OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18083673
	) CDTFA Case ID 534002
ADVENTURES BY THE SEA, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Gary Kimzey, Representative Frank Knight, President Michelle Knight, Corporate officer
For Respondent:	Kevin Smith, Tax Counsel III Cary Huxsoll, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Corin Saxton, Tax Counsel IV Deborah Cumins, Business Taxes Specialist III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Adventures by the Sea, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's untimely petition (late protest)[2] of a Notice of Determination (NOD) dated March 22, 2010. The NOD is for a tax of $154,510.12, applicable interest, and a negligence penalty of $15,451.01, for the period July 1, 2005, through June 30, 2008 (liability period). CDTFA later added a finality penalty of $15,451.01 pursuant to R&TC section 6565 when appellant failed to timely pay or

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

[2] Under regulations applicable at the time the late protest was filed, if a taxpayer filed a petition for redetermination after the 30-day time period specified in R&TC section 6561, CDTFA could accept it as an administrative (late) protest. (Cal. Code Regs., tit. 18, § 5220 [superseded by Cal. Code Regs., tit. 18, § 35019].)

petition the liability; however, CDTFA's decision granted conditional relief of the penalty, subject to appellant meeting certain payment requirements.[3]

Over the course of four reaudits, the most recent of which was completed by March 21, 2022, CDTFA now concedes to reducing the taxable measure from $2,131,174.00 to $1,766,362.00. The remaining measure represents approximately $128,061.00 in tax, and the concession will result in corresponding reductions to interest and the negligence penalty.[4] Appellant also made payments totaling $67,517.51 which are not at issue in this appeal.[5]

CDTFA also concedes to interest relief for the period January 1, 2014, through May 31, 2015. Interest remains at issue for additional periods. Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Keith T. Long, and Sara A. Hosey held an oral hearing for this matter in Sacramento, California, on February 22, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether appellant established that tax is inapplicable to any portion of the rental receipts.[6]
2. Whether adjustments are warranted to the audit liability as calculated by CDTFA.
3. Whether interest relief is warranted.

FACTUAL FINDINGS

1. Appellant, a California corporation, operates a business that provides tours and rentals in Monterey, California. As a part of that business, appellant rents equipment including

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[3] This item is conceded and, as such, it is not addressed further in this Opinion.

[4] CDTFA's fourth reaudit schedule R4-414A-2, dated February 7, 2022, computed tax of $128,061; however, by submission dated February 6, 2023, CDTFA indicated the computed tax is $131,382. In both submissions, CDTFA conceded to reducing the taxable measure to $1,766,362.

[5] CDTFA's decision did not address a claim for refund, and there is no claim in the record before OTA. CDTFA's decision indicated payments totaling $4,195.51 were barred by statute and the decision made no reference to any additional payments. The parties did not provide dates for any additional payments. OTA has not been asked to address a refund claim and, as such, this Opinion does not further address the payments.

[6] This Opinion rephrased the first two issues for ease of analysis. OTA previously identified the first issue as: "Whether adjustments are warranted to the measure of unreported taxable rental receipts," and the second issue as: "Whether adjustments are warranted to the measure of unreported taxable sales."

kayaks, surfboards, four-wheeled carriage-style bicycles (surreys),[7] bicycles, and related safety equipment such as life vests, wet suits, and dry suits (for kayaks).

2. Appellant rents kayaks and bicycles as a part of a tour group package. Appellant also rents equipment individually separate and distinct from the tour group packages.
3. For the liability period, when appellant provided bicycle and kayak tours, appellant charged a lump-sum all-inclusive price for the tour, the kayak, and the related safety equipment. The lump sum rental charge included taxable mandatory gratuities of 16 percent. As relevant to the kayak rentals, the available purchase receipts consist of five invoices for the purchase of 291 dry suits for kayakers, and one invoice for the purchase of a life vest. All six receipts reflect that appellant paid tax to its supplier at the time of purchase.
4. Appellant did not maintain any receipts for kayak purchases.
5. Appellant considered income from rentals included in tour group packages nontaxable in its entirety and did not report any such income on any sales and use tax returns.
6. Sometime during 2009, CDTFA initiated an audit of appellant for the liability period. The exact date CDTFA initiated the audit is not known, because CDTFA did not provide its audit contact history (commonly referred to as the "414Z") for the field audit when it submitted its audit file to OTA.[8] Some of the audit schedules are dated November 30, 2009, and there is a reference to an audit discussion held on November 4, 2009, wherein appellant expressed disagreement with the audit, and was given a deadline to submit additional documentation or else the auditor would submit the audit as disagreed.
7. On December 14, 2009, appellant requested that the audit be transferred from San Jose to Sacramento, to facilitate in-person discussions between the parties. CDTFA denied the request by letter dated December 16, 2009, and asked to schedule a phone meeting on the basis that the audit was "virtually complete" and only waiting on documentation from appellant to support a tax paid purchases resold allowance.

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[7] CDTFA conceded the liability with respect to surrey rentals, and they are no longer at issue.

[8] CDTFA provided 414Z history for the reaudits.

8. On or after December 21, 2009, CDTFA completed the field audit. For the liability period, appellant reported total and taxable sales of $412,556. CDTFA examined appellant's records and discovered a substantial difference between recorded and reported total sales. Using appellant's records, CDTFA scheduled unreported taxable sales of $2,131,174, consisting of the following three audit items: (1) $1,296,798 in unreported rental receipts; (2) $923,587 in additional unreported taxable sales; and (3) a deduction of $89,211 for tax paid purposes resold.[9]
9. On March 22, 2010, CDTFA issued an NOD for the liability disclosed by audit.
10. Appellant filed its untimely petition for redetermination on May 25, 2010. In response, CDTFA conducted a reaudit.
11. By June 22, 2010, CDTFA transferred the audit from its San Jose to Sacramento District Office, pursuant to appellant's earlier request.
12. On March 26, 2012, CDTFA completed the first reaudit. CDTFA's first reaudit asserted an overall increase to the liability, from $2,131,174 to $2,464,548 in additional taxable measure, consisting of the following three audit items: (1) $1,854,283 in unreported rental receipts; (2) $656,080 in additional unreported taxable sales; and (3) a deduction of $45,815 for tax paid purchases resold.[10]
13. On May 28, 2013, CDTFA held an appeals conference with appellant concerning the liability. Shortly thereafter, CDTFA placed appellant's appeal in abeyance on the basis that CDTFA intended to promulgate a new regulation which CDTFA thought might impact the application of tax to appellant's business model.
14. On June 18, 2015, CDTFA issued an internal memorandum stating that it decided not to proceed with the contemplated rulemaking and the appeals process may continue.
15. On October 28, 2015, CDTFA informed appellant that it would resume processing the appeal, and offered appellant a second appeals conference, which appellant declined.

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[9] This is erroneously listed in CDTFA's audit materials as a "credit"; however, it is undisputed that it was allowed as a deduction to reduce the taxable measure, not a dollar-for-dollar reduction to the amount of tax due.

[10] When summarizing the figures for the audit and reaudit totals in this Opinion, there may be difference of up to $1 because CDTFA's listed figures for the same audit items differ by up to $1, depending on which CDTFA audit schedule is examined. This difference is immaterial and may be the result of rounding.

16. On May 16, 2016, CDTFA issued its decision, ordering a second reaudit to, as relevant here, delete rental receipts allocable to property acquired tax paid.
17. On May 10, 2017, CDTFA met with appellant to discuss the results of the second reaudit. The second reaudit reduced the taxable measure from $2,464,548, to $2,167,740. The liability consisted of the following two audit items: (1) $1,535,326 in unreported rental receipts, a net decrease of $318,957 to the first audit item; and (2) $678,228 in additional unreported taxable sales, a net increase of $22,149 to the second audit item.
18. CDTFA completed a second audit report on October 19, 2017.
19. Shortly after the second reaudit, CDTFA completed a third reaudit to allow a $4,776 adjustment to the second audit item based on invoices for the third and fourth quarter of 2005, which reduced the taxable measure from $2,167,740 to $2,162,964. The third reaudit was completed in response to the directions of the May 16, 2016 decision.[11]
20. On January 26, 2018, CDTFA issued a letter informing appellant that if it did not file a request for reconsideration or a written concession within 30 days, CDTFA would transfer the appeal to OTA pursuant to appellant's prior request for an oral hearing before the State Board of Equalization. There is no evidence that appellant submitted a request for reconsideration or a written concession.
21. On August 30, 2018, CDTFA transferred the appeal to OTA.
22. On December 28, 2018, appellant requested to defer the case to pursue settlement with CDTFA, where it remained until November 6, 2020, when CDTFA informed OTA that it had removed the matter from settlement consideration.
23. From November 6, 2020, until July 27, 2022, the appeal was actively involved in the briefing process, and both parties requested and received multiple requests for extension of time to file their briefs and response briefs.
24. During the briefing process, on March 21, 2022, CDTFA submitted an additional brief containing the results of a fourth reaudit which CDTFA had completed in response to briefing submitted by appellant during the pendency of the appeal to OTA. The fourth reaudit reduced the taxable measure from $2,162,964 to $1,766,362, consisting of the following two items: (1) unreported rental receipts of $1,149,659, a net decrease of

[11] It is unclear why CDTFA issued two reaudits pursuant to the same decision.

$385,667 from the third reaudit, and (2) $662,518 in additional taxable sales, a net decrease of $10,934 from the third reaudit.

25. Following the fourth reaudit, the remaining amounts picked up in the audit include as follows:

- Kayak rentals: $928,367. This includes $398,675 for taxable rentals of kayaks included in a group tour package, and $548,638 for individual kayak rentals, less an allowance of $18,946 for tax paid equipment. The disputed amount is the $398,675 for the kayak rentals included in group tours.
- Bicycle rentals: $473,662. This includes $445,715 for individual bicycle rentals, and $27,947 for taxable rentals of bicycles included in a group tour package. The disputed amount is the $27,947 for bicycle rentals included in group tours.
- The parties agree that the charge for the tour guide is nontaxable. On average, CDTFA determined that 45.06 percent of the kayak and bicycle tour package income is allocable to nontaxable tour guide services. Appellant has not disputed this calculation.

26. The audit also included miscellaneous items that were not specifically disputed, such as unspecified other rentals, and sales of tangible personal property such as camera film, boogie board rentals, and surfboard rentals.

27. From July 28, until September 29, 2022, the appeal was in review with OTA.

28. On September 30, 2022, OTA informed the parties that a panel of three Administrative Law Judges had been assigned to the appeal, and the case was set for the queue to be heard on OTA's Sacramento oral hearing calendar.

29. On December 14, 2022, OTA notified the parties that the case was scheduled for an oral hearing to be conducted on February 22, 2023, and a prehearing conference to be held on January 26, 2023. OTA held both scheduled meetings as originally noticed.

30. During the January 26, 2023 conference, OTA asked appellant to clarify the scope of the appeal, considering the number of reaudits and adjustments. CDTFA agreed that appellant provided sufficient documentation to show the surrey rentals were nontaxable because appellant paid tax at the time it purchased the surreys, and appellant agreed that this item was deleted in the fourth reaudit and no longer at issue.

31. In a post-conference submission, appellant clarified that the remaining items for OTA to address are as follows:
    a. That the kayak rentals are nontaxable in whole or part either because: (1) the vendor, Johnson Outdoors, is liable for the tax; (2) the safety equipment rented with the kayaks was purchased tax paid and, as such, a greater allowance is warranted.
    b. Bicycle and kayak rentals included in group tour packages are nontaxable as a part of the provision of tour services.
    c. Appellant is entitled to a credit because its income statements reflect less income than appellant reported on its sales and use tax returns, resulting in an overreporting for the third quarter of 2005 (3Q05) and 4Q05. Appellant notes that CDTFA accepted appellant's figures for all other quarters and used the figures to determine the underreporting for the liability period, and that CDTFA's audit calculated an overreporting of $90,221 for 3Q05, and $24,223 for 4Q05, and an underreporting for all other quarters.
32. During the oral hearing, OTA asked appellant about the cost for kayaks. In response to that line of questioning, appellant's president testified during the hearing and clarified the following facts, which CDTFA does not appear to dispute:
    a. Appellant purchased kayaks for approximately $350 per kayak from Johnson Outdoors during the liability period.
    b. Appellant did not pay tax or tax reimbursement to CDTFA or Johnson Outdoors in connection with kayak purchases.
    c. Johnson Outdoors had sales agents who operate within this state, and who would demonstrate or show kayaks available for purchase to appellant in this state.
    d. Johnson Outdoors shipped the kayaks appellant purchased to appellant from its out-of-state location to appellant's location via common carrier.
33. In the fourth reaudit, CDTFA made an allowance of 2 percent for nontaxable leases of related safety equipment (life vests, dry suits) purchased tax paid and leased in the same form as acquired. During the hearing, appellant contended that the amount of the allowance should be in relation to the cost of safety equipment relative to the cost of the equipment plus the kayak, which appellant estimated to be 23.32 percent. CDTFA

indicated its position is that appellant was only able to establish an allowance with respect to the limited number of items covered in the 5 invoices it provided, and that there is insufficient evidence to conclude that all its other rental inventory was purchased tax paid.

DISCUSSION

Issue 1: Whether appellant established that tax is inapplicable to any portion of the rental receipts.

California imposes sales tax on a retailer's retail sales in this state of tangible personal property, 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.) Sales tax does not apply to the rentals payable under a lease of tangible personal property when such rentals are required to be included in the measure of use tax. (R&TC, §§ 6390, 6401.)

The term "lease" includes a rental, hire, or license. (R&TC, § 6006.3.) The term also includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his or her premises, is operated by, or under the direction and control of, the person. (Cal. Code Regs., tit. 18, § 1660(a)(1).) Any lease of tangible personal property for a consideration is a "sale" as defined in R&TC section 6006 and a "purchase" as defined in R&TC section 6010, and as such is required to be included in the measure of tax, unless specifically exempt or excluded by law. (R&TC, §§ 6011, 6012, 6051, 6201, Cal. Code Regs., tit. 18, § 1660(b)(1).)

Any lease which is not excluded from the definition of "sale" and "purchase" is a continuing sale and purchase in this state for the duration of any rental period that the leased property is situated in this state. (R&TC, §§ 6006.1, 6010.1.) Tax on such a lease is measured by the rentals payable. (Cal. Code Regs., tit. 18, § 1660(c)(1).) Subject to limited exceptions which are not relevant here, the applicable tax is the use tax. (R&TC, § 6390; Cal. Code Regs., tit. 18, § 1660(c)(1).) The use tax is imposed on the person storing, using, or otherwise consuming the property. (R&TC, § 6202.) A lessor deriving rentals from a lease of tangible

personal property in this state is required to collect the use tax from the lessee. (R&TC, §§ 6203, 6204.)

A lease excluded from the definition of a sale and purchase includes a lease of tangible personal property in substantially the same form as acquired and in a transaction that was a retail sale with respect to which the lessor paid sales tax reimbursement or timely paid use tax measured by the purchase price of the property. (R&TC, §§ 6006(g)(5), 6010(e)(5); Cal. Code Regs., tit. 18, § 1660(b)(1)(E).) If the tax has not been paid, and the lessor desires to pay tax measured by the purchase price, the lessor must timely report and pay tax with its return for the period during which the property is first placed into rental service. (Cal. Code Regs., tit. 18, § 1660(c)(2).) A lessor who does not timely make such an election may not retroactively do so. (*Action Trailer Sales, Inc. v. State Bd. of Equalization* (1975) 54 Cal. App.3d 125,131-132.)

Here, it is undisputed that appellant provided to customers the temporary transfer of tangible personal property, including bicycles, kayaks, and related safety equipment, for a consideration. This is the definition of a lease. (R&TC, § 6006.3; Cal. Code Regs., tit. 18, § 1660(a)(1).) As such, absent an exemption or exclusion, tax applies to appellant's rental income.

Tax-paid leases

First, appellant contends that an allowance is warranted for tax-paid kayak rentals because appellant's vendor, Johnson Outdoors, should have collected the applicable tax at the time appellant purchased the kayaks. OTA understands this argument to be a reference to the difference between the legal incidence of the sales tax versus the use tax. Under California's Sales and Use Tax law, both the retailer and the purchase remain liable for the use tax until paid to the state; however, the sales tax is imposed solely on the retailer, and not the customer. (R&TC, §§ 6051, 6202, 6203.) However, this distinction is not relevant here. This appeal involves lease transactions, and leases are subject to special rules summarized, in pertinent part, above.

The applicable exclusion for tax-paid leases requires that the lessor "has paid sales tax reimbursement or has paid use tax measured by the purchase price of the property." (R&TC, §§ 6006(g)(5), 6010(e)(5); Cal. Code Regs., tit. 18, § 1660(b)(1)(E).) It is undisputed that neither use tax nor sales tax reimbursement was paid to the seller or the state. Under these facts, it is irrelevant whether the applicable tax was a sales tax or a use tax, or whether Johnson

Outdoors should have collected the tax from appellant. Instead, the authorizing statute specifically requires that the tax must be timely paid in order for the exclusion to apply, and it is undisputed appellant failed to do. (*Ibid*.) As such, appellant failed to establish that the kayak rentals are excluded from tax on this basis.

With respect to appellant's second contention, both parties agree that a portion of appellant's leases of safety equipment for use with the kayaks qualify as tax-paid leases and, as such, are non-taxable. Because appellant billed its customers a lump sum rental for the kayaks and the related safety equipment, CDTFA made a 2 percent allowance for tax-paid leases of safety equipment based on the available documentation, which consists of five purchase invoices for the liability period. Appellant's president provided testimony to support a 23.32 percent allowance, which appellant estimated as follows: (1) $106.50, the estimated cost of safety equipment (e.g., life jackets), divided by (2) $456.70, the estimated cost of a kayak and related safety equipment.

Appellant carries the burden to prove entitlement to an exclusion with verifiable corroborating evidence such as purchase invoices reflecting sales tax paid to the seller. (See *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443.) Here, appellant testified based on its recollection of what transpired during an audit period that ended approximately 15 years ago. Appellant did not provide a single purchase invoice for a kayak, and only retained 5 purchase invoices for safety equipment. OTA is unable to conclude, from this information, the total tax paid rental inventory, the total rental inventory, that all safety equipment was purchased tax paid, or that any kayaks were purchased tax paid. As such, OTA finds that appellant failed to meet its burden to establish entitlement to a greater allowance for tax-paid leases of safety equipment.

Taxable leases versus nontaxable transportation services

Appellant's final contention is that bicycle and kayak rental income from tour packages qualifies as nontaxable transportation income ($27,947 and $473,662, respectively).[12] In

[12] Both parties agree that the charges for the tour guide qualify as nontaxable optional service charges. The issue here is the amount of the rental charge for the bicycles and kayaks when included in a tour package. Although the total kayak rentals disclosed in audit are $928,367, and the total bicycle rentals are $473,662, OTA understands that the disputed amount pertains to rentals included in group tour packages. In other words, OTA understands that standalone equipment rentals outside of the group tour packages are not disputed.

support, appellant cites former CDTFA Sales and Use Tax Annotation (Annotation)[13] 330.2283 (01/08/75),[14] which concluded that charges for horse pack rentals do not constitute leases because the horse remains under the control of the lessor. Appellant asserts that the bicycle and kayak tours are similar to the horse pack trips in that the tour guide maintains control of where the bicycles and kayaks can go, and the riders have no control over what routes are taken. Additionally, appellant cites to CDTFA Annotation 330.2040 (02/15/68), which concerns chartered fishing trips that CDTFA found to be contracts of carriage rather than boat rentals, and appellant argues bicycles and kayaks are merely a means of transportation because the customers do not have control of the routes or time of usage.

The law provides that a lease "includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his or her premises, is operated by, or under the direction and control of, the person." (Cal. Code Regs., tit. 18, § 1660(a)(1).) Here, the customers personally operate the bicycles and kayaks. The bicycles are powered by pedals operated using two feet and steered using one or two hands. The kayaks are powered and steered by hand and require the use of a paddle to do so. These were not tandem equipment operated by appellant, where the customer was merely along for a ride. The customer independently operated the equipment and, as such, appellant's president testified during the hearing that the tour group could only move as fast as the slowest participant. It is further undisputed that, subject to limited exceptions such as for minor children whose kayaks were connected via rope to an adult's kayak to ensure they did not get pulled astray, appellant's customers independently operated and steered the kayaks and bicycles by hand or foot and wore the related safety equipment on their person. Appellant's president testified that only when the participants veered off course beyond the safe area did the tour guides interfere. These facts are distinguishable from the Annotations cited such as the purchase of a ticket to ride on a fishing boat (where the customer did not steer or direct the boat), or use of a pack animal (where the horse was under the control of the lessor).[15] In summary, appellant's customers operate, power,

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[13] Annotations do not have the force or effect of law but may be entitled to some consideration by OTA. (*Appeal of Praxair, Inc.*, 2019-OTA-301P, citing *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 15.)

[14] This Annotation was deleted by CDTFA pursuant to Current Legal Digest (CLD) 1088 (2021). Each CLD is a 30-day notice of proposed changes to certain provisions in CDTFA's Business Taxes Law Guides.

and steer the bicycles and kayaks by hand and foot and, as such, there is no basis to conclude that appellant is provided nontaxable transportation services to its customers.

Issue 2: Whether adjustments are warranted to the audit liability as calculated by CDTFA.

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*.) 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).)

CDTFA examined appellant's income statements and accepted appellant's recorded amounts (less an allowance for nontaxable items) as appellant's rental receipts for these activities. Appellant's recorded rental receipts, less deductions allowed during the four reaudits, exceeded reported taxable sales for all but two quarters (3Q04 and 4Q05). CDTFA used the higher of the two figures (audited or reported taxable sales) to determine the liability. CDTFA is asserting the difference as an underreporting for the liability period. The initial burden test is a minimal threshold for CDTFA to meet, and R&TC section 6481 provides that in meeting this burden, CDTFA may use any information within its possession. The term "any information" would naturally include recorded amounts, reported amounts, audited taxable sales based on available information, and any combination thereof, whether applied on a per-quarter or annual basis. (*Ibid*.) OTA finds it is reasonable for CDTFA to use a taxpayer's own records or reported amounts to calculate the liability, whichever is higher. As such, it was reasonable and rational for CDTFA to use appellant's own records to determine the tax liability for unreported taxable rental receipts, and to accept the reported amounts for the two quarters in which reported amounts were higher. Appellant has the burden of establishing that an adjustment is warranted.

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[15] This Annotation separately concluded that the horse rentals were taxable when the lessee rode the horse, unless a separate exclusion applied (pertaining to charges for less than $20.)

For two of the 12 quarters examined during audit (specifically for 3Q05 and 4Q05), CDTFA determined that appellant's audited taxable rental income exceeded reported taxable sales. CDTFA computed audited taxable sales for these two quarters: for 3Q05, the difference was $90,221, and for 4Q05 the difference was $24,223. CDTFA accepted the audited taxable sales based on appellant's profit and loss statements for the ten quarters in which a deficiency was disclosed and rejected them for the two quarters in which a credit measure was disclosed. For those two quarters, CDTFA declined to assert any audit deficiency because the reported amounts exceeded audited taxable sales. OTA does not believe this approach was consistent with CDTFA's general audit methodology under the facts of this case. Having computed over the course of five audits (including four reaudits) detailed audited taxable sales, which included allowances for tax-paid leases and non-taxable tour guide services for all 12 quarters, CDTFA's audit was sufficient to establish that an adjustment was warranted for non-taxable tour guide services and tax-paid leases during 3Q05 and 4Q05. After adjusting for the allowances for tax-paid leases and non-taxable tour guide income, CDTFA's audit established that appellant overreported for these two quarters, and underreported for the remaining 10 quarters.

Therefore, under the unique facts of this case, OTA finds that appellant established a basis for a further reduction of $114,444 in measure to account for nontaxable tour guide income and tax-paid leases during 3Q05 and 4Q05. The basis for this adjustment is set forth in detail in CDTFA's audit work papers. OTA accepts CDTFA's audit computations for this adjustment (i.e., $90,221 for 3Q05, and $24,223 for 4Q05).

Issue 3: Whether additional interest relief is warranted.

There is no statutory right to interest relief. The law allows CDTFA,[16] 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 CDTFA acting in his or her official capacity. (R&TC, §§ 20, 6593.5(a)(1).) Such an 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

[16] Prior to January 1, 2023, R&TC section 6593.5 states "board"; however, on and after July 1, 2017, the term "board," generally means CDTFA. As an exception, on and after January 1, 2018, the term "board," with respect to an appeal, means OTA. (R&TC, § 20(a), (b).) Effective January 1, 2023, R&TC section 6593.5 now says CDTFA."

person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based.[17] (R&TC, § 6593.5(c).)

Delay while the appeal was pending before OTA (periods after August 30, 2018)

As a preliminary matter, appellant asks for interest relief for all periods while the appeal was pending before OTA (on and after August 30, 2018). R&TC section 6593.5 authorizes interest relief for certain unreasonable errors or delays that prevented the taxpayer from timely paying the tax. Such a delay means, for example, an unreasonable failure to work on an appeal. (*Appeal of Micelle Laboratories, Inc.,* 2020-OTA-290P.) On the other hand, interest relief does not extend to an allegedly "unreasonable" position taken on appeal, that is otherwise being actively maintained. (*Ibid*.) Working on an appeal is, by definition, not a "delay" for purposes of R&TC section 6593.5. (*Ibid*.)

Although this appeal has been with OTA since 2018, the record discloses no delay by OTA. According to OTA's administrative record, this appeal was consistently being worked on or pending action by the parties. This case was transferred to OTA on August 30, 2018. Shortly thereafter, appellant requested to defer the case to pursue settlement, and appellant's requested settlement deferral lasted from December 28, 2018, through November 6, 2020. From November 6, 2020, until July 27, 2022, the appeal was pending action by either appellant or CDTFA, because both sides requested postponements to provide additional briefing and submissions. From July 28, 2022, until a tax appeals panel was assigned on September 30, 2022, OTA was reviewing the parties' submissions to ensure the appeal was ready to schedule for an oral hearing. On December 14, 2022, OTA scheduled this case for an oral hearing on its February 22, 2023, oral hearing calendar. The hearing was held as scheduled, and this Opinion was timely written within 100 days of the date the record was closed. After reviewing the administrative record, OTA found no delay by OTA in processing, reviewing, or scheduling this appeal. As such, there is no unreasonable error or delay by OTA. Based on the finding that there was no delay by OTA, this Opinion does not address the issue of whether R&TC section 6593.5 authorizes OTA to grant relief of interest for a delay by OTA.

[17] California Code of Regulations, title 18, section 1703 restates, without adding further clarification to, the requirements for interest relief within the meaning of R&TC section 6593.5. (See Cal. Code Regs., tit. 18, § 1703(b)(1)(E).)

Delay by CDTFA

OTA will generally not second-guess the standard timeframes determined by CDTFA for purposes of granting discretionary interest relief, and will instead defer to CDTFA's decision absent evidence of an abuse of discretion. (*Appeal of Micelle Laboratories, Inc., supra*.) To show an abuse of discretion, a taxpayer must establish that, in refusing to relieve interest, CDTFA exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Eichler*, 2022-OTA-029P.) Where the administrative record is silent regarding the actions taken on a taxpayer's matter and the tax agency does not come forth with evidence to show that the employees assigned to the matter or involved in its review were actively working on it, there may be no apparent basis to support the agency's determination not to relieve interest, and the unsupported determination may constitute an abuse of discretion. (*Ibid*.)

Here, appellant requests interest relief for the entire time the appeal was before CDTFA.

The field audit process (sometime beginning in 2009, until March 22, 2010)

It is unclear when the field audit was first initiated because CDTFA did not provide its contact history for the field audit; however, appellant contends, CDTFA does not dispute, and the record supports, that the audit was initiated sometime during 2009. CDTFA's available audit file indicates that the audit was essentially complete by November 4, 2009, and waiting only on appellant to provide documentation on an allowance for tax-paid leases. Although appellant contends there was delay because the first auditor was replaced, there is no evidentiary basis to conclude that a period of no more than 11 months to complete an audit (assuming it was initiated in January 2009) constitutes an unreasonable delay, and for the remaining period until the NOD was issued any delay appears to have been the result of appellant's inability to provide documentation.

The petitions process with CDTFA (March 22, 2010, until May 16, 2016)

Appellant untimely petitioned the NOD on May 25, 2010, and any delay in filing a petition was due to appellant. From this point, CDTFA initiated a reaudit on June 22, 2010, and from that point until May 25, 2012, when the reaudit was transmitted to CDTFA's headquarters, the contact history reflects that CDTFA was actively working on the reaudit, including scheduling meetings and discussions with appellant. At this point, the appeal was placed on rotation for an appeals conference with CDTFA's Appeals Bureau, which was held on

May 28, 2013. From this point, absent an extension, CDTFA's Rules for Tax Appeals provided that a decision should have been written within 90 days. (See former Cal. Code Regs., tit. 18, § 5265(a).) On October 28, 2015, CDTFA informed appellant that it would resume processing the appeal, and offered appellant a second appeals conference because the person originally assigned to the appeal was no longer available. Appellant declined, and on May 16, 2016, CDTFA issued its decision ordering another reaudit.

Here, CDTFA concedes a delay occurred, because after the appeals conference CDTFA placed appellant's appeal in abeyance pending the promulgation of new regulations that may impact appellant's business model. On June 18, 2015, CDTFA issued an internal memorandum stating that the appeal could proceed because it decided not to pursue the contemplated rulemaking. CDTFA concedes to interest relief for the period January 1, 2014 (when the decision should have been completed) until May 31, 2015. However, we find that the period of time that CDTFA concedes to grant relief is inconsistent with the facts surrounding the delay.

First, CDTFA did not grant interest relief from the date of the appeals conference until the date CDTFA determined to place appellant's appeal in abeyance, even though CDTFA took more than six months to issue the decision after restarting appellant's appeal. This is more than twice the timeframe generally specified in CDTFA's own Rules for Tax Appeals applicable at the time to write the decision.

Second, CDTFA only granted interest relief until May 31, 2015, even though CDTFA's own records reflect that it did not restart appellant's appeal until October 28, 2015.

The delay was unilaterally at the decision of CDTFA to pursue rulemaking, which it ultimately elected not to pursue. We find holding an appeal in abeyance for the purposes of potentially retroactively changing application of the law to a pending appeal, and then deciding not to pursue any rulemaking, constitutes an unreasonable error or delay by CDTFA. This delay lasted almost two years.

Based on the above, OTA finds that CDTFA abused its discretion in failing to grant interest relief for the full amount of the unreasonable error or delay, from May 28, 2013 (when CDTFA held the appeals conference) until October 28, 2015 (when CDTFA restarted the appeal). OTA grants interest relief for this period. Although there was a 3-month delay in issuing its decision, there is insufficient evidence under the facts to show that CDTFA abused its discretion in failing to grant relief for this period, and that this amount of time was unreasonable.

The second and third reaudits (May 16, 2016, until August 30, 2018)

CDTFA's decision, dated May 16, 2016, ordered a reaudit, which was completed on October 19, 2017, followed shortly thereafter by a third reaudit. It appears from the available documentation that CDTFA was actively working on the reaudit during this timeframe. On January 26, 2018, CDTFA issued a letter informing appellant as follows:

> If, within 30 days of the date of this letter, you do not complete and return the enclosed form [agreeing with the Decision] or submit a request for reconsideration of our Decision, then, as stated above, your appeal will be forwarded to OTA for its review of our Decision, and OTA will notify you of the next step in your appeal.

There is no evidence that appellant conceded to CDTFA's decision or filed a request for reconsideration with CDTFA. CDTFA did not transfer the appeal to OTA until August 30, 2018. There is no explanation for the delay. Taxpayers are subject to strict deadlines to file an appeal with OTA, and failure to do so within 30 days will result in the taxpayer losing the ability to file an appeal with OTA. (See, e.g., Cal. Code Regs., tit. 18, § 30203(b)(1).) In this case, this appeal was pending a prior request for an oral hearing before the State Board of Equalization at the time CDTFA's decision ordered a reaudit, and as such it was the responsibility of CDTFA to timely transfer the appeal to OTA when the reaudit was completed. (See, e.g., Cal. Code Regs., tit. 18, § 30106(a).) OTA finds the failure to timely process the appeal to be an unreasonable delay, and that CDTFA abused its discretion in failing to abate interest for the period February 26, 2018, when the appeal should have been transferred to OTA, until August 30, 2018, when the appeal was transferred to OTA. Therefore, interest will be abated for this time period as well.

The settlement deferral period (December 28, 2018, through November 6, 2020)

CDTFA declined to provide any information about the settlement process, other than to state that its Settlement Bureau had reviewed the case and determined there was no delay during the settlement deferral period. While two years, absent more, might seem like a long time to discuss settlement, appellant provided a timeline indicating that it had pursued both settlement and an offer in compromise during this timeframe. Absent more, we are unable to conclude that the span of 23 months to review a settlement offer and an offer in compromise was an unreasonable amount of time, or that CDTFA abused its discretion in failing to grant interest relief for this period.

HOLDINGS

1. Appellant failed to establish entitlement to an exemption or exclusion from tax for its rental receipts.
2. An adjustment of $114,444 in measure is warranted. The $114,444 adjustment shall be allocated as follows: $90,221 for 3Q05, and $24,223 for 4Q05.
3. Appellant is entitled to interest relief for the following two time periods:

   (1) the period May 28, 2013, until October 28, 2015, due to unreasonable error or delay by CDTFA for holding appellant's appeal in abeyance to purportedly pursue a rulemaking to change how tax applied, and which ultimately failed to materialize;

   (2) the period February 26, 2018, until August 30, 2018, for unreasonable delay in transferring jurisdiction of the appeal over to OTA.

DISPOSITION

CDTFA's action is revised to reduce the taxable measure to $1,766,362, as conceded by CDTFA. In addition, the taxable measure shall be further reduced to $1,651,918 (by an additional $114,444) as determined by OTA. In addition, appellant is entitled to interest relief for the periods May 28, 2013, through October 28, 2015, and February 26, 2018, until August 30, 2018, respectively. CDTFA's action is otherwise sustained.

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
DC88A60D8C3E442...

Keith T. Long
Administrative Law Judge

DocuSigned by:
Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

Date Issued: 4/18/2023