

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 21078257
C BY KARINA, INC.) CDTFA Case IDs: 2-109-239, 2-271-076
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OPINION

Representing the Parties:

For Appellant: Karina Leigh, President
Justin Leigh, Witness

For Respondent: Amanda Jacobs, Tax Counsel III
Scott Claremon, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, C By Karina, 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 February 18, 2020. The NOD is for tax of \$52,407 and applicable interest for the period July 1, 2014, through December 31, 2017 (audit period).

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Andrew J. Kwee, and Suzanne B. Brown held a virtual hearing for this matter on March 22, 2022.² OTA closed the record on March 24, 2022, 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 matter was originally scheduled to be held in Cerritos, California; however, it was held virtually via Webex with the agreement of the parties.

ISSUE³

Is a reduction to the amount of disallowed claimed nontaxable sales warranted?

FACTUAL FINDINGS

1. Appellant operated as a dispensing optician in Beverly Hills, California, where it sold the following: (1) ophthalmic materials including eyeglass frames and lenses dispensed pursuant to prescriptions prepared by physicians and surgeons or optometrists; and (2) other frames and lenses that it dispensed without prescriptions.
2. Appellant obtained a seller's permit from CDTFA to operate its business beginning on February 15, 2011. Appellant registered with the American Board of Opticianry but did not register with any state agency that allowed it to be engaged in the business of dispensing prescription products in this state until June 1, 2018, when it registered as a dispensing optician with the California State Board of Optometry (CSBO).
3. For the audit period, appellant reported total sales of \$1,208,280. Appellant claimed deductions of \$43,104 for sales tax reimbursement included in reported total sales, \$80,727 for nontaxable sales of labor, and \$606,511 for "other" nontaxable sales, which represented claimed nontaxable sales of ophthalmic materials. In total, appellant reported taxable sales of \$477,938 for the audit period. Appellant also reported \$2,907 in purchases subject to use tax.
4. For audit, appellant provided to CDTFA its federal income tax returns for 2014 through 2016; federal 1099-K (*Payment Card and Third Party Network Transactions*) forms⁴ for the fourth quarter of 2014 through 2016; and purchase invoices from the audit period.
5. CDTFA accepted the accuracy of appellant's reported total sales; however, CDTFA disallowed appellant's claimed nontaxable sales of ophthalmic materials of \$606,511 and its claimed nontaxable sales of labor of \$80,727.

³ Appellant filed a timely protective claim for refund for tax or tax reimbursement that it paid with respect to its purchases during the audit period. Appellant provided documentation to demonstrate that it had paid tax or tax reimbursement on purchases of ophthalmic materials for resale totaling \$120,766 during the audit period. On appeal, appellant has not separately disputed the tax-paid purchases resold deduction established by CDTFA.

⁴ Form 1099-K is filed with the IRS by electronic payment processors to report a merchant's receipts from customers making electronic payments, whether by credit card, debit card, or third-party network.

6. CDTFA examined the purchase invoices provided by appellant and compiled an allowable deduction for tax-paid purchases resold of \$117,857. CDTFA also established a credit measure of \$2,907 for purchases subject to use tax reported in error.
7. The NOD issued to appellant on February 18, 2020, is based on an aggregate deficiency comprised of disallowed claimed nontaxable sales of ophthalmic materials and taxable fabrication labor totaling \$687,238, and allowances totaling \$120,766 for costs of tax-paid purchases resold and purchases subject to use tax reported in error.⁵
8. Appellant also filed a protective claim for refund in the amount of \$1 or more, or an amount to be established, for overpayments of tax on purchases made during the audit period.
9. Appellant filed a timely petition for redetermination disputing the determination in its entirety. CDTFA held an appeals conference with appellant on March 17, 2021, and issued a Decision in the matter on June 28, 2021, denying the petition for redetermination. This appeal to OTA followed.

DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For 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.) The sales tax is imposed upon retailers for the privilege of selling tangible personal property at retail in this state (R&TC, § 6051). Although a retailer may collect sales tax reimbursement from the purchaser if the contract of sale so provides (Civ. Code, § 1656.1(a)), there is no requirement that it do so, and failure to collect reimbursement is not a basis for relief from the tax. (See *Pacific Coast Eng. v. State of California* (1952) 111 Cal.App.2d 31, 34.)

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.) When CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid based on any

⁵ Due to rounding differences, the credit measure for costs of tax-paid purchases resold was increased by \$2, from \$117,857 to \$117,859.

information which is in its possession or may come into its possession. (R&TC, § 6481.) 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.*)

A taxpayer bears the burden of proving entitlement to an exemption or exclusion and must provide some credible evidence of that entitlement. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442-443; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 35003(a); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.)

Individuals, corporations, and firms engaged in the business of filling prescriptions of physicians and surgeons licensed by the Division of Licensing of the Medical Board of California or optometrists licensed by the State Board of Optometry for prescription lenses and kindred products, and as incidental to the filling of those prescriptions, doing any of the following acts, either singly or in combination with others, taking facial measurements, fitting and adjusting those lenses and fitting and adjusting spectacle frames, shall be known as dispensing opticians and shall not engage in that business unless registered with the Division of Licensing of the Medical Board of California. (Bus. & Prof. Code, §§ 2550, 2564.90.)⁶ A registered dispensing optician is a consumer, not a retailer, of ophthalmic materials including eyeglasses, frames, and lenses dispensed pursuant to a prescription prepared by a physician and surgeon or optometrist. (R&TC, § 6018; Cal. Code Regs., tit. 18, § 1592(b)(1).) Therefore, tax applies with respect to the sale of such materials to a registered dispensing optician, and tax does not apply to the registered dispensing optician's sales of ophthalmic materials dispensed on prescription. (Cal. Code Regs., tit., § 1592(b)(1).)

⁶ This language was in effect during the audit period. Subsequent changes have no material effect with respect to this appeal.

Here, appellant failed to register with the CSBO or with any other state agency that allowed it to be engaged in the business of dispensing prescription products. Nevertheless, appellant claimed as nontaxable its sales of ophthalmic materials dispensed pursuant to prescriptions, as if it were a registered dispensing optician, and it also claimed deductions for nontaxable sales of labor related to dispensing ophthalmic materials. Because no exemption or exclusion is available for sales of ophthalmic materials dispensed by persons other than physicians and surgeons, optometrists, or registered dispensing opticians, we find that it was reasonable for CDTFA to disallow the entire amount claimed by appellant as nontaxable sales of ophthalmic materials and labor. Thus, the burden shifts to appellant to provide evidence showing that an exemption or exclusion applies to its claimed nontaxable sales, or that a reduction to the liability is warranted because it overstated its reported total sales in error.

Appellant asserts that the accountants who had represented it for the past 25 years, who held power of attorney, and who were responsible for every aspect of its business had never advised it that registration with the CSBO was required. After CDTFA had advised it that registration with the CSBO was required to obtain an exemption for its sales of ophthalmic materials dispensed on prescription, appellant inquired of the CSBO about how people are supposed to know they are required to register. Appellant was told by the CSBO that the information was on its website. Appellant points out that websites were not available when its president started the business more than 20 years earlier. Appellant claims that it never collected any sales tax reimbursement because all available information stated that collecting sales tax reimbursement for sales of ophthalmic materials is illegal.⁷ Appellant explains that it has always run its business according to the letter of the law, and that the failure to register with the CSBO was not done willfully, but rather out of lack of knowledge of the requirement. Appellant contends that imposing a tax liability for sales of medical materials, after paying tax on the purchase of those materials, “does not reflect the spirit of the law.” Therefore, appellant requests that the liability be deleted.

⁷ One basis for appellant’s position is its reliance on a ruling from the IRS in 2012 that eyeglasses do not constitute “taxable medical devices” for purposes of the federal medical excise tax imposed on a manufacturer, producer, or importer under the Patient Protection and Affordable Care Act. (See former 26 U.S.C.A. § 4191(b).) In contrast, here the tax at issue is sales tax pursuant to California’s Sales and Use Tax Law, and thus the federal medical excise tax has no bearing on the present case.

CDTFA counters that appellant's ignorance of the law is not a defense to avoid tax liability. (See, e.g., *MacFarlane v. Department of Alcoholic Beverages Control* (1958) 51 Cal.2d 84, 90 [stating that knowledge of the law is presumed].) Furthermore, CDTFA asserts that none of the reasons appellant gave for the failure to register constitute a basis under the law to grant an exemption or exclusion.


OTA recognizes that appellant attempted for years to comply with the law and to keep good records, and that appellant performed the same services as a registered dispensing optician would perform. However, both R&TC section 6018 and California Code of Regulations, title 18, section 1592 are abundantly clear that *registered* dispensing opticians are consumers, not retailers, of ophthalmic materials dispensed pursuant to prescriptions. No tax exclusion for dispensing ophthalmic materials by any person other than a physician, surgeon, optometrist, or registered dispensing optician is allowed. Because OTA has no authority to allow an exemption or exclusion based on an interpretation of the spirit of the law, OTA must find that appellant's sales of ophthalmic materials pursuant to prescriptions are subject to tax. Therefore, we conclude that no reduction to the amount of disallowed claimed nontaxable sales of ophthalmic materials and labor is warranted.

HOLDING

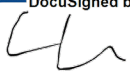
No reduction to the amounts of disallowed claimed nontaxable sales of ophthalmic materials and claimed nontaxable labor is warranted.


DISPOSITION

CDTFA’s action denying appellant’s petition for redetermination is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

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Suzanne B. Brown
Administrative Law Judge

Date Issued: 5/18/2022