OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No.: 20046148
	) CDTFA Case ID: 578948
H. NAVARRO,	)
dba La Puente Tire	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Heidi Cheng, Attorney H. Navarro, Appellant
For Respondent:	Nalan Samarawickrema, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals (OTA):	Deborah Cumins, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, H. Navarro, dba La Puente Tire (appellant) appeals a decision and recommendation (D&R) 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 21, 2011. The NOD is for tax of $542,044.31, a fraud penalty of $135,511.16, and applicable interest, for the period April 1, 2005, through December 31, 2009 (liability period).

Office of Tax Appeals Administrative Law Judges Andrea L.H. Long, Andrew Wong, and Josh Aldrich held a virtual oral hearing for this matter on November 19, 2021. At the

[1] Sales and use taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

conclusion of the hearing, the record was held open for additional briefing. After the additional briefing period, the record closed effective January 20, 2022.

ISSUES

1. Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales.
2. Whether CDTFA has established, by clear and convincing evidence, that the understatement was the result of fraud.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, began operating a tire shop on April 1, 2005, making retail sales and providing related services.[2] The business continued operating through September 14, 2010, when appellant reorganized as a corporation.
2. Appellant applied for seller's permit on June 1, 2005, with a retroactive start date of April 1, 2005. On the application, appellant reported projected monthly gross sales at $50,000 and identified Dapper Tire Company (Dapper) as a major California-based supplier from whom he would purchase tires. The application for seller's permit indicates that appellant was provided with the following publications: Publication 51 (Tax Products and Services for Small Business: Resource Guide), Publication 70 (Understanding Your Rights as California Taxpayer), Publication 73 (Your Seller's Permit), and Publication 74 (Closing Out Your Account).
3. CDTFA initiated an audit of the period January 1, 2007, through December 31, 2009. During that period, appellant reported total sales of $2,722,478,[3] claimed deductions of nontaxable labor of $626,897 and sales tax included of $167,060, and reported taxable sales of $1,928,521. After CDTFA concluded that the audited understatement was the

[2] According to the Report of Field Audit - Revised: "Taxpayer sells mainly tires and some parts for automobile[s]. Also, taxpayer provides services for installing new and used tires, repair of used tires, alignment of wheels, rotation, shocks, and brakes. Tires and parts were purchased ex-tax. Small tools were purchased [on a] tax-paid basis. Sales were mostly retail sales. There were some minimal sales for resale."

[3] For 2007, 2008, and 2009, appellant reported total sales of $2,722,478 or $821,974, $831,321, and $1,069,183 respectively. After subtracting the $167,060 sales tax included deduction, appellant reported total sales ex-tax of $2,555,418 for the liability period. In general, ex-tax means without payment of California sales tax reimbursement or use tax.

result of fraud, it extended the audit period to include the period April 1, 2005, through December 31, 2006.

4. During the liability period, appellant reported total sales of $4,226,371; claimed deductions of $1,224,055 for nontaxable labor and $233,876 for sales tax included in reported total sales; and reported taxable sales of $2,768,380.[4]

5. For audit, appellant provided federal income tax returns (FITRs) for 2007 and 2008. When CDTFA extended the audit period to include the earlier periods, appellant also provided Schedule C of his FITR for 2006. For the years 2007, 2008, and 2009, appellant also provided statements of income, bank statements, partial sales invoices (which were not numbered), and merchandise purchase invoices. Appellant did not provide a general ledger, a sales journal, a purchase journal, or any other summary record of sales or purchases.

6. In its preliminary examination, CDTFA found that the total sales reported on FITRs substantially reconciled with the amounts reported on sales and use tax returns (SUTRs). CDTFA compared the taxable sales of tangible personal property (TPP) reported on SUTRs to the recorded costs of goods sold to compute book markups of 6.27 percent for 2007, 0.01 percent for 2008, and 3.17 percent for 2009, which were lower than the markup CDTFA expected (from 30 to 50 percent).[5]

7. CDTFA also found that bank deposits exceeded total sales reported on SUTRs by $1,221,376 for 2007, $1,432,815 for 2008, and $1,090,674 for 2009.[6]

8. Because the book markups were substantially lower than expected, and because appellant was unable to explain the substantial differences between amounts deposited in the bank

[4] Total claimed deductions of $1,224,055 includes $51,684 that appellant claimed as exempt sales of food. The reported taxable sales are as follows: [($4,226,371 - $1,224,055) - $233,876] = $2,768,440. This difference of $60 represents an unexplained difference between the claimed deduction detail and the claimed deduction total for the fourth quarter of 2005 (4Q05).

[5] "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 $.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 (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup) is one that is calculated from the retailer's records. Here, recorded costs of goods sold were the amounts reported on FITRs for 2007 and 2008 and the amount recorded on the statement of income for 2009.

[6] CDTFA verified that there were no loans during the liability period and concluded that the bank deposits were all income deposits. In this comparison, CDTFA reduced the bank deposits and the amounts reported on SUTRs by the amount of sales tax reimbursement included.

and sales reported on his SUTRs, CDTFA concluded that further investigation was warranted.

9. CDTFA calculated audited taxable sales on a markup basis. CDTFA conducted a shelf test using sales invoices dated from July 1, 2008, through July 10, 2008.[7] Appellant provided sales invoices for that period, and CDTFA asked him to clarify the item(s) sold on each invoice and to provide the related purchase costs.[8] Using the known selling prices and costs, CDTFA computed an audited markup of 17.45 percent for retail sales of parts.

10. In its review of invoices, CDTFA found several sales to Consumer Auto on which no sales tax reimbursement had been charged. Appellant provided a valid resale certificate from the customer as evidence that the sales were for resale. CDTFA reviewed appellant's invoices for the month of July 2008 and found five sales to Consumer Auto, which CDTFA used (along with known costs) to compute a markup for sales for resale of 33.29 percent.

11. Appellant stated that sales for resale were not reported on his SUTRs. Using a schedule of sales for 2007, which appellant provided, CDTFA computed a ratio of sales for resale of 1.51 percent of reported taxable sales for 2007.

12. Since appellant's purchase records were incomplete, CDTFA requested purchase information from appellant's 12 known suppliers. Eight of the 12 suppliers provided information regarding their sales to appellant for calendar years 2007, 2008, and 2009. The purchases from those eight suppliers were totaled and compared to the amounts of purchases from the same eight suppliers that were recorded in appellant's statements of income to compute understatements as follows:

    a. For 2007, there were $1,122,043 in purchases according to the information supplied by vendors, compared to appellant's $344,712 in recorded costs of goods sold. The difference is $771,331 or 225.5 percent for 2007 [($1,122,043 - $344,712) ÷ $344,712 = 2.255].

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

[8] The auditor randomly verified the costs provided by appellant by referring to purchase invoices.

b. For 2008, there were $1,260,876 in purchases according to the information supplied by vendors, compared to appellant's $335,089 in recorded costs of goods sold. The difference is $925,787 or 276.28 percent [($1,260,876 - $335,089) ÷ $335,089 = 2.7628].

c. For 2009, there were $1,436,029 in purchases according to the information supplied by vendors, compared to appellant's $486,214 in recorded costs of goods sold. The difference is $949,815 or 195.35% [($1,436,029 - $486,214) ÷ $486,214 = 1.9535].

13. For 2007, 2008, and 2009, appellant recorded purchases from Dapper of $627, $1,479, and $0, respectively. In contrast, Dapper identified sales to appellant in the amounts of $653,284, $622,233, and $679,139, respectively.

14. Two of the suppliers, TDW The Hercules Tire (TDW) and Dapper also provided information regarding their sales to appellant for the period April 1, 2005, through December 31, 2006. For 2006, TDW and Dapper identified purchases by appellant of $218,115 and $622,352, respectively (a total of $840,467).

15. CDTFA used audited purchase information, based on documents provided by eight of appellant's vendors for 2007, to compute that appellant's purchases from the other six vendors in 2007 represented 19.87 percent of his purchases from TDW and Dapper.[9] Accordingly, to compute audited purchases for 2006 of $1,007,468 from those eight suppliers, CDTFA multiplied $840,467 by 1.1987. CDTFA computed that audited purchases for 2006 exceeded recorded purchases by 100.30 percent.[10]

16. CDTFA computed audited purchases by increasing recorded purchases for 2006, 2007, 2008, and 2009 by the computed percentages of understatement in recorded purchases. Audited purchases for 2006, 2007, 2008, and 2009, were $1,007,451, $1,763,777, $2,110,483, and $2,192,619, respectively. It reduced the amount for each year by the

[9] $1,122,043 purchases from eight vendors - $936,024 purchases from TDW and Dapper = $186,019. $186,019 ÷ $936,024 = 19.87 percent.

[10] $1,007,468 - $502,971 = $504,497. $504,497 ÷ $502,971 = 100.30 percent.

audited cost of sales for resale.[11] CDTFA then added a markup of 17.45 percent to establish audited taxable sales.

17. CDTFA compared audited and reported taxable sales to compute percentages of understatement of reported amounts of 139.58 percent for 2006, 257.50 percent for 2007, 322.16 percent for 2008, and 234.91 percent for 2009. It applied those percentages of error to reported taxable sales for the relevant years. Then it applied the lowest percentage from 2006, 139.58 percent, to reported amounts for the period April 1, 2005, through December 31, 2005, to compute an understatement of reported taxable sales of $6,343,667 for the liability period.[12]

18. CDTFA noted the substantial, recurring understatements and noted that the purchases identified by eight of appellant's suppliers exceeded the total sales appellant reported on his SUTRs (including nontaxable labor and sales tax) for each of the years 2006 through 2009. CDTFA also noted the substantial understatements of recorded purchases and the broad discrepancies between reported sales and the amounts appellant deposited in the bank. As a result of these observations, CDTFA concluded that the understatement was the result of fraud or intent to evade the tax.

19. On June 8, 2011, CDTFA issued a memorandum, which recommended the imposition of the 25 percent fraud penalty. CDTFA's analysis focused on the following:

    a. The substantial discrepancies between audited and reported taxable sales.
    b. Tax or tax reimbursement was properly charged on sales invoices, indicating knowledge of the law.
    c. Appellant filed SUTRs.
    d. The inadequacy of appellant's books and records. The fact that appellant utilized sales invoices that did not contain any invoice numbers. The error rates of under-recorded purchases. That appellant consistently under-

[11] To establish the audited sales for resale, CDTFA applied 1.51 percent to reported taxable sales. To compute the cost of the sales for resale, CDTFA divided the amounts of sales by 1.3329, the audited markup for sales for resale plus 100 percent.

[12] The audited understatements, from 2Q05 through 4Q09, are as follows: $162,942 for 2Q05; $184,449 for 3Q05; $139,337 for 4Q05; $166,612 for 1Q06; $171,565 for 2Q06; $187,245 for 3Q06; $160,125 for 4Q06; $297,639 for 1Q07; $396,272 for 2Q07; $397,270 for 3Q07; $395,384 for 4Q07; $524,141 for 1Q08; $502,673 for 2Q08; $465,550 for 3Q08; $393,290 for 4Q08; $415,868 for 1Q09; $411,555 for 2Q09; $501,700 for 3Q09; and $470,041 for 4Q09.

recorded purchases. The magnitude of the under-recorded purchases (over $4 million). Also, the fact that bank deposits exceeded gross receipts by $3,744,865 for the period of January 2007 through December 2009.

CDTFA concluded that the understatements were not the result of an honest mistake or negligence. CDTFA found, instead, that appellant chose to not record purchases in an attempt to conceal the magnitude of the business operations, with the intent to evade tax on a large portion of his sales.

20. On July 21, 2011, CDTFA issued an NOD for tax of $542,044.31, a fraud penalty of $135,511.16, and applicable interest.[13]
21. On August 1, 2011, appellant filed a petition for redetermination.
22. On July 10, 2013, CDTFA issued a D&R recommending denial of the petition.
23. Appellant requested an oral hearing before the board. A hearing was scheduled, and then rescheduled on various dates between February 2014, and February 2016, but a hearing was not held before the board.
24. The matter was then transferred to OTA.

DISCUSSION

Issue 1: Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales.

California imposes on retailers a sales tax measured by the retailer's gross receipts from the retail sale of TPP 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 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).)

[13] The July 21, 2011 NOD was timely issued for the years 2007, 2008, and 2009 because appellant agreed to extend CDTFA's deadline for issuing an NOD for those years until October 31, 2011. The NOD would be timely issued for the period April 1, 2005, through December 31, 2006, only if we uphold CDTFA's finding of fraud. (R&TC, § 6487.)

If CDTFA is not satisfied with the amount of tax reported by any taxpayer, or if any taxpayer fails to make a return, CDTFA may determine the amount required to be paid on the basis of any information within its possession or that 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*.)

In this case, appellant did not provide complete records to CDTFA, and the available records conflicted with one another. Under those circumstances, CDTFA's use of an alternate audit method was warranted. The markup method is a recognized and accepted accounting procedure (*Appeal of Amaya*, 2021-OTA-328P), and, in consideration of the available records and information from suppliers, we find that the markup method was appropriate in this matter. Accordingly, we find that CDTFA has shown that its determination was reasonable and rational. Therefore, appellant has the burden of establishing that adjustments are warranted.

Although appellant's argument primarily focuses on fraud, which we address later in this Opinion, appellant does dispute the measure of audited taxable sales. Appellant's primary contention regarding the audited measure is that unknown individuals made unauthorized cash purchases using his account with his suppliers. Appellant testified that he discovered, sometime before the audit was completed, that four of his suppliers were selling to other individuals under his account. Appellant recalled that one time he went to buy tires from Turbo Wholesale Tires, and they asked if he was there to pick up a large quantity of tires that were ordered the day before, even though he had not ordered any tires. Appellant indicated that this happened on two other occasions with a different supplier. Appellant also identified Valley Auto Parts and Walnut Auto Parts as suppliers that were selling to unauthorized persons under his account.

CDTFA asserts that during the underlying appeal, appellant stated that he could provide evidence of the purported unauthorized purchases. CDTFA contends that appellant has not provided documentation or other evidence to support his assertion that unknown individuals made unauthorized purchases at four of his suppliers.

We first note that appellant's unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*) Appellant has provided no

documentation to support his assertion that the difference between the recorded purchase amounts and the audited purchase amounts are attributable to suppliers permitting unauthorized cash purchases by unknown individuals. It is important to note the magnitude of this discrepancy: $504,497 for 2006, $777,331 for 2007, $925,787 for 2008, and $949,815 for 2009. Essentially, appellant asks us to accept that purchases totaling hundreds of thousands of dollars were made on his account at several businesses without his authorization. Appellant's argument is unpersuasive, and unsupported. As additional evidence, we note that, for TDW, Interstate Tire, Certified Undercar Parts, and Valley Auto Parts, the sales were listed invoice by invoice, and appellant has not identified a single invoice that did not represent a purchase he had made. Also, for every invoice listed by Interstate Tire, there is an entry showing that it was paid by check, and the information from Certified Undercar Parts indicates there were no cash sales. Based on the large continuous discrepancy and the documentary evidence which contradicts appellant's testimony, we find that the testimony is not reliable.

We also find that the evidence overwhelmingly supports CDTFA's decision to not make any adjustments to the amounts of purchases identified by appellant's suppliers. Appellant has not disputed the audited markup of 17.45 percent for retail sales, and that markup is lower than the markup CDTFA expected for this business. Further, we have reviewed the audit workpapers and have found no errors in procedures or computation.

We find that appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.

Issue 2: Whether CDTFA has established, by clear and convincing evidence, that the understatement was the result of fraud.

In the case of a deficiency determination, a penalty of 25 percent of the amount of the determination applies if any part of the deficiency is due to fraud or an intent to evade the Sales and Use Tax Law or authorized rules and regulations. (R&TC, § 6485.) Fraud or intent to evade must be established by clear and convincing evidence. (Cal. Code Regs., tit. 18, § 1703(c)(3)(C); *Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.) The express language of R&TC section 6485 makes it clear that a fraud penalty shall be imposed on the entire deficiency "if any part" of that deficiency determination is due to fraud. (*Ibid.*)

The R&TC does not define fraud, but there are many federal precedents that we may look to for guidance. (*Ibid.*) Fraud is intentional wrongdoing on the part of the taxpayer with the

specific intent to avoid a tax known to be owing. (*Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30; *Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307 (*Bradford*).) Fraud can be proven by circumstantial evidence. (*Tenzer v. Superscope, Inc.*, *supra*.) Circumstantial evidence of fraud or intent to evade taxation includes, but is not limited to: substantial discrepancies between recorded amounts and reported amounts that cannot be explained (the indication that a deficiency is due to intent to evade increases in direct proportion to the ratio of the understatement); when sales tax or sales tax reimbursement is properly charged, evidencing knowledge of the requirements of the law, but not reported; inadequate records; failure to cooperate with tax authorities; failure to file tax returns; and lack of credibility in the taxpayer's testimony. (*Ibid*; *Rau's Estate v. Commissioner* (9th Cir. 1962) 301 F.2d 51, 54-55; *Powell v. Granquist* (9th Cir. 1958) 252 F.2d 56, 60.) Federal courts have also concluded that the "'[m]ere omission of reportable income is not of itself sufficient to warrant a finding of fraud [but] repeated understatements in successive years when coupled with other circumstances showing an intent to conceal or misstate taxable income present a basis'" for inferring fraud. (*Rau's Estate v. Commissioner* (9th Cir. 1962) 301 F.2d 51, 54-55 [quoting *Furnish v. Commissioner* (9th Cir. 1958) 262 F.2d 727, 728].)

Here, there is no direct evidence of a specific intent to evade the tax. Therefore, we consider whether the various factors present, when taken together, clearly and convincingly establish that all or a significant portion of the understatement was due to fraud or intent to evade the law.

Appellant argues that CDTFA has not established fraud by clear and convincing evidence. On that basis, appellant asserts that the fraud penalty should be reduced to a negligence penalty, and the understatement for the period April 1, 2005, through December 31, 2006, should be deleted from the liability because the NOD was not timely issued for that period. Furthermore, appellant argues that: 1) any errors in reported amounts were not willful or intentional because he mistakenly relied on an individual whom he thought was a licensed CPA to file his taxes; 2) appellant's willing and voluntary compliance with the audit process is evidence that there was no intent to defraud the government; 3) CDTFA's only "evidence" of fraud is a conclusory statement that appellant intentionally attempted to evade the law, along with some circumstantial evidence; 4) appellant's failure to number his invoices is not evidence of fraudulent intent; 5) the amount of understatement is excessive because audited

purchases are overstated; and 6) CDTFA's determination was based on conjectures and estimates, with markups based on its experience.

Appellant testified that he started La Puente Tire beginning in 1982. Appellant began operating La Puente Tire as a sole proprietor on April 1, 2005. At that time, appellant had approximately 23 years of experience operating a tire shop. Two months later, appellant applied for a seller's permit on June 1, 2005, with a retroactive start date of April 1, 2005. The application for seller's permit indicates that appellant was provided with CDTFA Publications 51, 70, 73, and 74. These publications generally impart to the reader the rights and responsibilities for permit holders (e.g., accurately reporting sales and use taxes). Appellant collected sales tax reimbursement on his taxable sales, as evidenced by the available sales invoices, and he filed SUTRs. Since appellant had extensive experience operating a tire shop, received publications in response to the seller's permit application, added tax to sales invoices, and filed SUTRs, we find that appellant had sufficient knowledge to properly report and remit sales and use taxes.

Nonetheless, appellant's reporting practices resulted in a substantial understatement of reported taxable sales of $6,343,667, which represents 229.15 percent of reported taxable sales of $2,768,380. In addition, the understatements of recorded purchases were substantial. The percentages of understatement, for recorded purchases, are 100.30 percent for 2006, 225.50 percent for 2007, 276.28 percent for 2008, and 195.35 percent for 2009. Audited purchases exceeded reported taxable sales by over $4 million for the years 2006, 2007, 2008, and 2009.[14] Appellant's bank deposits exceeded reported total sales by $3,744,865 for the years 2007, 2008, and 2009. Appellant offered no plausible explanation for those extraordinarily high amounts of unrecorded purchases and differences between business receipts and reported sales. The lack of a plausible explanation for the consistent and substantial unrecorded purchases supports the imposition of the fraud penalty.

Reliance on purported CPA to report taxes

Appellant testified that he would take all of his receipts and invoices to a CPA and rely on that CPA to prepare the SUTRs for La Puente Tire. Appellant testified that he used

[14] Audited purchases for those years total $7,074,330 ($1,007,451 + $1,763,777 + $2,110,482 + 2,192,619); and reported taxable sales for the same period total $2,419,671. If we subtract reported taxable sales from audited purchases the total is $4,305,950 ($7,074,330 - $2,419,671).

Mr. Barrios as his CPA until he passed away in 2004 or 2005. Appellant then began using Mr. Lopez to prepare the SUTRs for La Puente Tire. Appellant asserts that he relied on Mr. Lopez, whom he thought was a CPA, to properly report his taxable sales. Appellant argues that, to the extent reported amounts were understated, those errors were not the result of willful and intentional conduct or participation of appellant, and, therefore, the fraud penalty is not applicable.

As a preliminary matter, we find badges of fraud in the preparation and maintenance of records. For example, the substantial discrepancy between recorded amounts and bank receipts, the discrepancy between recorded purchases in appellant's records versus the records provided by his suppliers totaling millions of dollars, the failure to include invoice numbers on invoices (which makes it easier to hide income), and the discrepancies between the testimony versus the evidence in the record. There is no evidence that this fraud is attributable to the CPA. There is evidence to support finding that appellant is responsible for the discrepancies, and that the CPA merely prepared returns based on the information maintained and provided by appellant. Nevertheless, we will address appellant's argument. Given the dearth of relevant case law as it applies to R&TC section 6485, we consider by analogy the standards that apply under Internal Revenue Code section 6663, the federal income tax fraud penalty statute. Under that standard, the relevant question here is whether appellant's agent was acting on behalf of, and not against, the business with the result that the business benefited from the agent's fraudulent acts. (*Alexander Shokai, Inc. v. Commissioner* (9th Cir. 1994) 34 F.3d 1480, 1488; *Ruidoso Racing Ass'n, Inc. v. Commissioner* (10th Cir. 1973) 476 F.2d 502, 506.) If so, the fraud of the agent may be imputed to the business. (*Ibid*.)

The evidence here shows that appellant received a direct benefit from the substantial understatement of reported taxable sales, since he did not remit the related sales tax reimbursement collected from his customers. Rather, the unremitted sales tax reimbursement remained with his business. While appellant argued that Mr. Lopez charged him a lot of money for his services and fled the country, there is neither argument nor evidence that Mr. Lopez benefited from the SUTRs he purportedly prepared. Hence, the evidence supports a conclusion that appellant benefited from the fraudulent acts (e.g., the $3,744,865 in excess bank deposits discussed above). Under those circumstances, appellant is responsible for the acts of his agent

(Mr. Lopez). Thus, we reject appellant's argument that there was no fraud because he relied on the advice of that individual regarding the reporting of taxable sales.

Appellant's compliance with the audit process

As previous stated, 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).) Relatedly, appellant has the duty to maintain records and documents, as required by California Code of Regulations, title 18, section 1698, and the duty to provide, or to make available, the records requested by CDTFA. (Cal. Code Regs., tit. 18, § 1698.5(b)(5)(A)-(C).) When taxpayers do not furnish the records that CDTFA requests, CDTFA has the authority to subpoena records. (Cal. Code Regs., tit. 18, § 1698.5(c)(9)(B)(1)-(4).) Appellant argues that he willingly and voluntarily complied with CDTFA's audit, even providing all relevant sales and bank statements. Appellant asserts that his voluntary cooperation is evidence that there was no fraud. However, appellant's assertion, that his cooperation is evidence that there was no fraud, does not logically follow his argument (i.e., a *non-sequitur* fallacy). Here, appellant already had the duty to maintain complete and accurate records as well as the duty to provide them to CDTFA upon its request. The purportedly cooperative actions appellant describes, such as disclosing available books and records, occurred after CDTFA initiated the audit, and we find that such cooperative actions do not negate fraudulent conduct that occurred during the liability period. Thus, we do not find this argument persuasive.

CDTFA's conclusory statement and circumstantial evidence

Appellant argues that CDTFA relied solely on a conclusory statement to determine that appellant willfully and intentionally participated in an attempt to evade payment of tax. According to appellant's January 8, 2021 brief, appellant also asserts that CDTFA "admits that all they have found is 'circumstantial evidence' of fraud."

CDTFA cited various elements of circumstantial evidence, including the following items: 1) evidence that appellant had knowledge regarding his responsibility to report all his taxable sales, based on CDTFA's review of available sales invoices, which reflected appropriate collections of sales tax reimbursement, and on the fact that appellant did file SUTRs; 2) a failure to maintain adequate records that fully accounted for all sales of TPP; 3) the use of sales invoices

without numbers; 4) appellant's bank deposits that exceeded reported sales by $3,744,865 for 2007, 2008, and 2009; 5) the unusually large amounts of understatement in reported taxable sales, with error rates ranging from 139.58 percent to 322.16 percent for the years 2006, 2007, 2008, and 2009; 6) appellant's consistent failure to record substantial amounts of purchases (with percentages of understatement ranging from 100.30 percent to 276.28 percent in the years 2006, 2007, 2008 and 2009; and 7) the fact that purchases compiled from suppliers exceeded reported total sales.

Regarding item 7, the purchases reported by just two suppliers for the period April 1, 2005, through December 31, 2006, totaled $1,598,379,[15] which exceeds reported taxable sales of $841,859.[16] For the years 2007, 2008, and 2009, the purchases compiled from the information provided by eight suppliers totaled $1,122,043, $1,260,876, and $1,436,029, respectively. In comparison, appellant reported total sales, including sales tax, of $821,974, $831,321, and $1,069,183 for the same years. Thus, purchases exceeded reported total sales (including sales tax and nontaxable labor charges) by $300,069 for 2007, $429,555 for 2008, and $366,846 for 2009. We reiterate, appellant's reported total sales were less than his purchases from the eight suppliers who responded to CDTFA's requests for information for 2007, 2008, and 2009.

Although the evidence CDTFA utilized is circumstantial evidence, fraud can be proven by circumstantial evidence. (*Bradford*, *supra*, 796 F.2d 303.) CDTFA provided persuasive evidence to support several of the "badges of fraud" listed above, including substantial understatement of income, inadequate records, implausible or inconsistent explanations of behavior, and a lack of credibility. We find that there is ample circumstantial evidence which, when considered together, provides clear and convincing evidence of fraud.

Failure to number invoices

Appellant argues that his failure to number his invoices is not definitive evidence of fraud. Appellant has correctly noted that there is no statutory requirement to utilize numbered

[15] This represents the total purchases reported by TDW & Dapper for the period April 15, 2005, through December 31, 2006, (81,976 + 218,115 + 675,936 + 622,352).

[16] CDTFA asserts that appellant's total reported sales (i.e., sales that included labor and sales tax) for the same period is $1,503,893. This assertion can be found in CDTFA's briefing, but we were unable to locate the corresponding figure in the audit workpapers.

sales invoices. There is, however, a requirement that retailers maintain complete and accurate records to support amounts reported on SUTRs and to make those records available. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Also, the failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade tax. (Cal. Code Regs., tit. 18, § 1698 (k).) The use of invoices without numbers, in conjunction with the absence of a sales journal where all sales are listed individually and totaled, makes it virtually impossible to determine whether all sales have been recorded and reported. Thus, the use of unnumbered sales invoices is one piece of circumstantial evidence that appellant intentionally did not record or report taxable sales. We have considered the failure to number invoices in concert with other circumstantial evidence of fraud, and we find that appellant's incomplete and inaccurate records are evidence of fraud or intent to evade.

Audited purchases are excessive

Throughout his appeal, appellant has asserted that the amounts of purchases identified by suppliers were excessive because they included cash purchases by an unidentified individual who allegedly used appellant's account number. We addressed and rejected this argument above. Here, we will note only that appellant is asking us to believe that some unknown and unidentified individual made purchases for hundreds of thousands of dollars in 2006, 2007, 2008, and 2009.[17] Certain specific differences offer additional information for analysis. For 2006, appellant recorded no purchases from TDW, while the supplier identified sales of $218,115 to appellant. For 2007, 2008, and 2009, appellant recorded purchases from Dapper of $627, $1,479, and $0, respectively, even though appellant had identified Dapper as his major California-based supplier. Conversely, Dapper provided records of sales to appellant of $653,284, $622,233, and $679,139, for the same years. When one compares recorded purchases and the amounts identified by suppliers, there seems to be no other plausible conclusion: appellant set out to and did keep woefully incomplete records of his purchases. As a result, the considerable size of his business and the true amount of his sales were not readily apparent from a review of his records. This level of error in appellant's records is strong evidence that the understatement of reported taxable sales was the result of fraud and intent to evade the tax.

[17] The understatement of purchases has not been quantified for the period April 1, 2005, through December 31, 2005, because appellant did not provide the amount of recorded purchases for that year.

CDTFA's assessment based on conjecture and estimates

Appellant argues that CDTFA's assessment was based on conjectures and estimates. In the details of his argument, appellant misconstrues the audit process. Since we have explained above how CDTFA's audit was conducted, we will limit our comments here.

CDTFA used appellant's records, sales invoices, and purchase costs provided by appellant to compute a representative markup for this business. CDTFA did not rely on "its experience" as alleged by appellant. Also, to establish audited purchases, CDTFA used information from appellant's suppliers, as previously described. We reiterate that appellant has not shown error in the suppliers' records. CDTFA did utilize the information provided by eight suppliers to compute percentages of error in recorded purchases for the remaining suppliers because the available information offered strong evidence that appellant routinely did not record all of his purchases.

We find that CDTFA conducted a markup audit using appellant's records to establish an audited markup and objective data from suppliers to establish audited purchases. We reject appellant's incorrect assertion that the audit was based on conjecture and estimates.

Timeliness of the NOD for the period April 1, 2005, through December 31, 2006

RT&C section 6487 provides, in pertinent part, that "except in the case of fraud . . . every notice of a deficiency determination shall be mailed within three years." A finding that any part of a deficiency determination was due to fraud is sufficient to suspend the statute of limitations to issue a deficiency determination as to the entire reporting period in which any part of the deficiency was due to fraud. (R&TC, §§ 6485, 6487.) Federal precedents also support the tolling of the statute of limitations to issue a deficiency determination, "if a return be fraudulent in any respect . . . it deprives the taxpayer of the bar of the statute for that year, and permits a general reaudit of the return throughout, and will toll the Statute of Limitations on the reaudit of any item of the tax." (*Lowy v. Commissioner* (2nd Cir. 1961) 288 F.2d 517, 520.) As discussed above, we have made several findings of fraud in the instant appeal. Therefore, the statute of limitations to issue a deficiency determination was properly suspended under R&TC section 6487 as to all reporting periods and all audit items. Accordingly, we find that the NOD for the period of April 1, 2005, through December 31, 2006, was timely issued.

HOLDINGS

1. Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.
2. CDTFA has established, by clear and convincing evidence, that the understatement was the result of fraud.

DISPOSITION

Sustain CDTFA's decision to deny the petition for redetermination.

DocuSigned by:
Josh Aldrich
48745BB80691 4B4...
Josh Aldrich
Administrative Law Judge

We concur:

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

DocuSigned by:
Andrea LH Long
272945E7B372445...
Andrea L.H. Long
Administrative Law Judge

Date Issued: 4/13/2022