

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 21129311
STUDIO 33 STAGE PRODUCTIONS, INC.)	CDTFA Case ID 661-819
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)	

OPINION

Representing the Parties:

For Appellant:	Samuel Hoppe, CPA
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For Respondent:	Nalan Samarawickrema, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
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For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III
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S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Studio 33 Stage Productions, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated February 13, 2019. The NOD is for a tax of \$58,792, plus applicable interest, for the period April 1, 2015, through December 31, 2018 (audit period).²

Office of Tax Appeals (OTA) Administrative Law Judges Suzanne B. Brown, Keith T. Long, and Andrew J. Kwee held an oral hearing for this matter in Sacramento, California, on October 19, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

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, “CDTFA” refers to BOE.

² The NOD was timely issued because appellant signed a series of waivers of the otherwise applicable statute of limitations, which extended the period for issuing an NOD until April 30, 2019. (R&TC, §§ 6487(a), 6488.)

ISSUE

Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales.

FACTUAL FINDINGS

1. Appellant is a corporation with a registration date with the California Secretary of State in June 2013 and a seller's permit that was effective from January 1, 2014, through March 31, 2019. Prior to appellant's incorporation, appellant's founder, B. Jackson, operated for many years as a sole proprietor, beginning in the 1980s.
2. During the audit period, appellant operated two separate businesses. One was a stage equipment business, wherein appellant was a retailer and lessor of stage equipment, as well as lighting and sound equipment; that business was headquartered in southern California. Appellant's other business was an ice rink in northern California. Appellant's southern California business closed in 2019, and thereafter appellant operated only the ice rink.
3. During the audit period, appellant reported total sales and taxable sales of \$193,512 for both businesses, claiming no deductions.
4. For audit, appellant provided federal income tax returns (FITRs) for 2016 and 2017. CDTFA obtained appellant's FITR for 2015 from the Franchise Tax Board. Appellant also provided bank statements for 2017 and 2018; its general ledger for 2016, 2017, and 2018; and a few sales invoices.
5. In its preliminary review of appellant's records, CDTFA found that the gross receipts reported on appellant's FITRs exceeded total sales reported on appellant's sales and use tax returns by \$605,885, \$621,375, and \$451,427 for 2015, 2016, and 2017, respectively.³ CDTFA regarded those differences as evidence that the amounts of total sales reported on sales and use tax returns were substantially understated.
6. CDTFA also found that there was a marked decrease in reported taxable sales after 2014. Specifically, appellant's reported taxable sales for 2015 decreased by 44 percent in comparison to the amount reported for 2014. In 2016, appellant's reported taxable sales

³ CDTFA also found that for 2014, appellant's reported taxable sales exceeded gross receipts on its FITR by \$132,229. According to comments in the audit working papers, CDTFA did not further investigate the differences for 2014 because the statute of limitations to issue a determination for that period had expired.

- decreased from a quarterly average of \$59,371 for the last three quarters of 2015 (\$67,882 for 2Q15, \$49,838 for 3Q15, and \$60,392 for 4Q15) to amounts ranging from zero to \$6,107 for the last eight quarters of the audit period.
7. CDTFA found that, during the audit period, appellant had recorded taxable equipment rentals as nontaxable “services.” Prior to the audit period, appellant’s rentals were recorded and reported as taxable transactions, not services. Since appellant did not identify significant changes in the type of business operations from 2014 to 2016, CDTFA regarded the significant decreases in reported taxable sales as evidence that reported taxable sales after 2014 were understated.
 8. CDTFA found that the gross receipts reported on appellant’s FITRs included income from both the stage equipment business and the ice rink.
 9. CDTFA also found that, for the ice rink business, appellant’s rentals of skates were excluded from the definition of a lease for sales and use tax purposes because appellant was making a restricted grant of a privilege to use property, as defined in California Code of Regulations, title 18, section 1660(e)(1).⁴ Accordingly, appellant’s rentals of the skates were not subject to sales or use tax. Appellant was the consumer of the skates, and appellant established that it had paid sales tax reimbursement when it purchased the skates. Therefore, CDTFA concluded that none of the income from the ice rink represented taxable gross receipts.
 10. To establish audited total sales for the stage equipment business for 2015 and 2016, CDTFA deducted recorded ice rink sales from the gross receipts reported on appellant’s FITRs. For 2017, CDTFA noted that bank deposits for the southern California location exceeded the amount computed by deducting recorded ice rink sales from gross receipts reported on the FITR. Therefore, to establish audited total sales for the stage equipment business for 2017, CDTFA used the bank deposits for the southern California location.
 11. For the first two quarters of 2018, appellant’s recorded bank deposits totaled \$52,266. Since that figure is less than the recorded amount for services (\$108,305), CDTFA concluded that the bank deposits were incomplete. Thus, CDTFA used appellant’s

⁴ To fall within the exclusion, the use of the tangible personal property must be for a period less than one continuous 24-hour period, the charge must be less than \$20, and the use of the property must be restricted to use on the premises or at a business location of the grantor of the privilege to use the property. (Cal. Code Regs., tit. 18, § 1660(e)(1).)

- recorded amount of services for the first two quarters of 2018 to compute audited total sales for the stage equipment business for those two quarters.
12. For the stage equipment business, appellant's income consisted of sales of equipment, rentals of equipment, and separately stated optional charges related thereto. CDTFA found that the optional charges were not taxable.
 13. Appellant informed CDTFA that B. Jackson, appellant's prior corporate officer and founder of the business, left the operation of the stage equipment business in 2015, and his daughter took over management of that business. B. Jackson continued to operate only the ice rink.
 14. CDTFA found that, during the audit period, appellant had recorded its rentals of stage equipment as services and had regarded them as non-taxable. However, CDTFA noted that in prior periods, the business had recorded and reported those transactions as taxable.
 15. During the audit, appellant provided nine invoices from the stage equipment business. All of those invoices represented sales, and some included charges for installation labor. The invoices were dated during the audit period and show that appellant charged sales tax reimbursement on the amount of the sale, net of charges for installation labor. Using that information, CDTFA computed a percentage of taxable to total sales of 85.85 percent.⁵
 16. CDTFA did not use the taxable percentage of 85.85 percent. Instead, CDTFA compared taxable and total sales reported on appellant's sales and use tax returns for 2014 with gross receipts recorded on the general ledger (excluding sales by the ice rink) to compute 71.13 percent taxable to total sales for the stage equipment business. CDTFA concluded that 71.13 percent was a reasonable percentage of taxable to total sales, and that using this lower percentage was favorable to appellant.
 17. To compute taxable sales for the stage equipment business, CDTFA applied 71.13 percent to the amounts of audited total sales for 2015, 2016 and 2017, which resulted in quarterly unreported taxable sales of \$59,589 for 2015, \$61,522 for 2016, and \$41,500 for 2017. For 2018, CDTFA computed quarterly unreported taxable sales of

⁵ In the audit working papers, CDTFA notes that, based on its review of the sales invoices, appellant could be a construction contractor. However, CDTFA found that, since appellant invoiced its customers on a time and material basis, with tax charged, appellant will not be considered the consumer of materials or fixtures for these types of contracts.

- \$38,519, using the recorded amount for sales of services for the first two quarters of that year.
18. For the audit period, CDTFA established an understatement of reported taxable sales of \$744,931.
 19. On February 13, 2019, CDTFA issued an NOD for tax of \$58,792, plus applicable interest.
 20. Appellant filed a timely petition for redetermination dated March 6, 2019.
 21. On November 4, 2021, CDTFA issued a Decision denying the petition for redetermination.
 22. 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).)

A "lease" includes a rental, hire, license, and "a contract under which a person secures for a consideration the temporary use of tangible personal property which ... is operated by, or under the direction and control of, the person or his or her employees." (R&TC, § 6006.3; Cal. Code Regs., tit. 18, § 1660(a)(1).) Generally, a lease of tangible personal property in California is a "sale" and a "purchase" within the meaning of R&TC sections 6006 and 6010. (Cal. Code Regs., tit. 18, § 1660(b)(1).) As an exception, a "sale" and "purchase" does not include a lease of tangible personal property in substantially the same form as acquired by the lessor as to which the lessor made a timely election to pay tax or tax reimbursement on the purchase price of the property. (Cal. Code Regs., tit. 18, § 1660(b)(1)(E), (b)(2).) When the lease is a "sale" and "purchase," then use tax generally applies, measured by the rental receipts, and the lessor must collect the tax from the lessee at the time rentals are paid and must remit it to CDTFA. (Cal. Code Regs., tit. 18, § 1660(c)(1).)

When 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 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.*)

In this case, appellant did not provide complete records, and CDTFA identified significant discrepancies between the available records and the amounts reported for sales and use tax purposes, such as substantial differences between amounts reported for income tax and sales and use tax purposes. Under these circumstances, CDTFA's use of an indirect audit method was warranted. CDTFA used appellant's records to establish the stage equipment business's total sales, and used appellant's reported taxable and total sales for 2014 to establish the stage equipment business's audited percentage of sales. Based on all of the evidence, OTA finds that CDTFA used the best available information to establish audited total sales and audited taxable sales, that the audit approach was appropriate, and that CDTFA's determination was reasonable and rational. Thus, the burden shifts to appellant to establish that adjustments are warranted.

Appellant contends that it paid sales tax reimbursement on all purchases of the tangible personal property that it leased for its stage equipment business. Therefore, appellant argues that the lease receipts are not subject to tax because it made a timely election to pay tax on the cost of the tangible personal property. Accordingly, appellant contends that CDTFA erred in using the 71.13 percent calculation for appellant's taxable sales, and that the amounts of taxable sales appellant reported on its sales and use tax returns were correct.

Appellant has been unable to provide evidence of the timely payment of tax or tax reimbursement on purchases of leased equipment (i.e., purchase invoices showing sales tax reimbursement paid to vendors or evidence of use tax paid on sales and use tax returns prior to the date the equipment was first leased). Appellant states that it no longer possesses the records related to those purchases because they occurred many years ago, beginning in the 1980s, and argues that requiring such lengthy retention of business records is unreasonable. Appellant states

that while it attempted to contact some of the sellers of the equipment, those sellers no longer had any records of appellant's purchases.

CDTFA states that appellant was reporting its leases of tangible personal property as taxable transactions prior to the audit period. According to appellant, the reporting practices prior to the audit period are irrelevant because, in 2014, appellant was incorrectly reporting non-taxable transactions as taxable.

The application of tax to appellant's receipts for leases of stage equipment rests on a finding of whether appellant made a timely election to pay tax before the equipment was first leased. Appellant's unsupported assertion that it paid sales tax when it purchased the equipment is not sufficient to satisfy its burden of proof. (See *Appeal of Talavera, supra.*)

In the absence of direct evidence regarding the timely payment of tax on purchases of stage equipment that was leased, OTA must consider the available facts. During the time that the business was operated by B. Jackson, appellant reported a significant portion of its total sales as taxable sales. In light of all evidence, OTA finds it is more likely than not that sales were being reported correctly during the time when the individual most familiar with the business was operating it. As a result, OTA finds unpersuasive appellant's unsupported assertion that, during 2014, when B. Jackson was in charge of the business, non-taxable sales were being reported erroneously as taxable. The evidence indicates it is more likely that, before 2015, appellant was correctly reporting tax on its lease receipts. Consequently, appellant has not established that its lease receipts for periods beginning in 2015 were not subject to tax.

HOLDING

Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.

DISPOSITION

Sustain CDTFA’s denial of the petition for redetermination.

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Suzanne B. Brown

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Suzanne B. Brown
Administrative Law Judge

We concur:

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Keith T. Long
Administrative Law Judge

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Andrew J. Kwee

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Andrew J. Kwee
Administrative Law Judge

Date Issued: 1/10/2023