OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18103866
	CDTFA Case IDs 183-075, 183-076
K. MARACCINI	
dba Ottavio	

OPINION

Representing the Parties:

For Appellant: K. Maraccini

For Respondent: Jarrett Noble, Tax Counsel IV
Stephen Smith, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, K. Maraccini (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's administrative protest of a July 20, 2015 Notice of Determination (NOD) for $24,869.06 tax, plus accrued interest, and a penalty of $42,486.91 for the period April 1, 2012, through September 30, 2012 and petition for redetermination of a November 18, 2015 NOD for $54,297.74 tax, plus accrued interest, and a penalty of $6,614.78 for the period October 1, 2012, through September 30, 2014 (liability period, collectively).[2] After the NOD's were issued, CDTFA completed a reaudit, which reduced the tax and penalties for the liability period.

[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] CDTFA completed a single audit for the period April 1, 2012, through September 30, 2014. CDTFA issued the July 20, 2015 NOD because appellant declined to sign a waiver extending the statute of limitations to issue a determination for the period April 1, 2012, through September 30, 2012. Thereafter, CDTFA issued the November 18,2018 NOD for the remainder of the liability period. Whether the NODs were timely issued is not in dispute.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Keith T. Long held an oral hearing for this matter in Sacramento, California, on July 20, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for an Opinion.

ISSUES

1. Whether appellant is liable for the tax arising from unreported taxable sales.
2. Whether any further reduction to the measure of unreported taxable sales is warranted.
3. Whether the understatement was the result of negligence.

FACTUAL FINDINGS

1. In 2010, appellant opened a restaurant known as Ottavio's (the business) in Walnut Creek, California. Appellant obtained a seller's permit with CDTFA effective May 7, 2010. Appellant is listed as the sole proprietor of the business on the seller's permit application, which appellant signed.
2. During the liability period, the business reported total sales and taxable sales of $583,219.
3. On or about January 1, 2013, appellant agreed to sell the business to V. and M. Luchin (the Luchins) for $100,000, payable in installments for a period of 60 months at a 3.5 percent interest rate. The Luchins made timely payments until approximately August 15, 2014. Appellant did not contact CDTFA to close his seller's permit, until October 2, 2014.
4. Thereafter, CDTFA closed appellant's seller's permit as of September 30, 2014.

5. In April 2015, CDTFA contacted appellant regarding an audit and appellant stated that the business was sold as of January 2013.[3] Appellant did not provide records for the audit.

6. For the audit, CDTFA obtained the following: appellant's federal income tax return for 2012 and appellant's merchant credit card sales information (Forms 1099K) for 2011 through 2013.[4] CDTFA compared appellant's federal income tax return for 2012 to appellant's sales and use tax returns for that year. Gross receipts recorded on the federal income tax return exceeded reported taxable sales by $304,465.

7. CDTFA used appellant's 2013 Form 1099K to calculate appellant's unreported taxable sales. CDTFA estimated that 90 percent of appellant's total sales were credit card sales and 80 percent of appellant's total sales were taxable. CDTFA based these estimates on audits of similar businesses. CDTFA used these ratios, along with the credit card sales reported on appellant's 2013 Form 1099K, to calculate audited taxable sales of $668,741. CDTFA reduced audited taxable sales by the sales tax reimbursement collected to calculate ex tax taxable sales of $534,993, which when compared to reported ex tax taxable sales of $218,016 for 2013, the audited taxable sales represent an error rate of 145.39 percent. CDTFA applied the 145.39 percent error rate to each quarter of the liability period and calculated unreported taxable sales of $847,943.

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[3] In support, appellant provided a Bill of Sale dated January 1, 2013, a promissory note dated January 1, 2013, and an untitled document which purports to be a "list of forms required for transfer" of the business. At the oral hearing, CDTFA objected to the untitled document, questioning its authenticity. OTA admitted the document over CDTFA's objection. However, appellant has not provided any evidence to verify the document's authenticity. To an untrained eye there is reason to question the authenticity of the untitled document and the Bill of Sale. OTA notes that all three documents have similar ink-skip in the letters V and L of Mr. Luchin's first name and in the L of Mr. Luchin's last name. There is also an identical pair of dots immediately after the L in Mr. Luchin's last name. Finally, there is a thin black line that appears underneath Mr. Luchin's signature on the untitled document and the bill of sale. OTA does not find these similarities when compared to other examples of Mr. Luchin's signature. Thus, OTA finds these documents less credible that the other evidence and gives them less weight.

However, there is no dispute that the Luchins made timely payments on the promissory note until approximately August 15, 2014. Additionally, the promissory note signature does not have a thin black line underneath it. Considered together, OTA gives some weight to the promissory note as evidence that a sales agreement existed as of January 1, 2013.

For reasons addressed in this Opinion, even if OTA were to find that all three documents were credible, the outcome of this appeal would not change.

[4] Form 1099-K is an IRS form that reports amounts paid to a merchant by a bank, credit card company, or third-party network when the customer pays for goods or services using a debit card, credit card, PayPal, or similar non-cash payment.

8. On July 20, 2015, CDTFA issued an NOD for the period April 1, 2012, through September 30, 2012, because the statute of limitations to issue an NOD for this period was set to expire on or after August 1, 2015. Appellant did not pay or petition the NOD within 30 days, and CDTFA added a finality penalty of $2,486.91.[5] On November 18, 2015, CDTFA issued an NOD for the period October 1, 2012, through September 30, 2014.

9. After the NOD was issued, CDTFA completed a reaudit, which included appellant's 1099K information for 2012 and 2014. Additionally, CDTFA corrected an error with respect to the 1099K information for 2013. Using this information, CDTFA calculated error rates of 73.47 percent for the period April 2012 to December 2012; 63.56 percent for 2013; 65.87 percent for the period January 2014 to September 2014; and an overall error rate of 67.4 percent. For each quarter of the liability period, CDTFA applied the related error rate and found audited unreported taxable sales of $395,689 for the liability period. This reduced the taxable measure by $452,254.

10. Appellant disputed the NODs in an administrative (late) protest and a timely petition for redetermination, which CDTFA denied. This timely appeal 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 purpose of 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.) 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 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

[5] On appeal, appellant has not made any contentions regarding the finality penalty. Therefore, OTA finds that it is not at issue, and the penalty shall not be discussed further.

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*.)

Every person desiring to conduct business as a seller within this state must file an application for a seller's permit for each place of business. (R&TC, § 6066.) A seller's permit can be held only by persons actively engaged in the business of selling tangible personal property within this state, and any person not so engaged must surrender his or her permit to CDTFA for cancellation. (R&TC, § 6072.)

Issue 1: Whether appellant is liable for the tax arising from unreported taxable sales.

On appeal, appellant does not dispute that he owned the business for all periods prior to January 1, 2013. Additionally, appellant obtained a seller's permit identifying himself as the business's sole proprietor. Accordingly, OTA finds that appellant was the owner of the business and liable for the tax for the period April 1, 2012, through December 31, 2012. However, appellant asserts that he sold the business to the Luchins as of January 1, 2013, and is not liable for the tax reported under his sole proprietor seller's permit on or after that date.

In general, the sale of a business occurs when a purchaser acquires all seller's rights to engage in the business at a given location. (See CDTFA's Business Taxes Law Guide Annotation 535.0090 (6/26/78).)[6] Here, there is no dispute that appellant agreed to sell the business as of January 1, 2013. There is also no dispute that the Luchins made timely payments on a promissory note securing the sale until approximately August 15, 2014. However, the available evidence shows that appellant did not transfer the business location's lease until April 29, 2014; appellant also did not transfer the business's liquor license until April 10, 2014; and appellant retained control of the business's bank accounts throughout the liability period. Additionally, appellant remained the named payee on the business's merchant credit card services. Appellant's merchant credit card services continued to receive payments through August 2014. In short, the evidence shows that appellant did not transfer all of the rights to

[6] CDTFA's annotations are not regulations, and they are not binding upon taxpayers, CDTFA, or OTA. (*Appeal of Martinez Steel Corporation*, 2020-OTA-074P; Cal. Code Regs., tit. 18, § 35101.) The annotations are digests of opinions written by the legal staff of CDTFA which are evidence of administrative interpretations made by CDTFA in the normal course of its administration of the Sales and Use Tax Law. (*Appeal of Martinez Steel Corporation*, *supra*.)

operate the business and therefore the sale was not completed. In fact, by virtue of the lease and liquor license, appellant remained the only person authorized to make liquor sales at the business. Thus, OTA finds that it was reasonable for CDTFA to conclude that appellant was the business's owner, and that appellant was liable for the tax. Thus, the burden of proof shifts to appellant. (*Appeal of Talavera, supra.*)

Regarding the lease transfer, appellant asserts that he did not sign any documents after January 1, 2013. Appellant contends that any signature thereafter is a forgery, including the signature appearing on the lease transfer. However, appellant has not provided any evidence in support of this assertion.[7] Appellant's unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*) Further, OTA finds no other evidence that appellant transferred the lease to the Luchins. For example, the Bill of Sale does not include a lease transfer or lease transfer clause. Similarly, appellant's list of forms required to transfer the business does not actually include a form transferring the lease. It is merely a list. In other words, the April 29, 2014 lease transfer is the only evidence of a lease transfer. Thus, OTA finds based on the evidence that the lease was transferred on or about April 29, 2014.

Similarly, appellant argues that he signed a request for liquor license transfer on January 1, 2013. However, appellant did not provide a copy of this document. Instead, OTA has two conflicting pieces of evidence. The first piece of evidence is a Notice of Intended Transfer of Retail Alcoholic Beverage License (ABC Transfer), which contains appellant's signature and is recorded by the Contra Costa County Clerk-Recorder on April 21, 2014. The second is a series of emails that indicate appellant did not sell the liquor license until 2015. Appellant asserts that the 2015 emails are accurate, and that the ABC Transfer was not finalized. In either event, the evidence indicates that appellant did not transfer the business's liquor license until at least April 21, 2014. Accordingly, OTA finds that appellant did not transfer the liquor license on January 1, 2013.

Similarly, OTA finds no evidence to support appellant's contentions that he attempted to close the business' bank account. Indeed, there is no dispute that the business bank account

[7] As with the Bill of Sale and the untitled document, which raised questions about the validity of Mr. Luchin's signature, OTA reviewed the lease transfer in response to appellant's assertion that his own signature was forged. OTA's review did not reveal the same markers of concern when compared to other signatures in the oral hearing record. For example, OTA could not find similar ink-skipping, stray markings, or lines on the other available signatures from appellant. Nor has appellant pointed to any additional examples to verify his claim.

remained open.[8] There is also no dispute that appellant's merchant credit card services account received payments until August 2014.

OTA notes appellant's submission of a labor commission order, which finds the assertion that appellant was not the business owner to be undisputed. The order dismisses him as a defendant to an employee wage claim dispute. In that case, appellant submitted a bill of sale, promissory note, and judgment against the Luchins as evidence that he was not the business owner. There is no indication that the labor commission considered appellant's evidence. Instead, the plaintiff in that case did not dispute appellant's contentions. Thus, we find that the labor commission order is of little relevance to OTA because the dismissal of appellant as a defendant was in the nature of a default judgment. In this appeal, however, appellant's contention that he sold the business is disputed, and so OTA must consider the available evidence. As detailed above, appellant retained control of the seller's permit, lease, liquor license, and bank accounts.

Finally, there is some evidence that Mr. Luchin held himself out as the business's owner. It is also undisputed that the Luchins made payments on a promissory note until approximately August 15, 2014. While this is some evidence that appellant sold the business on January 1, 2013, it is insufficient to overcome all of the evidence showing otherwise. Thus, OTA finds that appellant did not sell the business on January 1, 2013, because he retained the rights to do business at the location (i.e., the lease, the seller's permit, the liquor license, and the financial accounts.)

Next, OTA considers the period April 30, 2014, through September 30, 2014. As discussed above, appellant may have transferred control of some aspects of the business as of April 29, 2014. However, when a business is transferred, a taxpayer may still be liable for the business's outstanding sales tax liability if: (1) appellant failed to surrender his seller's permit upon transfer of the business, and if (2) he had actual or constructive knowledge that the transferee used the permit in any manner. (*Appeal of Pasatiempo Investments, Ltd.,* 2020-OTA-069P; Cal. Code Regs., tit.18, 1699(f)(2).) When the business is not transferred, but the permitholder allows another to use the permit, there is no time limit on liability for taxes reported under the permit. (*Ibid*.)

[8] While appellant asserts that he attempted to close the bank account, appellant also concedes that it was not in fact closed at that time.

A permitholder is said to have constructive knowledge if sales and use tax returns are filed under the permit number. (Cal. Code Regs., tit.18, 1699(f)(2).) In the case of a transfer, the predecessor's liability shall be limited to the quarter in which the business is transferred, and the three subsequent quarters. (R&TC, § 6071.1(a).) The limitation on a predecessor's liability shall not apply in cases where, after the transfer, 80 percent or more of the real or ultimate ownership of the business is held by the predecessor. Liability does not attach on and after the date that the permitholder establishes that CDTFA was notified to cancel the permit. (*Ibid.*)

Here, there is no dispute that appellant failed to close his seller's permit following the alleged sale or transfer of the business. According to CDTFA's decision, appellant informed them of the business sale on October 2, 2014. Additionally, sales and use tax returns were filed under appellant's seller's permit number throughout the liability period. Thus, appellant had constructive knowledge of the seller's permit's use. Accordingly, even if appellant transferred the business on April 29, 2014, he is liable for the business's sales tax liability as the predecessor through September 30, 2014, because that is the quarter immediately subsequent to the transfer. (See R&TC section 6071.1(a).)

Issue 2: Whether any reduction to the measure of unreported taxable sales is warranted.

As discussed above, 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 failed to provide any books and records for the audit. CDTFA examined appellant's federal income tax return and found discrepancies that appellant failed to explain. Specifically, CDTFA found that the gross receipts reported on appellant's federal income tax returns exceeded the taxable sales reported on appellant's sales and use tax returns by $304,465. To calculate the taxable measure, CDTFA used appellant's 2013 Form 1099-K to calculate an error ratio and project the taxable measure. Thereafter, CDTFA used Form 1099-K information from the years 2012, 2013, and 2014, to establish annual error rates, which were applied to each quarter of the liability period and reduced the taxable measure (as initially calculated by CDTFA). Considering the severely limited set of books and records, OTA finds that CDTFA's use of appellant's Forms 1099-K for the three years of the liability period to establish the audit

measure is reasonable and rational. Accordingly, the burden of proof shifts to appellant to show that adjustments are warranted.

On appeal, appellant does not make any arguments specific to the audit. Instead, appellant contends that he sold the business to the Luchins on January 1, 2013. Appellant also asserts that the Luchins maintained custody of the business's records. Appellant asserts that he cannot provide documents because he does not have them. However, as discussed above, OTA finds that appellant is liable for the business's tax liability throughout the audit period. Appellant has not met his burden of proof. (*Appeal of Talavera, supra*.) Accordingly, OTA finds that no adjustments to the taxable measure are warranted.

Issue 3: Whether the understatement was the result of negligence.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal. App. 4th 434, 447.) Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

A taxpayer shall maintain and make available for examination on request by CDTFA, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b).) Such records include but are not limited to the following: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1)(A)-

(C).) Failure to maintain and keep complete and accurate records is considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

Here, appellant did not provide a complete set of books and records for the audit. Appellant asserts that he could not provide a complete set of books and records because he sold the business. However, it is undisputed that appellant controlled the records prior to January 2013. Further, appellant maintained control of the business's bank account throughout the liability period. Appellant also maintained control of the business's merchant credit card services through August 2014. Despite these facts, appellant failed to provide any books or records for the audit.[9] Appellant's failure to maintain or provide any books and records for audit is strong evidence of negligence.

Further, the audit revealed that appellant failed to report taxable sales of $395,689. When compared to reported taxable sales of $583,219, this represents an error rate of 68 percent (rounded). OTA finds that this significant rate of understatement is additional strong evidence of negligence in reporting. Based on the foregoing, OTA finds that appellant could not have held a bona fide and reasonable belief that his bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Therefore, although this is the first audit of appellant, OTA finds that there is ample evidence of negligence, and the negligence penalty is fully warranted.

[9] CDTFA obtained appellant's Form 1099-K information from another source.

HOLDINGS

1. Appellant is liable for the tax arising from unreported taxable sales.
2. No further reduction to the measure of unreported taxable sales is warranted.
3. The understatement was the result of negligence.

DISPOSITION

CDTFA's action denying appellant's petition for redetermination and administrative protest subject to the reductions made upon reaudit are sustained.

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Keith T. Long
Administrative Law Judge

We concur:

DocuSigned by:
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Josh Aldrich
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 8/31/2022