

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
QUALITY MOTORS, LLC

) OTA Case No. 19095290
) CDTFA Account No. 97-578861
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OPINION

Representing the Parties:

For Appellant:

Azhar Kahn, Representative
Jesus Ochoa, LLC Member

For Respondent:

Nalan Samarawickrema, Hearing Rep.
Cary Huxsoll, 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, Quality Motors, LLC (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying, in part, appellant’s petition for redetermination of the Notice of Determination (NOD) issued on October 18, 2017. The NOD is for tax of \$153,190.73, plus accrued interest, and a negligence penalty of \$15,319.55 for the period January 1, 2013, through December 31, 2016 (audit period).

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Keith T. Long, and Suzanne B. Brown 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 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 referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to BOE; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

² The oral hearing was initially scheduled to take place in Sacramento, California; however, the parties later agreed to hold the hearing electronically via Webex.

ISSUES

1. Is a reduction to the amount of unreported taxable sales of vehicles warranted due to unwinds and rollbacks?³
2. Is a reduction to the amount of unreported taxable sales of repair parts warranted?
3. Is a reduction to the amount of additional taxable gross receipts warranted based on sales tax charged for smog fees and document preparation fees?

FACTUAL FINDINGS

1. Appellant obtained a seller's permit to operate a used car dealership and auto repair shop effective September 1, 1999. For the audit period, appellant reported total sales of \$2,279,706, and claimed deductions of \$94,051 for nontaxable sales for resale, \$139,804 for nontaxable labor, \$2,500 for exempt sales in interstate commerce, and \$550 for bad debt losses on sales reported as taxable, which resulted in reported taxable sales of \$2,042,801.⁴
2. For audit, appellant provided its federal income tax returns (FITRs), profit and loss statements, and repair shop income statements for 2013, 2014, and 2015; its sales and use tax worksheets for 2014 and 2015; bank statements for 2015; and a limited number of deal jackets for vehicle sale transactions for each year of the audit period.
3. During the period 2013 through 2015, the gross receipts reported on appellant's FITRS exceeded the total sales reported on its sales and use tax returns by \$1,585,614. During the same period, the cost of goods sold that appellant reported on its FITRs exceeded the total sales reported on its sales and use tax returns by \$738,165. CDTFA obtained electronic Report of Sale (ROS) records from the California Department of Motor Vehicles (DMV) for the years 2013 through 2016. The ROS records did not contain the vehicle selling prices but did contain the vehicle identification number, license plate number, year and make of vehicle, vehicle registration date, and a two-letter Vehicle License Fee (VLF) code designating a range of selling prices in \$200 increments.

³ A rollback is the transfer of ownership back to the dealer, and an unwind is when the buyer does not take possession of the vehicle, and the vehicle does not leave the dealership. (See <https://www.dmv.ca.gov/portal/handbook/vehicle-industry-registration-procedures-manual-2/odometer-mileage-reporting/rollbacks-and-unwinds/>.)

⁴ Appellant's claimed deductions were taken during the period 1Q13 through 2Q14. Appellant did not claim any deductions for the remainder of the audit period.

4. For the audit period, CDTFA compiled appellant's total vehicle sales using the selling prices shown in the vehicle deal jackets and using the lowest price in the range designated by the VLF code (in the ROS report) for those vehicles with missing deal jackets. CDTFA calculated that appellant had unreported taxable sales of vehicles of \$1,248,473 for the audit period.⁵
5. Appellant made taxable sales of automobile parts in its repair shop and collected sales tax reimbursement on those parts sales. For the period January 1, 2013, through December 31, 2015, appellant collected sales tax reimbursement of \$30,237 on its sales of repair parts, which represented taxable sales of \$345,567. Taxable sales of repair parts represented 14.53 percent of audited taxable sales of vehicles and repairs totaling \$2,377,830 for the 2013-2015 years.
6. Appellant's audited taxable sales of repair parts for the period January 1, 2016, through December 31, 2016, totaled \$126,761 (14.53 percent of audited taxable sales of vehicles and repairs totaling \$872,238 for 2016). Appellant's unreported taxable sales of repair parts totaled \$472,328 for the audit period.
7. Appellant added a "Document Preparation Fee" of \$65 and a "Smog Fee Paid to Seller" of \$50 to the selling price for each vehicle but did not add sales tax reimbursement to those fees for part of the audit period. The collected fees⁶ were retained by appellant and represented a part of its taxable gross receipts from sales of vehicles. CDTFA calculated appellant's unreported taxable gross receipts of \$50,485 by multiplying \$115 by 439 vehicles sold during the audit period.
8. CDTFA issued an NOD to appellant based on unreported taxable sales of vehicles of \$1,248,473, unreported taxable sales of repair parts of \$472,328, and unreported vehicle document preparation fees and smog fees of \$50,485. CDTFA imposed a negligence penalty.

⁵ CDTFA's audit schedules 12A-1 and 12A-3 show \$1,248,472 as the measure of unreported taxable sales, while CDTFA asserted tax based on \$1,248,473. The difference is nominal and has no effect on appellant's tax liability.

⁶ Appellant contends that it started charging tax on smog fees starting in 2015, and on both smog and documentation fees starting in 2016. Appellant claims that it reported the sales tax on its SUTRs and paid the collected sales tax reimbursement to CDTFA. As discussed, *post*, appellant did not submit any supporting documentation, and CDTFA declined to reduce this audit item without support for appellant's position.

9. Appellant timely filed a petition for redetermination. On August 20, 2019, CDTFA issued its Decision deleting the negligence penalty and otherwise denying the petition for redetermination. This appeal to OTA followed.

DISCUSSION

Issue 1: Is a reduction to the amount of unreported taxable sales of vehicles warranted due to unwinds and rollbacks?

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.)

A retailer is relieved from liability for sales tax insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. (R&TC, § 6055(a); Cal. Code Regs., tit. 18, § 1642(a).) A retailer may claim a bad debt deduction on its sales and use tax return in the period the debt is found to be worthless, provided that the sales tax was actually paid to the state. (*Ibid.*)

When CDTFA is not satisfied with the accuracy of the SUTRs filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, §§ 6481, 6511.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (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 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.*) That means that the taxpayer must prove both (1) the tax assessment is incorrect, and (2) the correct amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant provided an incomplete set of deal jackets, which were not sufficient to support the accuracy of its reported taxable sales of vehicles. In the absence of adequate records, OTA finds that CDTFA was justified in establishing audited taxable sales of vehicles using selling prices shown in the available deal jackets. CDTFA was also justified in approximating selling prices from the electronic ROS data obtained from the DMV for those transactions for which deal jackets were missing. Therefore, the burden of proof shifts to appellant to establish by documentation or other evidence that a reduction to the amount of audited taxable sales of vehicles is warranted.

Appellant contends that audited taxable sales of vehicles should be reduced to allow for unwinds and unclaimed bad debts. Appellant has provided no documentation or other evidence to support an adjustment for unwinds or for unclaimed losses from bad debts.

CDTFA identified seven vehicles that appellant sold twice and one vehicle that appellant sold three times during the audit period. The period between the first sale and the subsequent sale of each of these resold vehicles ranged from as low as 57 days to as high as 1,164 days (more than three years apart). Multiple sales of the same vehicle could indicate that there were unwinds or repossessed vehicles. However, because the DMV defines an unwind as a transaction for which the sale was canceled before the vehicle left the dealer's lot, in the absence of any other evidence, the lengths of time between each of the sales does not support a finding that any of the transactions were actually unwinds rather than resales. While appellant might have repossessed vehicles and sold them again, appellant did not claim deductions for bad debts on its FITRs, and therefore, did not meet the first requirement in California Code of Regulations, title 18, section 1642 for relief from the liability for sales tax due to bad debt losses.

OTA finds that the method used to establish audited taxable sales of vehicles was reasonable and concludes that appellant has not shown that a reduction is warranted.

Issue 2: Is a reduction to the amount of unreported taxable sales of repair parts warranted?

It is undisputed that appellant charged its customers sales tax reimbursement on the selling prices for parts sold in connection with repairs of vehicles, but it did not include sales of repair parts in the taxable sales reported on its SUTRs. Therefore, it was reasonable for CDTFA

to use appellant's records of sales tax reimbursement collected to establish audited unreported taxable sales of repair parts.

Appellant contends that audited taxable sales of repair parts should be reduced to allow for repair parts that it installed in vehicles held for resale. However, appellant has provided no documentation or other evidence to support any repairs performed on vehicles held in resale inventory.

Because audited taxable sales of repair parts were computed from the sales tax reimbursement that appellant added to the selling prices for repair parts, those nontaxable sales of repair parts were not included in audited taxable sales. Therefore, appellant has not established that an adjustment is warranted.

Issue 3: Is a reduction to the amount of additional taxable gross receipts warranted based on sales tax charged for smog fees and document preparation fees?

CDTFA agrees that appellant added a "Document Preparation Fee" of \$65 and a "Smog Fee Paid to Seller" of \$50 to the selling price for each vehicle sold during the audit period. There also is no dispute that the "fees" of \$115 per vehicle represented a part of appellant's taxable gross receipts from sales of vehicles. However, appellant states that, in 2013 and 2014, it was not aware that the fees represented additional taxable gross receipts, and it did not charge or collect sales tax reimbursement on the fees. According to appellant, in 2015, it began collecting sales tax reimbursement on the smog fees, and in 2016, it collected tax on both fees. For the periods during which it collected tax on both fees, appellant contends that the fees were included in its reported taxable sales. Because it already reported tax on a portion of the fees charged to its customers during the audit period, appellant contends that the amount established in the audit for additional taxable gross receipts is overstated.

As evidence that it collected sales tax reimbursement on the fees in 2016, appellant provided a sales tax reconciliation report for that year. The report includes a list of the vehicles sold, the names of customers, the dates of the transactions, the total prices and the taxable selling prices, the applicable sales tax rates, and the sales tax reimbursement charged on the transactions. A comparison of the taxable prices shown in appellant's report with the taxable vehicle selling prices shown in the audit schedules shows that the taxable prices in appellant's report are \$115 higher than the audited vehicle selling prices, which supports appellant's contention that it collected sales tax reimbursement on the documentation fees and the smog fees

in 2016. While appellant has provided no evidence showing that it included the fees in its reported taxable sales in 2016, we note that, even if appellant reported tax on the fees in 2016, CDTFA’s reconciliation of audited taxable vehicle sales with reported taxable sales provided appellant with credit for all taxes paid.


In the absence of any evidence showing that appellant did not add a documentation fee of \$65 and a smog fee of \$50 to the selling price of each vehicle it sold during the audit period, appellant has not established that a reduction to the amount of additional taxable gross receipts is warranted.

HOLDINGS

1. No reduction to the amount of unreported taxable sales of vehicles, based on rollbacks and unwinds, is warranted.
2. No reduction to the amount of unreported taxable sales of repair parts is warranted.
3. No reduction to the amount of additional taxable gross receipts, based on sales tax charged for smog fees and document preparation fees, is warranted.


DISPOSITION

CDTFA’s action in deleting the negligence penalty and otherwise denying the petition for redetermination is sustained.


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 Teresa A. Stanley
 Administrative Law Judge

We concur:

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 Keith T. Long
 Administrative Law Judge

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 Suzanne B. Brown
 Administrative Law Judge

Date Issued: 6/10/2022