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2022 – OTA – 417
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 19095233
PARTNERSHIP OF EDWARD J. PIECUL ET AL. dba Ray-Ken Auto Works	)	CDTFA Case ID 866157

OPINION

Representing the Parties:

For Appellant: G. Piecul, Partner
Jackie Hosey, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

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

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, the husband-and-wife partnership of Edward J. Piecul et al. (appellant)[1] appeals a decision issued by the California Department of Tax and Fee Administration (respondent)[2] denying, in part, appellant's petition for redetermination of a Notice of Determination (NOD) dated March 25, 2015.[3] The NOD is for tax of $14,200.17, plus applicable interest, and a negligence penalty of $1,420.02 for the period April 1, 2011, through March 31, 2014 (liability

[1] Under certain circumstances, an unincorporated business jointly owned by a married couple (i.e., a joint venture, co-ownership, or partnership by operation of law) may elect to not be taxed as a partnership for income tax purposes. (See Internal Revenue Code, § 761(f).) Instead of filing taxes as a partnership, the qualifying members (husband and wife) may elect to file as sole proprietors for income tax purposes. (*Ibid.*) Irrespective of federal income tax treatment, a husband-and-wife joint venture or co-ownership is recognized as a partnership by operation of law and treated as a separate entity for sales and use tax purposes. (R&TC, §§ 6005, 6015.)

[2] 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 respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "respondent" shall refer to BOE.

[3] Respondent timely issued the NOD because appellant signed a series of waivers of the otherwise applicable statute of limitations, which extended the deadline for issuing an NOD until July 31, 2015. (R&TC, §§ 6487(a), 6488.)

period). Respondent's decision and subsequent reaudit reduced the tax liability at issue in this appeal by $9,718.00, from $14,200.17 to $4,483.00.[4] In addition, respondent conceded to delete the negligence penalty.

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

ISSUE

Whether any additional adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Appellant operated an auto collision repair shop from April 1, 1986, through December 31, 2015. According to appellant, its only sales of automobile parts were those it billed to insurance companies. Appellant purchased the parts from car dealerships or a parts dealer at a discounted price, and then sold the parts to insurance companies at the "list price" shown on the purchase invoices, with sales tax reimbursement added to the selling price for parts. When appellant purchased shop supplies and tools used in its repair jobs, it paid the vendors sales tax reimbursement on those purchases (tax-paid purchases).
2. For the liability period, appellant reported total sales of $462,596, and claimed deductions for nontaxable sales of labor of $429,215, which resulted in reported taxable sales of $33,381. Respondent considered the ratio of taxable sales to total sales of 7 percent ($33,381 ÷ $462,596) to be low for an auto collision repair shop.
3. Upon audit, appellant provided its federal income tax return (FITR) for 2011; 13 random sales invoices from the liability period, showing total sales of $46,224; purchase invoices showing tax-paid purchases of materials and supplies; some purchase invoices for parts; some purchase invoices for sublet work; and one insurance settlement document.
4. Respondent found that appellant's reported cost of goods sold on its 2011 FITR included cost of parts of $59,000 and cost of materials and supplies of $42,000. When comparing appellant's 2011 reported taxable sales of $24,770 to appellant's cost of goods sold, respondent determined that appellant's costs exceeded its sales, and therefore concluded that appellant significantly understated its taxable sales. Due to a lack of adequate

[4] The difference is due to rounding.

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records, respondent decided to prepare a markup analysis to establish audited taxable sales.

5. Respondent found that the stated selling price for parts on an insurance estimate for repairs was the same as the "list price" shown on the purchase invoice for the parts. As a result, respondent compared the purchase prices for parts with their respective list prices shown on the available purchase invoices to compute an audited markup of 41.26 percent. Respondent applied the markup to appellant's reported cost of goods sold of $101,000 for 2011 and established audited taxable sales of $142,673.[5] Based on its comparison of audited taxable sales of $142,673 with appellant's reported taxable sales of $24,770 for 2011, respondent computed an error rate of 475.99 percent, which it applied to appellant's reported taxable sales of $33,381 for the liability period to establish unreported taxable sales of $158,890.
6. Respondent issued an NOD on March 25, 2015, and appellant timely filed a petition for redetermination. Although respondent had added a negligence penalty to the determination, respondent conceded to remove the penalty upon further review.
7. On September 26, 2017, respondent's Appeals Bureau held an appeals conference with appellant's representative. After the appeals conference, appellant provided additional records that included its FITRs for 2012 and 2013, and additional purchase invoices from 2011. Based on respondent's examination of the additional purchase invoices, respondent confirmed the audited markup of 41.26 percent. However, after making minor adjustments to allow for costs of tax-paid purchases resold, respondent found that adding the audited markup to the cost of goods sold from appellant's FITRs for 2012 and 2013 resulted in a reduction to audited taxable sales overall. Respondent reduced the amount of unreported taxable sales for the liability period by $51,620, from $158,890 to $107,270. Appellant continued to disagree with the adjusted measure of tax contending that respondent had relied on estimates that were not representative of appellant's business.
8. In its Decision issued on March 20, 2018, respondent's Appeals Bureau concluded that additional adjustments were warranted to exclude the cost for materials and supplies from

[5] Here, respondent added cost of parts of $59,000 to cost of materials and supplies of $42,000 to compute the audited cost of taxable goods sold. As explained below, respondent performed a reaudit, in which it deleted the cost of materials and supplies from the audited cost of taxable goods sold used in the markup analysis.

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the audited cost of goods sold markup analysis, and to further reduce the audited cost of taxable goods sold for 2012 and 2013 to allow for nontaxable cost of labor and sublet labor that were included in appellant's reported purchases. The subsequent reaudit resulted in an additional reduction of $57,601 to the amount of unreported taxable sales, from $107,270 to $49,669. This resulted in a reduction of the tax liability from $14,200.17 to $4,483.00.

9. Appellant continues to disagree with the unreported taxable sales of $49,669, and timely filed this appeal with the Office of Tax Appeals (OTA).

DISCUSSION

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of all tangible personal property in this state 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.) 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).)

California Code of Regulations, title 18, section 1546(b) states that if the retail value of parts and materials furnished in connection with repair work is more than 10 percent of the total charge, or if the repairperson makes a separate charge for such property, the repairperson is the retailer and tax applies to the fair retail selling price of the property. In addition, Business and Professions Code section 9884.8 provides that for automotive repair dealers, service work and parts shall be listed separately on the invoice. As a result, automotive repair dealers will always be the retailer of any parts used in the repair of vehicles.

If respondent is not satisfied with the amount of tax reported by any person, or if any person fails to make a return, respondent 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, 6511.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Amaya*, 2021-OTA-328P.) If respondent carries its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent'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 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. (*Appeal of Amaya*, *supra*.)

Here, appellant did not provide sufficient original source documentation to verify its reported taxable sales. As a result, respondent used a markup audit method to estimate appellant's taxable sales for the liability period. Specifically, respondent calculated a markup percentage based on purchase invoices that appellant provided, and respondent applied the markup percentage to appellant's reported cost of goods sold on its FITRs. This resulted in the audited taxable sales at issue in this appeal. OTA notes that the markup method is a recognized and accepted accounting procedure. (See *Appeal of Amaya*, *supra*.) Accordingly, respondent's determination is both reasonable and rational, and it is appellant's burden to show error in the determination.

Appellant asserts that it did not sell parts to insurance companies. Instead, appellant states that it purchased parts at a discounted price and used those parts to repair damaged vehicles. As a result, appellant argues that applying a markup to its cost of parts to establish audited taxable sales does not reflect its business model. In addition, appellant asserts that respondent assumed that appellant's business model was the same as three independent collision shops in the area, which appellant disputes. Appellant explains that the other businesses were healthy and thriving, while appellant's business was subject to a bankruptcy and a foreclosure. Based on these arguments, appellant contends that its liability should be reduced to zero.

With respect to appellant's first argument, the transactions at issue in this appeal involve parts that appellant billed to insurance companies. For example, there is one insurance estimate in the evidentiary record, which shows numerous parts and the estimated labor to repair a 2003 Nissan 350Z. Appellant listed each part separately with the part's respective price. In total, the insurance estimate listed taxable parts of $3,523.85 and sales tax reimbursement of $343.58. This evidence indicates that appellant made retail sales of the parts to the insurance companies. Furthermore, according to respondent's publication 25, entitled "Auto Repair Garages and Service Stations," the tax applies to jobs resulting from bids to insurance companies and is generally based on the parts estimated contained in the bid. (See p. 12.) "The selling price listed on an accepted bid is generally the taxable measure required to be reported by the auto repair

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shop." (*Ibid*.) Therefore, appellant sold the parts to the insurance company, and appellant's first argument is unpersuasive.

Although appellant argues that respondent's audit compared other businesses in the area to appellant's business, respondent's audit used information from appellant's business in determining the markup percentage. Specifically, respondent compared the selling price of the parts listed on the insurance estimate to appellant's purchase invoices for the same parts. Based on appellant's purchase price of the parts, respondent determined a markup percentage of 41.26 percent. In addition, respondent used appellant's reported cost of goods sold on its FITRs. There is no indication that respondent used any information from other businesses to determine the taxable measure in this appeal. Thus, appellant's second argument does not warrant any adjustments.

Based on the foregoing, appellant has not met its burden of proof.

HOLDING

No additional adjustments are warranted to the determined measure of tax.

DISPOSITION

Respondent's action in reducing the measure for unreported taxable sales to $49,669, deleting the negligence penalty, and otherwise denying the petition for redetermination is sustained.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

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Sara A Hosey
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