OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **PLATINUM EQUITY PARTNERS, INC.**	OTA Case No. 18124089 CDTFA Case ID 469497

OPINION

Representing the Parties:

For Appellant: Steven Mather, Esq.
H. Hojati, Witness

For Respondent: Ravinder Sharma, Hearing Representative
Jason Parker, Chief Headquarters Operations
Christopher Brooks, Tax Counsel IV

For Office of Tax Appeals: Deborah Cumins,
Business Tax Specialist III

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Platinum Equity Partners, Inc. (appellant) appeals a decision and recommendation (D&R) issued by respondent California Department of Tax and Fee Administration (respondent)[1] in response to appellant's timely petition for redetermination of a Notice of Determination (NOD), which is for a tax liability of $827,970.56 and applicable interest, and a negligence penalty of $82,797.10, for the period April 1, 2004, through March 31, 2007 (audit period). In its D&R respondent recommended a reaudit, which reduced the tax liability from $827,970.56 to $630,518.67 and the penalty from $82,797.10 to $63,051.90

[1] Sales 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 referring to acts or events that occurred before July 1, 2017, "respondent" shall refer to BOE; and when referring to acts or events that occurred on or after July 1, 2017, "respondent" shall refer to the California Department of Tax and Fee Administration.

and denied the remainder of the petitioned amount. In addition, respondent recommends relief of interest, in the amount of $102,459.25, for the period April 1, 2011, through October 31, 2013.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Teresa A. Stanley, and Natasha Ralston held an oral hearing for this matter in Cerritos, California, on December 13, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether the reaudit represents a new determination that was barred by the statute of limitations.
2. Whether further adjustments are warranted to the audited understatement of reported taxable sales.
3. Whether additional relief of interest is warranted.
4. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated four auto body repair shops in the Los Angeles area from December 1, 2003, through December 31, 2008.
2. Appellant signed a series of waivers of the statute of limitations, the latest of which extended the period for issuing an NOD to January 31, 2009.[2]
3. During the audit period, appellant reported total sales of $45,268,135; claimed deductions of $34,319,009 for nontaxable labor (including $871,051 which was inadvertently claimed as nontaxable sales for resale in June 2004) and $87,214 for sales tax reimbursement included; and taxable sales of $10,861,912.
4. For audit, appellant provided its federal income tax returns (FITRs); its sales and use tax returns (SUTRs); sales and use tax worksheets for the period October 2005 through

[2] Absent a waiver, the three-year period would have expired for the second quarter 2004 on July 31, 2007.

Period	Waiver signed	Limitation period extended to
4/1/04-9/30/04	6/21/07	1/31/08
4/1/04-12/31/04	10/12/07	4/30/08
4/1/04-3/31/05	12/21/07	7/31/08
4/1/04-6/30/05	6/6/08	10/31/08
4/1/04-9/30/05	9/8/08	1/31/09

March 2007; sales journals for the period October 2005[3] through March 2007; job folders for June 2006; and purchase invoices for 2006. For the years 2004 and 2007, appellant did not provide bank statements for the entire year.

5. The gross receipts reported on appellant's FITRs exceeded total sales reported on its SUTRs by $751,890 for 2004, $89,426 for 2005, and $613,355 for 2006.
6. The purchases reported on appellant's FITRs substantially exceeded reported taxable sales, such that the markups computed using those figures were negative (-49 percent, -33 percent, and -31 percent for 2004, 2005, and 2006, respectively). Appellant's purchases for 2006 of $5,054,689 exceeded reported taxable sales of $3,925,668 for that year on its SUTRs. Due to the negative markups, respondent conducted additional analysis.
7. For the period October 2005 through March 2007, the taxable sales of $6,555,515 recorded in the sales journals exceeded reported taxable sales of $6,054,409 by $501,106.
8. A review of appellant's job folders revealed recording errors, and approximately 100 job folders for June 2006 were missing. Thus, respondent concluded that appellant's job folders were unreliable for audit purposes.
9. Using the markup method, respondent established an understatement of reported taxable sales of $10,206,778.[4] Respondent concluded that the understatement was the result of negligence because appellant failed to maintain adequate books and records and because the understatement was 72 percent.
10. On October 10, 2008, respondent issued an NOD for tax of $827,970.56 and a negligence penalty of $82,797.10.
11. On November 5, 2008, appellant filed a timely petition for redetermination. Subsequently, respondent's Appeals Bureau held an appeals conference where the parties established that an accurate cost of purchases could not readily be obtained from appellant's records and agreed that the markup method was not appropriate for this case.
12. On February 16, 2010, respondent issued a D&R, recommending a reaudit. The D&R stated that, for the months of October and November 2004, May and June 2005, and

[3] According to respondent's D&R, appellant explained that the records for periods before October 2005 were not available because its computer had been stolen in 2005.

[4] OTA will not address the specifics of the markup computations because respondent used an entirely different audit approach in the reaudit, which is the basis of the understatement currently in dispute.

August and September 2006, appellant would provide ranges of repair order numbers for jobs completed at each of its locations. Respondent's Business Taxes and Fees Department (BTFD) would then select samples of job folders from each location (25 from each location for the first two two-month periods and 75 from each location for the third two-month period). The D&R directed BTFD to use the selected job folders to compute a percentage of taxable to total sales and to apply the percentage to audited total sales. The D&R directed BTFD to establish audited total sales using the gross receipts reported on FITRs, after adjustments for other income included therein. The D&R also directed BTFD to use appellant's bank statements to verify the reported gross receipts.[5]

13. BTFD conducted a reaudit.

a. Percentage of taxable to total sales. Respondent examined and transcribed each selected repair order provided by appellant and computed percentages of taxable to total sales of 36.9713 percent for 2004, 41.2769 percent for 2005, and 40.5231 percent for 2006.

b. Audited total sales. Respondent reviewed appellant's bank statements and found that the net amounts (the bank deposits related to sales by the business) exceeded the gross receipts reported on FITRs by $311,063 for 2005 and $310,450 for 2006. Accordingly, respondent added those amounts to the gross receipts reported on appellant's FITR's to establish audited total sales for the years 2004 through 2007.

c. Audited taxable sales. For each of the four years, respondent computed a quarterly amount of audited total sales. It then computed the quarterly taxable sales by applying the percentages of taxable to total sales mentioned above. For the first quarter 2007, respondent used the percentage it had computed for 2006 (40.5231 percent).

d. Understatement of reported taxable sales. Respondent totaled the audited taxable sales per quarter for the audit period to compute audited taxable sales of $18,668,761, which exceeded reported taxable sales of $10,861,912 by $7,806,849, the amount currently in dispute.

[5] The D&R included a specific requirement that the reaudit understatement account for the 8.28 percent understatement reflected in the difference between recorded and reported taxable sales for the period October 2005 through March 2007 ($6,555,515 - $6,054,409 = $501,106. $501,106 ÷$6,054,409 = 8.28 percent).

14. Respondent notified appellant of the results of the reaudit, which reduced the amount of tax to $630,518.67, and made a corresponding reduction to the 10 percent negligence penalty.
15. This timely appeal followed.

DISCUSSION

Issue 1: Whether the reaudit represents a new determination that was barred by the statute of limitations.

Generally, an NOD is timely if it is mailed within three years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined or within three years after the return is filed, whichever period expires the later. (R&TC, § 6487(a).) The period for timely issuance of an NOD may be extended if, before the expiration of the three-year period just described, the taxpayer consents, in writing, to the mailing of the notice after the three-year period. (R&TC, § 6488.) In that case, the NOD may be mailed at any time prior to the expiration of the period to which the parties agree. (*Ibid.*)

A person against whom a determination is made may petition for redetermination within 30 days after the service upon the person of the NOD. (R&TC, § 6561.) If a petition is not filed within the 30-day period, the determination becomes final at the expiration of the 30 days. (*Ibid.*) If a petition for redetermination has been timely filed, the determination does not become final at the end of the previously mentioned 30-day period. Respondent may then decrease or increase[6] the determination before it becomes final. (R&TC, § 6563(a).)

As noted above, appellant signed a series of waivers of the statute of limitations, the latest of which extended the period for issuing an NOD to January 31, 2009. The NOD was issued before that date, on October 10, 2008. It is undisputed that the NOD was timely mailed. However, appellant alleges that the reaudit, which reduced the tax liability asserted by

[6] There are limits to the time periods during which a determination may be increased, but they are not relevant here because respondent is not asserting an increase.

respondent, resulted in a new determination and that the "new determination" was issued after the expiration of the statute of limitations.[7]

Appellant misunderstands the process. The NOD was timely issued, and appellant filed a petition for redetermination within 30 days. Since the petition was timely filed, the NOD did not become final, and it still is not yet final. (See R&TC, §§ 6561, 6564.) Any revisions to the determination are merely adjustments to the NOD that was timely issued on October 10, 2008 and do constitute a new NOD, but are simply part of the appeals process.

In response to the petition for redetermination, respondent proceeded with its established appeals process, which included an appeals conference and a D&R issued by respondent's Appeals Bureau. Since it was established at the appeals conference that an accurate cost of purchases could not readily be obtained from appellant's records, the parties agreed that the markup method was not appropriate for this case. Therefore, the D&R recommended that BTFD conduct a reaudit using a different audit methodology.

The D&R did not "reject the determination in the NOD" as appellant asserts,[8] and the NOD did not become final when the D&R was issued. Instead, the D&R recommended a reaudit, which could have resulted in a decrease or increase to the NOD. The result of the reaudit was a reduction of the audited understatement of reported taxable sales, which was an adjustment to the NOD. There was no new determination, and there is no statute of limitations for respondent to reduce the amount asserted in the NOD. Accordingly, OTA finds that the reaudit did not constitute a new determination that was barred by the statute of limitations.

<u>Issue 2: Whether further adjustments are warranted to the audited understatement of reported taxable sales.</u>

The California sales tax is imposed on a retailer and measured by the retailer's gross receipts from its retail sales in this state of tangible personal property, unless the sale is

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[7] As part of its argument, appellant alleges that respondent reached faulty conclusions in the audit concerning the taxability of specific transactions. Appellant asserts that the D&R agreed with this position, rejected the determination, and ordered a reaudit. Although it is not pertinent to OTA's analysis of whether there was a "new determination," the D&R did not conclude that BTFD had improperly applied indirect methods in the audit. Instead, the D&R accepted appellant's assertion that there were numerous errors in its records (e.g., incorrect recording of payments for equipment and services as purchases of parts and paint). Therefore, due to concerns about the difficulty of establishing an accurate cost of purchases, BTFD agreed to use a different audit method.

[8] See footnote 9, *ante*, page 10.

specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination on request by respondent. (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, or if a person fails to file a return, respondent may compute and 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) If respondent meets its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

When a repair job is covered by insurance, the amount represented as the selling price of parts in an accepted bid is the taxable measure required to be reported by the repairperson unless there is a subsequent modification of the bid agreement and the customer or the insurer is informed of the change, provided, however, that the selling price of the parts is not less than the cost of the parts actually used. (Cal. Code Regs., tit. 18, § 1546(b)(5).) The bid agreement may be modified by an invoice or a priced repair order given to the customer or the insurer showing the sales price of the property actually furnished by the repairman. (*Ibid.*) If a bid is so modified and the customer or insurer is notified of the change, the amount represented as the selling price of the parts on the modified bid is the amount upon which tax must be reported. (*Ibid.*) When the accepted bid is in writing, the subsequent modification to the bid agreement must also be in writing. (*Ibid.*) The customer or the insurer should be notified of such modification prior to completion of the sale. (*Ibid.*)

For this case, respondent identified various discrepancies in appellant's records. For instance, appellant's recorded taxable sales for the period October 2005 through March 2007 exceeded reported taxable sales by $501,106. Also, the purchases reported on appellant's FITRs significantly exceeded appellant's reported taxable sales. Under those circumstances, it was appropriate for respondent to utilize an alternate audit method. Further it was appropriate for respondent to utilize appellant's FITRs and its bank statements to establish audited total sales. These documents are more credible because FITRs are filed with the IRS and bank statements are issued by an unrelated third party. With regard to establishing the audited percentage of taxable to total sales, respondent reviewed randomly chosen job folders from two months in each of the years 2004, 2005, and 2006. This sample was sufficient to establish representative percentages of taxable to total sales for each year. OTA also notes that the percentage remained relatively consistent from year to year, ranging from 37 percent (rounded) in 2004 to 41 percent (rounded) in 2005 and 2006. That consistency is evidence that the percentages are representative. Respondent has used appellant's own records to establish the audited total sales and the audited percentages of taxable to total sales. Therefore, respondent has shown that its determination is reasonable and rational. Appellant thus has the burden of establishing that adjustments are warranted.

Audited total sales

In its January 7, 2019 opening brief, appellant argues that audited total sales are excessive because the amounts of gross receipts reported on FITRs include sales tax, rebates from paint manufacturers, and other non-sales revenue from Enterprise Rent-a-Car and other service transactions. Exhibit C of appellant's opening brief is a schedule of annual amounts of adjustments that appellant is requesting.

In its March 6, 2019 response brief, respondent notes that appellant has provided no evidence to support the requested adjustments. In a May 9, 2019 reply brief, appellant states, "This documentation exists and will be provided at the hearing in this case."

In a September 11, 2019 letter to the parties, OTA explained that the hearing is not the proper venue for presenting documentation of this nature. OTA therefore asked appellant to identify specific errors in the audit workpapers, noting specific items that warrant adjustment, and to provide documentation to support the adjustments.

In its November 7, 2019 reply brief, appellant has provided additional explanation of its arguments regarding the audited amount of total sales. In that brief, appellant raises another argument regarding the audited amount of total sales. Appellant asserts that respondent reviewed appellant's bank statements and established audited total sales using the greater of the total bank deposits and the FITR gross receipts, implying that respondent chose the larger of the two amounts for each year.

OTA finds that assertion to be invalid. For the years 2004 and 2007, appellant did not provide bank statements for the entire year. Thus, respondent did not have sufficient information to compare the FITR gross receipts and bank deposits, and it used the FITR gross receipts in its computation of the average quarterly sales for those years. For 2005 and 2006, respondent reached the reasonable conclusion that funds deposited in the bank represented sales of tangible personal property or charges for labor unless appellant provided documentation that the funds were received from some other source. Since the amounts deposited in the bank (net of documented funds from non-sales sources) exceeded the FITR gross receipts for both of those years, respondent added the excess bank deposits to the FITR gross receipts to establish audited total sales.

Appellant further asserts that adjustments are warranted for significant amounts of deposits to the bank accounts that represent funds from sources other than sales. Exhibit A of the November 7, 2019 brief is a schedule of amounts, by month, that should be deducted from the bank deposits, according to appellant. Appellant asserts, however, that the documentation to support its proposed adjustments is based on dozens of boxes of documents which are too voluminous to be submitted with a brief.

In its December 6, 2019 brief, respondent notes that appellant’s schedule of bank deposits excludes all deposits to its Citibank account, which total $4,243,705. OTA has verified that respondent’s assertion is correct. Accordingly, appellant’s schedule of bank deposits is flawed and should be rejected. Moreover, appellant’s list of requested adjustments is of no evidentiary value without detailed documentation regarding each amount that appellant has described as funds from non-sale sources.

During the reaudit, respondent made adjustments to the bank deposits for all documented amounts received from non-sale sources. Of the total bank deposits of $50,313,133 for the period April 1, 2004, through March 31, 2007, respondent found that $3,644,613 represented funds from sources other than revenue earned by the business (sales of tangible personal property and charges for labor). Appellant has declined to provide the requisite documentation to support further adjustments, thus no reduction of audited total sales is warranted.

Audited percentage of taxable to total sales

In its opening brief, appellant argues that the audited percentage of taxable to total sales is incorrect, and it identifies three specific areas of disagreement.[9] First appellant states that, in

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[9] Appellant initially listed four areas of disagreement, but has since stated that it is no longer disputing the issue of bad debts.

its computation of taxable sales, respondent used the estimated amounts that were initially identified before the job started, rather than the amounts shown on the actual invoice created when the job was finished. With its November 7, 2019 brief, appellant provided an analysis of the repair orders, on which it had computed taxable sales percentages lower than those computed by respondent.

In its December 6, 2019 brief, respondent addresses the analysis of the repair orders, which is the same transcription of sales that was provided to respondent during the reaudit. Respondent notes that, due to errors in appellant's transcription, it had rejected appellant's analysis. The auditor then reviewed all the job folders and transcribed the information therein.

Regarding appellant's assertion that respondent erroneously relied on estimated sales prices, respondent asserts that the typical procedure in this industry is for the repair shop to bill the insurance company and receive a check from the insurance company to complete the repairs. The written estimate provided to the insurance company typically includes a detailed listing of all parts needed to repair the vehicle (as well as labor charges). Since appellant received payment based on those written estimates, respondent concludes that tax is due on the selling price of the parts as noted on the written estimates. Respondent asserts that appellant has not provided evidence that it made refunds to insurance companies for repairs completed for less than the estimate to the insurance company. Respondent asserts further that it did not find any written revised pricing information sent to the insurance companies in the job folders. Relying on California Code of Regulations, title 18, section 1546(b)(5), respondent asserts that there has been insufficient notice of any change in the bids and concludes that tax applies to the amounts represented as the sales price of parts in the bids accepted by the insurance companies. Respondent notes further that, when repair orders were paid directly by customers, it established the taxable amount of the sale using the final repair order[10] with a detailed listing of all parts sold.

Appellant has not provided evidence to show that bids issued to insurance companies were modified, in writing, to the insurance company or the customer as required by California Code of Regulations, title 18, section 1546. Appellant also has not documented that respondent used prices in the original bid, rather than those in the final repair order, to establish taxable sales

[10] Respondent explains that the "invoice" referred to by appellant was actually labeled as a final repair order in appellant's records.

for any sales for which payment was made by the customer. Accordingly, no adjustment is warranted for appellant's assertion that respondent used information from estimates rather than from the actual sales invoices.

Second, appellant states that respondent incorrectly identified sublet repairs[11] and other nontaxable items as taxable. Appellant has not identified specific errors in the audit workpapers and has not provided evidence that respondent regarded any nontaxable charge as a taxable sale. In the absence of evidence, no adjustment is warranted for this assertion.

Third, appellant argues that some invoices, which were a total loss, included charges for storage. Appellant asserts that those invoices were part of the total revenue received and reported on the FITR. In appellant's view, the storage charges should have been included as nontaxable sales in the computation of the percentage of taxable to total sales.

In its December 6, 2019 brief, respondent explains that the storage charges in question were ultimately written off as uncollectible.[12] Respondent states that it excluded those amounts from the calculation of the audited taxable percentage because the revenue was never received. Respondent also notes that it did include paid non-sale revenue, such as towing, as nontaxable sales in its computations.

Appellant has stated that the sales in question were "a total loss." That description is consistent with respondent's statement that the charges for storage were written off. Since appellant did not receive the revenue from the storage charges, there is no basis to consider those charges as "nontaxable sales" in the test used to compute the ratio of taxable to total sales.

Overall audited understatement

In the conclusion of its November 7, 2019 brief, appellant argues that, once its requested adjustments are made, there will be only a minor difference between the adjusted figures and reported taxable sales. On that basis, appellant argues that the determination should be reduced to zero.

[11] For sublet repairs, appellant had the option of issuing a resale certificate to the other repair business. If it did so, it would not have paid sales tax to the other repair business with respect to any parts included in the sublet repair. Instead, the selling price of the parts to appellant's customer (including any markup appellant added to the amount charged by the other repair business) would be subject to tax. Thus, without additional information, it has not been established that the sublet repairs appellant references were nontaxable.

[12] That explanation is consistent with the audit comments (e.g., on audit workpaper Schedule R1-12A-2a), which state that the charges in question were "written off storage charges."

As noted previously, for the period October 2005 through March 2007, the taxable sales of $6,555,515 recorded in the sales journals exceeded reported taxable sales of $6,054,409 by $501,106. Moreover, the amounts of purchases reported on FITRs materially exceeded reported taxable sales. Therefore, there is a significant understatement of reported taxable sales. For the reasons explained above, no adjustment is warranted to the audited amount of understatement.

Issue 3: Whether additional relief of interest is warranted.

The imposition of interest is mandatory. (R&TC, § 6482.) There is no statutory right to interest relief. (R&TC, § 6593.5.) The law allows respondent, in its discretion, to grant relief of all or any part of the interest imposed on a person under the Sales and Use Tax Law where the failure to pay the tax is due in whole or in part to an unreasonable error or delay by an employee of respondent acting in his or her official capacity. (R&TC, § 6593.5(a)(1).) Such a delay means, for example, an unreasonable failure to work on an appeal. (*Appeal of Micelle Laboratories, Inc*., 2020-OTA-290P.) An unreasonable error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c).)

The law allows respondent to grant interest relief "in its discretion," provided certain elements are met. (R&TC, § 6593.5.) OTA reviews respondent's decisions to deny interest relief on an abuse of discretion standard. (*Appeal of Micelle Laboratories, Inc., supra*; see *Appeal of Gorin*, 2020-OTA-018P.) To show an abuse of discretion, a taxpayer must establish that, in refusing to relieve interest, respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Gorin, supra; see Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)

In its opening brief, appellant requests "abatement of interest for 10 years to reflect the delays in processing [appellant's] appeal that were beyond [appellant's] control."

In its March 6, 2019 brief, respondent recommends relief of interest of $102,459.25, for the period April 1, 2011, through October 31, 2013. With its December 6, 2019 brief, respondent has provided a detailed timeline for this case, from the date it received appellant's petition, on November 5, 2008, until the case was referred to OTA. OTA has reviewed that timeline and finds no unusual delays by respondent's staff other than the delay that has been identified by respondent. Appellant has not disputed this timeline nor provided evidence that the timeline is incorrect. Furthermore, at the hearing, OTA asked appellant to identify any specific errors or delays by respondent that would support an abatement of interest, other than those already identified by respondent, but appellant was unable to do so. Thus, appellant has not established that, in refusing to relieve interest during this period, respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Eichler*, 2022-OTA-029P.) Therefore, no additional relief of interest is warranted.

Issue 4: Whether appellant was negligent.

R&TC section 6484 provides that, if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Taxpayers are required to maintain and make available for examination on request by respondent, or its authorized representative, 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 SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Furthermore, these records are required to be preserved for a period of not less than four years. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to determinations associated with the first audit of a taxpayer. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A).); also see *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167Cal App.2d 318, 321-324.) However, a negligence penalty should be upheld in a first audit if the understatement cannot be attributed to a bona fide and reasonable belief that the bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (*Ibid.*)

Respondent imposed the negligence penalty because it determined that appellant failed to maintain adequate books and records and because the understatement was 72 percent. At the hearing, appellant argued that the negligence penalty should be abated because appellant did not fail to exercise due care and maintain adequate books and records. Appellant asserts that its server was stolen and therefore appellant was left with only paper records. Appellant further argues that the understatement computed by respondent is overstated as it is based on estimated amounts.

After the reaudit, the understatement of reported taxable sales of $7,806,849 represents 72 percent of reported taxable sales of $10,861,912. Further, appellant had recorded taxable sales of $6,555,515 for the period October 2005 through March 2007, while it reported taxable sales of $6,054,409 for the same period. In addition, appellant's purchases for 2006 of $5,054,689 exceeded reported taxable sales of $3,925,668 for that year. Although appellant had not been audited previously, a taxpayer, even one with limited experience, would recognize that it needs to report all of its recorded taxable sales and that its reported sales of tangible personal property should exceed its purchases. Further, although appellant's server was stolen, appellant concedes that it still had access to the paper files and thus, if respondent's assessment was overstated, appellant could have used the paper records to refute the assessment. Thus, the negligence penalty was properly imposed and should not be abated.

HOLDINGS

1. The reaudit represents an adjustment to the NOD, rather than a new determination, and the NOD was timely issued.
2. No further adjustments are warranted to the audited understatement of reported taxable sales.
3. No additional relief of interest is warranted.
4. Appellant was negligent.

DISPOSITION

Sustain respondent's action to reduce the determined amounts of tax and penalty to $630,518.67 and $63,051.90, respectively; to relieve interest of $102,459.25 for the period April 1, 2011, through October 31, 2013; and to otherwise deny the petition.

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew Wong
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 3/7/2023