

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 21088358
WILLIAM B LLC) CDTFA Case ID 531-787
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OPINION

Representing the Parties:

For Appellant: Victor J. Yoo, Attorney

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Deborah Cumins,
Business Taxes Specialist III

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, William B LLC (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying appellant’s petition for redetermination of a Notice of Determination (NOD), dated March 7, 2019. The NOD is for a tax of \$857,531, applicable interest, and a negligence penalty of \$85,753.08 for the period January 1, 2016, through December 31, 2018 (liability period). By letter dated August 21, 2020, respondent notified appellant of a claim for an increase to the NOD pursuant to R&TC section 6563, which increased the tax and penalty to \$1,034,287 and \$103,428.11, respectively.

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

ISSUES

1. Whether appellant has shown that further adjustments are warranted to the determined measure of tax.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, “respondent” shall refer to BOE.

2. Whether appellant was negligent.

FACTUAL FINDINGS

1. During the liability period, appellant operated nine clothing stores in California.
2. For the liability period, appellant reported total taxable sales of \$3,538,730. Appellant did not claim any deductions.
3. Upon audit, appellant did not provide any books or records. However, respondent was able to obtain appellant's federal income tax returns (FITRs) for 2015 and 2016 and appellant's Form 1099-K² information for 2015, 2016, and 2017.
4. Using the 2015 and 2016 FITR information, respondent computed a book markup of 142.35 percent for 2015, 159.02 percent for 2016, and 151.94 percent for the two years combined. Although respondent expected a larger markup for this type of business, respondent nevertheless concluded that this information was the best available evidence of appellant's taxable sales for 2016. Accordingly, respondent compared appellant's total sales reported on its 2016 FITR of \$3,439,808 to appellant's total reported taxable sales on its sales and use tax returns (SUTRs) for 2016 of \$854,083. This resulted in a deficiency measure of \$2,585,725 ($\$3,439,808 - \$854,083$) for 2016.³
5. For 2017, respondent used appellant's Form 1099-K information to determine a deficiency measure of \$3,852,918. Specifically, respondent compiled total credit card receipts for 2015 and 2016, reduced the total credit card receipts by the sales tax reimbursement included therein, and compared the balance to the total reported sales on appellant's 2015 and 2016 FITRs. Based on this comparison, respondent calculated a credit card sales to total sales ratio (credit card sales ratio) of 84.94 percent. Respondent then divided appellant's 2017 total credit card receipts by the credit card sales ratio of 84.94 percent to arrive at total audited taxable sales, which was then reduced by appellant's 2017 total reported taxable sales. This resulted in the deficiency measure of \$3,852,918.

² Federal Form 1099-K, "Payment Card and Third Party Network Transactions," is a form used by credit card companies and third-party processors (payment settlement agencies) to report the gross amount of reportable payments made to the taxpayer by the payment settlement agency.

³ If respondent used a credit card sales ratio for 2016, respondent would have determined an even greater deficiency measure. As a result, using appellant's reported total sales from its 2016 FITR benefits appellant.

6. Lastly, for 2018, respondent did not have appellant's 2018 FITR or Form 1099-K information at the time of the audit. As a result, respondent estimated appellant's taxable sales for 2018 by calculating an error ratio of 224.24 percent between appellant's total reported sales on its 2015 and 2016 FITRs and appellant's total reported taxable sales on its corresponding SUTRs. Respondent applied the 224.24 error ratio to appellant's 2018 total reported taxable sales on its SUTRs to determine a deficiency measure of \$3,101,697.
7. In total, respondent determined a deficiency measure of \$9,540,340 (\$2,585,725 + \$3,852,918 + \$3,101,697). Respondent also concluded that appellant was negligent.
8. On March 7, 2019, respondent issued the NOD for tax of \$857,531 and a negligence penalty of \$85,753.08.
9. Appellant timely filed a petition for redetermination disputing the NOD in its entirety.
10. Subsequently, respondent obtained appellant's 2018 Form 1099-K information and conducted a reaudit of appellant's 2018 liability. Using the same credit card sales ratio method in calculating appellant's 2017 tax deficiency, respondent determined a deficiency of \$5,099,120 for 2018, which was greater than the originally determined deficiency measure of \$3,101,697. Respondent increased the March 7, 2019 NOD by this amount and notified appellant of the claim of increase by letter dated August 21, 2020, pursuant to R&TC section 6563.
11. Appellant continued to dispute respondent's determination, which included the increased amount.
12. Respondent issued a Decision dated July 1, 2021, denying appellant's petition for redetermination.
13. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has shown that further adjustments are warranted to the determined measure of tax.

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

proper administration of the Sales and Use Tax Law and to prevent evasion of the sales tax, the law presumes that all gross receipts are subject to 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 respondent is not satisfied with the amount of tax reported by the taxpayer, or if any person fails to make 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.) In the case of an 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.*)

Here, appellant did not provide any books and records upon audit. As a result, respondent used different indirect methods to estimate appellant's taxable sales for the liability period. Specifically, respondent used information from appellant's 2015 and 2016 FITRs and 2017 and 2018 Form 1099-Ks,⁴ and respondent estimated appellant's taxable sales for the liability period. We find that respondent used the best available evidence to determine appellant's deficiency measure. Therefore, we conclude that respondent has demonstrated that its determination is both reasonable and rational, and appellant has the burden to establish that any additional adjustments are warranted.

On appeal, appellant argues that respondent's audit uses pure approximation and speculation. While there is no dispute that respondent's audit of appellant's business uses estimates and different audit methods to calculate the deficiency determination, we note that appellant did not provide any books and records for respondent to audit. Thus, respondent's only option was to use different indirect audit methods with the available information that respondent was able to obtain. Furthermore, in situations where taxpayers fail to provide sufficient books and records, it is appropriate for respondent to use the credit card sales ratio method, an indirect audit method. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) Therefore, we find that appellant's argument does not warrant any adjustments to the determined measure of tax.

⁴ Respondent obtained this information through its own resources and not from appellant.

Appellant also states that it has provided adequate supporting documentation to show that its reported taxable sales are accurate.⁵ However, appellant has not provided such documentation to the Office of Tax Appeals. In addition, the exhibits provided by respondent do not contain any indication or record of appellant's submission of such documentation at any time during the audit or appeals process. As a result, we find this argument to be unpersuasive.

Based on the forgoing, we find that appellant has not met its burden of proof.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto.

As previously stated, taxpayers are required to maintain and make available for examination on request by respondent, or its authorized representative, 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 SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) 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, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Appellant has not specifically protested the application of the negligence penalty. However, appellant's general argument that it properly reported all of its taxable sales can also be interpreted to mean that appellant is protesting the negligence penalty.

Here, the audited understatement of taxable sales is substantial, both in the overall

⁵ Appellant also states that it has provided proof of alcohol sales and argues that respondent has made no effort to collect data from third party alcohol vendors. Since appellant is a clothing retailer, and there is no evidence in the record of alcohol sales, we presume that these comments were inadvertently included in the opening brief, and we do not address them any further.

amount (\$11,537,763) and in the percentage of error when compared to reported amounts (326 percent).⁶ This substantial understatement is evidence of negligence, and appellant has not provided an explanation for the substantial understatement of taxable sales. In addition, appellant did not provide any books and records for respondent to examine in respondent's audit of the business, which is also evidence of negligence. Appellant has not provided a sufficient explanation for its substantial understatement except to assert that it provided all documentation necessary to support its position. However, appellant has not provided any such supporting documentation to either respondent or the Office of Tax Appeals. Therefore, we find that appellant was negligent.

HOLDINGS

1. Appellant has not shown that further adjustments are warranted to the determined measure of tax.
2. Appellant was negligent.

DISPOSITION

Respondent's action is sustained.

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Daniel Cho

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Daniel K. Cho

Administrative Law Judge

We concur:

DocuSigned by:

Andrew Wong

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Andrew Wong

Administrative Law Judge

DocuSigned by:

Kenneth Gast

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Kenneth Gast

Administrative Law Judge

Date Issued: 3/21/2022

⁶ \$11,537,763 ÷ \$3,538,730 = 326.04 percent.