OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20106750
	) CDTFA Case ID 288-005
PEACOCK POWDER COATING, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Minaxi Kamath, Representative[1]

For Respondent: Jarrett Noble, Tax Counsel III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Peacock Powder Coating, Inc. (appellant) appeals a decision issued by California Department of Tax and Fee Administration (respondent) denying appellant's petition for redetermination of a Notice of Determination (NOD) dated October 20, 2016.[2] The NOD is for $153,469.09 in tax, a failure-to-file penalty of $15,346.94, and applicable interest, for the period July 1, 2006, through December 31, 2013 (liability period).[3]

This matter is being decided based on the written record because appellant waived its right to an oral hearing.

[1] Ms. Kamath is listed as appellant's agent for service of process with the California Secretary of State and states in her correspondence with respondent that she and her husband are the owners of appellant.

[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.

[3] The deficiency consists of a single item: unreported taxable sales of fabrication labor, measured by $1,743,672.

ISSUE[4]

Is appellant entitled to adjustments to the measure of unreported taxable sales of fabrication labor?

FACTUAL FINDINGS

1. Iron Knob Corporation (IKC) was formed in or around 1996. It was a construction contractor that manufactured and installed fences, gates, railings, window guards, and other metal products. IKC was registered with respondent and held a seller's permit during the liability period.
2. The owners of IKC formed and registered appellant, a corporation, in 2001.[5] Appellant, which operated out of the same facility as IKC, was engaged in the business of applying durable finishes (e.g., powder coatings) to its customers' tangible personal property (TPP). IKC was one of appellant's customers.[6]
3. Appellant never held a seller's permit and did not file sales and use tax returns (SUTRs) for any quarter included in the liability period. IKC and appellant maintained separate books and filed separate income tax returns.
4. IKC subcontracted work to appellant, who applied finishes to TPP manufactured and installed by IKC. IKC did not issue resale certificates or purchase orders to appellant, and appellant did not charge IKC tax or tax reimbursement.
5. During an audit of IKC, respondent discovered that appellant performed fabrication labor on TPP that IKC manufactured and installed pursuant to IKC's lump sum construction

[4] Although appellant argued in its agency-level appeal that it did not collect sales tax reimbursement from its customers and remit sales tax to respondent due to appellant's reasonable reliance on prior advice from respondent, appellant has made no such argument in this appeal, and we find nothing in the evidence to indicate reasonable reliance on prior written advice from respondent, which is what the law requires. (R&TC, § 6596(a).) Consequently, we do not address that issue below. In addition, appellant has not made any arguments or provided any evidence relevant to the failure-to-file penalty, nor has appellant submitted to us the required statement under penalty of perjury in support of a request for relief (R&TC, § 6592(b)). Therefore, we also will not address that issue below.

[5] The same shareholders formed and registered a third corporation, Iron Depot, USA, in 2005 to make retail sales of products manufactured by IKC. Respondent audited all three corporations, but only appellant's liability is at issue here.

[6] Although the evidence does not identify any of appellant's other customers, appellant's former website, a portion of which is attached to respondent's Decision, and its profit and loss statements show that appellant advertised for potential clients and one of appellant's owners referred to appellant's "clients" (plural) in a May 28, 2014 letter to respondent.

contracts. Respondent concluded that these transactions were taxable sales of fabrication labor and proceeded to determine the measure of tax.

6. Respondent compared appellant's profit and loss (P&L) statements for 2007 through 2013, inclusive, to appellant's federal income tax returns (FITRs) for 2008 through 2012 and found that amounts recorded in the P&L statements exceeded reported amounts in the FITRs for the years for which both were available (2008-2012) by $121,471. Total income recorded on the P&L statements was $1,743,672.

7. According to respondent, appellant's representative reported that the differences between total income recorded on the P&L statements and the gross income reported on FITRs were due to the P&L statements being prepared on an accrual basis and the FITRs being prepared on a cash basis.[7] Because retailers must report sales tax liability on an accrual basis, respondent determined that appellant had sales of taxable fabrication labor totaling $1,743,672 during the liability period.

8. According to respondent, appellant has indicated that both IKC and appellant ceased operations in 2015. California Secretary of State records show that appellant dissolved in January 2017.

9. On October 20, 2016, respondent issued the instant NOD to appellant. The NOD was based on a Field Billing Order for $153,469.09 in tax (based on a measure of $1,743,672 for the liability period), a failure-to-file penalty of $15,346.94, and applicable interest.[8]

10. On November 17, 2016, appellant filed a timely petition for redetermination.

11. Following an April 15, 2020 appeals conference, at which no one appeared for appellant, respondent issued its Decision denying appellant's petition for redetermination. This timely appeal followed.[9]

[7] We note that only the P&L statements for 2013 contain the legend "Accrual Basis." The others contain the legend "Cash Basis."

[8] A Field Billing Order is often used by respondent to notify a taxpayer regarding an additional tax liability or refund determined using procedures other than a completed audit.

[9] Appellant filed a request for appeal on August 25, 2020, but no opening or reply brief followed.

DISCUSSION

California imposes sales tax on a retailer's retail sales in this state of TPP, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) A "sale" includes producing, fabricating, or processing TPP for a consideration for consumers who furnish the materials used. (R&TC, § 6006(b); Cal. Code Regs., tit. 18, § 1526(a).) Thus, charges for fabricating TPP for a consumer are subject to sales tax unless specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) Fabrication includes any operation that results in the creation or production of TPP, or which is a step in a process or a series of operations resulting in the creation or production of TPP. (Cal. Code Regs., tit. 18, § 1526(b); see also Cal. Code Regs., tit. 18, § 1524(a).)[10]

All of a retailer's gross receipts are presumed subject to tax until the contrary is established, and the burden of proving the contrary is on the retailer. (R&TC, § 6091.) "Gross receipts" means the total amount of the sale price of a retailer's retail sales of TPP, including the cost of labor or services, as well as any services that are a part of the sale. (R&TC, § 6012(a)(2), (b)(1).) The retailer bears the burden of establishing its entitlement to any claimed deduction or exemption. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443.)

When respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, 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, 6511.) On appeal, 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*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

The undisputed facts include the following:

- appellant and IKC were at all times separate corporations, though they were owned and operated by the same persons;
- appellant was in the business of applying special finishes to its customers' TPP;
- appellant's gross receipts for the liability period totaled $1,743,672; and

[10] Fabrication does not include operations which constitute merely the repair or reconditioning of TPP to refit it for the use for which it was originally produced. (Cal. Code Regs., tit. 18, § 1526(b).)

- appellant filed no SUTRs for the liability period or any part thereof.

It does not appear that appellant disputes that the type of work appellant performed for IKC constituted fabrication labor or that the asserted measure equals appellant's recorded total income for the liability period. Appellant has not alleged that its sales to IKC were sales for resale or otherwise specifically exempt or excluded from taxation by statute.[11] Appellant's sole contention appears to be that the fabrication work it did on TPP provided by its related corporation, IKC, was merely a transfer between two businesses owned by the same persons and were not sales at all.

Appellant's apparent belief that the common ownership of the two businesses requires that we treat them as one and the same entity for sales and use tax purposes is mistaken. As used in the Sales and Use Tax Law, "seller" includes every person engaged in the business of selling TPP of a kind the gross receipts from the retail sale of which are required to be included in the measure of sales tax (R&TC, § 6014), and "person" includes a corporation. (R&TC, § 6005; see also Cal. Corp. Code, § 28043.) Corporations are treated as distinct entities and separate from their owners. (*Moline Properties v. Commissioner* (1943) 319 U.S. 436.) With few exceptions, the longstanding rule is that "the taxpayer does not have the same freedom to disregard the form [of a transaction] he has chosen, as does the government." (*W.E. Hall Co. v. Franchise Tax Board* (1968) 260 Cal.App.2d 179, 184.)

In determining whether an entity can be disregarded for tax purposes, the general rule is that courts should not disregard separate legal entities merely to grant tax relief, even when one corporation wholly owns the other and the corporations share corporate directors and officers. (*Mapo, Inc. v. State Board of Equalization* (1975) 53 Cal.App.3d 245, 248 (*Mapo*); see also *Appeal of Bachor (Rehearing)* (2020-OTA-172P).) In fact, a parent corporation's ownership of all the stock of its subsidiary does not, alone, establish that the separate parent and subsidiary entities should be treated as one and the same for sales and use tax purposes. (*Appeal of Bachor*, *supra*, citing *Macrodyne Industries, Inc. v. State Bd. of Equalization* (1987) 192 Cal.App.3d 579, 582, disapproved on another ground in *Beatrice Co. v. State Bd. of Equalization* (1993) 6 Cal.4th 767, 779.) Hence, *Mapo* offers a rare departure from the general rule, and in order to disregard a

[11] The evidence at least suggests that appellant's customers, including IKC, were the consumers of the TPP fabricated by appellant.

business entity's corporate existence, it must be established that the two entities in question were in substance the same entity. The factors that the *Mapo* court relied upon to determine whether a corporation's existence should be disregarded are: (1) the length of time the corporations separately existed and the benefit derived from such an arrangement; (2) the maintenance of distinct corporate identities; (3) the independent business purpose of each corporation; and (4) the observance of usual formalities of purchase and sale between the corporations. (*Mapo, supra* at p. 248.)

The evidence before us simply does not support a departure from the general rule. Appellant has not made any specific arguments or provided any evidence of particular facts, other than common ownership, in support of its assertion that IKC and appellant should be treated as one entity, at least for purpose of our analysis. What little evidence we have indicates that IKC was formed in 1996 when the owners took over an existing ornamental and structural iron company, and the same owners formed appellant when they moved to a new facility that provided more space. We have no information regarding why the owners formed appellant, as opposed to simply doing the finishing work through the existing corporate entity, or what benefit each corporation derived from their separate status. The evidence indicates that IKC and appellant maintained separate books and filed separate income tax returns, thus maintaining separate corporate identities. The two corporations appear to have had distinct business purposes, IKC being a construction contractor, manufacturing and installing TPP (fences, gates, etc.) on customers' property, and appellant being a metal finishing business and, at least according to its former website, offering its services to the general public.[12] Finally, appellant recorded and reported its sales to IKC. On the basis of these facts, we find inadequate cause to depart from the general rule that the separate identities of the corporations should be respected. Therefore, we find that appellant's sales of fabrication labor were retail sales subject to tax.

[12] Available evidence indicates that appellant operated its own public internet website and deducted expenses for "advertising." In addition, one of appellant's owners referred to appellant's "clients" (plural) in a May 28, 2014 letter to respondent. All of this suggests appellant was doing work for unrelated customers.

HOLDING

Appellant is not entitled to adjustments to the measure of unreported taxable sales of fabrication labor.

DISPOSITION

Respondent's action denying appellant's petition for redetermination is sustained.

DocuSigned by:
1A9B52EF88AC4C7...
Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
8A4294817A67463...
Andrew Wong
Administrative Law Judge

Date Issued: 8/20/2021