

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

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| In the Matter of the Appeal of: |) | OTA Case No. 20066270 |
| MARINA SAILING, INC. |) | CDTFA Case ID. 215-247 |
| |) | |
| |) | |
| |) | |

OPINION

Representing the Parties:

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| For Appellant: | Dale Hanger, CPA |
| For Respondent: | Ravinder Sharma, Hearing Representative Chad Bacchus, Tax Counsel IV Jason Parker, Chief of Headquarters Operations |

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Marina Sailing, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ in response to appellant’s petition for redetermination of the Notice of Determination (NOD) dated April 26, 2018. The NOD is for \$80,740.48 in tax, applicable interest, and a negligence penalty of \$8,074.09, and applicable interest, for the period October 1, 2013, through August 15, 2015 (liability period).

The NOD is based on an aggregate taxable measure of \$910,789, consisting of \$189,500 unreported fixed asset sales at the close of the business, \$185,522 unreported taxable boat rental receipts, \$525,000 unreported fixed asset purchases subject to use tax, and \$10,767 of unreported taxable sales. During CDTFA’s appeals process, CDTFA reduced the measure of unreported taxable sales of \$10,767 to zero, and the aggregate taxable measure to \$900,022. Otherwise, CDTFA denied appellant’s petition for redetermination.

On appeal to OTA, CDTFA now concedes that the measure of unreported fixed asset purchases subject to use tax should be reduced from \$525,000 to zero. Thus, the aggregate

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to BOE.

taxable measure is reduced from \$900,022 to \$375,022. This will correspondingly reduce the tax liability and the negligence penalty.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Andrew Wong, and Keith T. Long held an oral hearing for this matter in Cerritos, California, on May 9, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUES

1. Whether adjustments to the deficiency measure based on appellant's sale of business assets are warranted.
2. Whether adjustments to the deficiency measure based on appellant's boat leases are warranted.
3. Whether appellant was negligent or intentionally disregarded applicable authorities.

FACTUAL FINDINGS

1. Appellant, a California corporation, operated a boat rental business and a yacht membership club with six marina locations during the liability period,² generating revenues from boat leases, club membership dues, sailing instructions, chartering commissions, and sale of boat parts. Its seller's permit was effective July 1, 1985.
2. On or about August 15, 2015, appellant sold its business assets for \$3,500,000 pursuant to an Asset Purchase Agreement. Included in the sale were assets totaling \$189,500, including seven boats for \$129,500 and other tangible personal property such as furniture, equipment, and spare parts for \$60,000. Appellant closed out its seller's permit on August 15, 2015.
3. Successor used its boats for sailing lessons, training, and club-sponsored events, in addition to boat leases. Successor's seller's permit was effective August 16, 2015. CDTFA examined successor's account and determined that successor did not report or pay use tax on its purchase of the business assets. CDTFA found that appellant was liable for the payment of sales tax on its sale of the business assets measured by \$189,500.

² Five cities were reported during the liability period; the sixth location was only listed on appellant's rental fleet brochures and advertisements.

4. Upon audit, appellant did not provide records showing how it determined its taxable sales. For the audit, appellant provided federal income tax returns for 2013, 2014, and 2015.³ CDTFA compared the gross receipts, excluding sales tax, that appellant recorded on its federal income tax returns to the taxable sales that appellant reported on its sales and use tax returns for those years and found a difference of \$5,299,454.
5. CDTFA determined that appellant failed to report any taxable sales on its receipts from leases of boats. Appellant claimed that during the liability period 33.5 percent of its sales were attributable to boat leases, which CDTFA accepted.⁴ Therefore, CDTFA applied the boat lease rate of 33.5 percent to unreported receipts of \$5,299,454 and found unreported boat leases of \$1,775,318.
6. Appellant did not own all the boats that it operated during the liability period.⁵ CDTFA found that appellant did not owe tax on the leases of boats that it did not own. CDTFA calculated that appellant owned 10.45 percent of the boats that it operated.⁶ CDTFA applied the 10.45 percent ownership rate to appellant's unreported boat lease revenue to find unreported taxable boat leases of \$185,522.
7. On May 1, 2018, appellant filed a petition for redetermination, which CDTFA largely denied, except for the \$10,767 concession, which is no longer in dispute on appeal.
8. This timely appeal followed.

DISCUSSION

Issue 1: Whether adjustments to the deficiency measure based on appellant's sale of business assets are warranted.

Every person engaging in or conducting business as a seller within this state is required to hold a seller's permit. (See R&TC, § 6066(a).) A seller includes every person engaged in the

³ Appellant's federal income tax return represented a fiscal year rather than a calendar year. CDTFA estimated the amounts reported on appellant's sales and use tax returns to account for timing differences in the reporting method.

⁴ During the audit, appellant claimed that its gross revenues consisted of 33.5 percent boat rentals (leases), 32.5 percent sailing lessons, 33.5 percent membership dues and 0.5 percent part sales. During the audit, CDTFA did not include leases of a boat with a captain in its calculation of appellant's taxable boat leases.

⁵ Appellant leased a portion of its fleet and operated the leased boats as part of its business.

⁶ During the liability period, appellant owned (and sold) seven of the 67 total boats that it operated.

business of selling tangible personal property of a kind the gross receipts from the retail sale of which would be subject to sales tax when sold at retail, regardless of whether the seller makes retail sales of such property. (R&TC, § 6014.) Tax applies to the gross receipts from the retail sale of tangible personal property in this state, including capital assets in the sale of a business, by any seller holding or required to hold a seller's permit. (See R&TC, §§ 6006(a), 6012(a), 6015(a), 6066; Cal. Code Regs., tit. 18, § 1595(a)(1), (b)(1).) 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 the sales tax until the contrary is established. (R&TC, § 6091.)

A "lease" includes rental, hire, and license, as well as a contract granting temporary possession of tangible personal property by a lessor to a lessee for a consideration. (R&TC, §§ 6006.1, 6006.3; Cal. Code Regs., tit. 18, § 1660(a)(1).) Unless otherwise exempt, a lease of tangible personal property is a continuing sale and purchase for the duration of the lease. (R&TC, §§ 6006.1, 6010.1; Cal. Code Regs., tit. 18, § 1660(b)(1) & (2).) Generally, the applicable tax is a use tax upon the use in this state of the property by the lessee as measured by the rentals payable, and the lessor is required to collect the use tax from the lessee and pay it to the state. (Cal. Code Regs., tit. 18, § 1660(c)(1).)

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. (R&TC, § 6091.) 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 purposes of resale by the purchaser and has not been used by the purchaser for any purpose other than retention, demonstration, or display while holding it 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 pursuant to an audit of the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).)

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).) If 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 that 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.) 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.*) To satisfy the burden of proof, a taxpayer must prove: (1) that the tax assessment is incorrect, and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Here, it is undisputed that on August 15, 2015, appellant sold seven of its boats for \$129,500 and other business assets (e.g., furniture, equipment, and spare parts,) for \$60,000, totaling \$189,500, to successor. It is also undisputed that appellant did not obtain a resale certificate from successor upon the sale.⁷ Appellant must then demonstrate either that these boats were resold or held for resale (i.e., exclusively rented), or that successor paid use tax directly to CDTFA. (See Cal. Code Regs., tit. 18, § 1668(e).)

CDTFA, however, has examined successor’s business activities and discovered that successor used the boats for sailing lessons, training, and club-sponsored events, in addition to boat leases, thereby negating the claim that the transaction was a sale for resale. By comparison, appellant has not presented any evidence that successor used the boats for the exclusive purpose of leasing to customers, despite its claim that successor’s intent in acquiring the boats was to operate a boat leasing business.⁸ In other words, appellant merely claims that successor intended to lease the boats based on “discussions with the general managers of the various locations of the successor/purchaser” without providing any evidence that successor in fact exclusively leased the boats. Absent evidence to support its assertion, appellant has not satisfied its burden to prove that the transaction was a sale for resale.

⁷ OTA notes that this was not possible since successor’s seller’s permit was not effective until the next day, August 16, 2015.

⁸ Appellant’s briefing uses the term “charter.” At the oral hearing, appellant clarified that when it says “charter” it meant use of the boat only and that the boat was operated by the customer. No captain or crew were provided for the transactions at issue. Thus, in this context, “charter” means leases that qualify as continuing sales and purchases under California Code of Regulations, title 18, section 1660(b)(1)) for purposes of this appeal.

Similarly, appellant has not provided argument or evidence that the sale of other business assets (e.g., furniture, equipment, and spare parts) was for resale or is otherwise exempt from sales tax. Therefore, appellant is also liable for the sales tax due on the other business assets, as well as the seven boats.

Issue 2: Whether adjustments to the deficiency measure based on appellant's boat leases are warranted.

Here, CDTFA compared appellant's federal income tax returns to appellant's sales and use tax returns and found discrepancies that could not be explained (i.e., a \$5,299,454 difference between the amounts reported on the two types of returns). Appellant did not provide sufficient books and records for the audit showing how it reported taxable sales. Thus, to calculate the taxable measure, CDTFA used the gross receipts that appellant reported on its federal income tax returns, as well as appellant's own estimate that 33.5 percent of its sales were attributable to boat leases to calculate audited boat lease receipts. CDTFA then reduced audited boat lease receipts to include only the boats that appellant owned. Considering the lack of books and records, it was rational for CDTFA to calculate the taxable measure from the available information (i.e., appellant's federal income tax returns and appellant's own estimates) and the calculation is reasonable. Thus, the burden of proof shifts to appellant. (See *Appeal of Talavera, supra.*)

On appeal, appellant does not dispute that some of its sales were taxable boat leases. Instead, appellant contends that CDTFA's estimate is overstated because most of the seven boats that it owned and leased were 22 feet or smaller in length with no living accommodations and thus would not garner the same rental rate as a 46-foot boat with full accommodations would, as CDTFA allegedly assumed. Appellant also contends that its schedule listing the boat leases at its Marina Del Rey's location, which constituted 2.9 percent of its operations from November 2, 2014, to August 14, 2015, is a more accurate reflection of its total taxable boat leases for the entire liability period.

OTA is unconvinced that appellant's schedule is more representative of its total taxable sales for all locations for the entire liability period due to the limited scope of the schedule as well as the lack of supporting source documents. Specifically, the schedule pertains to only one of appellant's six marina locations, for nine months out of the three-year liability period. There is no evidence that the other locations rented boats with the same frequency as the Marina Del Rey location, or that all the locations rented the boats at the sustained rate of 2.9 percent for the

entire liability period. Moreover, without corroborating source documents such as rental invoices to support the purported rental rate and rental frequency, appellant's assertions are unsubstantiated and thus insufficient to satisfy its burden of proof. Absent substantiation of appellant's claims, OTA finds that adjustments are unwarranted.

Issue 3: Whether appellant was negligent or intentionally disregarded applicable 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 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, or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Generally, relevant records must be retained for at least four years. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable believe that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

Here, during CDTFA's audit, appellant provided no books and records to corroborate the calculation of reported taxable sales. Despite appellant's proffer on appeal of a single schedule

of boat leases, it is limited in scope as to time and location, and uncorroborated by source documents. Appellant’s failure to maintain source documents and workpapers used to prepare its sales and use tax returns, which is expected of an ordinarily prudent businessperson, is evidence of negligence.

Appellant contends that the documents CDTFA requested for the audit were difficult to obtain because “the taxpayers travel extensively” and were either turned over to the new owner or relocated to Hawaii and Washington states where appellant’s principals reside. Despite the principals’ travels and sale of the business, appellant still had a duty to maintain books and records as an ordinarily prudent businessperson would. Appellant is also required to make adequate books and records available for examination under the Sales and Use Tax Law. Appellant’s travel schedule is irrelevant to this requirement. Moreover, appellant presents no evidence of why it could not have maintained a copy, either electronic or paper, of its books and records before it sold the business. Appellant’s failure to do so is further evidence of negligence. Thus, the limited available records establish that the 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. Therefore, OTA finds that appellant was negligent.

HOLDINGS

1. Adjustments to the deficiency measure based on appellant’s sale of business assets are not warranted.
2. Adjustments to the deficiency measure based on appellant’s boats leases are not warranted.
3. Appellant was negligent.

DISPOSITION

CDTFA’s action denying appellant’s petition for redetermination is modified to the extent that CDTFA concedes that the measure of unreported fixed asset purchases subject to use tax should be reduced from \$525,000 to zero. Otherwise, CDTFA’s action denying appellant’s petition for redetermination is sustained.⁹

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Keith T. Long
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 6/26/2023

⁹ The resulting penalty amount is to be recalculated following the adjustments to the measure of tax.