OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19014244
	) CDTFA Case ID: 891303
PMR ENTERPRISES LLC	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Anthony Mandella, General Manager
For Respondent:	Nalan Samarawickrema, Hearing Representative Randy Suazo, Hearing Representative Christopher Brooks, Tax Counsel IV
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, PMR Enterprises LLC (appellant) appeals a 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) dated July 10, 2015. The NOD is for tax of $8,995.51, and applicable interest, for the period January 1, 2011, through December 31, 2013 (liability period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Michael F. Geary, and Daniel K. Cho held an oral hearing for this matter in Cerritos, California, on April 12, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

[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 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.

[2] The NOD was timely issued because on February 12, 2015, appellant signed the latest in a series of waivers of the otherwise applicable three-year statute of limitations, which allowed respondent until July 31, 2015, to issue an NOD for the period of January 1, 2011, through March 31, 2012. (R&TC, §§ 6487(a), 6488.)

ISSUE

Whether adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Appellant has operated a business selling race car components, parts, and accessories since January 1, 2011. Appellant also provides installation and repair labor. For the liability period, appellant reported total sales of $1,474,448, and claimed deductions of $309,704 for sales for resale, $480,664 for labor, $590,319 for sales in interstate commerce, and $787 for "other" nontaxable sales, which resulted in reported taxable sales of $92,974.
2. On audit, appellant provided its federal income tax returns, profit and loss statements, sales reports for the liability period, purchase journals for 2011, and sales invoices and merchandise purchase invoices for the fourth quarter of 2013 and October 2014. Respondent found significant discrepancies between the amounts of gross receipts reported on appellant's income tax returns and the amounts of total sales reported on its sales and use tax returns. Respondent also found that the cost of goods sold recorded in appellant's profit and loss statements exceeded the total sales of merchandise recorded in the sales reports by significant amounts. Given the discrepancies in the available records, respondent decided to use an alternative audit method, the markup[3] method, to establish audited taxable sales.
3. Because appellant's cost of goods sold reported on appellant's federal income tax returns included expenses other than just the cost of merchandise sold, respondent obtained appellant's merchandise purchase information directly from appellant's vendors for 2011. The purchase information showed total merchandise purchases of $126,685, which included merchandise purchases of $4,454 for which sales tax was paid directly to the vendors (tax-paid purchases).
4. Using appellant's sales reports, respondent compiled nontaxable sales for resale of $24,914 and exempt sales in interstate commerce of $56,887 for 2011. Appellant

[3] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is $.70 and it charges customers $1.00, the markup is $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (.30 ÷ .70 = 0.42857).

performed a shelf test to compute markups of 9.83 percent for nontaxable sales for resale and 19.25 percent for exempt sales in interstate commerce. Respondent accepted the results of appellant's tests and applied the markups to the recorded nontaxable sales for resale and exempt sales in interstate commerce to compute costs of $22,684 and $47,704, respectively, for 2011.

5. Respondent reduced the 2011 merchandise purchases of $126,685 by 1 percent to allow for shrinkage. Respondent further reduced the merchandise purchases by $70,388 to account for nontaxable sales for resale and exempt sales in interstate commerce, as noted above. This resulted in merchandise purchases of $55,030 that were expected to be taxable sales.
6. Respondent computed a weighted markup for the sale of parts and materials of 25.91 percent using appellant's sales reports, and appellant calculated a 16.10 percent markup based on its own shelf test. Respondent accepted appellant's calculation and combined it with respondent's weighted markup to compute an average weighted markup of 21.01 percent. Respondent applied the average weighted markup of 21.01 percent to the merchandise purchases of $55,030 and calculated taxable sales of $66,592. Respondent reduced the taxable sales of $66,592 for tax-paid purchases of $4,454, which resulted in audited taxable sales of $62,138 for 2011.
7. Respondent compared total audited taxable sales of $62,138 to appellant's reported taxable sales of $24,766 for 2011. This resulted in a deficiency measure of $37,372 for 2011. Using the deficiency measure of $37,372, respondent calculated an average quarterly deficiency measure of $9,343 and applied that amount to the remaining quarters in the liability period. Thus, respondent determined a deficiency measure of $112,116 for the liability period.
8. Respondent issued the aforementioned NOD to appellant on July 10, 2015, and appellant filed a timely petition for redetermination. On December 20, 2018, respondent issued a decision denying the petition for redetermination.
9. This timely appeal followed.

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).)

If respondent is not satisfied with the amount of tax reported by the taxpayer, respondent may determine the amount required to be paid upon the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) 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. (*Appeal of Amaya*, *supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, respondent conducted an audit of appellant's business using the markup method, which is a well-established audit method that has been shown effective and reliable if it is based on sufficient information to establish a reasonable markup and cost of taxable merchandise sold. (See *Appeal of Amaya*, *supra*.) Respondent obtained appellant's purchase information directly from its vendors for 2011, and respondent calculated an average weighted markup from appellant's records (appellant's sales reports). Respondent determined a deficiency based on this information. Based on the foregoing, respondent's determination is both reasonable and rational, and appellant has the burden of proof to establish that a different result is warranted.

On appeal, appellant contends that respondent's audit was unduly burdensome and time consuming, which had a negative effect on appellant's business. For example, appellant states that there were missed appointments between appellant's representative and respondent's auditor. This resulted in delays, loss of time, and undue stress upon appellant's representative. Appellant also states that there was poor communication between respondent's auditor and appellant's representative. As a result, appellant argues that an adjustment should be made to the deficiency measure. However, there is no provision in the Sales and Use Tax Law that would warrant any adjustments based on these arguments. Furthermore, OTA does not have jurisdiction to conclude that appellant would be entitled to any remedy for respondent's alleged

or actual violation of any substantive or procedural right to due process under the law. (See Cal. Code Regs., tit. 18, § 30104(d).)

Appellant also argues that respondent's audit is overstated and contains errors. Specifically, appellant states that invoices from Danchuk contained sales tax reimbursement paid to the vendor, and respondent failed to add these invoices to the tax-paid purchases amount of $4,454, which would reduce appellant's deficiency measure. After a review of the Danchuk invoices, which were contained in respondent's exhibit B, OTA notes that the Danchuk invoices do not include a charge for sales tax reimbursement to appellant. Therefore, respondent correctly excluded these amounts from the tax-paid purchases amount of $4,454, and this argument does not warrant any adjustments.

Appellant also states that it provided documentation demonstrating additional errors in respondent's calculations for purchases of merchandise that was either self-consumed or not sold during the liability period. Although appellant states that it highlighted the items on its expense report, appellant has not indicated how those highlighted items would impact respondent's audit of the business. For example, appellant highlighted a transaction that appears to be from Autozone on April 16, 2011; however, there is no corresponding transaction listed on respondent's audit work papers. Furthermore, respondent's audit examined appellant's purchases for 2011, and appellant has not indicated which of those purchases were mischaracterized. To the extent that appellant is attempting to question transactions or purchases that occurred in 2012 and 2013, these arguments are unpersuasive because respondent's audit did not use any purchase data from those years. Accordingly, this argument does not establish an error in the audit method used by respondent.

With respect to appellant's argument that respondent's audit fails to account for purchases of merchandise that was sold after the liability period, OTA notes that appellant is correct in this observation. However, if respondent had factored in any ending inventory, appellant's tax liability would have increased because respondent's audit method established unreported taxable sales for the liability period based on a markup of appellant's 2011 cost of goods sold. Generally, the cost of goods sold is calculated by adding beginning inventory to merchandise purchases and then subtracting ending inventory. According to appellant's 2011 federal income tax return, appellant reported beginning inventory of $77,294 and ending inventory of $75,968, which showed a reduction of $1,326 to its inventory. Because appellant's

inventory was reduced during 2011, an inventory adjustment in this case would increase the audited cost of goods sold and would result in an increase to the amount of unreported taxable sales. Accordingly, this argument would actually warrant an adjustment unfavorable to appellant. However, respondent has not asserted an increase to the NOD pursuant to R&TC section 6563. Thus, no adjustment is warranted based on this argument.

Finally, appellant argues that respondent's average weighted markup of 21.01 percent was overstated. Instead, appellant asserts that respondent should have used appellant's average markup of 16.10 percent when calculating audited taxable sales. According to the audit work papers, respondent calculated separate markups of 23.88 percent for sales of parts and 41.09 percent for sales of materials. Respondent then weighted the markups based on its determination that 88.14 percent of appellant's purchases were of parts and 11.86 percent were of materials, to compute a weighted markup of 25.91 percent. Appellant, on the other hand, computed a markup of 16.10 percent for parts and materials combined without accounting for the difference in quantities of products being sold. While respondent had no obligation to accept appellant's calculation, respondent agreed to combine the two markups for an average weighted markup of 21.01 percent. Appellant has not demonstrated why its calculation is more accurate than the average figure. Therefore, no adjustments are warranted to the audited average weighted markup of 21.01 percent.

Based on the foregoing, appellant has not demonstrated error in respondent's determination.

HOLDING

No adjustments are warranted to the determined measure of tax.

DISPOSITION

Respondent's decision to deny the petition for redetermination is sustained.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

DocuSigned by:
1A9B52EF88AC4C7...
Michael F. Geary
Administrative Law Judge

DocuSigned by:
8A4294817A67463...
Andrew Wong
Administrative Law Judge

Date Issued: 7/11/2022