

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

In the Matter of the Appeal of:	)	OTA Case No. 18124108
<b>INTERNATIONAL TRUCK &amp; TRAILER</b>	)	CDTFA Case ID 0-000-245-079
<b>SERVICES, INC.</b>	)	
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**OPINION**

Representing the Parties:

For Appellant:	Juan Guzman
For Respondent:	Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, International Truck & Trailer Services, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated January 6, 2017.<sup>1</sup> This NOD is for sales taxes totaling \$73,128.80 and three penalties totaling \$20,513.57,<sup>2</sup> for the period of February 10, 2012, through December 31, 2015 (liability period), plus applicable interest.

Appellant waived the right to an oral hearing, so we decide this matter based on the written record.

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<sup>1</sup> On July 1, 2017, CDTFA began administering the sales tax (the tax at issue in this appeal), assuming functions relevant to this case from the State Board of Equalization (BOE). (See Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to pre-July 2017 acts or events, “CDTFA” shall refer to BOE.

<sup>2</sup> The three penalties are: (1) a fraud/evasion penalty of \$13,200.65 for knowingly operating a business as a seller without a valid permit for the period of February 10, 2012, through March 31, 2013; (2) a failure-to-file penalty of \$2,640.15 for the same time period; and (3) a negligence penalty of \$4,672.77 for the period of April 1, 2013, through December 31, 2015. Appellant only disputes the fraud/evasion penalty, so we will not discuss the failure-to-file or negligence penalties any further.

### ISSUES

1. Whether appellant has shown that audited unreported taxable sales of \$520,178 for the period of February 10, 2012, through December 31, 2013, should be reduced.
2. Whether appellant is liable for the 50 percent fraud/evasion penalty under R&TC section 7155.

### FACTUAL FINDINGS

1. Appellant, a California corporation, operated a business repairing truck tractors and trailers in Fontana, California, from February 10, 2012, through June 30, 2016. As part of its repair business, appellant made taxable sales of parts for both truck tractors and trailers.
2. Appellant did not report any sales for the period of February 10, 2012, through March 31, 2013, and did not obtain a seller's permit until May 20, 2013. Its seller's permit was effective from May 20, 2013, through June 30, 2016.
3. For the period of April 1, 2013, through December 31, 2015, appellant reported total sales of \$79,578, claimed total deductions of \$1,983, and reported taxable sales of \$77,595, which consisted of the following: \$25,062 for the period April 1, 2013, through December 31, 2013; \$27,953 for 2014; and \$24,580 for 2015.
4. Upon audit, appellant provided the following books and records to CDTFA: federal income tax returns (FITRs) for 2012, 2013, 2014, and 2015; and sales invoices for 2014 and 2015. Appellant did not provide sales journals, other summary records of sales, or summary records or source documents for purchases.
5. In its preliminary review of the provided books and records, CDTFA noted that appellant reported gross receipts of \$537,179, \$489,811, and \$249,439 on its FITRs for 2013, 2014, and 2015, respectively, but only reported total sales of \$26,205, \$28,793, and \$24,580 on its quarterly sales and use tax returns (SUTRs) for those same years. CDTFA found that these reporting discrepancies were significant and warranted further investigation.
6. From appellant's sales invoices for 2014 and 2015, CDTFA compiled total sales of \$886,191 (\$531,232 for 2014 and \$354,959 for 2015) and taxable sales of \$454,885 (\$264,365 for 2014 and \$190,520 for 2015), and computed a taxable-to-total-sales percentage of 51.33 percent ( $\$454,885 \div \$886,191$ ).

7. CDTFA noted that appellant's sales of \$531,232 for 2014 and \$354,959 for 2015, which CDTFA compiled from appellant's sales invoices, exceeded the gross receipts of \$489,811 and \$249,439, which appellant respectively reported on its 2014 and 2015 FITRs. Thus, CDTFA concluded that the sales invoices represented the best evidence of appellant's sales for 2014 and 2015.
8. CDTFA compared taxable sales of \$454,885, which CDTFA compiled from appellant's sales invoices for 2014 and 2015, to taxable sales of \$52,533, which appellant reported on its quarterly SUTRs for those same years, to establish audited unreported taxable sales of \$402,352 for 2014 and 2015. Appellant conceded to this understatement.
9. To establish audited taxable sales for the period of February 10, 2012, through December 31, 2013, CDTFA applied the taxable-to-total-sales percentage of 51.33 percent (derived from appellant's 2014 and 2015 sales invoices) to gross receipts of \$525,038 and \$537,179, which appellant respectively reported on its 2012 and 2013 FITRs. As a result, CDTFA computed total audited taxable sales of \$545,240: \$269,502 for 2012 and \$275,734 for 2013. CDTFA compared audited taxable sales of \$545,240 to reported taxable sales of \$25,062 for the period February 10, 2012, through December 31, 2013,<sup>3</sup> and determined that appellant had audited unreported taxable sales of \$520,178 for that period.<sup>4</sup>
10. C. Meza was appellant's president. He and his spouse L. Meza were involved with the following two businesses, which existed and operated before appellant:
  - a. Meza Trailer Repair, Inc. (2004 – 2010): C. Meza served as Meza Trailer Repair, Inc.'s president, L. Meza served as its corporate secretary, and the business operated at the same Fontana address as appellant, selling trailer parts and new tires. It existed as a business entity from May 10, 2004, until January 13, 2010, and held a seller's permit effective from July 1, 2008, through December 31, 2009, when it indicated to CDTFA that it had discontinued its

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<sup>3</sup> As previously stated, appellant did not file sales and use tax returns for the period February 10, 2012, through the first quarter of 2013 (1Q13). Appellant's reported taxable sales of \$25,062 represented the period from 2Q13 through 4Q13.

<sup>4</sup> Audited unreported taxable sales of \$520,178 comprises the following quarterly underreporting: \$67,376 for each quarter of 2012; \$68,934 for 1Q13; \$58,148 for 2Q13; \$60,514 for 3Q13; and \$63,078 for 4Q13.

business. During the period its seller's permit was active, Meza Trailer Repair, Inc. reported taxable sales.

- b. M.T.T.R., Inc. (2008 – 2010): L. Meza served as M.T.T.R., Inc.'s president, and the business operated at the same Fontana address as appellant, repairing trailers. C. Meza was its landlord. M.T.T.R., Inc. existed as a business entity from March 10, 2008, until January 22, 2010, and held a seller's permit effective from October 1, 2008, through December 31, 2009, when it indicated to CDTFA that it had discontinued its business. During the period its seller's permit was active, M.T.T.R., Inc. reported taxable sales.

### DISCUSSION

Issue 1: Whether appellant has shown that audited unreported taxable sales of \$520,178 for the period of February 10, 2012, through December 31, 2013, should be reduced.

California imposes on a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property sold in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) For the proper administration of the Sales and Use Tax Law and to prevent evasion of the sales tax, it is presumed that all gross receipts are subject to the sales 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).)

If CDTFA is not satisfied with the amount of tax reported by a person, or if a person fails 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 shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*)

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. (*Appeal of AMG Care Collective*,

2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*) To satisfy its burden of proving that a result differing from CDTFA's determination is warranted, a taxpayer must prove both (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Appeal of AMG Care Collective, supra.*)

Here, upon audit, appellant provided limited books and records, which evidenced significant discrepancies and stymied CDTFA's ability to verify appellant's taxable sales using a direct audit method. Accordingly, we find it was appropriate for CDTFA to utilize an alternate, indirect audit method. To that end, CDTFA used appellant's own sales invoices and FITRs to compute a taxable-to-total-sales percentage and to establish audited taxable sales for the portion of the liability period in dispute: February 10, 2012, through December 31, 2013. We find that CDTFA has used the best available evidence to establish appellant's audited unreported taxable sales for this period and met its minimal burden to show that its determination is reasonable and rational. Therefore, the burden shifts to appellant to establish that an adjustment to CDTFA's determination is warranted.

On appeal, appellant contends that the amount of unreported taxable sales CDTFA estimated for 2012 and 2013 is totally wrong. Appellant alleges that its business operations, customers, vendors, and jobs did not change throughout the liability period. Accordingly, appellant argues that audited unreported taxable sales for 2012 and 2013 (\$520,178) should be reduced by \$117,260 to roughly match audited unreported taxable sales for 2014 and 2015 (\$402,352).

Here, appellant has not provided any evidence in support of its argument; unsupported assertions are insufficient to satisfy appellant's burden of proof. (*Appeal of Talavera, supra.*) Further, the available evidence shows that at least one aspect of appellant's business changed significantly during the liability period: gross receipts reported on appellant's 2012 and 2013 FITRs (\$525,038 and \$537,179, respectively) were much *higher* than those reported on appellant's 2014 and 2015 FITRs (\$489,811 and \$249,439, respectively). This suggests that taxable sales for 2012 and 2013 would also be higher than those for 2014 and 2015, which would contradict appellant's argument on appeal. Accordingly, we find that appellant has not shown that the \$520,178 measure of audited unreported taxable sales for the period of February 10, 2012, through December 31, 2013, should be reduced.

Issue 2: Whether appellant is liable for the 50 percent fraud/evasion penalty under R&TC section 7155.

R&TC section 7155 provides for a fraud/evasion penalty when a person operates in California as a seller but knowingly fails to obtain a seller's permit. "Any person who, for the purpose of evading the payment of sales or use tax due, knowingly fails to obtain a valid seller's permit prior to the date on which the first tax return is due shall be liable for a penalty of 50 percent of any tax determined to be due for the period during which the person engaged in business in this state as a seller without a valid seller's permit." (R&TC, § 7155(a); see also Cal. Code Regs, tit. 18, § 1703(c)(3)(C).) The 50 percent penalty shall not apply to any person whose measure of tax liability over the period during which the person was engaged in business in this state as a seller without a valid seller's permit averaged \$1,000 or less per month. (R&TC, § 7155(b); Cal. Code Regs, tit. 18, § 1703(c)(3)(C).)

In sum, per R&TC section 7155, the 50 percent fraud/evasion penalty applies when the seller satisfies the following three elements: (1) the seller did not obtain a seller's permit prior to the date the first tax return was due; (2) during the period of time a seller operated without a seller's permit, the seller's measure of tax liability averaged more than \$1,000 per month; and (3) the seller, while operating without a seller's permit, knew that one was required but failed to obtain one for the purpose of evading the payment of tax.

Regarding the first element, it is undisputed that appellant began operating on February 10, 2012, which is during the first quarter of 2012. For that quarter, appellant's first tax return would have been due on April 30, 2012, the last day of the month following the first quarter of 2012. (See R&TC, § 6452.) However, appellant did not obtain a seller's permit prior to April 30, 2012; instead, appellant obtained one over a year later, on May 20, 2013. Accordingly, the first element is satisfied.

Regarding the second element, appellant operated without a seller's permit from February 10, 2012, until May 20, 2013. During that time, appellant's audited unreported taxable sales were \$67,367 for each quarter of 2012 and \$68,934 for the first quarter of 2013.<sup>5</sup> These amounts translate to an average monthly tax liability measure of over \$20,000 per month, which is far above the \$1,000 threshold. Accordingly, the second element is satisfied.

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<sup>5</sup> See footnote 4, *ante*, page 3.

The third element requires both knowledge that a seller's permit was required as well as failure to obtain one due to fraudulent intent or the intent to evade. Regarding knowledge that appellant required a seller's permit while operating as a seller, the record shows that C. Meza, appellant's president, and his spouse, L. Meza, served as corporate officers of two prior business entities engaged in the same types of business (repairing truck tractors and trailers, selling associated parts), at the same Fontana address, as appellant. Each of these two prior business entities obtained seller's permits and reported taxable sales.

C. Meza and his spouse L. Meza's involvement with these prior business entities indicates that C. Meza knew that appellant required a seller's permit to operate a business repairing truck tractors and trailers and selling parts for the same. Despite C. Meza's knowledge, appellant commenced business operations on February 10, 2012, but did not obtain a seller's permit until May 20, 2013. With the knowledge sub-element satisfied, the issue then becomes whether appellant's failure to obtain a seller's permit was driven by the purpose of evading the payment of tax. We examine the record for so-called badges of fraud.

Fraud or intent to evade must be established by clear and convincing evidence. (Cal. Code Regs, tit. 18, § 1703(c)(3)(C).) The R&TC does not define fraud, but OTA may look to federal precedents for guidance. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.) Because fraudulent intent is rarely established by direct evidence, it may be inferred from strong, or various kinds of, circumstantial evidence. (*Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307.) The various "badges of fraud" include: the understatement of income; inadequate records; failure to file tax returns; implausible or inconsistent explanations of behavior; concealment of assets; failure to cooperate with tax authorities; and a pattern of conduct that evidences an intent to mislead. (*Ibid.*; *Sanchez v. Commissioner*, T.C. Memo. 2014-174.)

In determining fraudulent intent with respect to a corporation, the requisite proof of fraudulent intent is found in the acts of the corporation's officers. (*Bell Cap. Mgmt., Inc. v. Commissioner*, T.C. Memo. 2021-74; see also *Blossom Day Care Ctrs., Inc. v. Commissioner*, T.C. Memo 2021-87.)

A person's failure to report taxable sales in the sales and use tax context is similar to understating income, one of the badges of fraud in the income tax context. In Issue 1, we found that appellant did not report \$520,178 in taxable sales for the period February 10, 2012, through

December 31, 2013. This amount is substantial and unexplained, and therefore indicative of fraud.

Further, upon audit, appellant only provided FITRs for 2012 and 2013, and did not provide any sales invoices, sales journals, other summary records of sales, or source documents or summary records for purchases for those same years. The records appellant produced upon audit were clearly inadequate, especially for the period February 10, 2012, through December 31, 2013, and inadequate records constitute another badge of fraud.

Finally, based on his and his spouse's involvement with substantially similar predecessor businesses that filed quarterly SUTRs and reported taxable sales of similar products (trailer parts), C. Meza knew of appellant's requirement to file SUTRs to report the sales appellant was making. However, appellant failed to do so from its inception on February 10, 2012, until after obtaining a seller's permit on May 20, 2013, when it filed a SUTR for the second quarter of 2013 (2Q13). In all, appellant failed to file SUTRs and report its taxable sales for five consecutive reporting periods: February 10, 2012, through March 31, 2012; 2Q12; 3Q12; 4Q12; and 1Q13. Failure to file SUTRs is yet another badge of fraud, and appellant's failure to file for so many reporting periods—while making sales of tangible personal products that its president, C. Meza, already knew were subject to taxation—indicates that its failure to obtain a seller's permit was motivated by fraudulent intent.

Given these facts, we find that CDTFA has shown by clear and convincing evidence that appellant knowingly operated without a seller's permit for the purpose of evading taxes. Thus, we find that CDTFA has shown that appellant satisfied all three elements required by R&TC section 7155 for applying the 50 percent fraud/evasion penalty.

On appeal, appellant offers three arguments for why the 50 percent fraud/evasion penalty does not apply. First, appellant simply asserts that CDTFA “has not proven with factual evidence the purported intent to evade tax.” Above, we have reviewed the evidence on which we base our fraud finding, and appellant's mere assertion to the contrary does nothing to undercut this evidence. Accordingly, we find appellant's first assertion meritless.

Second, appellant contends that CDTFA has not obtained confirmation from vendors that appellant issued timely resale certificates, and asserts that its vendors should have charged sales tax on their sales to appellant. However, R&TC section 7155 does not require that CDTFA



confirm that a taxpayer provided resale certificates to its vendors. Accordingly, we conclude that appellant's second contention lacks merit.

Third, appellant contends that it did not collect sales tax reimbursement from customers and asserts that the auditor's listing of sales invoices for 2014 and 2015 in the audit working papers does not show that sales tax reimbursement was collected. If appellant collected no sales tax reimbursement, appellant argues that there should be no fraud penalty.

We have reviewed the audit working papers and find that appellant's assertion is incorrect. CDTFA scheduled the invoices for 2014 and 2015 on Schedule 12D-1, and column I of that schedule lists the tax shown on appellant's invoices. Further, collecting sales tax reimbursement from customers is not a requirement of the 50 percent fraud/evasion penalty under R&TC section 7155. Accordingly, we conclude that appellant's third and final contention also lacks merit.


We conclude that appellant is liable for the 50 percent fraud/evasion penalty under R&TC section 7155.

HOLDINGS

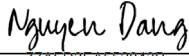
1. A reduction to audited unreported taxable sales of \$520,178 for the period of February 10, 2012, through December 31, 2013, is not warranted.
2. Appellant is liable for the 50 percent fraud/evasion penalty under R&TC section 7155.

DISPOSITION

We sustain CDTFA’s action.

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 Andrew Wong  
 Administrative Law Judge

We concur:

DocuSigned by:  
  
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 Nguyen Dang  
 Administrative Law Judge

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 Daniel K. Cho  
 Administrative Law Judge

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