**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No.: 19075030 |
| | ) CDTFA Case IDs: 707161 and 707162 |
| **CYBERANNEX CORPORATION** | ) |
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## OPINION

Representing the Parties:

For Appellant: Arman Aminloo, President

For Respondent: Chad T. Bacchus, Tax Counsel IV
Stephen Smith, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, CyberAnnex Corporation (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) partially denying appellant's petitions for redetermination of two Notices of Determination (NODs).[1] The first NOD, dated December 13, 2012, is for tax of $12,230.63, plus applicable interest, and a failure-to-file penalty of $1,223.16 for the liability period of January 1, 2003, through December 31, 2008.[2] The second NOD, dated December 19, 2012, is for tax of $48,548.21, plus applicable interest, and a

[1] The State Board of Equalization (BOE) formerly administered the sales and use taxes. On July 1, 2017, BOE functions relevant to this case 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, any mention of "CDTFA" actually refers to BOE.

[2] Because appellant did not file any sales and use tax returns (SUTRs) for any quarter in the liability period of January 1, 2003, through December 31, 2008, CDTFA had until eight years after the last day of the calendar month following each of those quarters to mail an NOD for that quarter. (R&TC, § 6487(a).) Thus, for the first quarter of 2003 (1Q03), 2Q03, 3Q03, and 4Q03, CDTFA had until April 30, 2011, July 31, 2011, October 31, 2011, and January 31, 2012, respectively, to either issue an NOD for that respective quarter or secure appellant's waiver of, and consent to extend, the relevant NOD mailing deadline. (See R&TC, §§ 6487(a), 6488.) Here, appellant first signed a waiver on December 8, 2011, so, as of that date, CDTFA's time to issue an NOD for 1Q03, 2Q03, and 3Q03 had already expired. Appellant signed an extension of the original waiver on April 25, 2012, which allowed CDTFA until January 31, 2013, to timely mail an NOD for the period of October 1, 2003, through December 31, 2008. Thus, the December 13, 2012 NOD was only timely issued for that period.

failure-to-file penalty of $4,854.85 for the liability period of January 1, 2009, through December 31, 2011.[3]

Originally, CDTFA based the two NODs on its determination that appellant had aggregate unreported taxable sales of $724,781 for the combined liability period.[4] Subsequently, CDTFA reduced the aggregate amount of unreported taxable sales to $512,921 and deleted the failure-to-file penalty of $4,854.85 from the second NOD.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Suzanne B. Brown, and Keith T. Long held an electronic oral hearing for this matter on November 19, 2021. At the conclusion of the hearing, OTA held the record open to allow the parties to submit additional materials. In response to appellant's submission, CDTFA indicated that it would further reduce the aggregate amount of unreported taxable sales by $13,662. On April 4, 2022, OTA closed the record, and this matter was submitted for an opinion.

## ISSUES

1. Whether the amount of unreported taxable sales of information technology (IT) equipment should be further reduced.
2. Whether the amount of unreported taxable sales of wireless phone equipment should be further reduced.
3. Whether the remaining failure-to-file penalty should be relieved.

## FACTUAL FINDINGS

1. Appellant operated a business in Irvine, California, offering IT services along with sales of IT equipment. For its Irvine location, appellant held a seller's permit effective from June 1, 2010, through December 31, 2010. Appellant's seller's permit was reinstated on July 12, 2011.
2. Beginning in 2010, appellant also operated a business in Colton, California, selling wireless phone service plans and equipment in Riverside County. For its Colton location, appellant held a seller's permit effective from August 16, 2010, through

[3] The December 19, 2012 NOD was timely issued because CDTFA issued this NOD within three years of December 12, 2012, the date appellant filed SUTRs for the liability period of January 1, 2009, through December 31, 2011. (See R&TC, § 6487(a).)

[4] For ease of reference, this Opinion will refer to the combined liability periods of January 1, 2003, through December 31, 2008, and January 1, 2009, through December 31, 2011, as "the combined liability period."

December 31, 2010. Appellant's seller's permit was reinstated on July 12, 2011. Appellant subsequently closed its Colton business.

3. Initially, during the combined liability period, appellant did not file any sales and use tax returns (SUTRs) with CDTFA.[5]

4. For its audit of appellant, CDTFA acquired the following books and records:
   a. Several sales invoices and sales agreements from 2007, 2009, 2010, and 2011.
   b. Sales journals for 2007 through 2010.
   c. Federal income tax returns (FITRs) for 2005 through 2009.

5. Although appellant had not filed any timely SUTRs or reported any taxable sales to CDTFA for the combined liability period, two of appellant's sales invoices from 2007 indicated that appellant had charged sales tax reimbursement on sales of IT equipment to customers. Appellant's sales journals for 2007 and 2008 also indicated that it had collected sales tax reimbursement of $1,805 for 2007 and $6,611 for 2008, which indicated that appellant had made unreported taxable sales in those years. In a discussion with CDTFA, appellant estimated that it had made 80 percent of its taxable sales of IT equipment in Orange County, 10 percent in Los Angeles County, and 10 percent in Fresno County. Based on this 80/10/10 breakdown, CDTFA apportioned appellant's total collected sales tax reimbursement for 2007 and 2008 among these three counties, then divided each resulting portion by their respective county's sales tax rate for that year to compute the taxable sales appellant made in each county in 2007 and 2008. CDTFA then totaled the results by year to estimate that appellant made taxable sales of $23,096 in 2007 and $84,545 in 2008.

6. Appellant did not provide any sales journals for 2003, 2004, 2005, or 2006, so, to estimate appellant's taxable sales of IT equipment for those years, CDTFA first analyzed the gross receipts appellant reported in its FITRs for 2005, 2006, and 2007. CDTFA detected a trend and determined that appellant's reported gross receipts for each year were 76 percent of the subsequent year's reported gross receipts. Based on this trend, CDTFA estimated that appellant made taxable sales in the following amounts (rounded):

[5] On December 12, 2012, after the combined liability period, appellant filed SUTRs for 2009 through 2011, reporting total/taxable sales of $0. However, on these SUTRs, appellant reported use tax liabilities of $1,695 for 2009, $1,861 for 2010, and $304 for 2011. Subsequently, appellant stated that it had misreported, and these figures represented sales tax liabilities. In other words, appellant had intended to report taxable sales rather than purchases subject to use tax.

$17,553 in 2006 ($23,096 x .76); $13,340 in 2005 ($17,553 x .76); $10,139 in 2004 ($13,340 x .76); and $7,705 in 2003 ($10,139 x 76).

7. Thus, for 2003 through 2008, CDTFA estimated that appellant made total unreported taxable sales of IT equipment of $156,378 ($7,705 in 2003 + $10,139 in 2004 + $13,340 in 2005 + $17,553 in 2006 + $23,096 in 2007 + $84,545 in 2008).

8. For 2009 and 2010, appellant's sales journals showed that it had collected sales tax reimbursement of $7,666 for 2009 and $8,534 for 2010. Appellant did not provide a sales journal for 2011, so, for that year, CDTFA averaged appellant's collected sales tax reimbursement for 2009 and 2010 to estimate collected sales tax reimbursement of $8,100 for 2011. From these amounts, CDTFA then subtracted reported sales tax liabilities of $1,695 for 2009, $1,861 for 2010, and $304 for 2011 (which appellant had initially misreported as use tax liabilities)[6] to compute revised collected sales tax reimbursement of $5,971 for 2009 ($7,666 - $1,695); $6,673 for 2010 ($8,534 - $1,861); and $7,796 for 2011 ($8,100 - $304). Based on the estimated 80/10/10 ratio of appellant's taxable sales of IT equipment in Orange, Los Angeles, and Fresno Counties, respectively, CDTFA apportioned appellant's revised collected sales tax reimbursement for 2009, 2010, and 2011 among these three counties, then divided each resulting portion by their respective county's sales tax rate for that year to compute the taxable sales appellant made in each county in 2009, 2010, and 2011. CDTFA then totaled the results by year to compute that appellant had made estimated taxable sales of IT equipment of $69,496 in 2009, $75,279 in 2010, and $93,236 in 2011.

9. Thus, for the period of 2009 through 2011, CDTFA estimated that appellant had made total unreported taxable sales of IT equipment of $238,011 ($69,496 in 2009 + $75,279 in 2010 + $93,236 in 2011).

10. In total, CDTFA determined that appellant had made unreported taxable sales of IT equipment of $394,389 for the combined liability period ($156,378 for 2003 through 2008 + $238,011 for 2009 through 2011).

11. With respect to appellant's Colton business, CDTFA acquired several of appellant's sales invoices and sales agreements for November and December 2010, which indicated that appellant had bundled wireless phone equipment with wireless service plans and sold

[6] See footnote 5, *ante*, page 3.

them together. However, appellant did not report or remit sales taxes with respect to its sales of the wireless phone equipment. CDTFA acquired appellant's wireless phone equipment vendor's sales journal, which showed that appellant had purchased $122,355 of wireless phone equipment for 2010 and 2011 but did not pay sales tax reimbursement to the vendor for these purchases. CDTFA applied an 18 percent markup to appellant's cost for wireless phone equipment for 2010 and 2011, and determined that appellant had made unreported taxable sales of wireless phone equipment in the amount of $144,379 (rounded) ($122,355 x 1.18) for those years.

12. In December 2012, CDTFA issued to appellant two NODs, which appellant timely petitioned for redetermination. Appellant also filed SUTRs for 2009 through 2011.[7]

13. On February 13, 2017, CDTFA issued its decision, which partly granted and partly denied appellant's petitions for redetermination. CDTFA affirmed the failure-to-file penalty of $1,223.16 for 2003 through 2008, but deleted the failure-to-file penalty of $4,854.85 for 2009 through 2011.

14. On June 20, 2017, CDTFA reduced the amount of unreported taxable sales of wireless phone equipment from $144,379 to $136,377 to account for a 1 percent pilferage allowance ($1,224 based on the wireless phone equipment's cost of $122,355), as well as appellant's remaining unsold inventory when its Colton business closed, which CDTFA estimated as the cost of one month's wireless phone equipment purchases ($5,558).

15. Subsequently, appellant appealed CDTFA's decision to OTA.

16. On May 14, 2020, CDTFA determined that it did not have sufficient evidence to show that appellant made taxable sales of tangible personal property in 2003 and 2004, so it deleted the determined amount of unreported taxable sales for those years ($7,705 for 2003 and $10,139 for 2004). Accordingly, CDTFA reduced the amount of unreported taxable sales of IT equipment from $394,389 to $376,545 [($138,534 for 2005 through 2008 + $238,011 for 2009 through 2011)]. CDTFA correspondingly reduced the remaining failure-to-file penalty, which was for 2003 through 2008, from $1,223.16 to $1,083.65.

[7] See footnote 5, *ante*, page 3.

17. Thus, for the combined liability period, CDTFA determined that appellant had made unreported taxable sales of IT equipment in the amount of $376,545 and unreported taxable sales of wireless phone equipment in the amount of $136,377.

18. On November 19, 2021, OTA held an electronic oral hearing for this matter, and held the record open for additional submissions. As described more fully below, following appellant's submission, CDTFA conceded to further reduce the amount of unreported taxable sales of IT equipment and the amount of unreported taxable sales of wireless phone equipment due to an unclaimed tax-paid purchases resold deduction and an increased pilferage allowance, respectively.

## DISCUSSION

Issue 1: Whether the amount of unreported taxable sales of IT equipment should be further reduced.

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of all 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 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).)

If any person fails to make a return, CDTFA will estimate the person's gross receipts based on any information that is within its possession or that may come into its possession. (R&TC, § 6511.) If a taxpayer files a return but 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 within its possession or that 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 Amaya*, 2021-OTA-328P.) If CDTFA meets its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The applicable burden of proof is by a preponderance of the evidence. (Cal Code. Regs., tit.18, § 30219(c).) That is, a party must

establish by documentation or other evidence that that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) To satisfy the burden of proof, a taxpayer must prove that: (1) the tax assessment is incorrect; and (2) the proper amount of the tax. (*Ibid*.)

Here, appellant initially did not file any SUTRs for the combined liability period. Upon audit, appellant did not provide complete books and records for the combined liability period (e.g., any sales invoices for 2005, 2006, and 2008; sales journals for 2005, 2006, and 2011; or FITRs for 2010 and 2011). Nevertheless, what books and records CDTFA was able to acquire, particularly for 2007 through 2011, showed that appellant charged and collected sales tax reimbursement in connection with unreported taxable sales of IT equipment during those years. Based on those books and records, CDTFA determined the amount of appellant's unreported taxable sales of IT equipment for 2007 through 2010. Then, based on the rest of the books and records acquired, CDTFA estimated appellant's unreported taxable sales of IT equipment for the rest of the combined liability period (i.e., 2005, 2006, and 2011). OTA has reviewed CDTFA's audit method, calculations, and adjustments, and finds that CDTFA has shown that its determination was reasonable and rational. Accordingly, the burden of proof now shifts to appellant to show that further adjustments are warranted.

On appeal, appellant argues that the determined amount of unreported taxable sales of IT equipment is still overstated for four reasons: (1) it is contradicted by the taxable sales recorded in appellant's books and records;[8] (2) it erroneously includes sales of IT equipment appellant purchased tax-paid from its vendors (thus entitling appellant to an offsetting deduction); (3) it erroneously includes nontaxable sales of services; and (4) it does not account for payments appellant has already made towards its tax liability for 2009 through 2011. OTA will examine each of these arguments in turn.

*Appellant's First Argument: Contradicted by Summary Sales Tax Reports*

Appellant argues that the determined amount of unreported taxable sales of IT equipment is contradicted by the taxable sales appellant made per its books and records and therefore should

[8] In its opening brief, appellant initially contended that it did not sell tangible personal property prior to 2010, but, at oral hearing, appellant conceded that it occasionally sold IT equipment to its customers during that period.

be reduced. In support, appellant produced summary sales tax reports for 2005 through 2011 after the oral hearing.

Here, appellant's summary sales tax reports allegedly record total taxable sales of $404,031.58 for 2005 through 2011.[9] This figure must be reduced by the taxable sales represented by appellant's reported sales tax liability of $1,659 for 2009, $1,861 for 2010, and $304 for 2011; based on these amounts, OTA estimates the reported taxable sales to be $44,360.40.[10] Subtracting estimated reported taxable sales of $44,360.40 for 2009, 2010, and 2011 from alleged recorded total taxable sales of $404,031.58 for 2005 through 2011 results in alleged unreported taxable sales of $359,671.18 for 2005 through 2011. By comparison, for those same years, CDTFA determined that appellant had audited unreported taxable sales of $376,545,[11] a difference of $16,873.82. Thus, appellant is essentially arguing that, based on the summary sales tax reports it produced after the oral hearing, the determined amount of unreported taxable sales of IT equipment should be reduced by that difference.

However, OTA questions the reliability and accuracy of the summary sales tax reports for two reasons. First, the summary sales tax reports appear to divide appellant's alleged taxable sales among four "territories" represented by the initials "OC," "LA," "SF," and "SD." During the audit, appellant communicated to CDTFA that it made taxable sales of IT equipment in Orange, Los Angeles, and Fresno Counties; appellant also owned a business making wireless phone equipment sales in Riverside County. While "OC" and "LA" may refer to Orange and Los Angeles Counties, the initials "SF" and "SD" do not appear related to either Fresno or Riverside Counties. This discrepancy undermines the reliability of the summary sales tax reports appellant provided to OTA after the oral hearing. Second, appellant has not supplied the backup or source documents the sales tax reports are summarizing, so OTA cannot verify the accuracy of

[9] Per appellant's summary sales tax reports, total alleged recorded taxable sales of $404,031.58 comprise taxable sales in the following amounts and years: $21,690 in 2005; $12,219 in 2006; $23,185.30 in 2007; $71,849.45 in 2008; $99,213.65 in 2009; $98,382.33 in 2010; and $77,491.85 in 2011.

[10] OTA calculated this figure by first apportioning appellant's reported sales tax liability for 2009, 2010, and 2011 ($1,659, $1,861, and $304, respectively) among Orange, Los Angeles, and Fresno Counties based on the 80/10/10 ratio appellant estimated for its taxable sales and communicated to CDTFA during the audit. OTA then divided each resulting portion by their respective county's sales tax rate for that particular year to compute the taxable sales appellant reported for each county in 2009, 2010, and 2011, which totaled $44,360.40.

[11] Unreported taxable sales of $376,545 consists of the following unreported taxable sales per year: $13,340 in 2005; $17,553 in 2006; $23,096 in 2007; $84,545 in 2008; $69,496 in 2009; $75,279 in 2010; and $93,236 in 2011.

the figures contained in the reports. For these two reasons, OTA finds the summary sales tax reports unreliable and appellant's first argument, which rests on them, unpersuasive.

*Appellant's Second Argument: Deduction for Tax-Paid Purchases Resold*

Appellant contends that it paid sales tax reimbursement to its IT equipment vendors and then charged and collected the same from its own customers. Thus, appellant maintains that it is entitled to a deduction for tax-paid purchases resold to offset its tax liability. (See Cal. Code Regs., tit. 18, § 1701.) In support, appellant provided the following documents after the oral hearing: (a) a February 22, 2010 invoice for IT equipment purchased from Allen Instruments & Supplies; and (b) a batch of invoices for IT equipment purchased from Dell in 2007, 2008, and 2009.

CDTFA reviewed appellant's documentation, as well as its available books and records, and determined that appellant did resell the IT equipment it purchased tax-paid from Allen Instruments in 2010. Accordingly, CDTFA found that appellant was entitled to a deduction of $10,504, the total amount of appellant's purchase.

However, regarding the tax-paid purchases from Dell, appellant did not supply any sales invoices showing that it had resold them to its own customers, and CDTFA could not match these purchases to any subsequent, corresponding taxable sales recorded in the sales journals appellant made available for audit. OTA reviewed the Dell invoices and appellant's available sales journals and could not reconcile them either. Accordingly, OTA finds that appellant is not entitled to any deduction related to its tax-paid purchases from Dell.

Based on appellant's second argument and supporting documents, the determined amount of unreported taxable sales of IT equipment should be reduced because of a deduction for tax-paid purchases resold amounting to $10,504 for 2010.

*Appellant's Third Argument: Mis-Identified/Recorded Non-Taxable Service Fees*

Appellant states that it purchased and resold internet services from vendors, who charged it fees that appellant passed on to its own customers. Appellant contends that it either mistakenly identified these fees as sales taxes in its sales invoices or mistakenly recorded them as collected sales tax reimbursement in its sales journals, and CDTFA mistakenly included these nontaxable fees in its audit method when determining the amount of appellant's unreported taxable sales of IT equipment.

In support, appellant provided the following six documents: (a) a February 13, 2003 invoice charging appellant $274.39 for internet services provided by O1 Communications in California, which included various taxes and fees totaling $7.39; (b) a September 26, 2006 invoice charging appellant $3,041.30 for internet and telephone services provided by Cox Communications in California, which included various taxes, fees, and surcharges totaling $43.20; (c) a September 1, 2008 invoice charging appellant $2,040.19 for internet services provided by New Edge Networks in New Mexico, Colorado, and Texas, which included various taxes, fees, and surcharges totaling $58.28; (d) an August 30, 2009 invoice charging appellant $2,806.43 for internet and telephone services provided by Cox Communications in California, which included taxes, fees, and surcharges totaling $91.24; (e) an October 1, 2009 invoice charging appellant $1,660.62 for internet services provided by New Edge Networks in New Mexico, Colorado, and Texas, which included various taxes, fees, and surcharges totaling $101.86; and (f) an October 8, 2021 invoice charging appellant $1,666.48 for internet services provided by CenturyLink Communications in Colorado, Oregon, and New Mexico, which included various taxes, fees, and surcharges totaling $466.48.

In response, CDTFA argues that appellant has provided no credible evidence that it mislabeled such fees as sales tax in its records.

Here, no adjustment is warranted for the 2003 invoice because CDTFA has already deleted the determined amount of unreported taxable sales for that year. Regarding the 2006 invoice, appellant did not provide any sales invoice or sales journal from 2006, either upon audit or appeal, so OTA cannot verify whether appellant passed on the taxes, fees, and surcharges included in that invoice to its customers. Regarding the 2008 and 2009 invoices, OTA has reviewed the record and could not trace the taxes, fees, and surcharges included therein to any sales invoice or sales journal entry in the record. Appellant has also not identified the taxable sales transactions through which it allegedly passed on these service fees to its customers as sales taxes or sales tax reimbursement. Finally, the 2021 invoice is irrelevant because that year is not within the combined liability period, which ended in 2011. For all these reasons, OTA finds appellant's third argument unpersuasive.

*Appellant's Fourth Argument: Entitled to Offsetting Credit for Alleged Past Payments*

Appellant contends that in 2013 it paid CDTFA nearly $5,000 towards its tax liability for 2009, 2010, and 2011, but has received no acknowledgement of these payments from CDTFA.

In support, following the oral hearing, appellant provided an excerpt from its check register, which allegedly showed that appellant issued the following three checks to CDTFA in early 2013: (a) a check dated February 26, 2013, for $2,210.69 with respect to 2009; (b) a check dated March 28, 2013, for $2,296.76 with respect to 2010; and (c) a check dated February 26, 2013, for $355.41 with respect to 2011.

In response, CDTFA argues that these payments do not warrant an adjustment because appellant has not explained how the payments relate to the issues on appeal.

OTA does not have jurisdiction to determine whether appellant is entitled to a remedy for CDTFA's actual or alleged violation of any substantive or procedural right to due process under the law, unless the violation affects the adequacy of notice, the validity of an action from which a timely appeal was made, or the amount at issue in this appeal. (Cal. Code Regs., tit. 18, § 30104(d).)

Here, CDTFA's alleged failure to credit appellant with past payments would not affect the amount of unreported taxable sales of IT equipment at issue (if anything, these alleged uncredited payments to CDTFA would only reduce appellant's tax liability). Further, CDTFA's alleged violation would not affect the adequacy of any notice or the validity of any action that appellant has appealed. Thus, OTA does not have jurisdiction to remedy the alleged violations at the heart of appellant's fourth argument.

*Summary*

The amount of unreported taxable sales of IT equipment should be reduced from $376,545 to $366,041 because of a deduction in the amount of $10,504 for 2010.

Issue 2: Whether the amount of unreported taxable sales of wireless phone equipment should be further reduced.

Tax applies to the gross receipts from the retail sale of a wireless telecommunication device (e.g., a wireless phone), and the retailer of the wireless telecommunication device is required to report and pay the tax. (Cal. Code Regs., tit. 18, § 1585(a)(1) & (b)(1).) Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction, measured by the unbundled sales price of that device. (Cal. Code Regs., tit. 18, § 1585(b)(3).) The unbundled sales price is the price at which the retailer has sold specific wireless telecommunication devices to customers who are not required to activate or contract for

utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale. (Cal. Code Regs., tit. 18, § 1585(a)(4).) If the retailer cannot establish an unbundled sales price to CDTFA's satisfaction based upon its own sales records, the unbundled sales price of the device shall equal the fair retail selling price of that device. (*Ibid*.) If tax is reported and paid on an amount equal to the cost of the device plus a markup on cost of at least 18 percent, such amount shall be regarded as the fair retail selling price of the device. (*Ibid*.)

Here, the record shows that appellant sold wireless phone equipment in a bundled transaction, collected some sales tax reimbursement on such sales, but did not report any sales to CDTFA. Appellant did not provide complete books and records regarding these sales or any books and records regarding its purchases of wireless phone equipment. Therefore, OTA finds that it was reasonable and rational for CDTFA to use information from appellant's wireless phone vendor to calculate appellant's cost of wireless phone purchases and to apply an 18 percent markup per California Code of Regulations, title 18, section 1585(a)(4).

Subsequently, CDTFA reduced appellant's $122,355 wireless phone costs by $1,224 for a 1 percent pilferage allowance and $5,558 for a one-month ending inventory allowance. A 1 percent pilferage allowance is the standard amount CDTFA allows in non-bar/restaurant audits absent documentation (see CDTFA's Audit Manual § 0407.10 [providing for a 1 percent pilferage allowance in general audits]),[12] so OTA finds a pilferage allowance for that amount reasonable and rational absent further evidence. Regarding the ending inventory allowance, appellant did not provide (and CDTFA did not acquire) any FITRs for 2010 or 2011 (the years appellant purchased wireless phone equipment from its vendor), which could have documented appellant's ending inventories, if any, for those years.[13] Absent these FITRs or any other documentation, OTA finds that an ending inventory allowance equivalent to one month's inventory is reasonable and rational. Accordingly, CDTFA has met its initial burden, and the burden of proof shifts to appellant to show that a result differing from CDTFA's determination is warranted.

[12] CDTFA's Audit Manual does not provide binding legal authority; however, OTA may look to it for guidance. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

[13] Appellant's FITRs for 2005 through 2008 reported ending inventories of $0. Appellant apparently did not report an ending inventory on its 2009 FITR.

On appeal, appellant argues it is entitled to a larger pilferage allowance (due to a break-in) and a larger ending inventory allowance. In support of a larger pilferage allowance, appellant provided the following documents: email correspondence from April and May 2011 between itself and an insurance company regarding stolen wireless phone inventory costing $2,676; and an April 29, 2011 invoice from a contractor for cleaning up and replacing a broken storefront window. In support of a larger ending inventory allowance, appellant provided email correspondence from March 2012 between itself and a Florida purchaser of appellant's remaining wireless phone and accessories inventory for $3,500.

In response, CDTFA increased the pilferage allowance by $2,676, from $1,224 to $3,900. However, CDTFA contends that increasing the ending inventory allowance of $5,558 is not warranted because it already exceeds the $3,500 figure supported by appellant's documentation.

OTA finds that appellant's documents support increasing the pilferage allowance by $2,676, from $1,224 to $3,900, but do not support increasing the current ending inventory allowance of $5,558; appellant's records only support an allowance of $3,500.[14] Overall, OTA finds that appellant has proven that, due to an additional pilferage allowance of $2,676, the $136,377 amount of unreported taxable sales of wireless phone equipment should be further reduced by $3,158 ($2,676 + 18 percent markup), to $133,219.

Issue 3: Whether the remaining failure-to-file penalty should be relieved.

On or before the last day of the month following each quarterly period of three months, a return for the preceding quarterly period must be filed with CDTFA. (R&TC, § 6452(a).) If a person fails to make the return, CDTFA will estimate the tax the person is required to pay the state and add a 10 percent failure-to-file penalty. (R&TC, § 6511; Cal. Code Regs., tit. 18, § 1703(c)(3)(B).)

Appellant did not file any SUTRs for the years 2005 through 2008 even though it was making taxable sales throughout, so CDTFA added a 10 percent failure-to-file penalty of $1,083.65 to the NOD issued to appellant for those years.

On appeal, appellant contends that it made a mistake by assuming that if it paid sales tax reimbursement to its vendors for the IT equipment it resold, then it did not need to file SUTRs. Appellant asks for leniency.

[14] OTA declines to disturb the ending inventory allowance of $5,558 as CDTFA has not argued for a reduction.

If OTA finds that a person's failure to make a timely return is due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person will be relieved of the failure-to-file penalty. (R&TC, § 6592(a)(1); Cal. Code Regs., tit. 18, § 1703(c)(8).)

Here, appellant ascribes its failure to file SUTRs to its faulty assumption regarding the requirement to file SUTRs and asks for leniency. However, "[k]nowledge of the law is presumed" (*Macfarlane v. Dept. of Alcoholic Beverage Control* (1958) 51 Cal.2d 84, 90), so appellant's subjective mistaken belief about the law by itself does not constitute reasonable cause. Further, appellant has not described any circumstances that were beyond its control that would have caused its failure to file SUTRs. Finally, OTA is not aware of any authority under the Sales and Use Tax Law authorizing relief of a penalty based on leniency. Accordingly, OTA concludes that relief of the failure-to-file penalty is not warranted.

## HOLDINGS

1. The amount of unreported taxable sales of IT equipment should be further reduced to $366,041.
2. The amount of unreported taxable sales of wireless phone equipment should be further reduced to $133,219.
3. Relief of the remaining failure-to-file penalty is not warranted.

## DISPOSITION

Per CDTFA's post-decision adjustments, OTA modifies CDTFA's decision, reducing the amount of unreported taxable sales of IT equipment to $376,545, the amount of unreported taxable sales of wireless phone equipment to $136,377, and the failure-to-file penalty for 2005 through 2008 to $1,083.65. On appeal, OTA further reduces the amount of unreported taxable sales of IT equipment to $366,041 due to an unclaimed tax-paid purchases resold deduction, and the amount of unreported taxable sales of wireless phone equipment to $133,219 due to an increased pilferage allowance. Otherwise, OTA sustains CDTFA's decision.

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Andrew Wong
Administrative Law Judge

We concur:

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Suzanne B. Brown
Administrative Law Judge

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Keith T. Long
Administrative Law Judge

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