

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

B. EFTEKHAR

) OTA Case No. 19034561
) CDTFA Account No. 53-008825
) CDTFA Case ID 597653
)
)
)

OPINION

Representing the Parties:

For Appellant: James Dumler, Representative

For Respondent: Sunny Paley, Tax Counsel

The Office of Tax Appeals: Corin Saxton, Tax Counsel IV

A. LONG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, B. Eftekhar (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), for tax of \$44,267.07, plus applicable interest, and a negligence penalty of \$8,426.75, for the period October 1, 2005, through September 6, 2008 (liability period). The NOD reflects CDTFA’s determination that appellant is personally liable for the unpaid tax liabilities of Mixserve, Inc. (Mixserve).

A hearing was scheduled for July 23, 2020. However, appellant subsequently waived the right to an oral hearing, and therefore, this matter is being decided based on the written record.

ISSUE

Whether CDTFA established that appellant is personally liable for Mixserve’s unpaid sales and use tax liabilities for the liability period.

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.

FACTUAL FINDINGS

1. Mixserve, a California corporation, operated a nightclub and bar. CDTFA closed Mixserve's seller's permit effective September 6, 2008, at appellant's request. At all relevant times, appellant was Mixserve's president.
2. Appellant provided financial records and other written documentation to Mixserve's bookkeeper, which were used to prepare the sales and use tax returns. On September 9, 2008, appellant visited CDTFA's Van Nuys district office to file Mixserve's final return and pay taxes due.
3. CDTFA conducted a close-out audit of Mixserve, which included an observation of the business on October 24, 2008. CDTFA compared Mixserve's recorded bar sales with the cost of goods sold and determined that Mixserve's book markups were lower than expected for a business of this type.
4. After a review of appellant's documentation, CDTFA issued an audit report to Mixserve for the period October 1, 2005, through September 6, 2008, which identified a deficiency measure of unreported taxable sales of \$1,021,418, based on a markup analysis. CDTFA thereafter issued an NOD to Mixserve for \$84,267.07 in tax, plus accrued interest, and a negligence penalty of \$8,426.75. Mixserve filed a timely petition for redetermination, and, on May 12, 2009, CDTFA issued a Decision and Recommendation (D&R) recommending a reaudit.
5. On October 19, 2011, CDTFA issued the NOD to appellant under R&TC section 6829 for tax of \$44,267.07,² accrued interest, and a negligence penalty of \$8,426.75. Appellant filed a timely petition for redetermination.
6. When CDTFA completed Mixserve's reaudit report, it reduced the deficiency measure for unreported taxable sales to \$821,823 and established an additional deficiency measure of \$10,342 for purchases of merchandise subject to use tax (self-consumption). As a result, CDTFA recommended that tax be redetermined to \$68,653.55 and the negligence penalty to \$6,865.38.³

² CDTFA applied a payment of \$40,000 Mixserve's account effective August 29, 2011. This payment was made from escrow from the sale of Mixserve's business.

³ Reductions to the aggregate deficiency measure reduced the tax liability to \$68,653.55, which was further reduced to account for the \$40,000 payment from escrow.

7. On November 19, 2013, the board held an oral hearing on Mixserve's appeal and redetermined Mixserve's liability as recommended in the reaudit report.
8. As a result of the redetermination of Mixserve's liability, and the \$40,000 payment, appellant's responsible person liability was also reduced to \$28,653 in tax, a negligence penalty of \$6,865.38, plus accrued interest.
9. On November 20, 2013, CDTFA held an appeals conference for appellant's petition for redetermination. CDTFA issued to appellant a D&R and a Supplemental D&R, denying the petition for redetermination. This timely appeal followed.

DISCUSSION

R&TC section 6829 provides that a person is personally liable for the tax, penalties, and interest owed by a corporation if all the following elements are met: (1) the corporation's business has been terminated, dissolved, or abandoned; (2) the corporation collected sales tax reimbursement on its sales of tangible personal property and failed to remit such tax reimbursement to CDTFA or consumed tangible personal property and failed to pay the applicable tax to the seller or CDTFA; (3) the person had control or supervision of, or was charged with the responsibility for, the filing of returns or the payment of tax, or was under a duty to act for the corporation in complying with the Sales and Use Tax Law; and (4) the person willfully failed to pay taxes due from the corporation or willfully failed to cause such taxes to be paid. (R&TC, § 6829(a), (c); Cal. Code Regs., tit. 18, § 1702.5(a), (b).) A person is regarded as having willfully failed to pay taxes, or to cause them to be paid, where he or she had knowledge that the taxes were not being paid; had the authority to pay the taxes, or to cause them to be paid on the date the taxes became due and when the person had knowledge; and had the ability to pay the taxes when the person had knowledge, but chose not to do so. (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(A) – (C).) CDTFA must prove these elements by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 1702.5(d).)

At the prehearing conference held on July 7, 2020, appellant conceded to the fact that Mixserve's business had been terminated. Therefore, the first element has been met and we analyze the remaining three elements.

Element 2 – Collection of Sales Tax Reimbursement

Personal liability can be imposed only to the extent the corporation collected sales tax reimbursement on its sales of tangible personal property, but failed to remit the tax to the state. (R&TC, § 6829(c).) Here, CDTFA performed an observation of this business on October 24, 2008, from 6:45 p.m. to 10:10 p.m. During the observation, Mixserve sold alcohol to the auditor on a tax-included basis. A Form BOE-1311-B, Bar Fact Sheet, was completed indicating that Mixserve displayed tax reimbursement notices pursuant to California Code of Regulations, title 18, section 1700.⁴ A presumption that the retailer and purchaser agreed to the addition of sales tax reimbursement of tangible personal property sold at retail to a purchaser arises if, among other things, the retailer posts a notice to the effect that that reimbursement for sales tax is included in the sales price. (Cal. Code Regs., tit. 18, § 1700(a)(2)(C).) Additionally, the dual packet noted that Mixserve’s former bookkeeper informed CDTFA that sales tax was collected. Therefore, the second element has been met.

Element 3 – Responsible Person

Personal liability can only be imposed on a responsible person. (R&TC, § 6829(b).) “Responsible person” means any person having control or supervision of, or who was charged with the responsibility for, the filing of returns or the payment of tax or who had a duty to act for the corporation in complying with any portion of the Sales and Use Tax Law when the taxes became due. (Cal. Code Regs., tit. 18, § 1702.5(b)(1).) As relevant here, personal liability applies only if, when the person was a responsible person for the corporation, the corporation sold tangible personal property and collected sales tax reimbursement on the selling price of the property and failed to remit such tax reimbursement when due. (Cal. Code Regs., tit. 18, § 1702.5(a).)

Here, appellant acknowledges that he was the president and general manager of Mixserve. Appellant is also listed on the alcohol beverage control license, the seller’s permit, and secretary of state documents as the contact for Mixserve. Additionally, appellant signed checks to the BOE, provided information to his bookkeeper for Sales and Use Tax Returns, signed the Waiver of Limitation for Mixserve, and handled issues with the BOE on behalf of

⁴ A representative for Mixserve reviewed the form, certified that the information was accurate, and returned it to CDTFA.

Mixserve. Appellant therefore was responsible for Mixserve’s tax compliance during the liability period; the third element has been met.

Element 4 – Willfulness

Finally, a person may be held personally responsible if the individual willfully failed to pay or caused to be paid the liabilities at issue. “Willfully fails to pay or cause to be paid” means that the failure was the result of an intentional, conscious, and voluntary course of action. (R&TC, § 6829(d); Cal. Code Regs., tit. 18, § 1702.5(b)(2).) This failure may be willful even if it was not done with a bad purpose or motive. (Cal. Code Reg., tit. 18, § 1702.5(b)(2).) In order to show willfulness, CDTFA must establish all of the following:

- (A) On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.
- (B) The responsible person had the authority to pay the taxes or to cause them to be paid
 - (i) on the date that the taxes came due and (ii) when the responsible person had actual knowledge.
- (C) When the responsible person had actual knowledge, the responsible person had the ability to pay the taxes but chose not to do so.

(Ibid.)

At the outset, we note that CDTFA’s short brief states that “the Decision and Recommendation (D&R)...and the Supplemental Decision and Recommendation (SD&R)...correctly sets forth the application of the sales and use tax law and reach the correct conclusion that Appellant is liable for the unpaid liabilities of Mixserve Inc.” and “incorporates by reference the findings and recommendations of D&R and SD&R” into its brief. However, the SD&R determined that the D&R’s finding of whether Mixserve had funds available to pay the liability “is not probative of whether Mixserve had funds available to pay the liability at issue.” In other words, the SD&R determined that the D&R’s findings for willfulness was not supported by the evidence, and the SD&R determined a basis for appellant’s willfulness on other grounds. Therefore, because CDTFA takes contrary positions in its D&R and SD&R, and CDTFA provides no clarification on the position it is taking at appeal, we will only review whether CDTFA has met its burden of establishing responsible person liability relating to the willfulness element based on the arguments from the SD&R.

The first requirement of willfulness is to prove actual knowledge. Here, CDTFA determined appellant's audit liability via a markup method after Mixserve ceased its business operations. CDTFA concedes that it has no direct evidence that appellant knew of an understatement of tax. However, CDTFA notes a variety of indirect evidence that it believes shows actual knowledge. Specifically, it argues that Mixserve must have been profitable given the weighted markup of 349.86 percent. Because Mixserve's general ledger and federal income tax returns for 05/06 and 06/07 show losses, CDTFA argues that Mixserve's recorded sales were understated. CDTFA also points to a contract dated September 2008, in which the business is contracted to be sold for \$400,000. Coupled with the fact that appellant was the only officer of Mixserve, CDTFA concludes that appellant knew Mixserve had significantly underreported its tax liabilities during the audit period.

CDTFA's argument does not distinguish between the types of tax liabilities that CDTFA alleges appellant knowingly underreported (i.e., sales tax and use tax). We note that CDTFA established Mixserve's use tax liability in a reaudit ordered in a D&R following an appeal by Mixserve of the underlying audit. The reaudit working papers do not explain the basis for the self-consumption adjustment to the markup analysis and the corresponding deficiency for consumption of ex-tax purchases. The reaudit working papers simply state that these adjustments were made pursuant to Mixserve's D&R, which is not part of the record. Furthermore, appellant's D&R states that the D&R issued for Mixserve's appeal recommended "a 2-percent standard self-consumption allowance" Therefore, it appears that CDTFA made the self-consumption adjustments pursuant to its standard audit methodology for a bar. As the record does not include evidence that appellant knew Mixserve consumed ex-tax merchandise, CDTFA has failed to show that appellant was aware of the use tax deficiency measure of \$10,342 prior to issuance of the reaudit report.

Regarding Mixserve's sales tax liability, CDTFA appears to argue that Mixserve made more sales than its records documented, and because appellant provided the records used to prepare Mixserve's sales and use tax returns, it is more likely than not that appellant was aware that Mixserve was underreporting its taxable sales. Thus, the crucial inquiry is whether appellant's reported taxable sales were understated to such an extent that it is more likely than

not that appellant was aware of this understatement at the time of reporting.⁵ Appellant recorded and reported taxable sales of \$848,730 for the liability period but failed to record and report taxable sales of \$821,823. This understatement represents a 97 percent error ratio when compared to reported taxable sales. Although an error rate of this magnitude is undoubtedly strong evidence of negligence, it is not high enough to support a finding of intentional underreporting or that appellant must have known of the underreporting by a preponderance of the evidence. Therefore, CDTFA has failed to show that appellant had actual knowledge of Mixserve's sales tax liability at the time of reporting.

Because each element must be established to show willfulness and CDTFA fails to establish that appellant had actual knowledge, we need not analyze the remaining factors. Therefore, CDTFA has failed to meet its burden of proof under R&TC section 6829.

HOLDING

CDTFA failed to establish that appellant is personally liable for Mixserve's unpaid sales and use tax liabilities for the liability period.

DISPOSITION

CDTFA's action is reversed.

DocuSigned by:



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Andrea L.H. Long
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:



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Josh Aldrich
Administrative Law Judge

Date Issued: 11/2/2020

⁵ Because there is no discrepancy between Mixserve's recorded and reported taxable sales, these figures are the same.