OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21027296
S. BAHRAMI AND N. BAHRAMI,	CDTFA Case ID: 018-982
dba Livingston Fitness	

OPINION

Representing the Parties:

For Appellant:	N. Bahrami
For CDTFA:	Mari Guzman, Tax Counsel III Cary Huxsoll, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Oliver Pfost, Tax Counsel

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, a partnership consisting of S. Bahrami and N. Bahrami (appellant)[1] doing business as Livingston Fitness, appeals a decision issued by respondent California Department and Tax and Fee Administration (CDTFA)[2] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated May 24, 2019. The NOD is for tax of $82,188.00, plus

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

[2] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events occurring before July 1, 2017, "CDTFA" refers to BOE.

applicable interest, and a negligence penalty of $8,218.79, for the period January 1, 2014, through December 31, 2016 (liability period).[3]

Office of Tax Appeals (OTA) Administrative Law Judges Suzanne B. Brown, Natasha Ralston, and John O. Johnson held an oral hearing for this matter in Sacramento, California, on December 15, 2022. At the conclusion of the hearing, the record was closed and the matter was submitted for an opinion.

ISSUES

1. Whether adjustments, including relief based on advice allegedly provided to appellant by CDTFA, are warranted to the measure of unreported taxable sales for the liability period.[4]
2. Whether CDTFA correctly imposed the negligence penalty.

FACTUAL FINDINGS

1. During the liability period, appellant operated two members-only fitness centers in California, and also sold fitness equipment. Appellant held a California seller's permit throughout the liability period.
2. For the liability period, appellant reported gross receipts from sales of fitness equipment of $230,451, $291,310, and $556,118 on its 2014, 2015, and 2016 federal income tax returns, respectively, for total gross receipts of $1,077,879.
3. Upon audit, appellant provided its federal income tax returns and sales and use tax returns for the liability period, a sales summary, sales invoices, bank statements, and yearly Forms 1099-K.[5] This was appellant's first audit.

[3] The NOD was timely issued because appellant signed a series of waivers of the otherwise applicable three-year statute of limitations, which allowed CDTFA until July 31, 2019, to issue an NOD for the period January 1, 2014, through December 31, 2015. (R&TC, §§ 6487(b), 6488.)

[4] Previously OTA identified a total of three issues for hearing in this matter: (1) whether adjustments are warranted to the measure of unreported taxable sales for the liability period; (2) whether appellant should be relieved of the liability based on reasonable reliance on erroneous advice from CDTFA; and (3) whether CDTFA correctly imposed the negligence penalty. To facilitate ease of reading, this Opinion has combined the first two of those issues to address them under Issue 1; this reorganization does not change the substance of the issues.

[5] Form 1099-K, "Payment Card and Third Party Network Transactions," is an IRS form that shows amounts paid to a merchant by a bank, credit card company, or third party network when the customer pays for goods or services using a debit card, credit card, PayPal, or similar non-cash payment.

4. On its sales and use tax returns for the liability period, appellant reported total sales of $11,247 and claimed no deductions, resulting in reported taxable sales of $11,247.[6] Appellant's monthly sales summaries did not include its fitness equipment sales, and appellant did not report its fitness equipment sales on its sales and use tax returns.
5. Appellant did not collect resale certificates from its customers, and appellant generally did not collect sales tax reimbursement on its sales of fitness equipment. Appellant stated that it believed its fitness equipment sales were nontaxable.
6. Appellant's 2014 sales invoices list fitness equipment sales totaling $37,693, and appellant's 2015 sales invoices list fitness equipment sales totaling $206,870. Thus, appellant's gross receipts listed on its federal income tax returns were greater than the total sales reflected on the sales invoices by $192,758 for 2014 and by $84,440 for 2015. Appellant also provided sales invoices for 2016, but CDTFA concluded that these sales invoices were incomplete, and therefore CDTFA's audit work papers did not include a schedule for the 2016 invoices.
7. CDTFA compared the reported taxable sales of $11,247 reported on appellant's sales and use tax returns to the gross receipts reported on appellant's federal income tax returns and established a deficiency measure of $1,077,879 for the liability period. This calculation is not in dispute by the parties on appeal.
8. On May 24, 2019, CDTFA issued an NOD to appellant based on the $1,077,879 deficiency measure.
9. Appellant filed a timely petition for redetermination. In a decision dated February 8, 2021, CDTFA denied appellant's petition for redetermination.
10. This timely appeal to OTA followed.

DISCUSSION

Issue 1: Whether adjustments, including relief based on advice allegedly provided to appellant by CDTFA, are warranted to the measure of unreported taxable sales for the liability period.

California imposes a 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, § 6051.) All of a retailer's gross receipts are

[6] Appellant stated that these reported taxable sales were for its sales of supplements and drinks, and that appellant collected sales tax reimbursement on those sales. Those sales are not part of the liability at issue here.

presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) While a taxpayer may collect tax reimbursement from its customers, there is no requirement that it do so, and sales tax applies to the retail sale of tangible personal property in this state regardless of whether the retailer charges or collects reimbursement for the tax from its customer. (*Appeal of Body Wise International, LLC*, 2022-OTA-340P.)

When a taxpayer challenges an NOD, CDTFA has a minimal, initial burden of showing that its determination is reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) If CDTFA carries that burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.)

R&TC section 6596(a) provides that if a person's failure to make a timely return or payment was due to that person's reasonable reliance on written advice from CDTFA, the person may be relieved of any sales or use taxes imposed. A taxpayer's request for written advice from CDTFA must set forth the specific facts and circumstances of the activity or transactions for which the advice is requested. (R&TC, § 6596(b)(1); Cal Code Regs., tit. 18 § 1705(b)(1).) The taxpayer may be eligible for relief if, in reasonable reliance on the written advice, the taxpayer failed to charge or collect sales tax reimbursement or use tax from its customer. (R&TC, § 6596(b)(3).) There is no applicable legal provision that would allow for relief of taxes based on reliance on oral advice. (See R&TC, § 6596(b)(2); Cal. Code Regs., tit. 18, § 1705(a); *Appeal of Salam and Perveen*, 2019-OTA-041P.)

Here, CDTFA's calculations are based on appellant's own reporting of gross receipts on its federal income tax returns, and appellant does not dispute the audit methodology or CDTFA's calculation of the audit liability. OTA finds that the audit approach was appropriate and CDTFA's determination of the audit liability was reasonable and rational. Therefore, the burden shifts to appellant to establish error in CDTFA's determination.

Appellant argues it did not collect sales tax reimbursement from sales of fitness equipment because it relied on erroneous oral advice from CDTFA. Appellant states that when it replaced an item of fitness equipment at one of its fitness centers, it would sell the old equipment to a reseller who would refurbish and resell the equipment. Appellant alleges that in 2013 it

spoke by telephone with a CDTFA employee who stated that appellant's "sales license" was a "wholesales license,"[7] which appellant understood to mean that its sales were sales for resale. Accordingly, appellant argues that due to its reliance on this erroneous advice, appellant should be relieved of the sales tax imposed by R&TC section 6051.

Appellant acknowledges that it did not receive the purported advice in writing. As noted above, R&TC section 6596 only authorizes relief of tax liability when there is reasonable reliance on written advice; there is no legal authority allowing relief of the tax liability based on reliance on oral advice. (R&TC, § 6596(a); Cal. Code Regs., tit. 18, § 1705(a); *Appeal of Salam & Perveen*, *supra*.) Therefore, there is no basis to grant relief of the liability pursuant to R&TC section 6596. Appellant did not contend that adjustments are warranted on any other basis, and OTA finds no grounds to support any adjustments.

Issue 2: Whether CDTFA correctly imposed the negligence penalty.

R&TC section 6484 provides if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d 310, 317; see also *People v. Superior Court* (*Sokolich*) (2016) 248 Cal.App.4th 434, 447.)

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (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 of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

[7] OTA understands that appellant uses the term "license" to refer to a seller's permit, and uses the term "wholesales" to refer to sales for resale.

In analyzing the issue of negligence, OTA must consider whether the taxpayer has been previously audited. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Generally, a negligence penalty should not be added when the taxpayer has not been previously audited, but there are circumstances where a penalty in a first audit would be appropriate. (*Ibid*.) However, a negligence penalty should be upheld in a first audit if the taxpayer's bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice 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); see *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

The understatement of $1,077,879 represents an error ratio in excess of 9,000 percent when compared to reported taxable sales of $11,247 (i.e., $1,077,879 ÷ 11,247). Hence, appellant reported only 1 percent of its taxable sales (i.e., $11,247 reported taxable sales ÷ $1,089,126 audited taxable sales). Also, the records appellant provided in the audit were incomplete, as appellant did not provide all sales invoices for the liability period, and the gross receipts reported on its federal income tax returns for 2014 and 2015 exceed total sales listed on appellant's sales invoices for those years by $277,198.

Although a negligence penalty is not generally recommended for a first audit, the penalty is appropriate when the inadequacy of a taxpayer's records and reporting cannot be attributed to the taxpayer's good faith and reasonable belief the records were in substantial compliance with legal requirements. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) While appellant states it believed its sales were nontaxable sales for resale, appellant's actions were not in accordance with such an understanding, as appellant failed to collect resale certificates. Appellant has not provided persuasive evidentiary support for its allegation that CDTFA orally advised appellant the sales at issue were nontaxable sales for resale, and it is unlikely that CDTFA would have provided such inaccurate information. In light of all of the above, OTA finds that appellant has not established that the understatement can be attributed to a good faith and reasonable belief its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. Accordingly, CDTFA properly imposed the negligence penalty.

HOLDINGS

1. Appellant is not entitled to relief or other adjustments to the measure of unreported taxable sales.
2. The negligence penalty was properly imposed.

DISPOSITION

CDTFA's action denying appellant's petition for redetermination is sustained.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

Date Issued: 3/15/2023