

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

In the Matter of the Appeal of:  
**Q-MOBILE, INC.**

) OTA Case No. 20036053  
) CDTFA Account No. 101-595389  
) CDTFA Case IDs 972084; 0-00-006-072  
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)

**OPINION**

Representing the Parties:

For Appellant: James Dumler, Representative

For Respondent: Jason Parker, Chief of Headquarters  
Operations

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

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Q-Mobile, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant's petition for redetermination of the Notice of Determination (NOD) dated July 18, 2016. The NOD is for \$282,817.45 in tax, a 10 percent negligence penalty of \$28,281.87, and accrued interest, for the period October 1, 2012, through September 30, 2015 (audit period). On June 27, 2019, pursuant to R&TC section 6563, CDTFA timely notified appellant that it was asserting an increase, and the revised total is \$406,296 in tax, plus accrued interest, and a negligence penalty of \$40,629.57 for the audit period.

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

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

### ISSUES

1. Whether adjustments are warranted to the measure of underreported taxable sales.
2. Whether the understatement was the result of negligence.

### FACTUAL FINDINGS

1. Appellant is an authorized retailer of MetroPCS cellular telephones and accessories.
2. CDTFA conducted an audit of the business for the period October 1, 2012, through September 30, 2015, and determined that appellant made unbundled sales of cellular telephones.<sup>2</sup>
3. For the audit period, appellant reported total and taxable sales of \$1,804,559 (claiming no deductions).
4. For the audit, appellant provided federal income tax returns (FITRs) for 2013 and 2014, and profit and loss statements (P&Ls) for the audit period.
5. CDTFA found substantial differences between the gross receipts that appellant reported on its FITRs and total sales reported on its sales and use tax returns (SUTRs) for the years 2013 and 2014. CDTFA calculated an error rate based on these differences, and CDTFA applied this error rate to appellant's reported taxable sales to establish underreported taxable sales of \$2,933,151 (audit item 1).<sup>3</sup>
6. Appellant's recorded taxable sales for the fourth quarter 2012 (4Q12) exceeded reported taxable sales for 4Q12 by \$18,301. Therefore, CDTFA computed a deficiency measure of \$18,301 for underreported taxable sales based on the difference between recorded and reported taxable sales (audit item 2).
7. On July 18, 2016, CDTFA issued the above-described NOD for the two audit items, and on July 25, 2016, appellant filed a timely petition for redetermination.
8. Following appellant's submission of a petition for redetermination, CDTFA received purchase records from appellant's vendors for 1Q13 through 3Q15.<sup>4</sup> CDTFA scheduled total cellular phone purchases (net freight, insurance, and price protection) of \$4,697,631

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<sup>2</sup> An unbundled transaction is one which does not require the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of the sale. (Cal. Code Regs., tit. 18 § 1585(a)(4).)

<sup>3</sup> For 4Q12, CDTFA applied the error rate to appellant's recorded taxable sales.

<sup>4</sup> The record is unclear as to when CDTFA received this documentation.

for 1Q13 through 3Q15. CDTFA applied an 18 percent markup (based on California Code of Regulations, title 18, section 1585(a)(4)) to audited purchases of \$4,697,631 to establish audited taxable sales of \$5,543,205 for the period 1Q13 through 3Q15. CDTFA subtracted appellant's reported taxable sales of \$1,643,745 for this period from audited taxable sales of \$5,543,205 to establish underreported taxable sales of \$3,899,460 for 1Q13 through 3Q15. Appellant's underreported taxable sales of \$1,156,603 for 2013 represent an error ratio of 208 percent when compared to reported taxable sales of \$555,833 for 2013. Because CDTFA did not receive purchase information for 4Q12, CDTFA applied this error ratio to appellant's reported taxable sales of \$160,814 for 4Q12 to establish underreported taxable sales of \$334,629 for 4Q12.<sup>5</sup> CDTFA then reduced this deficiency measure by the 4Q12 difference of \$18,301 between recorded and reported taxable sales to calculate underreported taxable sales of \$316,328 for 4Q12 and underreported taxable sales of \$4,215,787 for audit item 1.<sup>6</sup> Audit item 2 consists of the difference between recorded and reported taxable sales for 4Q12 of \$18,301.

9. On June 27, 2019, pursuant to R&TC section 6563, CDTFA timely asserted an increase to the July 18, 2016 NOD. After the increase, CDTFA is asserting tax of \$406,296 plus accrued interest, and a negligence penalty of \$40,629.57 for the audit period. The negligence penalty is based on a taxable measure of \$4,234,088 (\$4,215,787 for audit item 1 + \$18,301 for audit item 2).
10. CDTFA issued a Decision on January 31, 2020, recommending that the liability be redetermined in accordance with the June 27, 2019 notice of increase. This timely appeal followed.

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<sup>5</sup> Differences are due to rounding.

<sup>6</sup> The record is unclear as to why CDTFA applied the error ratio to appellant's 4Q12 reported taxable sales rather than appellant's recorded taxable sales, and it is also unclear as to why CDTFA reduced the deficiency measure for underreported sales by the \$18,301 discrepancy between 4Q12 recorded and reported taxable sales. However, as this methodology was favorable to appellant, we give it no further consideration.

## DISCUSSION

### Issue 1: Whether adjustments are warranted to the measure of underreported taxable sales.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

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. (*Appeal of Talavera*, 2020-OTA-022P.) 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. (*Ibid.*)

Generally, tax applies to the gross receipts from the retail sale of a wireless telecommunication device. (Cal. Code Regs., tit. 18, § 1585(b)(1).) Tax applies to the gross receipts from the retail sale of an unbundled wireless device measured by the actual gross receipts received by the retailer from the end-use customer from the sale of that device. (Cal. Code Regs., tit. 18, § 1585(b)(2).) If the retailer cannot establish an unbundled sales price based on its own sales records, the unbundled sales price of the device shall equal the fair retail selling price of the device. (Cal. Code Regs., tit. 18, § 1585(a)(4).) 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.*)

Here, appellant failed to provide any records to support the amounts of its reported sales. Therefore, we find it was reasonable and rational for CDTFA to use data from appellant's vendors to calculate telephone purchases and to apply an 18 percent markup (as set forth in California Code of Regulations, title 18, section 1585(a)(4)) to audited purchases. Further, appellant's recorded taxable sales for the fourth quarter 2012 (4Q12) exceeded reported taxable

sales for 4Q12 by \$18,301. Therefore, we find that it was reasonable and rational for CDTFA to rely on appellant's own records to compute a deficiency measure of \$18,301 for underreported taxable sales. Accordingly, the burden shifts to appellant to provide evidence establishing that adjustments to the measure of tax are warranted.

Appellant argues that the audited purchases include phones appellant sold for resale as well as phones appellant returned to its vendors. Appellant also argues that appellant netted sales for resale from total sales reported on its sales and use tax returns. However, appellant has not provided any support for these arguments, and therefore we find there is no basis to reduce the audited understatement of reported taxable sales.

Issue 2: Whether the understatement was the result of negligence.

R&TC section 6484 provides that if any part of the 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.

Taxpayers are required to maintain and make available for examination on request by CDTFA, or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to determinations associated with the first audit of a taxpayer. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.) However, a negligence penalty should be upheld in a first audit if the understatement cannot be attributed to a bona fide and reasonable belief that the bookkeeping

and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (*Ibid.*)

CDTFA imposed the negligence penalty because appellant substantially underreported its taxable sales and failed to provide complete records for the audit. On appeal, appellant argues that the negligence penalty is unwarranted because this was appellant's first audit and because appellant accurately reported its taxable sales.

Here, appellant's recorded sales for 4Q12 exceeded reported sales for 4Q12 by \$18,301, which is strong evidence of negligence. Additionally, underreported taxable sales of \$4,234,088 represents an error ratio of 235 percent when compared to reported taxable sales of \$1,804,559. Stated differently, appellant reported less than a third of its taxable sales ( $\$1,804,559 \text{ reported} \div \$6,038,647^7 \text{ audited taxable sales} = 30 \text{ percent}$ ), which is also highly probative of negligence. Moreover, the amounts of gross receipts reported on appellant's FITRs exceeded total sales reported on appellant's SUTRs, with a total difference of \$1,905,625 for the years 2013 and 2014.

We find that any reasonably prudent businessperson, even one who may not be sophisticated in accounting and legal matters, would recognize these broad discrepancies. Specifically, we would expect appellant to notice that its recorded taxable sales for 4Q12 were significantly greater than its reported taxable sales for 4Q12, and we would expect appellant to notice that it was reporting significantly more on its FITRs than it was reporting on its SUTRs. In addition, the only accounting records provided for audit were FITR's for 2013 and 2014, and P&Ls for the audit period, and appellant provided no source documents. Accordingly, we find that the evidence supports a finding of negligence in reporting and negligence in recordkeeping. Further, we find that appellant's own records establish that the understatement cannot be attributed to a bona fide and reasonable belief that appellant's bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Therefore, the penalty was properly applied.

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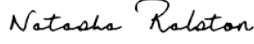
<sup>7</sup>  $\$1,804,559 \text{ reported} + \$4,234,088 \text{ understatement} = \$6,038,647$ .

HOLDINGS


1. No adjustment is warranted to the measure of underreported taxable sales.
2. The understatement was the result of negligence, and the penalty was properly applied.


DISPOSITION

CDTFA’s action denying appellant’s petition for redetermination is sustained.

DocuSigned by:  
  
 DE5000E566FD40F  
 Natasha Ralston.  
 Administrative Law Judge

We concur:

DocuSigned by:  
  
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 Josh Lambert  
 Administrative Law Judge

DocuSigned by:  
  
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 Andrew Kwee  
 Administrative Law Judge

Date Issued: 11/4/2020