OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18063297
V. ONYEABOR	) CDTFA Case ID: 762702
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	David Pidal, Representative
For Respondent:	Nalan Samarawickrema, Hearing Rep. Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Spec. III

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 6561, appellant V. Onyeabor appeals a decision issued by respondent California Department of Tax and Fee Administration[1] in response to appellant's timely petition for redetermination of a Notice of Determination (NOD). The NOD assessed a liability of $34,396.55 of additional tax, plus applicable interest, and a negligence penalty, for the period January 1, 2009, through December 31, 2011 (Audit Period). In a subsequent decision, respondent reduced the aggregate deficiency measure from $386,154 to $329,751, which reduced the assessed tax liability from $34,396.55 to $29,321.97, and deleted the negligence penalty. Subsequently, respondent further reduced the aggregate deficiency measure from $329,751 to $326,126 and denied the remainder of the petitioned amount.

[1] Sales taxes were formerly administered by the Board of Equalization (BOE). Effective July 1, 2017, functions of BOE relevant to this case were transferred to the California Department of Tax and Fee Administration. (Gov. Code, § 15570.22.) When this Opinion refers to acts or events that occurred before July 1, 2017, the term "respondent" refers to BOE.

Office of Tax Appeals (OTA) Administrative Law Judges Nguyen Dang, Andrew Wong, and Alberto T. Rosas held an oral hearing on July 20, 2021.[2] At the conclusion of the hearing, OTA closed the record and submitted this matter for decision.

ISSUE

Whether appellant has shown that further adjustments are warranted to the audited amount of unreported taxable sales.[3]

FACTUAL FINDINGS

1. Appellant operated as a seller of used motor vehicles. Appellant had a wholesale license in effect during the Audit Period. Appellant did not use a vehicle lot to display an inventory of used vehicles, whether for retail or wholesale transactions.
2. During the Audit Period, appellant reported total sales of $48,028 and claimed deductions for nontaxable sales of the same amount, reporting no taxable sales.
3. Respondent conducted an audit and a revised audit. Appellant provided no records other than the purchase records for 2011. Respondent utilized alternate audit methods. Respondent contacted auto auctions in appellant's area and obtained information regarding appellant's purchases of 99 vehicles during the period October 1, 2008, through March 31, 2011. Respondent also obtained information from the Department of Motor Vehicles' (DMV) database to identify 39 vehicles that appellant did not sell at retail.[4]
4. In the revised audit, respondent established an aggregate deficiency measure of $386,154. This total included unreported taxable sales of $377,688.[5]

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[2] Although noticed for Cerritos, California, OTA conducted this hearing electronically due to COVID-19.

[3] There were two additional issues. Audit Item 2: Whether appellant has shown that further adjustments are warranted to the unreported cost of vehicles purchased for use. Audit Item 3: Whether appellant has shown that further adjustments are warranted to the audited amount of unreported fair rental value of vehicles used while held in resale inventory. During the oral hearing, appellant clarified that these items were no longer in dispute because appellant conceded the issues.

[4] Using information from the DMV database, respondent determined that 39 of the 99 vehicles were either: 1) gifted to a relative; 2) resold to a car dealership; or 3) sold back to an auction house. But there was no information explaining how appellant disposed of the remaining 60 vehicles. Thus, respondent treated these approximate 60 vehicles as forming part of unreported taxable sales transactions. As explained below, respondent used the total vehicle costs of these approximate 60 vehicles and then added an estimated markup.

5. On August 22, 2013, respondent issued an NOD in the amount of $34,396.55 tax, a negligence penalty, and applicable interest.
6. Appellant filed a timely petition for redetermination.
7. Respondent held an appeals conference. After the appeals conference, respondent obtained additional information from the DMV, which indicated that 15 of the vehicles at issue were either retained by appellant, gifted to someone else, or used by appellant prior to being resold to another dealer. Based on its review of the information from the DMV, respondent recommended reducing unreported taxable sales from $377,688 to $317,688. (Respondent made two more recommendations related to the two matters now conceded.) Respondent recommended reducing the aggregate deficiency measure from $386,154 to $334,701 and deleting the negligence penalty.
8. On October 10, 2017, respondent issued a Decision and Recommendation (D&R) recommending, amongst other things, adjustments reducing the amounts of unreported taxable sales to $317,688. The D&R reduced the aggregate deficiency measure from $334,701 to $329,751 and deleted the negligence penalty.
9. After appellant filed this timely appeal, OTA requested additional information from the parties. Respondent identified a duplicate purchase of a vehicle in the audit workpapers and reduced the audited amount of unreported taxable sales by $3,625, from $317,688 to $314,063,[6] which reduced the aggregate deficiency measure from $329,751 to $326,126.
10. As part of this appeal, OTA admitted various exhibits into the evidentiary record. The evidence included appellant's cost and sales-for-resale prices for 23 vehicles only, which were part of non-taxable sales-for-resale transactions. Exhibit A, page 34, identified 15 vehicles that appellant purchased for a total cost of $15,525 and sold back to the auction house for resale for a total price of $19,214. Exhibit C, page 32, identified six vehicles

[5] The audit report identified this amount as additional sales, while the Decision and Recommendation (D&R) dated October 10, 2017, used the terminology "disallowed claimed nontaxable sales." Although the D&R noted that appellant claimed all of her reported total sales as nontaxable sales, she only reported sales of $48,028. Thus, the majority of the understatement established by audit represents taxable sales that were not reported on appellant's sales and use tax returns. Therefore, we will use the term "unreported taxable sales" for ease of reference.

[6] To explain how respondent computed the unreported taxable sales, we begin with total vehicle costs of $251,250 for vehicles that were not non-taxable sales transactions. Respondent then added an estimated markup. Originally, respondent had used a 50 percent markup but then changed the markup to 25 percent. Thus, using a 25 percent markup, respondent computed the unreported taxable sales of $314,063 ($251,250 + 25% = $314,063).

that appellant purchased for a total cost of $11,450 and sold back to the auction house for resale for a total price of $13,350. Exhibit A, page 31, identified two vehicles that appellant purchased for a total cost of $5,200 and sold back to the auction house for resale for a total price of $5,875. In summary, these three exhibit pages identified a total of 23 non-taxable sales transactions; appellant purchased these 23 vehicles for a total cost of $32,175 and sold back to the auction house for resale for a total price of $38,439.

DISCUSSION

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) A retail sale is a sale for any purpose other than resale in the regular course of business. (R&TC, § 6007.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) If the seller does not timely obtain a valid resale certificate, the seller will be relieved of liability for the tax only where the seller shows either that the purchaser in fact resold the property or is holding it for resale and did not use the property for any purpose other than retention, demonstration, or display, or that the purchaser consumed the property and reported or paid the tax directly to respondent. (Cal. Code Regs., tit. 18, § 1668(e).)

When respondent is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

In the case of an appeal based on unreported taxable sales, respondent "has a minimal, initial burden of showing that its determination was reasonable and rational. [Citations.]" (*Appeal of TFCG, Inc.*, 2019-OTA-389P.) 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. (*Ibid.*, citing *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616 (*Riley*).)

Whether Respondent Met Its Minimal, Initial Burden.

We begin with the first step in the analysis. Respondent "has a minimal, initial burden of showing that its determination was reasonable and rational." (*Appeal of TFCG, Inc.*, *supra*, citing *Schuman Aviation Co. Ltd. v. U.S.* (D. Haw. 2011) 816 F.Supp.2d 941, 950 (*Schuman Aviation*) [federal excise taxes]; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514 [income taxes]; and *Appeal of Myers* (2001-SBE- 001) 2001 WL 37126924 [income taxes].) As explained below, to show that its determination was reasonable and rational, respondent must provide a minimal factual foundation for its determination.

Although *Schuman Aviation* deals with federal excise taxes, it cites to a federal income tax case for the principle that "deficiency determinations and assessments for unpaid taxes are normally entitled to a presumption of correctness so long as they are supported by a minimal factual foundation." (*Schuman Aviation, supra,* 816 F.Supp.2d at p. 950, citing to *Palmer v. IRS* (9th Cir. 1997) 116 F.3d 1309, 1312 (*Palmer*).)[7] Cases involving unreported income are persuasive in the context of unreported taxable sales because they involve the same principle: the difficulty inherent in proving a negative. (See *Appeal of TFCG, Inc.*, *supra*.)

In the matter of unreported taxable sales, for respondent to show that its determination was reasonable and rational, we conclude that respondent must similarly provide a minimal factual foundation for its determination.[8] Here, appellant provided no records other than the purchase records for 2011; respondent then utilized alternate audit methods and contacted the auto auctions to obtain information regarding appellant's purchases. In addition to the NOD, the relevant evidence includes the following: appellant operated as a seller of used

[7] In the case of unreported income, the rule in the U.S. Court of Appeals for the Ninth Circuit is that the presumption in favor of the tax agency arises only where it is supported by a minimal factual foundation linking the taxpayer with income-producing activity. (See, e.g., *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935*; Delaney v. Commissioner* (9th Cir.1984) 743 F.2d 670, 671, affg. T.C. Memo. 1982–666; *Edwards v. Commissioner* (9th Cir.1982) 680 F.2d 1268, 1270; *Weimerskirch v. Commissioner* (9th Cir.1979) 596 F.2d 358, 360–361 ["the Commissioner must offer some foundational support for the deficiency determination before the presumption of correctness attaches to it"], revg. 67 T.C. 672 (1977).)

[8] In cases dealing with unreported income, the government has established a minimal factual foundation with the following non-exhaustive types of evidence: stipulated evidence that included Forms W–2 and third-party payroll information (*Shimanek v. Commissioner*, T.C. Memo. 2015-165); evidence showing that the Employment Development Department made payments to the taxpayer (*Agudelo v. Commissioner*, T.C. Memo. 2015-12); use of bank deposits method by analyzing records of bank deposits and checks cashed (*Ocampo v. Commissioner*, T.C. Memo. 2015-150); worksheets to calculate tax and evidence linking taxpayer to the income *(Hardy v. Commissioner* (9th Cir.1999) 181 F.3d 1002, 1005, affg. T.C. Memo.1997–97); and tax returns, IRS agent declaration, and account transcripts (*U.S. v. Vacante* (E.D. Cal. 2010) 717 F.Supp. 2d 992, 1004).

motor vehicles and had a wholesale license in effect during the Audit Period, and appellant did not use a lot to display an inventory of used vehicles. Respondent contacted auto auctions and learned that appellant had purchased 99 vehicles from October 1, 2008, through March 31, 2011. Respondent also obtained information from the DMV database to identify 39 vehicles that appellant did not sell at retail. Respondent obtained additional information from the DMV, which indicated that 15 of the vehicles at issue were either retained by appellant, gifted to someone else, or used by appellant prior to being resold to another dealer. Respondent's determination is based, in part, on this evidence.

In addition, we note that respondent added an estimated markup of 25 percent to the cost amount to compute unreported taxable sales. Because of the difficulty inherent in proving a negative, when unreported income or unreported taxable sales are at issue, the taxing agency is not required to calculate the determination with an absolute precise measure in order to provide a minimal factual foundation; and this lack of precision will not rebut the presumption of correctness. (See *Pittman v. Commissioner* (7th Cir. 1996) 100 F.3d 1308, 1318.)

Based on the totality of the evidence, we conclude that respondent provided a minimal factual foundation for its determination, thereby showing that its determination was reasonable and rational. Accordingly, because it is supported by a minimal factual foundation, respondent's determination is entitled to a presumption of correctness. (*Schuman Aviation, supra,* 816 F.Supp.2d at p. 950, citing to *Palmer, supra,* 116 F.3d at p. 1312.)

Next, we will discuss the second step in the analysis.

Whether Appellant Can Rebut the Presumption of Correctness.

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. (*Appeal of TFCG, Inc.*, *supra*, citing *Riley*, *supra*, 61 Cal.App.3d at p. 616.) At this stage, the burden of proof is that of a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of Cal., Inc. v. Construction Laborers Pension Trust for So. Cal.* (1993) 508 U.S. 602, 622.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) To satisfy its burden of proving that a result differing from respondent's determination is warranted, a taxpayer must prove both (1) the tax assessment is incorrect, and (2) the proper

amount of the tax. (See *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; see also *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

The remaining issue concerns approximately 60 of the 99 vehicles. Appellant did not provide resale certificates or other evidence that she had made sales for resale of these vehicles, with a total cost of $251,250; thus, respondent presumed these sales were subject to tax per R&TC section 6091. Respondent added an estimated markup of 25 percent to the $251,250 cost amount to compute unreported taxable sales of $314,063. During the hearing, appellant stated that the remaining vehicles at issue were either sold for resale or constituted sales in interstate or foreign commerce. Because of appellant's lack of resale certificates or other evidence, appellant conceded that the law presumes that these vehicles are subject to tax, and appellant agreed that she cannot prove otherwise. But appellant argues that the tax assessment is incorrect because respondent's estimated markup of 25 percent was arbitrary and erroneous.

Originally, respondent used a 50 percent markup on all the purchases derived from the auction house data. Respondent then changed the markup to 25 percent. At oral hearing, respondent stated: "All the used car dealers have an average industry markup of 50 percent. The department decided to use a 25 percent markup to estimate audited taxable sales for the audit period to give a benefit for the appellant." Respondent submitted no evidence to support either the 50 or 25 percent markups. However, respondent pointed to 15 vehicles that appellant purchased from an auction house for a total cost of $15,525 and sold back to the auction house for resale for a total price of $19,214. (Exhibit A, page 34.) The average non-taxable sales-for-resale markup for these 15 vehicles was 23.76 percent. Based on this average non-taxable sales-for-resale markup, respondent argued at oral hearing that "it was fair and reasonable to use 25 percent markup to estimate audited taxable sales for the Audit Period" because retail sales actually have a higher markup than wholesale markups.

Appellant argues that a 25 percent markup is unrealistic, that it is too high for a wholesale used car dealer that sells the types of vehicles appellant sold, under comparable circumstances. Appellant argues that a markup of 7.24 percent is reasonable. To calculate that percentage, appellant used the same 15 vehicles described above (Exhibit A, page 34), added two additional vehicles that appellant purchased for a total cost of $5,200 and sold for resale for $5,875 (Exhibit A, page 31), and then removed the two vehicles with the lowest markups and the two vehicles with the highest markups. The remaining 13 vehicles had an average markup of 7.24 percent.

Both parties' representatives make arguments about the average retail markups in the industry and about their extensive audit experience. But this is mere argument. It is well established that argument is not evidence. (*People v. Cash* (2002) 28 Cal.4th 703, 734; *Hoffman v. Brandt* (1966) 65 Cal.2d 549, 552; see *Mel Williamson, Inc. v. U.S.* (1982) 229 Ct. Cl. 846, 848 [indicating that "[a]rgument is not fact"]; and see also Evid. Code, § 140 [" 'Evidence' means testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact"].)

Based on the limited evidence admitted into the record regarding the vehicles at issue, we are aware of appellant's cost and the auction houses' sales-for-resale price for 23 vehicles only, which were part of non-taxable sales-for-resale transactions. Both parties seek to support their respective arguments by picking and choosing a select number of these 23 vehicles. On the one hand, appellant focuses on 13 out of 23 vehicles to arrive at a 7.24 average markup, arguing that this is in line with average retail markups for comparable businesses. On the other hand, respondent focuses on 15 out of 23 vehicles to arrive at a 23.76 percent markup, similarly arguing that this is in line with the 25 percent average retail markups for comparable businesses.

But neither party provides evidence regarding the average retail markups for comparable businesses, making it impossible to conduct an apples-to-apples comparison. There is no evidence to support appellant's claim that, of these 23 vehicles, we should use the average markup of 13 select vehicles only. Likewise, there is no evidence to support respondent's claim that we should use the average markup of 15 select vehicles only. We know the average non-taxable sales-for-resale markup of 23 vehicles; this sample is already small. We are not convinced that using only a limited portion of this small sample—13 or 15 vehicles—would produce a more reasonable result. Neither party provided evidence of the average retail markups used by other used car businesses that are similar to appellant's business. Without such evidence, this panel cannot say whether a markup of 25 percent is reasonable, or, for that matter, whether a markup of 7.24 percent is reasonable.

When a party "present[s] no evidence regarding an average price markup in the [relevant] market," the trier-of-fact is left "with no countervailing evidence with which to do a comparison." (*Queen City Home Health Care Co. v. Sullivan* (6th Cir. 1992) 978 F. 236,

246.)[9] In cases involving damages for lost profits, one recognized method of proving lost profits is the "yardstick test," which "consists of a study of the profits of business operations that are closely comparable to the plaintiff's. Although allowances can be made for differences between the firms, the business used as a standard must be as nearly identical to the plaintiff's as possible." (*Lehrman v. Gulf Oil Corp.* (5th Cir.1974) 500 F.2d 659, 667.) We understand these cited cases do not concern unreported taxable sales, but we are persuaded by the principle that for a trier-of-fact to compare a party's business to other similar businesses in the market, there must be relevant evidence regarding those other businesses.

Here, the only factual evidence in the record concerning average markups is that of the 23 vehicles that appellant purchased from auction houses and then re-sold to auction houses for resale. The total cost of these 23 vehicles to appellant was $32,175 and the total sales-for-resale price to the auction houses was $38,439, for an average non-taxable sales-for-resale markup of 19.47 percent. We realize that taking an average non-taxable sales-for-resale markup and applying it in the context of taxable retail sales is akin to an apples-to-oranges comparison, but this is a comparison that the parties are already willing to do because of the lack of evidence and because appellant did not operate a traditional retail business—for example, appellant did not use a vehicle lot to display an inventory of used vehicles—which suggestions that the retail markups may have been similar to appellant's wholesale markups. Thus, although this evidence is not perfect, it is the only relevant evidence available to the triers-of-fact tasked with deciding this appeal.[10]

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[9] See, e.g., *U.S. v. Midwest Suspension and Brake* (E.D. Mich. 1993) 824 F.Supp. 713, 735-736 [defendant did not introduce any evidence that would allow the trier-of-fact to compare the size of defendant's brake shoe rehabilitation business with other businesses involved in brake shoe rehabilitation] and *DiLando v. Commissioner*, T.C. Memo. 1975-243 [respondent's statistical evidence was unreliable for purposes of determining the proper markup of cost of goods sold because there was no evidence of whether the businesses used in the reports were comparable to the business at issue; nevertheless, the statistical evidence was useful to the trier-of-fact in determining whether its own calculations, based on what other evidence is available, are too far out of line].

[10] Although appellant submitted additional evidence, we find it to be irrelevant. Appellant submitted into evidence an excerpt from respondent's audit manual that indicates that used car wholesale operations are "based on quick turnover at small margin of profit ($25 – $50 per unit)." But we do not believe that this typical $25 to $50 per unit markup is relevant here. First, based on the evidence, it is clear that appellant's operation is not the typical used car wholesale operation. Second, when reviewing the 23 non-taxable sales transactions, we note that the average markup was much higher: $272.35 per unit. Thus, this provision of respondent's audit manual is not applicable to the unique facts of this case. Similarly, appellant also submitted an article about used car operations, which is focused on used cars that are priced between $10,000 to $20,000. But because the 23 non-taxable sales transactions were priced between $35 to $4,709, this article is irrelevant to the unique facts of this case.

Accordingly, based on the limited evidence and our inability to make a proper factual apples-to-apples comparison of appellant's business to other closely comparable businesses in the market, we reject respondent's use of a 25 percent markup. But we also reject appellant's use of a 7.24 percent markup. Both markups are arbitrary and unsupported by the evidence. Based on the limited evidence, the only average markup available to use is the average non-taxable sales-for-resale markup of all 23 vehicles—19.47 percent.

Having weighed and considered all evidence presented by the parties and having applied the preponderance of the evidence standard of proof, we find that further adjustments are warranted to the amount of unreported taxable sales. We find that appellant met her burden of proving that the tax assessment, which used a 25 percent markup, is incorrect. We also find that appellant met her burden of proving that the proper amount of the tax requires the use of a 19.47 percent markup. Thus, as to the further adjustments, starting with a cost amount of $251,250, we conclude that respondent shall apply a markup of 19.47 percent, thereby computing unreported taxable sales of $300,168, which results in a reduction of the entire understatement of reported taxable measure from $326,126 to $312,231.

HOLDING

Appellant showed that further adjustments are warranted to the audited amount of unreported taxable sales. The adjustments are based on applying a markup of 19.47 percent.

DISPOSITION

As to respondent's decision, we sustain it in part and deny it in part. Appellant conceded the issues related to the unreported cost of vehicles purchased for use and the audited amount of unreported fair rental value of vehicles used while held in resale inventory. As to the issue of the unreported taxable sales, we reject respondent's use of a 25 percent markup; and, instead, we order respondent to make further adjustments to the audited amount of unreported taxable sales by applying a markup of 19.47 percent. Based on these further adjustments, which will reduce the assessed tax liability, respondent shall revise the interest amount on that liability accordingly. In all other respects, we sustain respondent's decision.

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

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Nguyen Dang
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Nguyen Dang
Administrative Law Judge

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Andrew Wong
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Date Issued: 10/14/2021