disallowed claimed "other" deductions were duplicated in the unreported taxable sales, and thus, CDTFA recommended that those two measures of tax be deleted in a reaudit. CDTFA also recommended that appellant be given an opportunity to provide documentation to support allowable bad debts, and to provide documentation to support the differences between sales tax reimbursement recorded and sales tax reimbursement reported on the sales and use tax returns. CDTFA otherwise denied the petition.
6. CDTFA prepared a reaudit in which the taxable measures of $514,549 for disallowed claimed bad debt deductions, and $61,890 for disallowed claimed "other" deductions were deleted. CDTFA stated that appellant did not provide additional documentation to support allowable bad debts or explain the differences between sales tax reimbursement recorded and sales tax reimbursement reported on appellant's sales and use tax returns. As a result, CDTFA made no other adjustments in the reaudit, which reduced the total measure of tax from $3,816,309 to $3,239,870.
7. 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.) However, gross receipts do not include the sales price of property returned by customers when that entire amount is refunded in either cash or credit. (R&TC, § 6012(c)(2); Cal. Code Regs., tit. 18, § 1655(a)(1).)

California Code of Regulations, title 18, (Regulation) section 1585, sets out specific rules for tax treatment of sales of cellular phones. Tax applies to the gross receipts from the retail sale of a wireless telecommunication device, and the retailer of the wireless telecommunication device is required to report and pay the tax. (Cal. Code Regs., tit. 18, § 1585(b)(1).) Tax applies to the gross receipts from the retail sales of wireless telecommunication devices sold in unbundled transactions, measured by the actual gross receipts received by the retailer from the end-use customer. (Cal. Code Regs., tit. 18, § 1585(b)(2).) Tax applies to the gross receipts

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from the retail sale of a wireless telecommunication device sold in a bundled transaction, measured by the unbundled sales price of that device. (Cal. Code Regs., tit. 18, § 1585(b)(3).) The unbundled sales price is the price at which the retailer has sold specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with an independent wireless telecommunications service provider as a condition of that sale. (Cal. Code Regs., tit. 18, § 1585(a)(4).) If the retailer cannot establish an unbundled sales price to the satisfaction of CDTFA based upon its own sales records, the unbundled sales price of the device shall equal the fair retail selling price of that device. (*Ibid*.) If tax is reported and paid on an amount equal to the cost of the device plus a markup on cost of at least 18 percent, such amount shall be regarded as the fair retail selling price of the device. (*Ibid.*) The retailer of the wireless telecommunication device is required to report and pay tax measured by the unbundled sales price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. (Cal. Code Regs., tit. 18, § 1585(b)(3).)

In general, a retailer is relieved from liability for sales tax or from liability to collect use tax insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes. (R&TC, § 6055(a); Cal. Code Regs., tit. 18, § 1642(a).) A retailer may claim a bad debt deduction provided that the sales tax, or amount of use tax, was actually paid to the state. (*Ibid*.) 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).) In determining that amount, all payments and credits to the account may be applied ratably against the various elements comprising the amount the purchaser contracted to pay (pro rata method), may be applied as provided in the contract of sale (contract method), or may be applied by another method which reasonably determines the amount of the taxable receipts (alternative method). (*Ibid*.) In support of deductions or claims for refund for bad debts, 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 account of the purchaser, evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally

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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).)

Retailers reporting tax measured by the unbundled sales price of a wireless telecommunication device may take a bad debt deduction pursuant to Regulation section 1642 when a payment or rebate from a wireless telecommunications service provider is charged back to the retailer based on a customer's termination of its contract with the wireless telecommunications service provider before the date specified in the utility service contract. (Cal. Code Regs., tit. 18, § 1585(c)(2).) The amount of bad debt deduction claimed by a retailer may not exceed the difference between the gross receipts on which tax was reported and paid by the retailer, and the total amount collected and retained by the retailer from the sale of the wireless telecommunication device excluding any amounts collected from the customer as tax or tax reimbursement. (*Ibid*.)

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.)

In this case, audited taxable sales are based on information from appellant's own records. The sales tax reimbursement recorded in appellant's sales tax payable account is evidence of appellant's taxable sales. We find that CDTFA's use of appellant's sales tax payable account to establish appellant's taxable sales is both reasonable and rational. Therefore, CDTFA has met its initial burden, and the burden of proof shifts to appellant to show that a result differing from CDTFA's determination is warranted.

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Appellant asserts that it reported the correct amount of taxable sales. Appellant explains that the unreported taxable sales represent returns and cancellations, which appellant contends were not accounted for in the sales tax payable account. In support of this argument, appellant has provided a copy of a single sales invoice in an effort to show that it charged its customers the correct amount of tax.

While returns and cancellations are normal in appellant's industry, appellant has not identified the specific returns and cancellations at issue. Also, appellant has not shown that its sales tax payable account failed to account for returns and cancellations. We note that appellant's sales tax payable account did not have any material differences for the first four quarters of the liability period. Appellant has not explained why its system suddenly failed to account for returns and cancellations. Nonetheless, appellant needed to reconcile the $301,777 tax difference between the tax accrued in its sales tax payable account and the tax reported on the sales and use tax returns by providing detailed information regarding the specific returns and cancellations that account for the $301,777 difference, which appellant has not done. Thus, we find that this argument does not meet appellant's burden of proof to establish that an adjustment is warranted based on returns and cancellations.

Appellant also argues that it is entitled to bad debts represented by charge backs from Verizon Wireless. With its briefs, appellant has provided copies of monthly reports entitled Summary Commission Statements, which show charge backs. Appellant has provided these reports for each month in 2006, 2007, 2008, 2009, and 2011.[3] Appellant has also provided a worksheet for 2011. In the worksheet, appellant calculated total charge backs of $506,119 for that year which are based on the Summary Commission Statements. The worksheet also reports that appellant only claimed $290,956 of bad debts on its sales and use tax returns for that year. Thus, appellant contends that it is entitled to the additional bad debt deduction.

While appellant has provided monthly totals for charge backs during certain months, appellant has not provided sufficient documentation to identify each individual charge back, nor has appellant matched each individual charge back with the original sale, as required in Regulation section 1642. Without this information, we cannot verify what portion of the charge backs relates to taxable sales and what portion relates to non-taxable revenue. Furthermore, only the portion relating to taxable sales can be claimed as a bad debt for sales tax purposes. (Cal.

[3] We note that the period January 1, 2006, through June 30, 2009, is prior to the liability period.

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Code Regs., tit. 18, § 1642(b).) It appears that appellant is attempting to claim as a bad debt the entire amount charged back, which is not permissible. In addition, appellant did not claim a bad debt deduction on its 2010 and 2011 federal income tax returns (as transcribed in the audit working papers), and thus, there is no evidence that appellant wrote off the alleged bad debts for income tax purposes as required in Regulation section 1642. Lastly, appellant's schedule includes bad debts for the period January 1, 2006, through June 30, 2009, which is prior to the liability period. Appellant has not shown that charge backs occurring prior to the liability period were written off as bad debts during the liability period. Therefore, we find that appellant has not provided sufficient evidence to support an adjustment for bad debts.

Based on the foregoing, we conclude that appellant has failed to meet its burden of establishing that any further reduction to the measure of unreported taxable sales is warranted.

HOLDING

Appellant has not established that any further reductions to the determined measure of tax is warranted.

DISPOSITION

CDTFA's action in reducing the taxable measure to $3,239,870 but otherwise denying the petition for redetermination is sustained.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

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