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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18043011
MARCO CRAFTMASTERS, INC.	CDTFA Case ID 729919

OPINION

Representing the Parties:

For Appellant:	Nedeen Nasser, Attorney
For Respondent:	Nalan Samarawickrema, Hearing Representative Chad Bacchus, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Marco Craftmasters, Inc. (appellant) appeals from an April 14, 2015 Decision and Recommendation (Decision) issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) issued on April 5, 2013. The NOD was for tax of $55,005.19, accrued interest, and a negligence penalty of $5,500.53 for the period January 1, 2011, through June 30, 2012 (liability period).[2]

[1] Prior to July 1, 2017, sales and use taxes (and other business taxes and fees) were administered by respondent's predecessor, the State Board of Equalization (BOE). When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to BOE.

[2] The NOD was based on an audit that determined a deficiency measure of $597,505, consisting of two audit items: (1) unreported taxable sales of $198,100 based on the difference between total sales reported to respondent and gross receipts reported to the IRS; and (2) disallowed claimed nontaxable sales for resale of $399,405. Additionally, respondent added a 10-percent penalty for negligence based on its finding that appellant failed to provide adequate books and records to support its reported amounts and its reporting errors were substantial.

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Office of Tax Appeals (OTA) Administrative Law Judges Richard Tay, Andrew J. Kwee, and Michael F. Geary held an oral hearing in this matter in Cerritos, California, on August 17, 2022. At the conclusion of the hearing, the record remained open to allow appellant until September 17, 2022, to submit appellant's original 2011 federal income tax return (FITR) and evidence to show that appellant's amended 2011 FITR had been signed by appellant and filed with the IRS. There was no timely submission, and on September 22, 2022, the record was closed and this matter was submitted for decision.[3]

ISSUES[4]

1. Is appellant entitled to a reduction to the measure of unreported taxable sales?
2. Is appellant entitled to a reduction to the measure of disallowed claimed sales for resale?
3. Did respondent correctly impose the negligence penalty?

FACTUAL FINDINGS

1. At all relevant times, appellant was a wholesaler and retailer of furniture. Appellant's seller's permit was effective January 1, 2011.
2. At or about the times in question, appellant's owners, I. Sultan and V. Sultan, either separately, together, or with others, owned at least two other entities that were engaged in similar businesses: Danny's Handcrafted Furniture, Inc. (Danny's), whose seller's permit was effective March 1, 2003; and Milano Fine Furniture, Inc. (Milano), whose seller's permit was effective December 1, 2005.
3. For the liability period, appellant reported total sales of $910,786, nontaxable sales of $848,465, and taxable sales of $62,321.
4. For this audit, appellant's first, appellant provided: its FITR,[5] profit and loss statement

[3] By email dated September 20, 2022, appellant informed OTA that it had requested the returns from the IRS by fax but had not received a reply. A copy of the request was not provided, and there has been no further communication from appellant regarding the matter.

[4] Appellant raised interest relief as an issue in its opening brief, arguing that all interest attributable to delay caused by the transition of authority from BOE to the California Department of Tax and Fee Administration and the Office of Tax Appeals should be abated. However, interest relief was not identified as an issue in the Prehearing Conference Minutes and Orders or at the beginning of the hearing when the issues were again identified and agreed upon by the parties. Finally, appellant offered no argument or evidence concerning interest relief at the hearing. Therefore, interest relief will not be further discussed in this Opinion.

[5] As discussed below, appellant also later provided a claimed amended 2011 FITR.

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(P&L), and merchandise purchase invoices for 2011; a hand-written taxable sales summary and unnumbered sales invoices for the first quarter of 2011 (1Q11); business bank statements and cancelled checks for the liability period; and some resale certificates.

5. According to the audit work papers, appellant stated that: it computed its total sales from bank deposits and provided the total sales amount and hand-written monthly summary worksheets of taxable sales and exempt sales in interstate commerce to an outside accountant, who prepared appellant's sales and use tax returns (SUTRs);[6] it reported the difference between total sales and the sum of taxable sales and claimed exempt sales in interstate commerce as nontaxable sales for resale; and corporate officer I. Sultan deposited some cash from sales directly into his personal bank account. I. Sultan did not provide his personal bank account statements or any other evidence from which the amount of such cash deposits could be ascertained either to respondent (for the audit) or to OTA (for this appeal).

6. Respondent found that gross receipts of $610,748 reported on appellant's 2011 FITR exceeded the total sales reported on the SUTR's for that year by $198,100. Additionally, respondent found "other income" of $198,100 recorded in appellant's 2011 P&L and noted that merchandise purchases reported on appellant's 2011 FITR ($460,363) exceeded merchandise purchases recorded in appellant's 2011 P&L ($379,702) by $80,661 (rounded).

7. According to the audit workpapers, respondent met with appellant's former accountant on September 30, 2012, to discuss the proposed audit findings, which by that time was focused, in part, on the $198,100 difference between gross receipts reported on appellant's 2011 FITR and total sales reported on appellant SUTRs for 2011. According to an October 10, 2012 letter from respondent to appellant's accountant, which letter purports to confirm matters discussed at the meeting and in a subsequent telephone discussion between respondent and appellant's owner, the accountant told respondent that appellant intentionally overstated gross receipts by $198,100 in its 2011 FITR because a lender was concerned about appellant's ability to repay a debt, and that the accountant corrected that misrepresentation by amending the 2011 return to reduce gross receipts and cost of goods sold (COGS) by $198,100. The letter also states that in the later telephone

[6] In the audit, respondent allowed all claimed sales in interstate commerce.

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discussion, I. Sultan gave a different explanation for the difference, stating that he had instructed the accountant to add $198,100 to gross receipts to account for consignment sales through two other furniture stores, Lovell's Gallery (Lovell's) in San Francisco and Paradise Art, Inc. (Paradise Art) in Florida, but because those sales never occurred, appellant had to take the furniture back and, therefore, needed to file the amended return to adjust appellant's gross receipts.

8. On June 24, 2013, and again on December 4, 2014, a different accountant (i.e., not the one referred to in the preceding paragraph) gave respondent several letters from Bank of America dated in November 2010, June 2011, and March 2012. All the letters are addressed to I. Sultan and V. Sultan and some are also addressed to Danny's and Milano. Generally, the letters refer to commercial real estate loans and advise the recipients that they are in default for failing to meet the "combined debt service coverage ratio of at least 1.25 to 1.00."[7] The March 2012 letter also mentions the Sultans' failure to provide updated financial information.

9. On or about December 4, 2014, appellant provided copies of an amended 2011 FITR, which was dated October 16, 2012, but unsigned, and purportedly prepared by appellant's former accountant. This amended return refers to gross receipts of $412,648, which is exactly equal to appellant's total sales reported on its SUTRs for 2011 and $198,100 less than gross receipts reported on the FITR previously provided by appellant. The COGS stated in the amended return had been reduced by that same amount.

10. Respondent used appellant's bank statements to compile total bank deposits quarterly and for the liability period. Total bank deposits were $1,044,976 for the liability period, or $134,190 more than total sales reported to respondent. For four quarters (1Q11, 3Q11, 1Q12, and 2Q12) bank deposits exceeded reported total sales (including sales tax) by $164,244. For the two remaining quarters (2Q11 and 4Q11) reported sales exceeded bank deposits by a total of $35,665. Deposits during 2011 totaled only $400,368, which was $210,380 more than gross receipts reported on the first FITR and $12,280 more than gross receipts stated on the amended FITR. Given these discrepancies and the evidence

[7] A debt service coverage ratio is generally considered a measure of a borrower's ability to pay a debt. In simple terms, the first number, 1.25 here, represents net operating income, and the second number, 1.00 here, represents the debt service amount (i.e., principal and interest). In other words, the borrowers here were required to show that net operating income was at least 125 percent of the debt service amount.

that I. Sultan was depositing substantial amounts of cash from sales into his personal account, respondent concluded that the original FITR was the best evidence available to show appellant sales during 2011. On that basis, respondent established the $198,100 measure of unreported taxable sales for 2011.

11. Appellant claimed nontaxable sales for resale totaling $631,700 for the liability period. According to the audit work papers, appellant stated during the audit that it made sales for resale to only two customers: Lovell's and Paradise Art.[8]

12. Appellant provided a resale certificate for its sales to ALAER-90, Inc., dba Lovell's, and respondent was able to confirm to its satisfaction that the sales to Lovell's, which totaled $232,295, were for resale. These claimed sales for resale are not at issue.

13. To support claimed sales for resale to Paradise Art, appellant provided:

- a Florida Certificate of Registration bearing the date November 18, 2006, and indicating that Paradise Art registered to collect and remit sales tax in Florida in 2003
- a 2007 Florida Annual Resale Certificate, which carries, on its face, an expiration date of December 31, 2007
- shipping documents that show that Carlos and Bravo Trucking made five deliveries from appellant to Paradise Art, four in 2011 and one in 2012, and
- unknown other information that respondent relied upon to schedule "unconfirmed sales to Paradise Art, Inc." totaling $139,680 for the liability period.[9]

14. Because appellant did not provide sufficient documentation to support its claimed sales for resale to Paradise Art, respondent gave appellant the opportunity to send XYZ letters to the customer. Paradise Art did not respond to the XYZ letter, and respondent was unable to confirm through its electronic records or an internet search that Paradise Art resold the merchandise purchased from appellant. Consequently, Respondent deducted the allowed sales for resale to Lovell's from the total claimed sales for resale to calculate disallowed claimed sales for resale of $399,405.

[8] According to the audit work papers, appellant's former accountant confirmed that the sales to Paradise Art were included in claimed sales for resale.

[9] Respondent scheduled "unverified" claimed sales for resale to Paradise Art totaling $139,680, but there are no source documents (e.g., invoices or receipts) in the record to show that such sales occurred other than a single invoice dated April 30, 2011, in the amount of $8,000. The shipping documents also are not in the record.

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15. On April 5, 2013, respondent issued the NOD to appellant.

16. Appellant timely filed a petition for redetermination, which began respondent's internal appeal process. As part of that process, the parties participated in an appeals conference on December 3, 2014. After the appeals conference, appellant provided a list of sales to six companies that it then asserted, for the first time, were nontaxable sales for resale. Appellant claimed:

- four sales totaling $32,420 to Del Mar Medici, Inc. (Del Mar) during the period March 24, 2011, through October 19, 2011
- eight sales totaling $11,550 to Elegante Furniture (Elegante) during the period February 15, 2011, through October 30, 2011
- four sales totaling $28,950 to Lawrence Gallery & Fine Art, Inc. (Lawrence) during the period February 15, 2011, through June 1, 2012
- five sales totaling $39,930 to The Verci, U.S.A., dba Art de Europe (Art de Europe) during the period February 16, 2011, through May 18, 2012
- five sales totaling $477,700 to MMR35, LLC, dba Rasoyli's (Rasoyli's) during the period February 20, 2011, through June 30, 2012, and
- 12 sales totaling $94,430 to Milano during the period March 7, 2011, through June 15, 2012.

Appellant provided copies of incomplete sales invoices,[10] which purport to document sales to these six businesses and Paradise Art. It also provided copies of resale certificates purportedly issued by three of the entities (Lawrence, Rasoyli's, and Milano), a copy of a business license issued to Del Mar, and copies of seller's permits for all except Del Mar. No relevant shipping documents or evidence of payments received are in the record.

17. According to respondent's records:

- The seller's permit issued to Del Mar was closed effective June 30, 2009, almost 21 months before the earliest of the alleged sales for resale, after the business informed respondent that it was closing or had closed without a successor.
- The seller's permit issued to Elegante was closed effective June 23, 2010, almost

[10] None of the invoices contain payment information, signatures of the purchasers, or the purchaser's seller's permit number in the spaces provided for that information.

eight months before the earliest of the alleged sales for resale, after the business informed respondent that it was closing or had closed without a successor.

- The seller's permit issued to Lawrence was closed effective November 30, 2009, almost 15 months before the earliest of the alleged sales for resale, after the business informed respondent that it was closing or had closed without a successor.
- The seller's permit issued to Art de Europa was closed effective November 5, 2007, over three years and two months before the earliest of the alleged sales for resale, after the business informed respondent that it was closing or had closed without a successor.
- The seller's permit issued to Rasoyli's was closed effective June 30, 2011, over 10 months before three of the five alleged sales for resale, after the owner informed respondent that the business had been sold.

18. In the Decision issued on April 14, 2015, respondent recommended that the petition for redetermination be denied. This timely appeal followed.

DISCUSSION

Issue 1: Is appellant entitled to a reduction to the measure of unreported taxable sales?

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property (TPP), 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 until the retailer proves otherwise. (R&TC, § 6091.)

If respondent is not satisfied with the amount of tax reported by the taxpayer, respondent 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.) 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).)

In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once

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respondent has met its initial burden, the burden of proof shifts to the taxpayer to prove that a different result (i.e., different from that asserted by respondent) is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) A taxpayer also bears the burden of proving entitlement to an exemption or exclusion and must provide credible evidence of that entitlement. (*Appeal of Owens-Brockway Glass Container, Inc.*, 2019-OTA-158P.) The applicable burden of proof is by a preponderance of the evidence, which means that appellant must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Ibid*.)

Appellant did not maintain and provide business records that were sufficient for sales and use tax purposes. Appellant's claim that it worked around the absence of sufficient business records by relying on deposits and monthly sales summaries to complete its SUTRs is not supported by the evidence. Unknown and probably substantial amounts were not deposited into the business account; the only monthly sales summary that is in evidence refers to taxable sales only; and appellant has not provided a credible explanation for its failure to provide evidence or for the many discrepancies in the evidence that it did provide. Under the circumstances, it was reasonable for respondent to rely on the 2011 FITR that appellant provided originally for the audit as the best available evidence of taxable sales.

Appellant argues that it was unfair for respondent to audit appellant for only six quarters when most audits cover at least twice that number. However, its primary contention is that respondent incorrectly relied on the original FITR when it should have relied on the amended FITR. Appellant asserts that it has explained why the original FITR knowingly reported false information to the IRS, which was to misrepresent its finances to its lender. According to appellant, the amended FITR, not the original, is consistent with other documents, and there is no justification for respondent's decision to reject the gross receipts amount contained in the amended return.

There is no requirement that respondent audit taxpayers for a minimum of twelve quarters, and appellant has not made a persuasive argument why this fact should be considered material to the issues presented. It will not be discussed further.

Although the amended 2011 FITR contains a different amount for gross receipts that would, if persuasive, reduce the measure of unreported sales to zero, that "amended" amount is not persuasive for a number of reasons. The record does not contain a *signed* amended return

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(i.e., one signed by a corporate officer) and there is no evidence that the amended return was actually filed with the IRS. Appellant has not provided a convincing explanation of why the amendment was needed. The timing of the amendment suggests that it was done to eliminate the basis for audit item 1. Neither of the explanations for the amendment are supported by the evidence. That is, there is no evidence to support the claim that appellant reported and then had to reverse gross receipts from sales on consignment that it had reported prematurely; and the letters from Bank of America do not show why appellant would have intentionally overstated its gross receipts *and its COGS*. The net result of increasing gross receipts and COGS by the same amount is zero (and indicates no profit on the "additional" COGS). In other words, the amended did not affect appellant's or its shareholders' net income. In light of this evidence, respondent was correct to question and eventually reject the reduced gross receipts amount shown on the amended FITR. Respondent relied on the best available evidence to determine the measure of unreported taxable sales; and that determination was reasonable and rational. Consequently, the burden of proof shifts to appellant, who must establish a more accurate measure of tax. (*AMG Care Collective*, 2020-OTA-173P.)

Other than appellant's argument, already discussed above, that respondent should have relied on the gross receipts amount stated in the amended FITR, appellant has not argued or provided evidence to show either an error in respondent's determination of unreported taxable sales or a more accurate measure of such sales. It has thereby failed to carry its burden of proof, and on that basis, OTA finds that appellant is not entitled to a reduction to the measure of unreported taxable sales.

Issue 2: Is appellant entitled to a reduction to the measure of disallowed claimed sales for resale?

It is presumed that all of a retailer's gross receipts are subject to tax until the contrary is established, and the burden of proving that a sale of TPP is not a sale at retail is upon the person who makes the sale, unless that seller timely and in good faith takes from the purchaser a certificate to the effect that the property is purchased for resale (a resale certificate). (R&TC §§ 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).)

Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a resale certificate with respect to the sale of the property described in the document if it contains all of the following essential elements: 1) the signature of the

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purchaser, purchaser's employee or authorized representative of the purchaser; 2) the name and address of the purchaser; 3) the number of the seller's permit held by the purchaser, or a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number; 4) a description of the property to be purchased, and a statement that the property described in the document is purchased "for resale; and 5) the date of execution of the document, although an otherwise valid resale certificate will not be considered invalid solely on the grounds that it is undated. (Cal. Code Regs., tit. 18, § 1668(b)(1).)

A resale certificate which is not timely taken is not retroactive and will not relieve the seller of the liability for the tax. (Cal. Code Regs., tit. 18, § 1668(e).) If a seller fails to timely obtain a resale certificate in proper form, the seller will be relieved of liability for the tax only where the seller shows that the purchaser: (1) in fact resold the property and did not make a taxable use of the property; or (2) is holding the property sold for resale and has not made a taxable use of that property; or (3) consumed the property sold, and reported the tax due directly to respondent on its SUTRs; or (4) consumed the property sold, and paid the tax due to respondent pursuant to an assessment or an audit. (*Ibid*.)

A seller who does not timely obtain a resale certificate may use any verifiable method of establishing that it should be relieved of liability for the tax, including the use of "XYZ letters," which are letters in an approved format sent to the seller's customers inquiring as to the disposition of the property purchased. (Cal. Code Regs., tit. 18, § 1668(f)(1)-(3).) When there is no response to any XYZ letter, respondent staff should consider whether it is appropriate to use an alternative method to ascertain whether the seller should be relieved of tax with respect to the questioned or unsupported transaction(s). (Cal Code Regs., tit. 18, § 1668(f)(4).)

According to the audit workpapers, appellant consistently stated during the audit that it made nontaxable sales for resale during the liability period to just two customers, Lovell's and Paradise Art, and that it computed its nontaxable sales for resale for reporting purposes by subtracting the sum of its taxable sales and exempt sales in interstate commerce from its reported total sales. Respondent allowed the claimed sales for resale to Lovell's. The claimed resales to Paradise Art were not allowed in the audit because respondent found no evidence that appellant timely and in good faith took a valid resale certificate from Paradise Art, and appellant had not otherwise established that these were valid sales for resale. Respondent concluded that appellant

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had not proved that it made nontaxable sales for resale of $399,405 to Paradise Art.[11] Therefore, that became the measure for this audit item.

Appellant now claims that it made sales for resale totaling $394,660 ($4,745 less than the reported amount) to Paradise Art and six other purchasers. Regarding the claimed sales for resale to Paradise Art, appellant relies on the documents referred to in Factual Finding 12, above, and a printed result of an Internet inquiry to Florida's Department of Corporations regarding the status of Paradise Art, Inc. That latter document, which is in evidence, bears the date April 28, 2017, and indicates that the corporation was "inactive," and that the last event was an administrative dissolution on September 28, 2012. Appellant asserts that this evidence shows that respondent incorrectly concluded that Paradise Art went out of business in 2007. Appellant further contends that respondent was required to use an alternative method to establish sales for resale when Paradise Art failed to respond to the XYZ letter. Finally, it argues that the sales to Paradise Art should have been allowed as exempt sales in interstate commerce.

As additional proof that Paradise Art was not in business when the alleged sales occurred, respondent points to two Google Maps "street view" photographs, also in evidence, of Paradise Art's business premises: one allegedly taken in January 2008, showing the "Paradise Art" sign above the windows and door; and the other, allegedly taken in April 2011, showing the same location but without the "Paradise Art" sign and with "Going Out of Business" signs prominently displayed in the windows. Appellant's response to this evidence is that furniture stores are notorious for having "going out of business" sales that last months or years, and it argues that the photographs confirm that, contrary to respondent's assertion, Paradise Art was still in business, at least until sometime after the latter photograph was taken.

The evidence does not prove that appellant timely and in good faith took a valid resale certificate from Paradise Art; consequently, the burden is on appellant to prove that those sales were, in fact, nontaxable sales for resale.

Appellant's argument that respondent improperly failed to use some alternative method to verify the claimed sales for resale (i.e., alternative to the XYZ letters) when Paradise Art failed to respond to an XYZ letter is incorrect and unpersuasive. It is incorrect because the evidence shows that respondent did investigate the claimed sales for resale by examining its

[11] As indicated above, appellant claims that it determined the measure of sales for resale by subtracting sales in interstate commerce from total sales.

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records (e.g., to verify the status of the alleged purchasers' seller's permits) and by conducting online research regarding those businesses. This was how respondent came to allow the claimed sales for resale to Lovell's.[12] The results of respondent's investigations into the other purchasers were simply not favorable to appellant. Appellant's argument is unpersuasive because it is based on an apparent misunderstanding of California Code of Regulations, title 18, (Regulation) section 1668(f). The XYZ letter is a tool that respondent makes available to help taxpayers carry their burden to prove that sales were nontaxable sales for resale. Although it is true that when a purchaser does not reply to an XYZ letter, Regulation section 1668(f)(4) states that respondent should consider an alternative method to prove that the taxpayer should be relieved of the tax, the Regulation does not place on respondent the burden to identify or devise such a method. That burden remains with the taxpayer, as stated in Regulation section 1668(e).

The record contains only one invoice that purports to document a sale by appellant to Paradise Art. The record contains no relevant shipping documents or evidence of payments received in connection with the alleged sales.[13] The audit work papers show that Florida's Department of Revenue stated that Paradise Art went out of business by December 31, 2007, and there is nothing in the record to directly contradict that information. The photographs appear to show Paradise Art's business location with a sign in 2008 and the same building location but without a sign in 2011, but the later photograph is not evidence that Paradise Art was having the "going out of business" sale advertised in the later photograph. Also, the status of the corporation is not necessarily the status of the business of the corporation. It is not unusual to have corporations remain in existence long after the business of the corporation has wrapped up. Considering the evidence as a whole and giving each item of evidence the weight to which it is entitled, OTA finds that the evidence does not prove that appellant made nontaxable sales for resale to Paradise Art during the liability period.

Appellant also contends that respondent wrongfully refused to allow the claimed sales for resale to the other six purchasers, asserting that the status of the purchasers' seller's permits is

[12] Respondent was not required to allow those claimed sales for resale based only on Lovell's response to the XYZ letter. (Cal. Code Regs., tit. 18, § 1668(f)(3).)

[13] Appellant stated during the audit that sales to Paradise Art were for cash. Conducting large wholesale transactions in cash and without reliable records does not seem to be calculated to improve tax compliance; but more to the point, appellant's statement seems to be at odds with the evidence, which includes numerous references to Paradise Art paying Danny's (one of the Sultans' other furniture businesses) using credit cards and checks.

not conclusive evidence that the purchasers were not still engaged in business. It argues that even if the purchasers' permits had been closed, appellant's sales to those purchasers were "inadvertent," which OTA takes to mean in good faith. Appellant contends that at the very least, the sales for resale to Milano should have been allowed because its seller's permit was active at the time of the alleged sales.

The evidence regarding the alleged sales for resale to the other six entities is also not persuasive towards appellant's position. The audit workpapers indicate that appellant identified only Lovell's and Paradise Art as the customers to which it made sales for resale. Appellant did not mention these six other claimed purchasers for resale until long after the audit and well into respondent's internal appeals process, and it did not provide the supporting documents to respondent until after the appeals conference. The late allegations regarding these sales and the late production of these records raise questions regarding whether the records existed before a few weeks prior to the appeals conference, and regarding when and how the seller's permits issued to five of the entities and a business license issued to the sixth came into appellant's possession. There is nothing in the evidence that answers these questions.

Because appellant has not proved that it timely and in good faith took resale certificates from any of the six alleged purchasers, it must prove that the sales to these six customers were, in fact, nontaxable sales for resale. Appellant has not done this. The copies of the seller's permits, resale certificates, and business license have little bearing on the issue, and the invoice copies constitute little more than an unsupported assertion by appellant that it made the sales the invoice copies purport to document. Under these facts, additional verification is required. Appellant provided no such verification.

OTA agrees that persons engaged in the business of selling TPP do not always hold a valid seller's permit. Appellant's burden is not to prove that these six purchasers held valid seller's permits. Appellant's burden is to prove that the questioned sales were nontaxable sales for resale. The evidence that shows that these entities did not hold valid seller's permits when most of the sales occurred is material because it allows OTA to infer that these entities were not engaged in the business of selling TPP at those times. Appellant has provided no evidence to prove otherwise.

Appellant's good faith belief that these entities were properly permitted is not material to the issue at hand. Good faith is relevant to a seller's acceptance of a resale certificate, but there

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is no evidence that appellant did that in connection with any of these sales. A good faith belief that a purchaser is in the business of selling TPP does not prove that a sale to that purchaser is a nontaxable sale for resale. Even evidence that the purchasers held seller's permits at the time of the sales, as is the case for the sales to Milano and two of the sales to Rasoyli's, is not evidence of a nontaxable sale for resale.

Regarding appellant's interstate commerce argument, OTA is inclined to agree that, regardless of evidence showing that appellant claimed the sales as nontaxable sales for resale, the sales to Paradise Art should be removed from the measure of disallowed claimed sales for resale if the evidence proves the sales were exempt. Gross receipts from the sale of TPP are exempt from sales tax if, pursuant to the contract of sale, the TPP is required to be shipped and is shipped to a point outside this state by means of: 1) facilities operated by the retailer; or 2) delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point. (R&TC § 6396; Cal. Code Regs., tit. 18, § 1620(a)(3)(B).) Bills of lading or other documentary evidence of the delivery of the property to a carrier, customs broker, or forwarding agent for shipment outside this state must be retained by the retailer to support deductions for exempt sales in interstate commerce. (Cal. Code Regs., tit. 18, § 1620(a)(3)(D).) The taxpayer has the burden of proving its right to the exemption. (*Appeal of Snowflake Factory LLC*, 2020-OTA-270P.) Unsupported assertions are not sufficient to satisfy the requirement of proof by a preponderance of the evidence. (*Appeal of Talavera*, *supra*.)

The record contains a single invoice that says nothing about shipment of the items out of California. Notably, there are no shipping charges stated.[14] The record does not contain any bills of lading or other documentary evidence of the delivery of the property to a carrier for delivery to Paradise Art in Florida.[15] Appellant has not carried its burden of proving that the

[14] Even if OTA was to infer, from the schedule listing "unconfirmed sales to Paradise Art, Inc." totaling $139,680 for the liability period, that additional invoices were provided to respondent, it would be unreasonable for OTA to infer that the required shipping information was included on those other invoices.

[15] Appellant apparently provided shipping documents to respondent, but respondent rejected those as inadequate, and they have not been submitted to OTA for review.

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sales to Paradise Art were exempt sales in interstate commerce. Therefore, the sales should remain in the measure of disallowed sales for resale.

On the basis of the entire hearing record, OTA finds that appellant is not entitled to a reduction to the measure of disallowed sales for resale.

Issue 3: Did respondent correctly impose the negligence penalty?

Generally, if any part of a liability for which a deficiency determination is made is due to negligence, respondent must add a penalty equal to 10 percent of the amount of the determination. (R&TC, § 6484.) One exception is that a negligence penalty is not typically added to deficiency determinations made in a taxpayer's first audit unless the bookkeeping and reporting errors on which the penalty is based cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices 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).)

Although the term "negligence" in not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal. App. 5th 1129, 1157.) As previously stated, a taxpayer must maintain and make available for examination on request by respondent 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 returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: 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 or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records is evidence of negligence and may result in imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 1698(k).) A negligence penalty also can be based on reporting errors. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323.)

According to respondent's Decision, appellant argued then that appellant's accountant was entirely at fault. Appellant asserted that it gave all information to its accountant, who erred by failing to report accurately and by failing to inform appellant regarding proper record

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keeping. In its prehearing briefs filed with OTA, appellant argued only that the penalty should be reduced if the tax liability was reduced. While appellant later argued at hearing that the negligence penalty should be abated because respondent did not meet its burden of proof, appellant never provided evidence or a rationale to support its contention that the penalty was not correctly imposed.

As OTA has already found, above, appellant's records were inadequate for sales and use tax purposes. Taxable sales cannot be verified and appellant's stated method of calculating and reporting sales for resale and taxable sales is seriously flawed, in part due to appellant's officer diverting unknown amounts of cash to his personal account. Taken as a whole, the evidence shows that appellant did not have a good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. In addition, the determined understatement was substantial, with appellant reporting less than 10 percent of the total taxable sales determined by respondent. The evidence further establishes a likelihood that appellant, not its accountant, was responsible for the substantial underreporting of taxable sales and that such underreporting was not the result of a good-faith and reasonable belief that taxable sales were being accurately reported.

On the basis of the evidence, OTA finds that respondent correctly imposed the negligence penalty on appellant.

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HOLDINGS

1. Appellant is not entitled to a reduction to the measure of unreported taxable sales.
2. Appellant is not entitled to a reduction to the measure of disallowed claimed sales for resale.
3. Respondent correctly imposed the negligence penalty.

DISPOSITION

Respondent's decision to deny appellant's petition for redetermination and to redetermine appellant's liability without adjustment is sustained.

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Michael F. Geary
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

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Richard Tay
Administrative Law Judge

Date Issued: 12/20/2022