OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21017152
	CDTFA Case ID: 1-512-320
P. COLAMBAARACHCHI,	
dba Perfume Hut	

OPINION

Representing the Parties:

For Appellant: Gihan Weerasekera, Representative

For Respondent: Randy Suazo, Hearing Representative
Jason Parker, Chief of Headquarters Ops.
Kevin Smith, Tax Counsel III

For Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, P. Colambaarachchi (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) partially denying appellant's petition for redetermination of a Notice of Determination (NOD) dated January 27, 2020. The NOD is for tax of $74,198.00, applicable interest, and a negligence penalty of $7,419.76, for the period January 1, 2016, through March 31, 2019 (liability period).[1] CDTFA issued a decision on October 9, 2020, deleting the negligence penalty but otherwise denying appellant's petition.

Office of Tax Appeals (OTA) Administrative Law Judges Huy "Mike" Le, Andrew J. Kwee, and Teresa A. Stanley held an electronic oral hearing for this matter on January 26, 2023. At the conclusion of the hearing, the record was closed, and OTA submitted this matter for an opinion.

[1] Although CDTFA's decision stated that appellant "conceded unreported taxable sales" for 2017 of $325,171, appellant filed an appeal disputing the entire liability period. During appeal, appellant did not concede the 2017 liability period.

ISSUES

1. Whether adjustments to CDTFA's computation of taxable sales are warranted.[2]
2. Whether appellant is responsible for remitting sales tax.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, dba Perfume Hut, operated two retail stores selling perfumes in a shopping mall located in Moreno Valley, California. Appellant's seller's permit was opened with an effective start date of November 23, 2012, with one location. The second location began operations on May 10, 2013, and was closed in December 2017. Appellant's seller's permit was closed with an effective date of June 11, 2019.
2. For the liability period, appellant reported on her sales and use tax returns (SUTRs) total sales and taxable sales of $376,348, claiming no deductions. Appellant prepared a daily sales spreadsheet by transcribing sales from her point-of-sale (POS) system's monitor and used the daily sales spreadsheet to prepare the SUTRs. There were significant differences between recorded and reported sales amounts.
3. For audit, appellant provided federal income tax returns (FITRs) for 2016 and 2017; profit and loss statements for 2018 and the first quarter 2019 (1Q19); daily taxable sales spreadsheets for October 1, 2017, through March 31, 2019; POS sales summary spreadsheets for the liability period; electronic POS summary sales reports for December 15, 2017, through March 31, 2019; bank statements for the liability period; and various merchandise purchase records for the liability period. Appellant did not provide POS sales detail reports or cash register z-tapes,[3] or source documentation, such as cash register receipt tapes or sales invoices, for the liability period.
4. CDTFA performed various sales tests (including a comparison of SUTRs and profit and loss statements with FITRs and a bank deposits analysis) wherein the results showed appellant had unreported taxable sales.

[2] The audit items at issue are unreported taxable sales of $616,271 based on a bank deposit analysis and unreported taxable sales of $325,171 based on differences between federal income tax returns (FITRs) and sales and use tax returns (SUTRs). CDTFA also established unreported taxable sales of $78,673 subject only to district taxes, which is not in dispute.

[3] A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain time period (e.g., a day or a shift).

5. CDTFA compared total sales reported on the SUTRs for 2016 and 2017 to the corresponding gross receipts, excluding sales tax reimbursement,[4] reported on the FITRs, noting differences of $314,177 and $325,171 in 2016 and 2017, respectively (FITR method). CDTFA compared total sales reported on the SUTRs for 2018 and 2019 to the corresponding total sales recorded in the profit and loss statements for 2018 and 1Q19 noting differences of $204,179 and $26,497 in 2018 and 1Q19, respectively (profit and loss method). CDTFA computed unreported taxable sales of $870,024 for the liability period. Appellant stated that the differences related to sales for resale, but she did not provide sales invoices, resale certificates, or other records to support the alleged sales for resale.
6. For the bank deposits method, CDTFA compiled bank deposits (excluding sales tax reimbursement) from sales proceeds of $1,263,094 for the liability period. Upon comparison to taxable sales of $376,348 reported on the SUTRs, CDTFA computed unreported taxable sales of $886,746 for the liability period, as follows: $336,477 in 2016; $270,476 in 2017; $254,249 in 2018; and $25,545 in 1Q19. Appellant stated that the differences between the SUTRs and bank deposits resulted from cash-back transactions included in the credit card deposits. CDTFA concluded that any cash-back transactions included in the credit card deposits would be offset by an equal reduction in cash deposited and thus, have no effect on the result.
7. To compute the taxable measure for the liability period, CDTFA used a combination of the FITR method and the bank deposits method. CDTFA used the bank deposits method for 2016 to determine unreported taxable sales of $336,477, switched to the FITR method for 2017 to determine unreported taxable sales of $325,171, and returned to the bank deposits method for 2018 and 1Q19 to determine unreported taxable sales of $254,249 and $25,545, respectively. In the audit work papers, CDTFA explained that it alternated between the two methods based on which method would result in higher audited taxable sales in stating that the "[a]uditor used the higher of FITR or bank deposit difference to arrive at audited taxable sales."

[4] CDTFA reduced gross receipts reported on the FITRs by sales tax reimbursement claimed on the FITRs under other expenses.

8. CDTFA issued an NOD to appellant with a tax liability of $74,198.00, and a negligence penalty of $7,419.76, plus applicable interest.
9. Appellant filed a timely petition for redetermination disputing the NOD in its entirety.
10. CDTFA subsequently issued a decision, deleting the negligence penalty but otherwise denying the petition.
11. Appellant timely appealed to OTA.
12. At the prehearing conference, OTA placed the parties on notice that, in deciding this appeal, OTA may consider "[w]hether respondent was justified in selecting the bank deposit method for 2016, 2018 and the first quarter of 2019 and gross receipts from the [FITR] for 2017. The parties may be asked to address the auditor's comment in Audit Schedule 12D, which states that the auditor selected the method (between the two) that resulted in the higher difference in each year."[5]

DISCUSSION

Issue 1: Whether adjustments to CDTFA's computation of taxable sales are warranted.

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) The law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) The burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a certificate from the purchaser that the property is purchased for resale.[6] (*Ibid.*; Cal. Code Regs., tit. 18, § 1668(a).) 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).)

[5] It is the role of OTA to compute the correct amount of tax. (*Appeal of Sheward*, 2022-OTA-228P.) "Otherwise, our function would resolve itself merely into the determination of a dispute between [the tax agency] and a taxpayer, both of whom may be wrong." (*Ibid.*)

[6] If the seller does not timely obtain a valid and complete resale certificate, the seller will be relieved of liability for the tax only where the seller shows that the property: 1) was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business; 2) is being held for resale by the purchaser and has not been used for any purpose other than retention, demonstration, or display, while being held for sale in the regular course of business; or 3) was consumed by the purchaser and tax was reported by the purchaser directly to CDTFA on the purchaser's returns or in an audit of the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid based on any information which is in its possession or may come into its possession. (R&TC, § 6481.) 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.) Where a determination is "shown to be arbitrary and excessive or based on assumptions which find no support in the record," OTA may revise the computation based on all the available evidence. (*Appeal of Rose* (76-SBE-027) 1976 WL 4043.) 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. (*Appeal of Talavera*, *supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, appellant's books and records were incomplete and inadequate to verify sales reported on appellant's SUTRs for the liability period using a direct audit method (that is, compiling audited sales directly from appellant's records). CDTFA performed various tests that showed discrepancies in appellant's records. Thus, CDTFA was justified in using an indirect audit method to compute appellant's sales. The FITR method and the bank deposits method may be used to compute appellant's sales since CDTFA may use any information which is in its possession or may come into its possession. (R&TC, § 6481.)

CDTFA used the bank deposits method for 2016, switched to the FITR method for 2017, and returned to the bank deposits method for 2018 and 1Q19. In the audit work papers, CDTFA explained that it alternated between the two methods based on which method would result in higher audited taxable sales in stating that the "[a]uditor used the higher of FITR or bank deposit difference to arrive at audited taxable sales." Notably, if for the entire liability period CDTFA used either the bank deposits method or the FITR method, the two methods result in similar calculations of unreported taxable sales: $886,746 and $870,024, respectively. Instead, by selectively choosing which indirect audit method to use, CDTFA increased unreported taxable sales to $941,442. This arbitrary selection made solely to increase unreported taxable sales is not reasonable and rational. Where CDTFA alternates between indirect audit methods because one method produces a higher result, CDTFA is no longer attempting to estimate the correct measure of tax but instead is arbitrarily increasing the tax measure.

On appeal, CDTFA argues that it selected the FITR method for 2017 because "the bank deposits may not have all cash deposited into the bank" in 2017, and that it may have selected

the bank deposits method for 2016, 2018 and 1Q19 because the income tax returns "may not be accurate because obviously there are additional [bank] deposits in addition to what they reported on their income tax returns." However, OTA cannot assume that one indirect audit method is more accurate in one period than another just because it produces a higher result. OTA finds no support in the record for CDTFA's assumption that the bank deposits method is less accurate in 2017 than in the other periods such that it would be reasonable and rational for CDTFA to switch to the FITR method in 2017.

For this case, given CDTFA's concerns that appellant's profit and loss statements for 2018 and 1Q19 were inaccurate because normal expenses (such as cost of labor and rent) were not listed, it would be reasonable and rational for CDTFA to use the bank deposits method for the entire liability period to estimate the correct measure of tax.[7] Accordingly, OTA finds that the use of the bank deposits method for the entire liability period is reasonable and rational, and the burden now shifts to appellant to provide evidence from which a more accurate determination may be made.

Appellant argues that adjustments to CDTFA's computation of taxable sales are warranted based on sales for resale and cash-back transactions. However, appellant not only failed to maintain and provide resale certificates but also failed to prove by other evidence that she sold perfumes for resale. As to cash-back transactions, appellant asserts that she provided cash back to customers during the liability period; however, appellant provided no supporting documentation other than two receipts outside of the liability period. In the absence of verifiable supporting evidence, OTA finds no adjustment is warranted based on sales for resale and cash-back transactions to the measure of unreported taxable sales established in the audit.

Appellant also alleges CDTFA did not obtain a warrant to access appellant's computer system and alleges CDTFA violated her Fourth Amendment rights under the United States Constitution by allegedly accessing appellant's computer without permission and alleges CDTFA deleted appellant's sales tax data. OTA, however, lacks the authority to address these concerns. (Cal. Code Regs., tit. 18, § 30104(d) [OTA lacks jurisdiction to determine whether an appellant is entitled to a remedy for CDTFA's actual or alleged violation of any substantive or procedural right to due process under the law, unless the violation affects the adequacy of a

[7] To be clear, in other cases where the use of the FITR method and the profit and loss method is reasonable and rational, CDTFA may use the method it finds to be most reliable.

notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal]; see also *Appeals of Dauberger, et al*. (82-SBE-082) 1982 WL 11759) ["We have no power to remedy any other real or imagined wrongs that taxpayers believe they may have suffered at the hands of the [state tax department]"].)

In summary, OTA finds that adjustments are warranted to the extent that CDTFA should use the bank deposits method for the entire liability period. In all other respects, appellant has not established that any further adjustments are warranted to the measure of tax.

Issue 2: Whether appellant is responsible for remitting sales tax.

Appellant argues that she is not responsible for remitting sales tax because she did not charge and collect sales tax from certain sales. However, the Sales and Use Tax Law imposes liability for sales tax on the retailer, and not the purchaser, of tangible personal property sold at retail in this state. (R&TC, §§ 6051, 6091.) While a retailer may charge and collect sales tax reimbursement from the purchaser with respect to the retail sale of tangible personal property (Civ. Code, § 1656.1(a); Cal. Code Regs., tit. 18, § 1700(a)), it is still the retailer who bears the legal responsibility of remitting the sales tax to the state, and the retailer's failure to collect reimbursement from customers does not relieve the retailer of its liability for the sale tax due. (R&TC, § 6051; *Pacific Coast Engineering Co. v. State of California* (1952) 111 Cal.App.2d 31, 34.) Accordingly, appellant's argument is without merit.

HOLDINGS

1. CDTFA must use the bank deposits method for the entire liability period and shall adjust the taxable measure accordingly. Other adjustments to the measure of tax are not warranted.
2. Appellant is responsible for remitting sales tax.

DISPOSITION

CDTFA's action in denying the petition for redetermination is reversed, in part, and sustained, in part. The taxable measure shall be reduced based on the use of the bank deposits method for the entire liability period. Except for the reduction in the taxable measure, CDTFA's action is sustained.

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Huy "Mike" Le
Administrative Law Judge

I concur:

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 4/26/2023

A. KWEE, Concurring and Dissenting, in part:

I concur with the majority in all respects, except for the decision to reduce the taxable measure. The California Department of Tax and Fee Administration (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*.)

Here, the majority made an adjustment based on finding that CDTFA failed to meet its initial burden. Appellant did not have documentation on her taxable sales because such information was stored electronically and was lost or destroyed. It is undisputed that appellant underreported her total sales to CDTFA. For example, CDTFA's decision stated that appellant "conceded unreported taxable sales based on the difference found between gross receipts reported on the federal income tax return (FITR) for 2017 of $325,171."

Appellant appealed CDTFA's decision and the entire liability to the Office of Tax Appeals (OTA) on the basis that the "disputed [sales and use] tax amounts were not collected due to the sales being [nontaxable] resale sales." During the hearing, appellant also clarified the reason for the "vast discrepancy on the sales tax reported versus the income taxes. The reason being is on the sales tax [returns], Appellant only reported the taxable sales only, not the nontaxable sales." At no point during the appeal before OTA has appellant ever disputed CDTFA's calculation of the audited total sales based on the 2017 FITR. To the contrary, appellant's dispute on appeal to OTA is her contention that the disputed amount (i.e., the difference between gross receipts reported on her federal income tax return and her reported taxable sales to CDTFA) represents nontaxable sales, such as nontaxable sales for purposes of resale.[1]

The majority concluded that CDTFA's use of gross receipts reported on FITRs for 2017 of $325,171 was unreasonable, and reduced the measure for 2017 to $270,476, based on a review

[1] Appellant also contended that some of the credit card sales are overstated and include nontaxable cash-back transactions; however, CDTFA did not use a credit card sales analysis to compute the liability.

of bank deposits.[2] CDTFA did not use this approach during the audit due to a concern that not all cash was deposited into the bank account for that time period.

The initial burden test is a *minimal* threshold for CDTFA to meet. (*Appeal of Talavera*, *supra*.) Regarding this burden, Revenue and Taxation Code (R&TC) section 6481 authorizes CDTFA to compute the amount of tax "upon the basis of any information within its possession or that may come into its possession." (R&TC, § 6481.) The term "any information" would include taxpayer-conceded amounts, recorded amounts, reported amounts, audited taxable sales based on available information, and any combination thereof, whether applied on a quarterly, annual, or per-audit-period basis. Thus, there may be more than one method which is reasonable and rational, and CDTFA may select any reasonable and rational method. For example, to the extent that appellant's bank account reflects cash sales exceeding reported sales, there would be no reason for CDTFA to accept an amount lesser than the cash sales observed in the bank account. Furthermore, to the extent that appellant acknowledges total sales as reported on her FITRs, there would be no reason for CDTFA to accept a lesser amount than the amount acknowledged by appellant.[3] The burden is upon appellant to establish that any of these acknowledged total sales are nontaxable or exempt. Based on the above facts, I would find that CDTFA met its initial burden in selecting *any* combination of the above information to calculate the liability. Furthermore, and in the absence of available documentation from appellant to support nontaxable or exempt sales, I would find that appellant failed to meet her burden to establish entitlement to an exemption or exclusion.

[2] For ease of analysis, an approximate figure for the adjustment ordered by the majority is as follows: $325,171 - $270,476 = $54,695. The exact amount will be calculated by CDTFA as provided by the majority Opinion's holding and disposition.

[3] Although appellant stated during the oral hearing that the FITR amounts reflect total sales, I would emphasize that in absence of documentation from appellant, CDTFA may calculate the liability based on any reasonable method, even without a taxpayer concession or acknowledgement.

On appeal, and during the hearing, appellant argued that adjustments are warranted for nontaxable sales. The majority correctly concluded that appellant failed to establish any adjustments were warranted, and I concur in that aspect of the majority's holding for the reasons stated therein.

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Andrew J. Kwee
Administrative Law Judge