OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20086441
	) CDTFA Case ID 991-846
THE ROWDY ROSE, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Ryan Bolender, Esq.
For Respondent:	Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Craig Okihara, Business Tax Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, The Rowdy Rose, Inc. (appellant) appeals a Decision issued by California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of the January 16, 2019 Notice of Determination (NOD) for $141,661.10 in tax, plus applicable interest, and a negligence penalty of $14,166.10 for the period October 1, 2014, through June 30, 2018 (liability period).[2] The NOD is based on a revised audit that determined a deficiency measure totaling $1,790,341, consisting of the following audit items: (1) unreported taxable sales measured by $47,538, based on a difference between sales tax accrued and sales tax reported; (2) additional unreported taxable sales measured by $1,639,809, based on a bank deposit analysis; (3) additional unreported sales measured by $99,000, based on disallowed claimed occasional sales; and (4) unreported purchases subject to use tax measured by $3,994.

[1] Prior to July 1, 2017, sales and use taxes (and other business taxes and fees) were administered by the State Board of Equalization (BOE). When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to BOE.

[2] Respondent prepared an audit and a revised audit. The audit covered the period October 1, 2014, through September 30, 2017. However, respondent added three additional eligible periods (October 1, 2017, through June 30, 2018) for the revised audit, on which the NOD was based.

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

ISSUES

1. Is appellant entitled to a reduction to the $47,538 measure of unreported taxable sales, which is based on recorded versus reported sales tax reimbursement collected?
2. Is appellant entitled to a reduction to the $1,639,809 measure of additional unreported taxable sales, determined using a bank deposit analysis?
3. Is appellant entitled to a reduction to the $3,994 measure of out-of-state purchases subject to use tax?
4. Did respondent correctly impose the negligence penalty?

FACTUAL FINDINGS

1. At all times during the liability period, appellant held a seller's permit to operate a retail store in Banning, California, selling western-style clothing, accessories, and furniture, as well as animal feed and, on occasion, other items. Appellant also operated an online market and made sales at special events in and outside of California. Appellant stated that that it recorded all sales in its point-of-sale (POS) system and used POS Daily Activity Reports (POS reports) to prepare sales and use tax returns (SUTRs).
2. On its SUTRs for the liability period, appellant reported total sales of $3,033,652 and claimed deductions of $966,045, resulting in reported taxable sales of $2,067,607. The claimed deductions were $39,517 for sales for resale, $24,105 for returns (of merchandise), $5,007 for sales to tax-exempt, nonprofit organizations, and $897,416 for "other" (representing claimed exempt sales of hay).[3]
3. Appellant provided the following records for the audit: federal income tax returns (FITRs) for 2014, 2015, and 2016; QuickBooks-generated profit and loss (P&L) statements for 2014, 2015, 2016, and January 1, 2017, through September 30, 2017; POS

[3] Respondent did not examine claimed merchandise returns, and it disallowed the claimed exempt sale(s) to nonprofit organizations because there is no such exemption from sales and use tax in California. Appellant does not dispute these items.

reports for October 1, 2014, through June 30, 2017, and the first quarter of 2018 (1Q18); bank statements for the liability period; and POS "receipts" for 1Q16.[4]

4. Respondent compared total sales reported on the SUTRs to gross receipts reported on the FITRs, total income recorded in the P&L statements, and total sales recorded in the POS reports, finding significant differences among the various records. Appellant was unable to explain the differences, and respondent concluded that additional testing was required to verify appellant's reported taxable sales.

5. Respondent compared $142,956 in sales tax reimbursement recorded in POS reports in connection with California sales for the periods October 1, 2014, through June 30, 2017, and 1Q18 (the POS test periods) to $139,153 in sales tax reimbursement reported on appellant's SUTRs for the same period. Respondent then divided the $3,803 difference, which constituted unreported sales tax reimbursement, by the applicable sales tax rate for each quarterly reporting period to calculate unreported taxable sales of $47,538 for the POS test periods. This became audit item 1.

6. Using bank statements[5] appellant provided for the liability period, respondent compiled total bank deposits of $4,992,081. Respondent then deducted $1,237,127 from the bank deposit total, as follows: (1) $3,829 for earned discounts (rebates) and rodeo winnings recorded in appellant's P&L statements; (2) $349,688 for claimed loans and gifts consistent with the bank statements;[6] (3) $202,000 for occasional sales;[7] (4) $47,075 for

[4] What we refer to in this Opinion as POS receipts may be more accurately described as transaction confirmations. Some are customer copies of POS receipts that are signed by the customer. Others are unsigned customer copies, merchant copies, or delivery tickets, the latter usually pertaining to sales of hay.

[5] Bank deposits are not gross receipts. (See R&TC, § 6012(a).) However, a retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of TPP, and respondent can use that evidence to determine audited taxable sales when sales cannot be accurately established using a direct approach because of a lack of adequate records.

[6] It appears that respondent allowed the following claimed loans, totaling $349,688: $50,000 of a confirmed $54,681 deposit on October 31, 2014; a confirmed $50,000 deposit on March 9, 2015; a confirmed $10,000 deposit on August 26, 2016; a confirmed $10,000 deposit on October 5, 2016; a confirmed $9,440 deposit on January 5, 2017; a confirmed $10,031 deposit on May 1, 2017; two confirmed $70,000 deposits on August 15, 2017; and a confirmed $70,217 deposit on June 19, 2018.

[7] Although this amount was deducted from the measure determined from bank deposits, respondent established a separate measure of unreported sales (measured by $99,000 after allowances) based on disallowed claimed occasional sales. Appellant conceded this measure in its June 23, 2021 supplemental brief. However, we find below that this measure should be increased (in conjunction with a related decrease, as discussed below).

exempt sales to Indians;[8] (5) $339,203 for sales in interstate commerce; (6) $165,176 for sales tax reimbursement deposited during the POS test periods; (7) $18,966 for nontaxable shipping charges deposited during the POS test periods; (8) $21,523 for gift certificate revenue deposited during the POS test periods;[9] (9) $43,499 for revenue from exempt sales of hay deposited during the POS test periods;[10] and (10) $46,168 for estimated sales tax reimbursement, nontaxable shipping charges, gift certificate revenue, and exempt hay revenue deposited during periods for which appellant did not provide records (3Q17, 4Q17, and 2Q18).[11]

7. To determine allowable exempt sales of hay, respondent compiled recorded taxable hay sales of $296,370 and recorded (claimed) nontaxable hay sales of $708,484 during the POS test periods. Respondent performed a test to verify whether appellant's claimed nontaxable sales of hay were qualified as exempt under California Code of Regulations, title 18 (Regulation), section 1587(b)(2)(A). Respondent examined POS receipts for hay sales for January 2016 and February 2016 and feed exemption certificates (provided by appellant) and found that many of the feed exemption certificates were illegible and none could be matched to a POS receipt for hay sales. Because the hay sold was of a kind customarily used to feed both food animals and non-food animals, respondent only allowed sales of four or less bales of hay as nontaxable hay sales. Respondent compiled recorded nontaxable hay sales of $44,245 and allowable exempt hay sales of four bales or less of $224 for January 2016 and February 2016. Appellant additionally provided hay sales summary worksheets for January 2018 and February 2018. Because the hay sales summary worksheets did not indicate the number of bales sold, respondent considered sales less than $100 as hay sales of four bales or less. Respondent computed allowable

[8] Respondent allowed three of the four claimed exempt sales to a member of the Morongo Band of Mission Indians based on evidence that appellant delivered the TPP to the buyer on the Morongo Indian Reservation during the liability period. Respondent disallowed a fourth sale that was made outside the liability period.

[9] Although it seems likely that at least some of the gift certificates would have been redeemed in taxable sales transactions during the liability period, respondent allowed the entire deduction.

[10] We will describe respondent's analysis of claimed exempt hay sales in some detail below.

[11] Respondent did not reduce bank deposits for appellant's claimed sales for resale measured by $22,000 because the claim was supported only by a customer's letter describing purchases of hay for resale during 2016 and 2017 and without other supporting documentation, such as sales invoices and a resale certificate. Because appellant has not argued or provided any evidence to contest this item, we will not address it further.

exempt hay sales of four bales or less of $4,403 for January 2018 and February 2018. Respondent calculated recorded nontaxable hay sales of $31,134 ($46,469 recorded nontaxable sales of hay for 1Q18 × 67 percent) for January 2018 and February 2018. For the two periods combined (January-February 2016 and January-February 2018), respondent computed recorded nontaxable hay sales of $75,379 ($44,245 + $31,134) and allowable exempt hay sales of four bales or less of $4,627 ($224 + $4,403) and calculated an allowable exempt hay sales ratio of 6.14 percent ($4,627 ÷ $75,379). Respondent multiplied recorded nontaxable sales of hay of $708,484 for the POS test periods by the allowable exempt hay sales ratio of 6.14 percent to compute audited exempt hay sales of $43,499 (rounded).

8. For the periods without supporting POS reports (3Q17, 4Q17, and 2Q18), respondent used the audited $18,145 total for appellant's 2Q17 sales tax ($12,191), shipping charges ($805), gift certificates ($915), and hay sales ($4,234) to estimate the same totals for 3Q17 and 4Q17, and it used the audited $9,878 total for appellant's 1Q18 sales tax ($4,675), shipping charges ($2,050), gift certificates ($300), and hay sales ($2,853) to estimate the same categories for 2Q18. For the three quarters combined, respondent computed estimated reductions to bank deposits of $46,168 ($18,145 + $18,145 + $9,878).

9. Thus, in total, respondent computed audited taxable sales of $3,754,954 ($4,992,081 - $3,829 - $349,688 - $202,000 - $47,075 - $339,203 - $165,176 - $18,966 - $21,523 - $43,499 - $46,168) for the liability period. After deducting taxable sales of $2,067,607 reported on appellant's SUTRs, respondent computed a difference of $1,687,347. To avoid duplication of the $47,538 measure of additional unreported taxable sales based on recorded sales tax reimbursement, respondent deducted $47,538 from $1,687,347 to compute additional unreported taxable sales of $1,639,809 for the liability period based on the bank deposit analysis. This became audit item 2.

10. As noted previously, respondent reduced bank deposits by $202,000 for claimed occasional sales but established a separate measure for that item. Appellant did not provide sales invoices or bills of sale supporting any of the eight transactions, but on the basis of information provided by appellant, respondent concluded that four transactions were taxable sales by appellant: sales of two horses, one for $14,000 and another for

$15,000; a sale of jackets for $25,000; and a sale of a forklift for $45,000. Thus, respondent disallowed occasional sales of $99,000 for the liability period. This became audit item 3.

11. Respondent reviewed appellant's FITR depreciation schedules and identified a fixed asset purchase from an out-of-state vendor without the payment of sales tax reimbursement. Respondent found that the non-California vendor did not hold a California seller's permit. Thus, respondent established a measure of $3,994 for the unreported purchase of fixed assets subject to use tax. This became audit item 4.
12. To test the reasonableness of its determination, respondent compiled credit card sales deposits of $2,577,581 and bank deposits from sales proceeds of $3,749,713 using bank statements for the POS test periods. Respondent deducted sales tax reimbursement of $165,176 recorded in the POS reports and computed bank deposits from sales proceeds, excluding sales tax reimbursement, of $3,584,537 ($3,749,713 - $165,176) for the POS test periods. Respondent compared credit card deposits to bank deposits from sales proceeds, excluding sales tax reimbursement, and computed a credit card sales ratio of 71.91 percent ($2,577,581 ÷ $3,584,537). Based on its experience in audits of similar businesses in appellant's area, respondent concluded that the credit card sales ratio was reasonable and that the test supported audited sales computed by the bank deposit analysis.
13. Respondent issued the January 16, 2019 NOD to appellant.
14. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
15. Respondent held an appeals conference with appellant, and subsequently issued a Decision on May 11, 2020, denying the petition.
16. Appellant timely appealed to the Office of Tax Appeals (OTA).
17. In its original submission to OTA dated August 7, 2020, appellant indicated that it had located POS receipts from 3Q17 through 4Q17 that had not been previously provided. Appellant did not provide the receipts to respondent or to OTA at that time. In later briefs, appellant indicated that it would be willing to provide these new records to respondent and OTA, which "should allow [respondent or OTA] to re-compute a more accurate liability for the taxpayer, as now, only one quarter of the audit period, 2Q18, is not accounted for, on the subject of excess bank deposits."

18. In its final brief dated October 28, 2021, appellant states, "The additional receipts that we have ascertained span from 4Q14 through 2Q16, which were previously unavailable, until recently discovered." Attached to the brief are thousands of pages of documents, including what appear to be thousands of receipts without any real organization or analysis.

DISCUSSION

Issue 1: Is appellant entitled to a reduction to the $47,538 measure of additional unreported taxable sales, which is based on recorded versus reported sales tax reimbursement collected?

Generally, sales tax reimbursement must be remitted to respondent. (R&TC, § 6451.) If a retailer collects sales tax reimbursement in excess of the amount actually due, and the retailer does not timely refund the excess sales tax reimbursement to its customers, such excess sales tax reimbursement must be paid to respondent. (Cal. Code Regs., tit. 18, § 1700(b)(2).) When a taxpayer appeals a determination, 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*.)

Respondent's determination of the $47,538 measure (see Factual Finding 5, above) appears to be both reasonable and rational. Consequently, the burden of proving error and a more accurate determination rests with appellant, who has not contested this measure, either in its appeal to respondent or in its appeal to OTA. Therefore, we find that appellant is not entitled to a reduction to the $47,538 measure of unreported taxable sales, which is based on recorded versus reported sales tax reimbursement collected.

Issue 2: Is appellant entitled to a reduction to the $1,639,809 measure of additional unreported taxable sales, determined using a bank deposit analysis?

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property (TPP) in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) To ensure 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.)

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.) As previously stated, once respondent has met its initial burden, the burden of proof shifts to the taxpayer. (*Appeal of Talavera*, *supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available to respondent for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

Regulation section 1587(b)(2)(A) provides that tax does not apply to sales of feed for food animals or for any non-food animals which are to be sold in the regular course of business. In the absence of evidence to the contrary, sales of feed of a kind ordinarily used *only* in the production of meat, dairy or poultry products for human consumption, sales in small units (two standard sacks of grain or less and/or four bales of hay or less) of feed of a kind customarily used either for food production or other purposes (feeding work stock), and sales of feed that is specifically labeled by the manufacturer for food animals are presumed exempt. (Cal. Code Regs., tit. 18, § 1587(d)(1).) For all other sales, the seller must prove its entitlement to the exemption (*H. J. Heinz Co. v. State Board of Equalization* (1962) 209 Cal.App.2d 1), and it is the seller's responsibility to obtain feed exemption certificates from the buyer (Cal. Code Regs., tit. 18, § 1587(d)(1)).[12] In addition, information on the invoices for sales claimed as exempt should match the information contained on the exemption certificates. (Cal. Code Regs., tit. 18, § 1587(d)(3).)

Here, respondent's preliminary analysis found large unexplained differences between reported total sales, reported gross receipts, and recorded total sales, which were indications that appellant's records were unreliable and that taxable sales reported on the SUTRs may be understated. Thus, respondent was unable to verify sales reported on appellant's SUTRs for the liability period using a direct audit method (that is, compiling audited sales directly from appellant's records). On the basis of the evidence, we find that respondent was justified to question reported sales and use an indirect audit method to compute appellant's sales. A bank deposit analysis is an acceptable sales and use tax audit methodology. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616-617.) Furthermore, we have examined the

[12] Regulation section 1587(d)(1) describes an appropriate form for the exemption certificate.

bank deposit analysis and find that respondent used the methodology correctly to reasonably estimate appellant's taxable sales. Therefore, we conclude that respondent has established that its determination is reasonable and rational. Consequently, the burden shifts to appellant to prove more accurate measures of tax.

Appellant contends that audited taxable sales are based on estimates and argues that bank deposits do not accurately reflect the gross income of the business. Appellant does not identify any specific error in the revised audit. Instead, appellant provides, or more correctly, it offers to provide thousands of additional POS receipts and asserts, in essence, that with these additional records, respondent and OTA should be able to compute a more accurate liability. Alternatively, appellant contends that respondent should have allowed additional deductions from total deposits for claimed exempt sales of hay and personal loans and gifts.

We understand appellant to argue that it has now offered to provide sufficient documentation supporting the POS reports to enable respondent to directly determine audited taxable sales on the basis of POS receipts rather than using the indirect bank deposit analysis method. However, the audit is done, and we have already found that respondent's decision to use the bank deposit analysis was reasonable and rational under the circumstances and that the results of that analysis constitute a reasonable estimate of appellant's liability. Thus, respondent has met its minimal burden of proof. The burden now rests with appellant. To carry that burden and to prevail in this appeal, appellant must provide arguments and evidence to persuade this panel that a measure less than that determined by respondent is more accurate. (*Appeal of Talavera*, *supra*.)

The parties to an appeal choose the methodology each will rely upon to carry their respective burdens. Respondent may determine a liability on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) It is not required to accept the taxpayer's books and records as conclusive evidence of what they purport to represent, even when the books and records are in agreement with each other and with SUTRs. (*Riley B's, Inc. v. State Bd. of Equalization*, *supra*, 61 Cal.App.3d at 615.) Likewise, the taxpayer is also free to select an audit methodology that best serves its purpose of supporting the taxpayer's argument that a lesser liability is more accurate. A taxpayer is not limited to the methodology used by respondent, but whatever arguments and accounting methods a party chooses, they must be sufficient to carry the burden of proof.

Appellant appears to misunderstand what it must do to carry the burden of proof. Responsibility for the analysis of a taxpayer's business records to discover possible audit errors by respondent or to calculate an audit result that is more accurate than the deficiency calculated by respondent rests squarely with the taxpayer. The taxpayer cannot carry its burden by providing – much less by offering to provide – piles of records and inviting OTA to redetermine the liability based on those records (*Appeal of Amaya*, 2021-OTA-328P), which is essentially what appellant attempts to do here. It is incumbent upon a taxpayer to analyze the documents and present its analysis to OTA in some cogent form, pointing out respondent's errors and showing how a more accurate measure can be calculated. Appellant did not do this.

Appellant's alternative argument, that respondent should have allowed additional claimed exempt sales of hay, is also unpersuasive.[13] Although appellant provided in excess of 2,500 new POS receipts, only 11 of those appear to be from the periods tested by respondent, and appellant has not provided corresponding exemption certificates to support an allowance of additional claimed exempt sales of hay.[14] We examined the 11 POS receipts from January 2016 that appellant identified as hay sales and note that three (Nos. 16625, 16803, and 17536) were included in respondent's test, one (No. 16808) was for a taxable sale of hay, and four (Nos. 16843, 17049, 17401, and 17525) totaling $3,630 were not for sales of hay at all, though they were recorded as nontaxable hay sales. While three (Nos. 9859, 16586, and 16636) totaling $78 were for hay sales of four bales or less, including these POS receipts would increase the allowed exempt hay sales to $4,705 ($4,627 + $78) and recorded nontaxable hay sales to $79,087 ($75,379 + $78 + $3,630) which would *decrease* the allowable exempt hay sales ratio from 6.14 percent to 5.95 percent ($4,705 ÷ $79,087).[15] We thus find that appellant has not shown any error in respondent's allowance of deductions (from total deposits) for claimed exempt sales of hay.

[13] We explain in Factual Findings 7 and 8, above, how respondent calculated allowed claimed exempt sales of hay totaling $54,820 ($43,499 + $4,234 + $4,234 + $2,853) during the liability period.

[14] The 11 invoices are from January 2016. As indicated above, respondent's analysis included receipts from January and February 2016 and hay sales summary worksheets for January and February 2018.

[15] Appellant's Excel spreadsheet includes references to various POS receipts in January 2015, February 2016, and April 2016, all with the notation "Hay Non Tax per memo," but that description is merely conclusory; it has no evidentiary value, and there is insufficient purchaser detail and evidence (e.g. exemption certificates) to support that description. Only one sale (in January 2015) listed in the Excel spreadsheet was less than $100, but that sale was not during respondent's test periods.

Appellant's other alternative argument, that respondent incorrectly calculated allowed deductions for personal loans or gifts, also substantially fails. Appellant argues that respondent allowed only $190,000 as loans or gifts from family and appears to argue that it should have allowed loans and gifts totaling $287,500. In fact, respondent allowed loans and gifts totaling $349,688, which is $62,188 more than the amount to which appellant claims entitlement. We could end our analysis here, but out of an abundance of caution we will examine appellant's specific contentions regarding the alleged loans and gifts.

Appellant provided a written statement from a purported donor, the grandmother of appellant's president, describing gifts totaling $170,000, $50,000 in 2014, $50,000 in 2015, and $70,000 in 2017. It also provided copies of seven checks for alleged loans and gifts totaling $207,500 purportedly deposited into appellant's bank account: (1) a $40,000 check dated October 31, 2014 (deposited same date), from appellant's president; (2) a $50,000 check dated March 8, 2015 (deposited March 9, 2015), from the grandmother of appellant's president; (3) a $12,500 check dated May 31, 2016 (deposited June 8, 2016) from the grandmother; (4) a $15,000 check dated July 13, 2016 (deposited same date) purportedly from the mother of appellant's president but drawn on the account of Sunset Beach Bed & Breakfast Sunset Suites (Sunset Suites); (5) a $10,000 check dated August 26, 2016 (deposited same date) from the Sunset Beach account; (6) a $10,000 check dated October 4, 2016 (deposited same date) from the Sunset Beach account, and (7) a $70,000 check dated August 15, 2017 (deposited same date), which appears to have been drawn on a joint account of appellant's president and her mother.[16] We will examine this evidence below.

Aside from the written statement, the only *potential* evidence we have of the grandmother's $50,000 gift in 2014 is respondent's reference to a $54,681 deposit on October 31, 2014; but we also have the president's $40,000 check from that same date, without any other corresponding deposit. Respondent might have allowed a $40,000 loan based on the president's check, or a $50,000 gift based on the grandmother's written statement. It chose to do the latter, which allowed a $10,000 deduction from total deposits for which evidence was marginal. We find that this $50,000 allowance and respondent's refusal to allow an additional $40,000 (on the basis of the president's check in that amount) was appropriate and that appellant has failed to prove otherwise.

[16] The checks are all made payable to appellant, appellant's president, or both.

The grandmother's statement that she gave another $50,000 to appellant's president is consistent with the copy of the March 8, 2015 check (No. 2, above) and with the evidence of the deposit of a like amount the following day. This item is not in dispute.

The evidence indicates that the third check, in the amount of $12,500 and also signed by the grandmother, was deposited on June 8, 2016. However, while the audit work papers show that there was a confirmed $18,808.88 deposit on June 8, 2016, appellant claimed during the audit that this deposit included $12,000 received in an exempt sale of cattle. The deposit appears to be the only evidence that supports this claim. We find that respondent gave appellant the benefit of the doubt when it allowed the $12,000 adjustment for the claimed exempt sale of cattle based only on the June 8, 2016 deposit. Had appellant not made a conflicting claim, it is unlikely that we would have disturbed respondent's allowance; but appellant has made a conflicting claim, one which essentially negates the only evidence that supported appellant's claimed exempt sale of cattle. Given the evidence that the grandmother's check was deposited on June 8, 2016, we cannot rely on the June 8, 2016 deposit to explain two transactions in the approximate amount of $12,000, and there is no evidence of any other large deposits that could support the other claimed deduction. Although it could be argued that appellant accepted the benefit of that allowed claimed occasional sale of cattle and should not now be allowed the benefit of any part of the claimed $12,500 loan or gift, we must follow the evidence; and while OTA generally will not disallow what respondent has allowed, these circumstances warrant an exception. The evidence shows that the $12,500 check was deposited on June 8, 2016. We therefore find that the deduction from total deposits of allowed personal loans or gifts shall be increased by $12,500, from $349,688 to $362,188. However, because appellant's claimed occasional sale of cattle for $12,000 is now unsupported, that allowance shall be reversed, which will result in a $12,000 *increase* (from $99,000 to $111,000) to the measure of additional unreported taxable sales based on disallowed netted occasional sales. The net result is a $500 reduction in measure benefitting appellant.

It appears that something similar occurred with regard to the fourth check listed above, a $15,000 check from the president's mother. During the audit, appellant claimed that the $15,000 deposited on July 13, 2016, was from a nontaxable, occasional sale of a horse or an all-terrain vehicle (ATV).[17] We find that, similar to what occurred with appellant's claimed exempt sale of

[17] The audit work papers refer to the ATV as a "Gator."

cattle, respondent gave appellant the benefit of the doubt and allowed an adjustment for the claimed nontaxable occasional sale based only on the confirmed large deposit and appellant's statement. However, the evidence now shows that the mother's $15,000 check was deposited on July 13, 2016, and there is now no evidence that supports appellant's claimed $15,000 occasional sale. Consequently, we find that the deduction from total deposits of allowed personal loans or gifts shall be increased by an additional $15,000, from $362,188 to $377,188, while the measure of additional unreported taxable sales based on disallowed netted occasional sales shall again be increased by the same amount from $111,000 to $126,000.

The fifth, sixth, and seventh checks listed above, totaling $90,000, appear to have been deposited on the dates they were written. Respondent allowed all as loans or gifts, and they are not in dispute.

We have now discussed all of the adjustments for loans and gifts claimed by appellant, totaling $287,500. Respondent had already allowed all but the two that we allowed, above, with corresponding increases to the measure of additional unreported taxable sales based on disallowed netted occasional sales. No additional adjustments are warranted by the evidence. Furthermore, although we find little in the record to support the three additional deductions allowed by respondent, we will not disturb them.[18]

In summary, we find that appellant is entitled to a $27,500 reduction to the $1,639,809 measure of unreported taxable sales, determined using a bank deposit analysis, but only in exchange for a $27,000 increase to the measure of additional unreported taxable sales based on disallowed netted occasional sales. If completed, these adjustments would decrease the measure of unreported taxable sales, determined using a bank deposit analysis, to $1,612,309 and increase the measure of additional unreported taxable sales based on disallowed netted occasional sales from $99,000 to $126,000.

Issue 3: Is appellant entitled to a reduction to the $3,994 measure of out-of-state purchases subject to use tax?

When sales tax does not apply, use tax applies to the storage, use, or other consumption of TPP purchased from any retailer for storage, use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (R&TC,

[18] Respondent also allowed: (1) a $9,440 deposit on January 5, 2017; (2) a $10,031 deposit on May 1, 2017; and (3) a $70,217 deposit on June 19, 2018.

§§ 6201, 6401.) The person who stores, uses, or otherwise consumes in this state TPP purchased ex-tax[19] from a retailer is responsible for payment of the tax. (R&TC, § 6202.) TPP sold by any person for delivery in this state is presumed to have been sold for storage, use, or other consumption in this state until the contrary is established. (R&TC, § 6241.)

Respondent determined that during the liability period appellant purchased shelving units ex-tax from an out-of-state vendor at a cost of $3,994. Because appellant's business location at the time was in California, respondent included this use tax measure in appellant's deficiency measure. It appears from the evidence that use tax is due in connection with appellant's purchase of the shelving units. On that basis, we find that respondent has carried its minimal burden, and the burden shifts to appellant to show error and a measure of tax more accurate than that determined by respondent. Appellant has presented no specific arguments or evidence to support its position. Therefore, we find that appellant is not entitled to a reduction to the $3,994 measure of out-of-state purchases subject to use tax.

Issue 4: Did respondent correctly impose the negligence penalty?

As relevant here, if any part of a liability for which a deficiency determination is made is due to negligence, respondent must add a penalty equal to 10 percent of the amount of the determination. (R&TC, § 6484.) Although the term "negligence" in not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal. App. 5th 1129, 1157.) As previously stated, a taxpayer must maintain and make available for examination on request by respondent 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 returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: 1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; 2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and 3) 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 is evidence of negligence and may result in imposition of a negligence penalty. (Cal. Code Regs.,

[19] In this context, the term "ex-tax" means without the payment of sales tax reimbursement or use tax.

tit. 18, § 1698(k).) A negligence penalty also can be based on reporting errors. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318.) Respondent relies on both grounds here.

Generally, a penalty for negligence should not be added to deficiency determinations made in the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Conversely, though, a negligence penalty can be upheld in a first audit if there is evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. (*Ibid*.)

In its initial brief, appellant argued that the negligence penalty should be waived because this was its first audit. Appellant goes on the explain that it reasonably relied on its POS system and QuickBooks to create and maintain adequate books and records, and that problems with the POS system "led to incorrect transactions being input and improperly notated on the system." Appellant claimed that the company from whom appellant purchased the system provided a letter, but appellant has not submitted that letter to OTA. In its later briefs, appellant seems to agree that the negligence penalty was correctly imposed, but it predicted that "the receipts that will be produced" should result in a lower penalty.

The evidence indicates that appellant did not exercise ordinary and reasonable care to maintain and provide its books and records. According to appellant, all sales were recorded in its POS system, and it used POS data to produce POS reports from which appellant prepared its SUTRs. However, appellant did not provide all POS data and reports or any other books or records adequate for the audit. We find that these failures were the result of negligence.

Appellant also appears to have exercised little care to report accurately. It substantially underreported its total sales, did not report any of the $339,203 in audited sales in interstate commerce or the $47,075 in audited exempt sales to Indians, and it failed to prove its entitlement

to most of the claimed deductions.[20] We find that these failures were also the result of negligence.

Although this was appellant's first audit, we cannot attribute these failures to appellant's good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. Appellant never provided a reasonable and credible explanation for its multiple failures. The evidence does not indicate there was a problem with either QuickBooks or the POS system. Even if there were issues with the POS system, that would not explain why appellant did not provide all the records upon which its SUTRs were allegedly based. Consequently, we find that respondent correctly imposed the negligence penalty.

[20] As indicated in Factual Finding 2, appellant claimed deductions of $39,517 for sales for resale, $24,105 for returns of merchandise, $897,416 for "other," which appellant explained as sales of animal feed, and $5,007 for sales to tax-exempt nonprofit organizations. Respondent did not examine claimed returns of merchandise and appellant was able to support no sales for resale, no nontaxable sales to tax-exempt nonprofit organizations (because there is no such exclusion or exemption) and only about 6 percent of its claimed "other" deduction.

HOLDINGS

1. Appellant is entitled to a $27,500 reduction to the $1,639,809 measure of unreported taxable sales, determined using a bank deposit analysis, but only in exchange for a $27,000 increase to the $99,000 measure of additional unreported taxable sales based on disallowed netted occasional sales.
2. Appellant is not entitled to a reduction to the $47,538 measure of additional unreported taxable sales, which is based on recorded versus reported sales tax reimbursement collected.
3. Appellant is not entitled to a reduction to the $3,994 measure of out-of-state purchases subject to use tax.
4. Respondent correctly imposed the negligence penalty.

DISPOSITION

The measure of unreported taxable sales, determined using a bank deposit analysis, shall be decreased by $27,500 from $1,639,809 to $1,612,309, and the measure of additional unreported taxable sales based on disallowed netted occasional sales shall be increased by $27,000 from $99,000 to $126,000, but respondent's action denying the petition shall be sustained is all other respects.

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

We concur:

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

DocuSigned by:
Natasha Ralston
25F8FE08EF56478...
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Date Issued: 3/8/2022