

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**B. CLARK**  
**dba Engine Dynamics**

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) OTA Case No. 21108786  
) CDTFA Case ID 1-526-455  
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**OPINION**

Representing the Parties:

For Appellant: Paul Azir, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

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

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, B. Clark (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated October 31, 2019. The NOD is for tax of \$88,134 and applicable interest for the period January 1, 2016, through December 31, 2018 (audit period).<sup>2</sup>

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

**ISSUE**

Whether appellant established that adjustments are warranted to the measure of unreported taxable sales determined by CDTFA.

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<sup>1</sup> 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.

<sup>2</sup> The NOD was timely issued because on February 8, 2019, appellant signed a waiver of the otherwise applicable three-year statute of limitations, which allowed CDTFA until October 31, 2019, to issue an NOD for the period January 1, 2016, through June 30, 2016. (R&TC, §§ 6487(a), 6488.)

### FACTUAL FINDINGS

1. Appellant performs automobile repairs and smog check services. Appellant also makes retail sales of automobile parts and tires.
2. For the audit period, appellant reported total sales of \$4,642,881, claimed deductions of \$3,472,601 for nontaxable sales of labor, and reported taxable sales of \$1,170,280.
3. For audit, appellant provided his federal income tax returns (FITRs) for calendar years 2015 and 2016; bank statements for the period October 2015 through July 2018; cancelled checks for purchases made from January 1, 2016, through September 30, 2018; and an incomplete set of sales invoices for the period January 1, 2016, through September 30, 2018.
4. CDTFA obtained appellant's federal Forms 1099-K for the years 2015, 2016, and 2017.<sup>3</sup>
5. CDTFA's initial review disclosed several inconsistencies. First, CDTFA found that total sales reported on appellant's sales and use tax returns for 2016 exceeded the gross receipts reported on his FITR for that year by \$362,633. Second, merchandise purchases of \$495,381 reported on the 2016 FITR substantially exceeded appellant's reported taxable sales of \$349,119 for that year.<sup>4</sup> Third, appellant's reported merchandise purchases exceeded his reported taxable sales, which indicates a negative markup.
6. Upon further investigation, CDTFA found that the sales invoices appellant provided for the third quarter of 2017 (3Q17) appeared to represent the most complete set of sales invoices available. Based on its examination of the 639 sales invoices available for 3Q17, CDTFA compiled recorded nontaxable sales of labor of \$115,820.56, recorded taxable parts sales of \$169,421.88, recorded sales tax reimbursement of \$12,896.56, and recorded total sales of \$298,139.00.
7. An examination of the sales invoice numbers indicates a substantial number of invoices were missing from the numbering sequence, which is evidence of missing sales records. For example, for 3Q17, the most complete quarter available, 485 sales invoice numbers

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<sup>3</sup> 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. The gross amount of a reportable payment does not include any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts, or any other amounts. (See [www.irs.gov/businesses/understanding-your-form-1099-k](http://www.irs.gov/businesses/understanding-your-form-1099-k))

<sup>4</sup> A similar comparison was not performed for the year 2015 because appellant had combined his merchandise purchases with his costs of labor in the costs of goods sold reported on his FITR for that year.

were missing from the numbering sequence. During the audit, appellant contended that the discrepancy was due, in whole or part, to his practice of using invoices to write up work estimates. CDTFA noted that invoice numbers were written on repair estimates and did not pursue the missing invoices further.<sup>5</sup>

8. Recorded total sales of \$298,139 in 3Q17 are significantly less than appellant's reported total sales of \$410,465 for that quarter and are also significantly less than credit card sales of \$354,317 shown on the 1099-K forms for 3Q17.
9. The difference between recorded (\$168,795) and reported (\$92,812) taxable automobile part sales for 3Q17 was \$75,983.<sup>6</sup> This amount represents an error rate of 81.87 percent when compared to reported taxable sales ( $\$75,983 \div \$92,812$ ). CDTFA accepted appellant's recorded amounts for 3Q17, and used the 3Q17 underreporting error rate to determine the underreporting for the remainder of the audit period. CDTFA multiplied appellant's reported taxable sales by the error rate to establish unreported taxable sales of \$958,108 for the audit period.
10. On October 31, 2019, CDTFA issued the NOD for the liability disclosed by audit.
11. Appellant timely petitioned the NOD. On September 13, 2021, CDTFA issued a Decision denying the petition. This appeal to the Office of Tax Appeals followed.

### DISCUSSION

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) The law creates a statutory presumption that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) The retailer has the burden of proving that a sale of tangible personal property is not a retail sale unless the retailer timely and in good faith obtains a resale certificate from the purchaser. (R&TC, § 6091; Cal. Code. Regs., tit. 18, § 1668(a).) It is the retailer's responsibility to maintain complete and accurate

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<sup>5</sup> Due to the lack of records, there is insufficient information to ascertain to what extent the 485 missing invoices for 4Q17 represent missing taxable sales records versus non-sale transactions as described by appellant (e.g., work estimates prepared by appellant where the customer ultimately went with a different repair shop).

<sup>6</sup> After finding that charges for smog check services of \$627 had been erroneously included with taxable sales of automobile parts for 3Q17, CDTFA reduced recorded taxable parts sales by \$627 to establish audited taxable sales of \$168,795 for 3Q17.

records to verify the accuracy of any return made and to make them available to CDTFA 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, or in the case of a failure 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 reported merchandise purchases of \$495,381 on his 2016 FITR, but his 2016 sales and use tax returns filed with CDTFA reported taxable sales of \$349,119. In addition, appellant's own records (available sales invoices) reflected taxable automobile part sales of \$168,795 for 3Q17, and yet appellant only reported taxable sales of \$92,812 for 3Q17. Clearly, there is evidence to demonstrate an underreporting. Under these facts, it was reasonable and rational for CDTFA to reject appellant's reported amounts and to establish a deficiency. CDTFA accepted the recorded amounts per appellant's available sales invoices for 3Q17 and billed for the difference between recorded and reported taxable sales (based on projecting 3Q17 to the rest of the audit period). At a minimum, the discrepancy between recorded and reported taxable sales demonstrates a more than reasonable baseline for the underreporting.<sup>7</sup> As such, appellant has the burden of establishing entitlement to any adjustments.

Appellant contends that the amount of unreported taxable sales should be reduced by an unspecified amount to account for nontaxable sales for resale. Aside from his one-sentence appeal letter, appellant did not provide any documentation to support his appeal. For example, appellant failed to provide resale certificates, sales invoices showing sales for resale, or any other evidence showing that tax did not apply to any portion of his sales of automobile parts. (See Cal.

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<sup>7</sup> It appears there may be a significant amount of collected, but potentially unremitted, sales tax reimbursement that was not asserted in the audit or NOD. CDTFA could have reasonably and rationally determined a much higher liability. For example, comparing recorded taxable parts sales of \$168,795 for 3Q17 with recorded total sales of \$285,242 (excluding sales tax reimbursement), establishes a taxable sales ratio of 59.18 percent. Applying the taxable sales ratio to appellant's reported total sales of \$4,642,881 would result in taxable sales of \$2,747,471, which is over \$600,000 higher than the total taxable sales (\$1,170,280 + \$950,108 = \$2,120,388) determined in the audit.

Code. Regs., tit. 18, § 1668(a.) Thus, there is no evidence in the written record from which we could determine an adjustment is warranted.

HOLDING

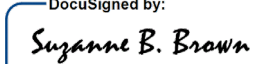
Appellant failed to establish a basis for any adjustments to the measure of unreported taxable sales determined by CDTFA.


DISPOSITION

CDTFA’s action is sustained.

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Andrew J. Kwee  
Administrative Law Judge

We concur:

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Suzanne B. Brown  
Administrative Law Judge

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Teresa A. Stanley  
Administrative Law Judge

Date Issued: 6/16/2022