

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**MEHARRA JEWELLERS, INC.**

) OTA Case No. 18073423  
) CDTFA Account No. 101-583643  
) CDTFA Case ID 846918  
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**OPINION**

Representing the Parties:

For Appellant:

Jack Iyer, Accountant

For Respondent:

Lisa Renati, Hearing Representative  
Dana McBeth Flannigan, Tax Counsel IV  
Jason Parker, Chief, Hdqrs. Ops. Div.

For Office of Tax Appeals:

Lisa Burke, Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, appellant Mehrra Jewellers, Inc. appeals a decision issued by respondent California Department of Tax and Fee Administration denying, in part, appellant’s petition for redetermination of the Notice of Determination (NOD) issued on September 8, 2014. The NOD assessed a tax liability of \$128,839.86, plus accrued interest, and a negligence penalty of \$12,884.02 for the period May 2, 2010, through September 30, 2013 (liability period).<sup>1</sup>

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Jeffrey G. Angeja, and Michael F. Geary held an oral hearing for this matter in Sacramento, California, on January 29, 2020. At the conclusion of the hearing, we closed the record, and the parties submitted the matter for decision.

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<sup>1</sup> On appeal, and as explained further below, respondent reduced the total deficiency measure substantially and deleted the negligence penalty.

### ISSUES

1. Is appellant entitled to an additional reduction to the measure of disallowed claimed exempt sales of bullion?
2. Is appellant entitled to a reduction to the amount of disallowed claimed deductions for sales tax reimbursement included in reported total sales?

### FACTUAL FINDINGS

1. Appellant has operated a jewelry store in California since May 2, 2010, making sales of gold or silver coins (monetized bullion), numismatic coins, gold or silver nonmonetized bullion, and jewelry. Appellant also offers jewelry repair services. All of the jewelry that appellant sells is manufactured in India by another business it owns.
2. During the liability period, appellant reported total sales of \$15,918,148, and claimed deductions totaling \$12,733,697, comprised of \$12,214,169 for claimed exempt sales of monetized bullion and numismatic coins, \$42,794 for nontaxable repair labor, \$22,997 for exempt sales in interstate commerce, \$288,140 for sales tax reimbursement included in reported total sales, and \$165,597 for returned merchandise.
3. During the period February 1, 2011, through May 10, 2013, respondent received multiple complaints from customers stating that appellant had told them that it would not charge sales tax reimbursement if the customer purchased jewelry for more than \$1,500. When respondent contacted appellant, appellant indicated that it believed that jewelry sales in excess of \$1,500 were not subject to sales tax, which was not correct. Because appellant essentially admitted that it had not been reporting tax due on such sales, respondent audited appellant.
4. For the audit, appellant provided copies of its federal income tax returns for 2010, 2011, and 2012, sales invoices and purchase invoices for the period May 1, 2010, through December 31, 2010, and sales and use tax returns.
5. Respondent performed several tests to determine the amount of taxable jewelry sales that appellant had erroneously included in its claimed exempt sales of bullion. In the absence of complete books and records, respondent was required to rely on several estimates in its tests. Results of the tests showed that appellant's claimed exempt sales of bullion erroneously included taxable sales of jewelry totaling \$1,161,197. Respondent also

found errors in appellant's other claimed deductions and disallowed claimed exempt sales in interstate commerce totaling \$5,006 and claimed nontaxable repair labor totaling \$5,234. Additionally, respondent found that appellant's claimed deduction of \$288,140 for sales tax reimbursement included in reported total sales exceeded the tax of \$274,683 that appellant reported and paid for the liability period. Respondent considered the difference of \$13,457 (\$288,140 - \$274,683) to be collected but unreported sales tax reimbursement, and it included the measure of \$156,024, represented by the unreported sales tax reimbursement, in the deficiency measure.<sup>2</sup>

6. Respondent prepared a field billing order (FBO), and on September 8, 2014, issued an NOD to appellant. In the NOD, respondent included a 10-percent penalty for negligence. Appellant filed a timely petition for redetermination.
7. On January 5, 2017, respondent held an appeals conference with appellant. During the appeals conference, after a discussion of the methodology used to establish disallowed claimed exempt sales of bullion, the parties agreed that respondent would conduct a reaudit using a different methodology, one that would rely primarily on marking up appellant's purchases of bullion. Using the agreed-upon markup method, respondent compared sales of bullion of \$78,554.50 shown in the available sales invoices for the test period, May 1, 2010, through December 31, 2010, with the related costs of \$77,465.40 shown in purchase invoices for the same period and computed a markup of 1.41 percent. Respondent then added the markup of 1.41 percent to appellant's recorded purchases of bullion of \$1,597,457 for 2010 to establish audited exempt sales of bullion of \$1,619,981 for 2010. Appellant's claimed exempt sales of bullion of \$1,715,606 for 2010 exceeded audited exempt sales of bullion by \$95,625, which represented an error rate of 5.90 percent. Respondent applied the error rate to appellant's claimed exempt sales of bullion of \$12,214,169 for the liability period to establish disallowed claimed exempt sales of bullion of \$720,983. In the decision issued after the appeals conference and reaudit, respondent recommended that the amount of disallowed claimed exempt sales of bullion be reduced by \$440,214, from \$1,161,197 to \$720,983. Respondent also recommended

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<sup>2</sup> Additionally, respondent disallowed the entire amount claimed by appellant for returned taxable merchandise during the audit period, \$165,597. However, the measure for disallowed claimed returned taxable merchandise has since been deleted.

that the negligence penalty be deleted, and that the petition for redetermination otherwise be denied. This appeal followed.<sup>3</sup>

### DISCUSSION

#### Issue 1 – Is appellant entitled to an additional reduction to the measure of disallowed claimed exempt sales of bullion?

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.)

Tax applies to sales of coins as collectors' items or as an investment, except as otherwise specified. (Cal. Code Regs., tit. 18, § 1599(a)(1).) Tax does not apply to sales of monetized bullion, nonmonetized gold or silver bullion, and numismatic coins provided the sales are in bulk and the sales are by or through a person registered or not required to be registered pursuant to the Commodity Exchange Act. (R&TC, § 6355; Cal. Code Regs., tit. 18, § 1599(a)(3).) For sales occurring on or after January 1, 2009, a sale in bulk occurs if the total market value of the monetized bullion, nonmonetized gold or silver bullion, and numismatic coins sold in a single transaction is \$1,500 or more.

When respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, respondent 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 respondent has met its initial 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.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of

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<sup>3</sup> Appellant does not dispute the amounts of disallowed claimed exempt sales in interstate commerce and disallowed claimed nontaxable repair labor. Therefore, these two issues will not be discussed further.

proof. (See *Riley B's, Inc.*, *supra*, at p. 616; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Here, it is undisputed that appellant was unaware that its sales of jewelry for \$1,500 or more did not qualify for the exemption afforded to bulk sales of coins and bullion. Therefore, we find that it was reasonable for respondent to conclude that appellant's claimed exempt sales of bullion erroneously included taxable sales of jewelry. In the absence of reliable records of appellant's sales and purchases for the liability period, we also find that it was reasonable for respondent to use an alternative audit method, the markup method, to establish disallowed claimed exempt sales of bullion for the liability period. Based on the evidence, we find that respondent correctly calculated the deficiency using the markup method, and that the burden of proof shifted to appellant to establish by documentation or other evidence that a reduction to the amount of disallowed claimed exempt sales of bullion is warranted.

Appellant contends that respondent's initial determination was incorrect because it does not account for appellant's exchange of damaged jewelry acquired for resale for bullion. It states that jewelry sometimes arrived damaged from its supplier in India, and it would typically trade that damaged jewelry for bullion. Appellant argues that, as a result, respondent underestimated nontaxable bullion sales and overestimated taxable jewelry sales and concludes that respondent's determination that 77 percent of appellant's purchases were of coins and bullion and 23 percent were of jewelry is wrong.<sup>4</sup>

Appellant's arguments appear to relate to respondent's initial findings, now abandoned. Appellant has not made an argument to show that respondent's determination based on the markup method is wrong, and it has not provided evidence to prove a more accurate determination. Nevertheless, we examine appellant's argument and evidence to determine their potential effect on the current audit findings.

As stated above, respondent compared costs of bullion of \$77,465.40 with sales of bullion of \$78,554.50 during the test period (May through December 2010) to compute a markup of 1.41 percent. Appellant appears to argue that the 35 pages of invoices in evidence document additional purchases of bullion that were not included in respondent's calculation. If that evidence proved additional purchases of bullion during the test period, it could also impact

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<sup>4</sup>This determination was part of the initial audit, which was superseded by the reaudit.

respondent's markup analysis by increasing appellant's purchases of bullion. As we explain below, the evidence does not advance appellant's cause.

We count 17 invoices for transactions during the test period. The invoices, issued by Austin & Co., which was appellant's bullion supplier, appear to document purchases of bullion and jewelry by appellant, but they do not establish appellant's exchange of damaged jewelry for bullion.<sup>5</sup> Most refer to payment by check, and in many instances, check numbers are stated. Appellant did not testify or provide copies of the checks or any other evidence to shed further light on the significance of these invoices.

In addition, the 17 invoices total over \$58,000. The inclusion of an additional \$58,337 in bullion purchases during the test period would have required respondent to conclude that appellant sold bullion during the test period for \$57,250 *less* than it paid for it, which would be an unlikely scenario, to say the least. Thus, we are not persuaded that the invoices show purchases of bullion not considered in respondent's calculations. Consequently, we find that appellant has not met his burden of proof and is not entitled to an additional reduction to the measure of disallowed claimed exempt sales of bullion.<sup>6</sup>

Issue 2 – Is appellant entitled to a reduction to the amount of disallowed claimed deductions for sales tax reimbursement included in reported total sales?

Under certain circumstances, a retailer is allowed to add sales tax reimbursement (hereinafter, "sales tax") to the sales price of the tangible personal property sold at retail. (Cal. Code Regs., tit. 18, § 1700(a).) The retailer may add the sales tax to the price as a separate item or include sales tax in the sales price. California's sales and use tax return (SUTR) forms allow a retailer to report total (gross) sales, on line 1 of the form, with tax included. When a retailer includes sales tax on line 1, it claims a deduction on line 9 of the return for the amount of sales tax included in line 1. Thus, the amount claimed on line 9 is not included in the measure of taxable sales.

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<sup>5</sup>Two invoices appear to document appellant's purchase of jewelry.

<sup>6</sup>This finding is dispositive of the issue. However, we also note that when respondent applied the audited markup of 1.41 percent to all of appellant's recorded purchases of coins and bullion to establish audited exempt sales of bullion, it assumed that all of appellant's sales of coins and bullion were bulk sales in amounts of \$1,500 or more. However, our examination of the audit working papers shows that appellant made taxable sales of coins and bullion for amounts less than \$1,500 in 2010. In other words, respondent reduced the measure of disallowed claimed exempt sales of bullion more than was warranted by the evidence, which has resulted in a windfall to appellant.

Here, appellant reported total sales tax due for the liability period of \$274,681, but it claimed deductions on line 9 of its SUTRs for \$288,140 of sales tax included in total sales reported on line 1 of the returns. In other words, appellant claimed \$13,457 more in deductions for tax included in gross sales than it reported as total tax due. Respondent included the measure that corresponds to that tax amount, \$156,024, in the deficiency measure.

At hearing, appellant argued that the alleged discrepancy between sales tax reported as included in reported total sales and sales tax reported as due was the result of appellant using an “incorrect formula,” and that using the correct formula reduces the disallowed claimed deduction from \$13,457 to \$2,482. Appellant provided no evidence to support its assertions.

We note that appellant has not denied that it claimed \$288,140 in included sales tax deductions during the liability period. Respondent takes these numbers from appellant’s returns and appellant has not provided a copy of a single return to show respondent’s numbers are wrong. Yet, appellant’s arguments include calculations which simply change the Department’s numbers with the only support being appellant’s vague references to “wrong formulas.” Appellant’s arguments defy logic and common sense. Appellant’s SUTRs show that it claimed excess deductions for sales tax included, and it has not made an argument or provided evidence that persuades us that respondent’s inclusion of this measure was erroneous.

It is relevant here that respondent also found that appellant reduced its recorded and reported total sales amounts when taxable merchandise was returned. Therefore, when appellant claimed deductions of \$165,597 for returned taxable merchandise, it took credit for returned merchandise twice, first by reducing its recorded and reported total sales, and then by taking the deduction. Initially, respondent disallowed the entire amount claimed by appellant for returned taxable merchandise during the liability period. This measure was included on the FBO as audit item 5. However, upon further review during OTA’s briefing process, respondent agreed that appellant’s error in claiming deductions for returned taxable merchandise had resulted in the discrepancy between the claimed deductions for sales tax reimbursement included in reported total sales and the tax that appellant reported and paid for the liability period. Based on the fact that both the overstated claimed deductions for returned taxable merchandise and the discrepancy between claimed sales tax reimbursement included in reported total sales and reported tax resulted from the same reporting error and represented essentially the same transactions, respondent deleted the deficiency measure for disallowed claimed returned taxable merchandise.


We find it likely that the difference between appellant’s claimed deductions for sales tax reimbursement included in reported gross sales and the tax that appellant reported and paid for the liability period resulted from appellant’s error in claiming deductions for returned taxable merchandise after it had already reduced its recorded and reported total sales by the amounts it had refunded to customers when they returned taxable merchandise. Therefore, we find that appellant is not entitled to a reduction to the amount of disallowed claimed deductions for sales tax reimbursement included in reported total sales.

HOLDINGS

1. Appellant is not entitled to an additional reduction to the measure of disallowed claimed exempt sales of bullion.
2. Appellant is not entitled to a reduction to the amount of disallowed claimed deductions for sales tax reimbursement included in reported total sales.


DISPOSITION

We sustain respondent’s action in reducing the amount of disallowed claimed exempt sales of bullion to \$720,983, deleting the measure of \$165,597 for disallowed claimed returned taxable merchandise, deleting the negligence penalty, and otherwise denying the petition.

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 Michael F. Geary  
 Administrative Law Judge

We concur:

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 Jeffrey G. Angeja  
 Administrative Law Judge

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 Teresa A. Stanley  
 Administrative Law Judge

Date Issued: 4/21/2020