OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 20086475 CDTFA Case ID: 679-933
A. VENTURA, **dba Rolling Tires & Wheels #5**	

OPINION

Representing the Parties:

For Appellant: Raul Carrega, CPA

For Respondent: Randy Suazo, Hearing Representative
Cary Huxsoll, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

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

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A. Ventura (appellant), dba Rolling Tires & Wheels #5, appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's petition for redetermination of a Notice of Determination (NOD) dated October 16, 2018.[1] The NOD is for a tax liability of $41,115.00, plus applicable interest, and a negligence penalty of $4,111.51 for the period of January 1, 2015, through December 31, 2016 (liability period).

Following a reaudit during the briefing period for this appeal before OTA, CDTFA reduced the aggregate amount of unreported taxable sales from $456,838.00 to $262,212.00, the tax liability from $41,115.00 to $23,600.00, and the negligence penalty from $4,111.51 to $2,359.99. Remaining in dispute are unreported taxable sales of $177,413.00 (out of $262,212.00) established on a markup basis.

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Lauren Katagihara, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on March 15, 2023. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Whether the amount of unreported taxable sales established on a markup basis should be further reduced.
2. Whether appellant was negligent or intentionally disregarded relevant authorities.

FACTUAL FINDINGS

1. Appellant was a sole proprietor who sold new and used tires, rims, and auto parts (e.g., brakes and rotors), and performed related installation and repair services, from July 22, 2013, through December 31, 2016. Thereafter, appellant closed her seller's permit and obtained a new seller's permit to operate her business as a corporation.
2. For either all or some part of the liability period, appellant operated three locations in Southern California: (1) one in Bellflower (for the entire liability period); (2) one in Wilmington (for the period of April 1, 2016, through December 31, 2016); and (3) one in Lynwood (for the period of July 1, 2016, through December 31, 2016).
3. For the liability period, appellant reported total sales of $537,722; claimed deductions of $17,763 for sales tax reimbursement included and $310,394 for nontaxable labor;[2] and reported taxable sales of $209,565 ($88,256 for 2015 and $121,309 for 2016).
4. For audit, appellant provided CDTFA with federal income tax returns (FITRs) for 2015 and 2016;[3] bank statements for the liability period for the Bellflower location; and sales invoices dated throughout the liability period for the Bellflower location.
5. On its FITRs, appellant reported the following costs of goods sold: $142,304 for 2015 and $102,249 for 2016 for the Bellflower location; $55,000 for 2016 for the Wilmington location; and $53,857 for 2016 for the Lynwood location. Appellant also reported the

[2] The $310,394 amount of nontaxable labor includes $33,767 that appellant inadvertently claimed as exempt food sales for the second quarter of 2015.

[3] The audit working papers include information scheduled from separate Schedule C forms from the FITR for 2016, showing the sales and expenses for each location.

following gross receipts: a total of $380,939 for 2015 and 2016 for the Bellflower location; $80,291 for 2016 for the Wilmington location; and $76,564 for 2016 for the Lynwood location. In its preliminary examination, CDTFA found that the gross receipts reported on FITRs reconciled with the total sales reported on sales and use tax returns (SUTRs).

6. CDTFA used the costs of goods sold claimed on FITRs and the taxable sales reported on SUTRs to compute book markups of -38 percent for 2015 and -43 percent for 2016.[4] CDTFA determined that the negative markups indicated that appellant was not accurately reporting taxable sales, which warranted further investigation.

7. CDTFA attempted to conduct a shelf test to establish a representative markup for appellant's business.[5]

8. CDTFA asked appellant to provide purchase invoices for a purchasing cycle, along with corresponding sales invoices. Appellant provided purchase invoices for tires purchased from four vendors for the Bellflower location during the first quarter of 2016 (1Q16). Appellant did not provide purchase invoices for any of the other items she sold (i.e., rims, brakes, and rotors).

9. Per CDTFA's audit activity log, on multiple occasions, CDTFA requested appellant's records for the Wilmington and Lynwood locations, but appellant did not provide them:

    a. June 4, 2018: "Told [appellant's representative] that the permit being audited has other locations like Wilmington and Lynwood and that the records for those locations also need to be provided."

    b. August 23, 2018: "Reminded [appellant's representative] that he has only provided some books and records for Bellflower location and that the Lynwood and Wilmington locations are still pending. Requested records to be provided...in order to finish the audit as soon as possible."

    c. August 27, 2018: "Explained to [appellant's representative] that the

[4] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is $.70 and it charges customers $1.00, the markup is $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. A negative markup results when costs exceed sales.

[5] A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

> permit being audited has the sublocations and that the letter [requesting appellant's books and records] was sent to the mailing address on file[,] which is the Bellflower location[,] but that the audit is for all sublocations under that permit."

10. CDTFA contacted twelve of appellant's known vendors and received replies from eight, including each of the four vendors from whom appellant had provided purchase invoices. CDTFA found that the purchase invoices appellant had provided for 1Q16 represented only about 34 percent of the purchases from those four vendors for that quarter.[6]
11. The sales invoices provided by appellant for the liability period for the Bellflower location evidenced sales totaling $286,757. CDTFA noted that the sales invoices for tires did not identify the brand name or type of tires sold, only their size.
12. CDTFA reviewed the available sales invoices for 1Q16 and 2Q16, and found only six invoices (all from 1Q16) that represented sales of tires whose sizes matched tire purchases recorded in the available purchase invoices for 1Q16. For each of those six transactions, CDTFA compared the cost of a tire of a certain size, as shown on a purchase invoice, with the selling price of a tire of the same size, as shown on a sales invoice, and computed a markup of 90.55 percent.
13. To establish the audited costs of goods sold, CDTFA used the information from appellant's FITRs for 2015 and 2016. CDTFA reduced the amounts of purchases by 1 percent for pilferage and accepted the beginning and ending amounts of inventory claimed on the FITRs.[7]
14. CDTFA used the audited costs of goods sold and the markup of 90.55 percent to compute aggregate unreported taxable sales of $456,838. It reduced that amount by $84,799, which represents the difference between recorded and reported taxable sales for the Bellflower location, to compute unreported taxable sales of $372,038 (rounded)

[6] The purchase invoices provided by appellant evidenced total purchases of $3,530. However, the four vendors reported sales to appellant of $10,232 for 1Q16. Thus, the provided purchase invoices represented about 34 percent of the purchases from those four vendors ($3,530 ÷ $10,232).

[7] According to the audit working papers, appellant declined to provide an estimate for self-consumption but stated that the amount was minimal. Accordingly, CDTFA did not reduce purchases by the cost of any self-consumed merchandise.

established on a markup basis. CDTFA included the $84,799 difference as a separate audit item.

15. CDTFA found that the understatement resulted from negligence. This was appellant's first audit.

16. On October 16, 2018, CDTFA issued the NOD, which appellant timely petitioned for redetermination on October 23, 2018.

17. On April 8, 2020, CDTFA's Appeals Bureau held an appeals conference where both appellant's representative and CDTFA's appeals staff appeared by telephone. There, appellant conceded the $84,799 difference between recorded and reported taxable sales for the Bellflower location.

18. CDTFA issued a Decision denying appellant's petition on June 17, 2020.

19. Appellant timely appealed to OTA.

20. During the briefing period for this appeal, CDTFA concluded that the limited shelf test it conducted during the audit was insufficient for two reasons: (1) information about the tires appellant sold was incomplete (i.e., no brand name was recorded), making it difficult to ensure that costs and selling prices related to the same product; and (2) from the purchase and sales invoices CDTFA acquired, only six transactions seemed to represent the same tire based on size.

21. CDTFA performed a reaudit and prepared a reaudit report dated November 9, 2020. Using an industry average markup of 34.90 percent sourced from CSIMarket.com, an industry website, CDTFA reduced the amount of unreported taxable sales established on a markup basis from $372,038 to $177,413, which is the measure at issue.

DISCUSSION

Issue 1: Whether the amount of unreported taxable sales established on a markup basis should be further reduced.

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property in this state unless a 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, it is presumed that all gross receipts are subject to tax until the contrary is established. (R&TC,

§ 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination on request by CDTFA. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax or other amount required to be paid by any person, or if any person fails to make a return, CDTFA may compute and determine the amount required to be paid upon the basis of any information within its possession or that may come into its possession. (R&TC, §§ 6481, 6511.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Amaya*, 2021-OTA-328P.) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

If CDTFA meets its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Appeal of Amaya, supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) To satisfy the burden of proof, a taxpayer must prove that: (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, *supra*.)

In this case, appellant provided incomplete records, and the costs of goods sold claimed on her FITRs were substantially greater than the amounts of taxable sales reported on her SUTRs. Under these circumstances, OTA finds that CDTFA's use of an indirect audit method was reasonable and rational. Further, OTA finds CDTFA's use of the markup method, a recognized and accepted accounting procedure (*Appeal of Amaya*, *supra*), was also reasonable and rational. But the markup method is only effective and reliable if CDTFA has sufficient information to establish the cost of taxable merchandise sold and a reasonable markup. (*Ibid*.) Here, CDTFA sourced information about appellant's costs of goods sold from her own FITRs, and adopted an industry-average markup sourced from a third-party industry website. OTA finds that these were sufficient and reasonable sources of information in light of the incomplete records provided. Thus, OTA finds that CDTFA has shown that its determination, which was established on a markup basis, was reasonable and rational, and the burden of proof now shifts to appellant to establish that adjustments to CDTFA's determination are warranted.

On appeal, appellant offers eight contentions: (1) CDTFA engaged in fraud; (2) CDTFA's analysis of appellant's negative book markups was flawed; (3) the statistical samples from which CDTFA computed and/or applied an audited markup were inadequate; (4) CDTFA's requests for additional documents from appellant were unreasonable; (5) CDTFA's audit method did not make adjustments for inventory; (6) CDTFA is not independent; (7) the authorities cited by CDTFA in its Decision are irrelevant; and (8) the case of *Maganini v. Quinn* (1950) 99 Cal.App.2d 1 is distinguishable and inapplicable here. OTA will examine each contention in turn.

CDTFA's Alleged Fraud

Throughout this appeal, appellant frequently asserts that CDTFA's audit staff acted fraudulently by falsifying "legal" documents. Appellant's argument specifically focuses on Schedule 12A-2 in CDTFA's audit working papers, where CDTFA computed the markup of 90.55 percent. Appellant alleges that CDTFA's auditor fraudulently "altered" sales invoices referenced in that schedule. By that, appellant means the following: when the auditor could not match a tire from a purchase invoice to a selling price or a tire on a sales invoice, the auditor allegedly chose a premium tire brand with the highest selling prices as a match. According to appellant, this, in turn, yielded an unrealistically high markup.

OTA has reviewed Schedule 12A-2 and the audit working papers and finds no evidence of fraud. Regarding Schedule 12A-2, it lists six purchase invoices, from which CDTFA scheduled appellant's costs for the tires sold, and matches them to six sales invoices, from which CDTFA scheduled appellant's selling prices. In the comment for each match, CDTFA notes the invoice number, the lack of any brand name for the tires sold, and the basis for matching the tires being purchased/sold (i.e., their size/measurements were the same). Essentially, in this audit schedule, CDTFA records information from appellant's records and analyzes it, but does not alter that information. Appellant has also not provided either the purchase invoices or the sales invoices to show that the data scheduled by CDTFA was incorrect or altered. Accordingly, OTA concludes that appellant's assertions that the audit staff committed fraud are meritless.

Negative Book Markups

Appellant disputes CDTFA's finding that the negative book markups (-38 percent for 2015 and -43 percent for 2016) are evidence that reported taxable sales were understated. According to appellant, the negative book markups support the assertion that appellant sold tires at cost. Appellant also asserts that CDTFA's analysis indicating appellant had negative book markups is flawed because CDTFA has not factored in variables such as single-entry accounting (versus double-entry accounting) or cash-basis accounting (versus accrual-method accounting).

Here, the book markups do not indicate that appellant sold tires and other auto parts at cost. Rather, the book markups show that the sales of tangible personal property appellant reported on the SUTRs were 38 percent and 43 percent less than the costs of goods sold she reported on FITRs for 2015 and 2016, respectively. Negative book markups are problematic because, in general, retail businesses exist to make a profit and do not routinely sell products below cost. Retail businesses like appellant's, which sell both tangible personal property (here, tires and related auto parts) and nontaxable services (here, installation and repair services) together in mixed transactions, are expected to establish fair retail selling prices for the tangible personal property. (See, e.g., Cal. Code Regs., tit. 18, § 1546(b)(1) ["If the retail value of the property is more than 10 percent of the total charge, the repair[person] must segregate on the invoices to his [or her] customers and in his [or her] records the fair retail selling price of the parts and materials from the charges for labor of repair, installation, or other services performed"].) Appellant's negative book markups indicate that appellant did not segregate its charges in a manner that reflected a fair retail selling price for the tangible personal property sold.

Regarding appellant's contention that CDTFA's analysis of the book markups does not reference single-entry accounting, CDTFA's findings do not relate to any single transaction. CDTFA observed that appellant's recorded costs of goods sold (in total) exceeded appellant's reported sales of tangible personal property (in total). CDTFA supported its finding with the actual amounts of costs of goods sold reported by appellant on her FITRs and the actual amounts of taxable sales appellant reported on her SUTRs. Thus, no further documentation or reference to single-entry accounting is necessary to establish that appellant's book markups were negative; further, appellant has not detailed nor provided evidence of how factoring in single-entry accounting would prove otherwise.

Regarding the method of accounting (cash basis versus the accrual method), this is not relevant because all retailers are required to report their sales tax liability on an accrual basis (Cal. Code of Regs, tit. 18, § 1642 (c)). Further, appellant has failed to show how the cash method of accounting would alter CDTFA's determination.

For the above reasons, OTA finds that appellant's arguments regarding the negative book markups lack merit.

Adequacy of Sampling

Appellant asserts that CDTFA's testing, from which it computed a markup of 90.55 percent, was based on an inadequate sample. Appellant notes that CDTFA used only six purchase invoices and argues that CDTFA should have reviewed all the invoices and selected a statistical sample for review.

Appellant is correct on the first point: the sample size was too small. However, the reason for this was inadequate records provided by appellant. CDTFA reviewed all the purchase invoices provided by appellant, which were all dated in 1Q16, from four vendors, but only represented about 34 percent of appellant's purchases from those four vendors for that quarter. CDTFA attempted to find sales invoices that represented sales of the tires identified on those purchase invoices, with the goal of comparing documented costs and selling prices to compute a markup. But CDTFA found only six sales invoices for tires of sizes that matched those recorded on appellant's purchase invoices. Appellant contends that CDTFA did not review enough invoices to compute a representative markup, yet she provided incomplete purchase invoices and sales invoices. Similarly, appellant states that there was "[n]o mention of the tire brand anywhere" by CDTFA. This is because appellant's sales invoices did not record the brand or type of tires sold, only the size of the tires. OTA finds that appellant's contentions regarding inadequate sampling are without merit and concludes that the deficiencies in the sample identified by appellant are of her own making and not a basis for adjusting the audit findings. Moreover, CDTFA has addressed the inadequate sampling issue in the reaudit, which used a reduced industry-average markup of 34.90 percent.

On this note, appellant also argues that CDTFA's use of this industry-average markup, allegedly calculated from the markups of large companies and not from small businesses like appellant's, is not appropriate, and CDTFA should use the available source documents to compute a markup. However, as already explained, the source documents are not sufficiently

complete for CDTFA to conduct a viable shelf test. Further, appellant has failed to prove any basis on which to disqualify the industry-average markup. Accordingly, OTA is not persuaded by appellant's arguments against using the industry-average markup.

CDTFA's Request for Additional Documents to Expand the Shelf Test

In an argument related to the adequacy of the sample, appellant asserts that CDTFA made an unreasonable request for additional documents in order to expand the shelf test. Appellant asserts that she provided all requested records.

Appellant's assertion is contradicted by the record. Appellant only provided sales invoices for the Bellflower location, and not for the Wilmington and Lynwood locations despite CDTFA's multiple documented requests for them. (See Factual Finding No. 9.) Although the sales invoices reflected dates throughout the liability period, the invoices themselves were not complete. The sales invoices evidenced total sales of $286,757. However, in comparison, appellant reported combined gross receipts of $380,939 on her FITRs for 2015 and 2016 for the Bellflower location.

With respect to purchase invoices, appellant provided purchase invoices for 1Q16 for four vendors only (all of which sold only tires; there were no invoices for purchases of rims, brakes, rotors, or other products). The total of the purchase invoices was $3,530. CDTFA received transaction information from those same four vendors. For 1Q16, those four vendors identified total sales to appellant of $10,232. Therefore, the purchase invoices provided by appellant represented about 34 percent of the purchases ($3,530 ÷ $10,232) from four of appellant's vendors for one quarter.

OTA finds that, contrary to appellant's assertion on appeal, CDTFA's request for additional records was reasonable and necessary for computing a representative markup, but appellant refused to provide additional records.[8] And appellant's refusal prevented CDTFA from expanding the shelf test or addressing appellant's complaints regarding the inadequacy of the shelf test. In any case, OTA concludes that appellant's allegation regarding the unreasonableness of CDTFA's request for records or her contention that she provided all requested records are unfounded.

[8] In appellant's opening brief, her representative summarizes his response to CDTFA's request, made during CDTFA's internal appeals process, for additional records in order to expand the shelf test: "My reply – NO."

Adjustments for Inventory

Appellant argues that CDTFA did not address inventory. However, CDTFA did account for inventory: in the audit working papers, CDTFA adjusted audited costs of goods sold for the beginning and ending inventory amounts appellant reported on her FITRs. Thus, OTA concludes that this argument lacks merit.

Independence of CDTFA's Appeals Bureau

Appellant argues that CDTFA's Appeals Bureau was not independent, asserting that her representative was not allowed to physically attend the appeals conference, but was required to give his presentation by phone, while CDTFA's audit staff was physically present with the Appeals Bureau's Appeals Conference Auditor.

Appellant's assertion conflicts with the information recorded on CDTFA's June 17, 2020 Decision: all parties appeared by telephone. Thus, appellant's description of the conference is not accurate.[9] Further, regardless of the appeals conference's logistics, appellant has yet to provide any valid evidence in support of her assertion that CDTFA's Appeals Bureau was not independent. OTA finds appellant's argument unpersuasive.

Relevance of the Authorities Cited by CDTFA in its Decision

In her opening brief, appellant lists most, if not all, of the authorities cited in the Decision, argues that the Decision implies that she did not comply with the authorities cited, and asserts that the cited authorities are irrelevant and have nothing to do with her assertions on appeal.

The authorities cited in CDTFA's Decision include various sections of the R&TC, related regulations, business tax-related caselaw, and CDTFA's Audit Manual. In citing to these authorities, CDTFA was providing the bases for its factual findings and legal conclusions. Each authority addresses some element in the process of establishing the amount subject to tax. Because this is a tax appeal involving a dispute over a tax matter, OTA concludes that, in general, the authorities cited by CDTFA in its Decision are relevant. Further, appellant has not detailed her disagreement with how CDTFA applied any of the statutory, regulatory, or judicial references to her appeal except *Maganini v. Quinn* (1950) 99 Cal.App.2d 1 (discussed below).

[9] It is not clear from the record whether appellant requested a telephone conference or whether the conference was changed from an in-person conference to a telephone conference due to COVID-19 concerns.

OTA does not find appellant's argument against the authorities cited in CDTFA's Decision persuasive.

Relevance of Maganini v. Quinn

Appellant disputes CDTFA's reliance on the case of *Maganini v. Quinn* (1950) 99 Cal.App.2d 1 (*Maganini*) when CDTFA concluded that it was appropriate for CDTFA to compute and estimate appellant's tax liability by alternative means. Appellant notes that the business in *Maganini* was a bar, while appellant operated as a tire retailer. Appellant also states that it provided invoices, while the taxpayer in *Maganini* did not.

However, neither of these distinctions are relevant. Appellant did not provide complete records, as detailed previously. The findings of the *Maganini* case establish that, when records are incomplete and inadequate, CDTFA does not exceed its authority in establishing taxable receipts based on costs of goods sold plus appropriate markups. OTA concludes that this case is directly on point.

Summary

For the reasons stated above, OTA is not persuaded by any of appellant's contentions on appeal. Thus, appellant has failed to establish that a result differing from CDTFA's determination is warranted, so OTA concludes that the amount of unreported taxable sales established by CDTFA on a markup basis should not be further reduced.

Issue 2: Whether appellant was negligent or intentionally disregarded relevant authorities.

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 CDTFA 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 SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) 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).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A).) However, such a penalty may be added in a first audit if there exists evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (*Ibid*.)

Here, appellant provided inadequate records. Although she sold tire accessories and auto parts, such as brakes and rotors, in addition to tires, appellant did not provide any purchase or sales invoices for the non-tire items upon audit. Appellant also did not provide any books and records for her Wilmington and Lynwood locations even though CDTFA informed her that they were part of the audit and had requested the books and records for those locations on at least three occasions. Additionally, the books and records appellant provided for the Bellflower location were incomplete. Appellant only provided purchase invoices representing about 34 percent of the purchases appellant made from four of its vendors in 1Q16. Appellant only provided sales invoices representing total sales of $286,757 for the liability period at the Bellflower location, while appellant reported gross receipts of $380,939 on her FITRs for 2015 and 2016 for the same location. These requested-but-missing/incomplete records all point to recordkeeping failures on appellant's part and constitute evidence of negligence.

Also, appellant's post-reaudit aggregate understatement of $262,212 represents approximately 125 percent of reported taxable sales of $209,565. An error ratio of 125 percent is substantial and constitutes evidence of negligence in reporting.

Moreover, $84,799 of the post-reaudit aggregate understatement of $262,212 represents the difference between recorded and reported taxable sales for the Bellflower location, which appellant conceded at CDTFA's appeals conference. Regardless of experience level, a

businessperson should be able to accurately report recorded taxable sales (i.e., sales that her own records indicate are taxable).

Additionally, a businessperson should question the differences between the costs of goods sold claimed on FITRs ($142,304 for 2015 for the Bellflower location and $211,106 for 2016 for all three locations combined) and taxable sales reported on SUTRs ($88,256 for 2015 and $121,309 for 2016), when the cost of the goods is more than the sales reported. Such differences should alert the business owner to inaccuracies in the records, in reporting, or both.

OTA finds that appellant's numerous recordkeeping and reporting errors, along with the substantial understatement, are evidence of negligence in record keeping and in preparing returns. Given the nature and breadth of these errors, OTA finds that, although this was appellant's first audit, appellant's understatement cannot be attributed to a bona fide and reasonable belief that appellant's bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Accordingly, OTA finds that the understatement was the result of negligence, and CDTFA properly applied the penalty.

HOLDINGS

1. Further reductions to the amount of unreported taxable sales established on a markup basis are not warranted.
2. Appellant was negligent.

DISPOSITION

Reduce the aggregate amount of unreported taxable sales from $456,838.00 to $262,212.00, the tax liability from $41,115.00 to $23,600.00, and the negligence penalty from $4,111.51 to $2,359.99, per CDTFA's reaudit, but otherwise sustain CDTFA's decision to deny appellant's petition as to the remaining amounts.

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

We concur:

DocuSigned by:
Lauren Katagihara
F595B34010D8470...
Lauren Katagihara
Administrative Law Judge

DocuSigned by:
Josh Aldrich
48745BB8069148...
Josh Aldrich
Administrative Law Judge

Date Issued: 5/23/2023