

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18053078
A1 AUTO AND) CDTFA Case ID 919733
TRUCK SERVICES, INC.)
 _____)

OPINION

Representing the Parties:

For Appellant: Jack T. Ferguson, CPA

For Respondent: Ravinder Sharma, Hearing Representative
Christopher Brooks, Tax Counsel IV
Jason Parker, Chief of Headquarters
OperationsFor Office of Tax Appeals: Richard A. Zellmer,
Business Taxes Specialist III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A1 Auto and Truck Services, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's petition for redetermination of the Notice of Determination (NOD) dated July 30, 2015. The NOD is for tax of \$11,512.72, and applicable interest, for the period July 1, 2011, through September 30, 2014 (liability period).

Office of Tax Appeals Administrative Law Judges Sara A. Hosey, Andrew Wong, and Keith T. Long held an oral hearing for this matter on March 29, 2022.² At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

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

² The electronic hearing was originally noticed for Cerritos, California.

ISSUE

Whether appellant has shown that additional adjustments to the deficiency measure are warranted.

FACTUAL FINDINGS

1. Appellant operated an automobile and truck repair shop specializing in import automobiles from January 1, 2008, through October 31, 2015. During the liability period, appellant reported taxable sales of \$448,883 to CDTFA.
2. CDTFA audited appellant for the liability period. Appellant did not provide a complete set of books and records for the audit.³ Appellant explained to CDTFA that it used sales tax worksheets to prepare its sales and use tax returns, and that it did not report repair labor on its sales and use tax returns. However, appellant did not provide the sales tax worksheets for audit. Instead, appellant provided federal income tax returns for 2011, 2012, and 2013; profit and loss (P&L) statements for the liability period; incomplete sales and purchase invoices; and bank statements for the liability period.
3. For the audit, CDTFA compared the taxable sales that appellant reported on its sales and use tax returns to the total sales of parts that appellant recorded in its P&L statements and found that appellant's recorded parts purchases exceeded its reported taxable sales. CDTFA calculated a negative book markup⁴ throughout the liability period. CDTFA expected the book markup for this type of business to be in the range of positive 20 to 30 percent. Based on this information, CDTFA determined that further investigation was warranted.

³ On appeal, appellant contends that it provided a complete set of invoices and reconstructed records to CDTFA. However, appellant concedes that many of the original records were damaged by water resulting from a roof leak and by a rat infestation. Further, in a letter to CDTFA dated November 7, 2017, appellant stated “[t]he documents were ruined and covered in dirt, roofing tar and not readable.” Thus, we find that the books and records provided to CDTFA were not complete because they were damaged to the point of being unreadable.

⁴ “Markup is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent ($0.30 \div 0.70 = 0.42857$). A “book markup” (sometimes referred to as an “achieved markup”) is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent ($0.30 \div 1.00 = 0.3$).

4. CDTFA performed a shelf test, which is an accounting comparison of known costs and associated selling prices. CDTFA compared the costs recorded on appellant's purchase invoices to the selling price recorded on appellant's sales invoices for August 2011, September 2011, September 2012, October 2012, August 2013, and September 2013, and found an audited markup of 27.19 percent.
5. CDTFA reviewed appellant's P&L statements to determine appellant's total recorded parts purchases for the liability period. CDTFA reduced appellant's purchases to allow for pilferage, spoilage, and theft (shrinkage) by 1 percent for the period July 1, 2011, through December 31, 2012, and by 2 percent for the period January 1, 2013, through September 30, 2014, and found audited cost of goods sold (COGS) of \$468,129 for the liability period. CDTFA applied the audited markup of 27.19 percent from the shelf test to the audited COGS and found audited taxable sales of \$595,414 for the liability period. CDTFA compared the audited taxable sales to appellant's reported taxable sales of \$448,883 and found unreported taxable sales of \$146,531.
6. CDTFA issued appellant the NOD for the audited unreported taxable sales.
7. Appellant filed a timely petition for redetermination disputing the NOD. On February 2, 2018, CDTFA issued a decision reducing the audited markup from 27.19 percent to 25.08 percent,⁵ and reducing appellant's COGS for non-merchandise purchases.⁶ CDTFA prepared a reaudit, which reduced the taxable measure from \$146,531 to \$129,455. This timely appeal followed.

DISCUSSION

California imposes on 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, § 6051.) For the purpose of 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,

⁵ CDTFA's reduction of the markup is based on its finding that certain discounted sales were erroneously omitted from the audit shelf test.

⁶ CDTFA's reduction of COGS is based on evidence introduced by appellant during the CDTFA appeals process that one of its suppliers charged for advertising and other fees, which were erroneously recorded as parts purchases.

§ 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 the taxpayer, or if any 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 of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide a complete set of books and records for the audit. During CDTFA's appeals process, appellant stated that some of the requested records were damaged and unreadable. (See footnote 3.) CDTFA examined the available books and found discrepancies that could not be explained. CDTFA compared the taxable sales that appellant reported on its sales and use tax returns to the purchases of parts that appellant recorded on its P&L statements and found a negative book markup. This means that appellant consistently reported the sale of parts at prices less than their cost during the liability period. CDTFA also compared the purchases recorded on appellant's P&L statements to the sales of parts that appellant recorded on its invoices, CDTFA found an audited markup of 27.19 percent. Upon reaudit, the audited markup was reduced to 25.08 percent.

When CDTFA cannot compute taxable sales from appellant's records, it is appropriate to use an indirect audit method. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) To calculate the taxable measure, CDTFA used appellant's P&L statements and sales invoices to calculate appellant's audited markup, which it then used to calculate the taxable measure. The markup method is a standard and accepted audit procedures. (*Appeal of Amaya*, 2021-OTA-328P.) Thus, given appellant's failure to provide a complete or legible set of books and records, we conclude that it was reasonable for CDTFA to use the markup method to calculate appellant's audited taxable sales. Accordingly, the burden of proof shifts to appellant to establish that a different result is warranted. (*Appeal of Talavera, supra.*)

Appellant contends that CDTFA used industry averages to determine the taxable measure. However, as discussed above, CDTFA used appellant's own books and records (i.e., P&L statements and invoices) to calculate the audited taxable sales.

Next, appellant contends that during the liability period it was required to reduce prices due to local economic conditions. In support, appellant provided coupons advertising discounted prices.⁷ However, CDTFA's reaudit reduced the markup rate from 27.19 percent to 25.08 percent to account for discounted sales. There is no way to determine from appellant's coupons alone whether the markup on discounted sales was less than the 25.08 percent markup computed by CDTFA during the reaudit. As such, we find no basis to further reduce the audited markup.

Finally, appellant asserts without evidence that it was the victim of theft by its owner's brother. Appellant's unsupported assertions are not sufficient to satisfy its burden of proof. (See *Appeal of Talavera, supra.*) Accordingly, we find that no reduction to the taxable measure for pilferage is warranted beyond the amounts CDTFA allowed for shrinkage during the audit. Based on the foregoing, we find that no adjustments are warranted.

⁷ Not all the coupons that appellant provided were issued during the liability period.

HOLDING

Appellant has not shown that any additional adjustments to the deficiency measure are warranted.

DISPOSITION

We sustain CDTFA’s decision to reduce the taxable measure to \$129,445 and to otherwise deny the petition for redetermination.

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Keith T. Long
Administrative Law Judge

We concur:

DocuSigned by:



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Andrew Wong
Administrative Law Judge

DocuSigned by:



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Sara A. Hosey
Administrative Law Judge

Date Issued: 4/19/2022