OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19064908) CDTFA Case ID 197-049
V. HARRISON **dba VONZIE AUTO SALES**	)

OPINION

Representing the Parties:

For Appellant:	Melisa Coates, Enrolled Agent
For Respondent:	Kevin Hanks, Chief, Headquarters Operations Bureau
For Office of Tax Appeals:	Richard A. Zellmer Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 and California Code of Regulations, title 18, sections 5220[1] and 30103(b)(1), V. Harrison (appellant) appeals a Decision issued by the California Department of Tax and Fee Administration (respondent)[2] denying, in part, appellant's administrative protest (protest) of a Notice of Determination (NOD) issued on July 3, 2015. The NOD was for tax of $36,377.77, plus accrued interest, and a negligence penalty of $3,637.78 for the period July 1, 2011, through June 30, 2014 (liability period). When appellant did not timely file a petition for redetermination or pay the determination when due and payable, the liability became

[1] Under regulations promulgated by respondent and applicable at the time the petition was filed, if a taxpayer files a petition for redetermination after the 30-day time period specified in R&TC section 6561, respondent may accept it as an administrative (late) protest, which is reviewed in the same manner that a petition for redetermination is reviewed. (Cal. Code Regs, tit. 18, § 5220(b).) The Office of Tax Appeals is authorized to review decisions issued by respondent.

[2] Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (BOE). In 2017, the California Legislature transferred functions of the BOE relevant to this case to respondent. (Gov. Code, § 15570.22.) The effective date of the transfer of all but adjudicatory functions was July 1, 2017. (Adjudicatory functions were transferred to the Office of Tax Appeals effective January 1, 2018.) When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to BOE.

final, and a finality penalty in the amount of $3,637.78 was added to the liability.[3] After issuing the NOD, but prior to this appeal to the Office of Tax Appeals, respondent reduced the understated measure of tax to $236,567,[4] which will result in reductions to the tax, deleted the negligence penalty, and conditionally relieved the finality penalty, but otherwise denied the protest.[5]

We decide the matter on the basis of the written record because appellant waived an oral hearing.[6]

ISSUE

Are additional reductions warranted to the measure of unreported taxable sales?

FACTUAL FINDINGS

1. Appellant operates a used car dealership in Sacramento.
2. On his sales and use tax returns (SUTRs) for the liability period, appellant reported total sales of $1,175,115 and claimed deductions for sales tax reimbursement included in reported total sales of $81,641, resulting in reported taxable sales of $1,093,474. For an audit by respondent, appellant provided sales reports for the liability period and sales jackets for all periods in the liability period except the second quarter of 2012 (2Q12).[7] Appellant did not provide general ledgers, purchase journals, bank statements, or federal income tax returns for audit. Respondent found the records provided by appellant

[3] The penalty (often referred to as a finality penalty) is mandated by R&TC section 6565.

[4] As the result of a reaudit before issuing its Decision, respondent reduced the measure of tax from $457,104 to $260,136. Respondent's Decision held, in part, that the measure would be further reduced to $249,491. However, as a result of the second reaudit, respondent reduced the measure of tax to $236,567.

[5] Respondent imposed the usual conditions for relief of the finality penalty: payment of the tax portion of the liability in full within 30 days after mailing of the notice of a final decision. This Opinion is the final decision.

[6] Appellant failed to timely respond to the notice of hearing. Although appellant submitted a late response requesting that the matter be returned to the oral hearing calendar, the Office of Tax Appeals denied that request without prejudice on August 3, 2021, because appellant had not shown that there was good cause for the failure to timely respond. Appellant has not renewed his request.

[7] Sales jackets (or dealer jackets) are envelopes utilized by used car dealers to record sales. They usually contain the purchase and sales documents, invoices associated with repairs, delivery, and parts, an odometer statement, the vehicle identification number and stock number, and other records pertaining to the sale.

incomplete and for that reason computed appellant's sales using the markup method.[8] In the audit, respondent computed unreported taxable sales of $457,104 using the markup method.

3. Respondent issued the July 3, 2015 NOD, which was based on the audit, to appellant.
4. Appellant filed an untimely petition for redetermination protesting the NOD in its entirety, which respondent accepted as a protest.
5. Respondent obtained new information and, based thereon, prepared a reaudit (first reaudit), which resulted in a reduction of unreported taxable sales to $260,137.
6. The parties participated in an appeals conference on October 17, 2018, and on May 17, 2019, respondent issued its Decision, which deleted the negligence penalty, conditionally relieved the finality penalty, and concluded that another reaudit was needed to calculate further reductions to the taxable measure.
7. In the second reaudit, respondent used appellant's sales journals to compile taxable sales of $1,093,574 for the liability period. It then compared appellant's sales jackets to the sales journals and found 71 additional vehicle sales from the sales jackets that were not recorded in the sales journals, totaling $116,386 for the liability period with the exception of 2Q12, for which sales jackets were not provided. Respondent calculated that the $116,386 understatement represented an error ratio of 11.82 percent, which it applied to recorded taxable sales for 2Q12 to compute an understatement of $14,444 for that period. In total, respondent calculated unrecorded (and unreported) sales from sales jackets of $130,830 ($116,386 + $14,444).
8. Respondent also obtained information from the Department of Motor Vehicles (DMV) regarding sales that appellant reported to DMV on Report of Sale (ROS) forms, and information from two auto auctions regarding appellant's purchases of vehicles from them during the period July 1, 2011, through December 31, 2013. By comparing vehicle identification numbers (VINs) referred to in this data with the other sources, respondent identified 48 vehicles that were purchased from the auto auctions that were not listed in the DMV data, appellant's sales journals, or appellant's sales jackets.

[8] The markup method, which uses cost of goods sold and markup percentages to compute taxable sales, is a generally accepted method for calculating audited taxable sales.

9. Respondent used the markup method to determine the measure attributable to sales of the 48 vehicles shown in auction records only. Appellant's cost for these 48 vehicles was $45,375. Respondent performed a shelf test,[9] comparing costs and selling prices of 36 vehicles to compute a markup of 114.95 percent. Respondent added the 114.95 percent markup to the cost of the 48 vehicles to compute unrecorded taxable sales (using the markup method) of $97,535 for the period July 1, 2011, through December 31, 2013. Respondent then compared unrecorded sales computed using the markup method for 2013 to recorded taxable sales for that same year to compute an error ratio of 6.01 percent. Respondent applied the error ratio of 6.01 percent to recorded taxable sales for the period January 1, 2014, through June 30, 2014, to compute an understatement of $8,102 for that period. In total, respondent computed unrecorded taxable sales of $105,637 ($97,535 + $8,102) using the markup method.

   Respondent computed audited taxable sales of $1,330,041 ($1,093,574 recorded taxable sales + $130,830 unrecorded taxable sales from the sales jackets + $105,637 unrecorded sales established using the markup method) and deducted reported taxable sales of $1,093,474, to compute unreported taxable sales of $236,567 for the liability period.

10. Respondent informed appellant regarding the results of the second reaudit. This timely appeal followed.

DISCUSSION

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.)

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).) If respondent is not satisfied with the accuracy of the SUTRs filed, respondent may base its determination of the tax due upon

[9] A shelf test is an accounting comparison of known costs and associated selling prices, used to compute markups.

the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.)

When a taxpayer appeals an NOD, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) 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*.; Cal. Code Regs., tit. 18, § 30219(a).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.)

The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) That is, a party must establish by testimony, documents, or other evidence that the circumstances it asserts are more likely than not correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) To satisfy the burden of proof, a taxpayer must prove that the tax assessment is incorrect and the correct amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Appellant's sales reports and sales jackets are evidence of appellant's sales, and we find that respondent acted reasonably in compiling sales from those two sources. Appellant did not provide for audit a purchase journal, federal income tax returns, or other records that could be used to compile appellant's vehicle purchases. Thus, we find that respondent acted reasonably when it obtained purchase information from the auto auctions and used that information to establish additional sales. We find that respondent has met its initial burden to show that its determination was both rational and reasonable. Therefore, the burden of proof shifts to appellant to prove a measure that is more accurate than the results of respondent's second reaudit.

Appellant makes several arguments. Appellant contends that sales tax reimbursement is included in total sales, and thus, audited taxable sales should be reduced by sales tax reimbursement. Appellant also argues that respondent should not have used information from multiple sources (sales jackets, DMV, and auto auctions) and that if respondent does not have confidence in the information from a source, that information should not be relied upon in one part of the audit and rejected in another part of the audit. Appellant asserts that the $130,830 measure of tax for sales from sales jackets that were not recorded in the sales reports represent

sales that were never completed, which is why none of these sales were included in the information obtained from DMV. Finally, appellant contends that the $105,637 of sales that result from marking-up purchases of 48 vehicles based on information obtained from the auto auctions should be deleted. Appellant notes that these 48 sales were not included in the information obtained from DMV, which appellant argues is evidence that appellant did not make these 48 sales.

Regarding appellant's contention that audited taxable sales should be reduced by sales tax reimbursement, we have reviewed the workpapers for the original audit, the first reaudit, and the second reaudit, which indicate that appellant claimed deductions on his SUTRs for sales tax reimbursement included in reported total sales. Respondent therefore subtracted sales tax reimbursement from reported total sales to arrive at reported taxable sales. However, the fact that reported total sales included sales tax reimbursement does not impact the audit calculations because respondent compared audited taxable sales to reported taxable sales. An adjustment for sales tax reimbursement would only be in order if appellant can show that *audited* taxable sales included sales tax reimbursement.

In the original audit and the first reaudit, respondent erroneously included sales tax reimbursement in the amounts of recorded taxable sales for 3Q11 and 4Q11. However, respondent corrected this error in the second reaudit. Appellant has not identified any other specific instance where audited taxable sales as computed in the second reaudit includes sales tax reimbursement. We note that recorded taxable sales computed in the second reaudit of $1,093,574 is very close to taxable sales that appellant reported on his SUTRs of $1,093,474. Appellant also has not shown that any of the amounts that respondent scheduled from the sales jackets include sales tax. Respondent's method of computing sales using the markup method would not result in a tax-included amount. Thus, we find that recorded taxable sales as computed in the second reaudit do not include sales tax. On that basis, we conclude that no adjustment is warranted for sales tax included in total sales.

Regarding appellant's argument that respondent should not have used information from multiple sources, we note that, as stated above, 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.) Appellant has not cited any authority that would limit respondent to the use of one source of information in its audits, and we are not aware of any such authority.

Moreover, we find that respondent's comparison of the information in appellant's books and records with information from multiple outside sources is prudent under these circumstances. Appellant did not provide a purchase journal or any other single source of information that accurately identified all of appellant's purchases. The documents appellant did provide to show purchases did not include all purchases. We find that it was appropriate for respondent to use all of the available information, including the sales reports, sales jackets, information from DMV, and information from the auto auctions, in its audit and that respondent's use of multiple sources does not support any grounds for adjustment.

Appellant's argument that it never sold the 119 vehicles identified from sales jackets and the auto auction's records, as evidenced by DMV records that show no ROS forms filed for those vehicles, is unpersuasive.[10] The information that respondent obtained from the sales jackets and auto action records includes details regarding each vehicle, including the make and model year of the car and the VIN.[11] Thus, appellant's own records show the 119 vehicles in appellant's inventory during the liability period. On the basis of that evidence, respondent reasonably concluded that appellant sold the vehicles. It thus became incumbent on appellant to prove otherwise, and appellant should be in the best position to produce evidence to prove these vehicles were not sold at retail if that was, in fact, the case.

Appellant's total reliance on the absence of ROS forms filed with the DMV is misplaced. Although a filed ROS form is evidence that a sale occurred, the absence of a filed ROS form does not prove the contrary. The filing of an ROS form is entirely within appellant's control. If appellant did not sell any of these 119 vehicles at retail, appellant should have evidence to prove that the vehicles remained in inventory or were returned to the vendor, disposed of in a nontaxable transaction, or otherwise lost or destroyed. Appellant has provided no such evidence. On the basis of the evidence, we find that appellant sold these 119 vehicles at retail.

For the reasons stated above, we find that appellant has failed to prove facts from which a more accurate determination can be made, and on that basis, we conclude that additional reductions to the measure of unreported taxable sales are not warranted.

[10] The 119 vehicles consist of the 71 vehicles for which appellant has sales jackets and the 48 vehicles identified in auto auction records as having been purchased by appellant, none of which appellant included in reported taxable sales.

[11] Auction records typically included the purchase price.

HOLDING

The measure of unreported taxable sales should be reduced from $457,104 to $236,567, the negligence penalty should be deleted, and the finality penalty should be conditionally relieved, all as conceded by respondent, but additional reductions to the measure of unreported taxable sales are not warranted.

DISPOSITION

Respondent's action in deleting the negligence penalty, conditionally relieving the finality penalty, and reducing the taxable measure for unreported taxable sales to $236,567, but otherwise denying the administrative protest, is sustained.

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Michael F. Geary
Administrative Law Judge

We concur:

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Josh Lambert
Administrative Law Judge

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Josh Aldrich
Administrative Law Judge

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