OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. DONALDSON,** **dba Beverly Hills Bridal Exchange**	OTA Case No.: 19105417 CDTFA Case ID: 153-061

OPINION

Representing the Parties:

For Appellant: M. Donaldson

For Respondent: Sunny Paley, Attorney
Carey Huxsoll, Attorney
Jason Parker, Chief of Headquarters Ops.

M. GEARY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, M. Donaldson (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent), denying appellant's petition for redetermination of a Notice of Determination (NOD) dated February 9, 2018. The NOD was for tax of $11,627.67 and applicable interest for the period July 1, 2014, through June 30, 2017 (liability period).

Office of Tax Appeals (OTA) Administrative Law Judges Andrea L.H. Long, Suzanne B. Brown, and Michael F. Geary held an oral hearing for this matter in Cerritos, California, on June 7, 2023. At the conclusion of the hearing, the parties submitted the matter, and the record was closed.

ISSUE

Is appellant entitled to a reduction of the measure of disallowed claimed nontaxable labor?

FACTUAL FINDINGS

1. Appellant operated a consignment store in Corona, California, specializing in the sale of bridal gowns and accessories.[1] Appellant acquired gowns for resale from several sources. Designers/manufacturers (designers) and bridal gown retailers[2] (collectively, vendors) would consign gowns that could not be sold to their wholesale or retail customers because they were soiled or damaged or because they were no longer serviceable as samples of available designs. Individuals would also sometimes consign gowns because the garments were no longer needed.[3] The store also rented men's formal wear and provided or arranged for alterations to improve the fit of items sold.
2. Respondent audited appellant for the period July 1, 2014, through June 30, 2017. Appellant had reported total sales of $751,481, claiming deductions of $157,768 for nontaxable labor (alterations on gowns),[4] resulting in reported taxable sales of $593,713.
3. Respondent concluded that unless the consignors used the gowns for purposes other than demonstration or display while holding them for sale in the regular course of business, no taxable use occurred prior to appellant's sale of the gowns. Respondent thus concluded that the gowns consigned by designers and bridal gown retailers should be considered new when acquired by appellant, gowns consigned by others should be considered used when acquired by appellant, and charges for alterations to new gowns were includable in taxable receipts.
4. In a "block" test[5] of the fourth quarter of 2014 (4Q14), 3Q15, 2Q16, and 1Q17, respondent noted that the sales invoices did not indicate if the alterations were performed

[1] This Opinion uses the term "gown" to refer to wedding gowns and other formal gowns available at appellant's store.

[2] While appellant testified that she does not consider herself to be a retailer, apparently because she sells gowns at substantial discounts below suggested retail, appellant fits the statutory description of a "retailer." (R&TC, § 6015(a).) References in this Opinion to "bridal gown retailers," and in some instances that will be clear from context, to retailers, are references to the retailers from whom appellant acquired gowns on consignment.

[3] Only the gowns consigned by designers and retailers are at issue in this appeal.

[4] These deductions were actually claimed on the sales and use tax returns as $32,853 for labor and $124,915 for "other." Appellant explained during the audit that all of the claimed deductions were for alterations.

[5] A "block" test is an audit procedure that examines transactions in just part of the period being audited (audit period), a "block" of time believed to be representative of the whole audit period. Adjustments found to be

on "new" gowns consigned by designers and bridal gown retailers or on used gowns consigned by others. Respondent therefore treated all alterations as taxable, though it allowed dress steaming, dress preservation,[6] and tuxedo rental as nontaxable labor charges.

5. The test disclosed errors (taxable alteration charges) totaling $43,989, which represented an error rate of 92.07 percent. Respondent used actual, audited nontaxable sales for the tested periods and applied that error rate to claimed nontaxable sales for the other eight reporting periods in the liability period to compute disallowed claimed nontaxable labor deductions of $146,019.
6. On the basis of the audit, respondent issued the February 9, 2018 NOD to appellant.
7. Appellant filed a timely petition for redetermination of the NOD.
8. On May 30, 2019, the parties participated in an appeals conference as part of respondent's internal appeals process.
9. On September 24, 2019, respondent issued its decision denying appellant's petition. This timely appeal followed.
10. In testimony at the hearing, appellant described the bridal gown business, and how appellant's store fits into that business, as follows: Designers show their new gowns twice yearly to display their spring and fall collections. Bridal gown retailers purchase samples of gowns that are used for demonstration and display in their showrooms and at bridal shows and other events.[7] Customers order gowns from the retailers at prices 200 to 300 percent above the retailers' cost. When the retailer no longer has use for some gowns and needs to dispose of that inventory, usually to make room for new lines, some retailers enter into a consignment contract with appellant, who is allowed a specified period of time (e.g., 90 days) to sell the gown at appellant's store. If the gown sold, it was always at substantially below its former retail price, and approximately 40 to 50 percent of the sales proceeds were paid to the retailer who provided the gown for

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appropriate for the test period, which are usually expressed in terms of percentages, are applied to the entire audit period. (See, e.g., respondent's Audit Manual § 0405.20.)

[6] Dress preservation involves thorough cleaning, damage repair, if needed, and packaging for long-term storage.

[7] Appellant also testified that these retailers are prohibited from selling the samples in their stores, and thus the only purpose of these gowns is to be used as samples for demonstration and display. There is no corroborating evidence to support this particular assertion, but in any event, OTA need not make a finding on this point.

consignment sale (the consignor). If appellant did not sell the gown within the allowed time, the gown was donated or returned to the consignor.

11. Appellant provided letters from some of the vendors who consigned gowns with appellant. One of appellant's vendors described the gowns as damaged or dirty gowns or gowns from previous years' collections no longer available from the designers. Another described them as used and discontinued samples. A third described them as outdated, used samples not appropriate for resale in their store. Another, one that described itself as a designer, stated the gowns consigned to appellant had been used at bridal shows. All vendors that provided letters agreed that the gowns are not new when consigned and that the gowns are no longer suitable for demonstration or display for, or sale to, their customers.

DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property (TPP) sold in California, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) A retail sale is a sale of TPP for a purpose other than resale in the regular course of business. (R&TC, § 6007.) All of a retailer's gross receipts are presumed subject to tax until the contrary is established, and the burden of proving the contrary is on the retailer. (R&TC, § 6091.) "Gross receipts" means the total amount of the sale price of a retailer's retail sales of TPP, including the cost of labor or services, as well as any services that are a part of the sale. (R&TC, § 6012(a)(2), (b)(1).)

A "sale" includes producing, fabricating, or processing TPP for a consideration for consumers who furnish the materials used. (R&TC, § 6006(b); Cal. Code Regs., tit. 18, § 1526(a).) Thus, charges for fabricating TPP for a consumer are subject to sales tax unless specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) Fabrication includes any operation that results in the creation or production of TPP or that is a step in a process or a series of operations resulting in the creation or production of TPP. (Cal. Code Regs., tit. 18, § 1526(b); see also Cal. Code Regs., tit. 18, § 1524(a).) Fabrication does not include operations that constitute merely the repair or reconditioning of TPP to refit it for the use for which it was originally produced. (Cal. Code Regs., tit. 18, § 1526(b).) The retailer bears the burden of establishing its entitlement to any claimed deduction or exemption. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443.)

California Code of Regulations, title 18, (Regulation) section 1524, which discusses alterations of new and used items, states:

> Alteration of new items means and includes any work performed upon new items such as garments, bedding, draperies, or other personal and household items to meet the requirements of the customer, whether the work involves the addition of material to the item, the removal of material from the item, the rearranging or restyling of the item, or otherwise altering the item, when such alterations result in the creation or production of a new item or constitute a step in the creation or production of a new item for the customer.

(Cal. Code Regs., tit. 18, § 1524(b)(1)(A).) As relevant here, charges for the alteration of new garments are generally subject to tax, regardless of whether the charges are separately stated or included in the price of the item, or whether the alterations are performed by the seller of the item or by another person. (*Ibid*.) Charges for the alteration of used items, on the other hand, are not subject to tax. (Cal. Code Regs., tit. 18, § 1524(b)(1)(B).) The pivotal factual question in this appeal is whether the gowns consigned by the vendors were new or used when they came into appellant's hands.

When respondent is not satisfied with the amount of tax reported by the taxpayer, respondent may determine the amount required to be paid on the basis of any information that is in its possession or may come into its possession. (R&TC, § 6481.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Respondent argues that OTA should look to the totality of the circumstances to determine whether a gown is new or used and that one of the circumstances is whether there has been a prior taxable use of a gown. Another factor, according to respondent, is whether the gown had been used for its intended purpose prior to the alterations. The audit work papers indicate that appellant told customers that the gowns were new, and respondent appears to argue that this is also a factor supporting its position. Respondent argues, by analogy, that the gowns are like new cars. A new car dealer's (dealer's) use of a car for demonstration or display does not make a new car used; and likewise, the vendors' use of the gowns for demonstration and display did not

make those new gowns used. Respondent's position is that while garments consigned by individuals were used and alterations to used garments are not subject to tax, the evidence does not show the consignor of each altered garment. Respondent contends that it allowed all adjustments for which there was supporting evidence in the audit and that the audit measure is presumed taxable because appellant has not shown otherwise.

Appellant agrees that the determinative question is whether the gowns consigned by the vendors were new or used, and she asserts that the evidence shows that the gowns consigned by vendors, which are the only garments at issue, were used. Appellant testified that she never informed a customer that the gowns were new and that she never said anything to the contrary to respondent; rather, she told respondent that she does not tell her customers that the gowns are being sold on consignment. She contends the evidence establishes that the designers manufactured gown samples for their own use and to be sold to the bridal gown retailers for the purpose of using them as samples for demonstration or display; appellant asserts that the vendors used the gowns for that intended purpose, and that only when that purpose had been served did the vendors then consign the gowns to appellant for sale, not at retail prices and not in the regular course of the vendors' businesses.

OTA finds that there are several things that distinguish the consigning vendors from a dealer. Much like the consigning bridal gown retailers, dealers acquire inventory from the manufacturer, and while all new cars will have a few miles on the odometers when they come into the dealer's possession, all are correctly considered new when acquired by the dealer, just as the gown samples are new when first acquired by those retailers. It is what the dealer can do and does with the cars that causes the analogy to fall apart.[8] As explained below, a car is not like a gown.

The dealer maintains an inventory and decides which cars to use for demonstration or display. Most customers want to drive the car they intend to buy, but they do not need to drive the car in the color they wish to purchase or with all the equipment they want included on their car. With few, if any, exceptions, the dealer purchases every car for eventual resale, and every

[8] Although not important to OTA's analysis, respondent offered no authority for its argument that demonstration and display of a new car does not make the car used. An analysis regarding whether the demonstration or display of a "new" car while being held for resale is a taxable use is not the same as an analysis of whether that same car should be considered used after being "regularly used or operated as demonstrators in the sales work of a dealer." (See Veh. Code, § 665; *Hawley v. Johnson* (1943) 58 Cal.App.2d 232, 239.)

car, including every car that was used by the dealer for demonstration, display, or some other purpose, is eventually resold by the dealer in the regular course of its business.[9]

The vendors and their customers are looking at the purchasing process from a different perspective. The samples used by the vendors purport to be exactly like the gown the customer can order in the customer's size. Unlike the dealers' new cars, the gown samples were not necessarily held by the designers[10] or purchased by the bridal gown retailers for resale in the regular course of business. They were held or purchased for the primary purpose of using them as samples to sell the gown's design, its look and feel, to the customer. (See *Kaiser Steel Corp. v. State Board of Equalization* (1979) 24 Cal.3d 188, 192.) The evidence establishes that the gowns were used by the vendors for their intended purpose: to sell gowns of the same design. Appellant's testimony and the vendors' letters confirm the use and that, as a result of that use, the gowns could not be sold to the vendors' usual customers. Furthermore, while the evidence shows that the samples, or at least some of them, were resold on consignment through appellant, those sales were not the vendors' primary purpose for holding or purchasing the gowns, and the sales by appellant did not occur in the regular course of the vendors' businesses.

Respondent's argument that the gowns acquired by appellant should be considered new because there had been no prior taxable use of the gowns is not persuasive under the circumstances shown by the evidence. These gowns are not comparable to new cars. This appeal presents a situation that is unlike those about which respondent has previously opined. To the extent the designers may have held their samples and sold the samples to the bridal gown retailers primarily for use as samples and not for resale in the regular course of business, use of the gowns for demonstration or display would have been a taxable use. (*Kaiser Steel Corp. v. State Board of Equalization*, *supra*.) To the extent the vendors simply demonstrated or displayed the gowns while holding them for resale in the regular course of business, there would have been no taxable use (see, e.g., Cal. Code Regs., tit. 18, § 1669); but when such use rendered the gowns no longer new due to soiling, damage or other degradation, such that they could not be sold as

[9] Dealers may assign vehicles to sales staff, executives, or the loaner fleet, but even those are destined for eventual resale, though not necessarily as "new."

[10] At least one of appellant's vendors was a designer.

new, as was the case here, the gowns should be considered used for the purposes of applying Regulation section 1524.

Appellant credibly testified, and the vendors' letters confirm, that appellant and the vendors considered the gowns used when consigned to appellant; in addition, OTA finds persuasive appellant's testimony that she never told customers that the gowns were new. More importantly, the evidence establishes that the gowns were generally soiled, damaged, outdated, or otherwise not suitable for sale at retail prices when consigned to appellant, and OTA can give little weight to what appellant's customers might have been told about the condition or history of the gowns.

Respondent relies on *Duffy v. State Board of Equalization* (1984) 152 Cal.App.3d 1156 (*Duffy*), and on Annotations 210.0180 (5/13/1959) and 210.0068 (1/15/1963),[11] but all of these are distinguishable. *Duffy* involved alterations performed by the taxpayer, a tailor, on new clothing purchased from a retailer but not previously worn by the tailor's customer. In other words, the court in *Duffy* was not considering clothing that was soiled, damaged, or unsuitable for a sale as new clothing.

Similarly, Annotation 210.0180 states:

> The gratuitous furnishing of expensive jewelry, not imitation or costume jewelry, to a motion picture studio for the use of an actress while making a motion picture is a demonstration. There is no depreciation in the value of the jewelry and the jeweler is seeking to sell his merchandise.

The question presented to the legal department was whether the jeweler would owe use tax. The question before OTA now is whether the gowns should be considered new, such that alteration of the gowns should be considered, essentially, part of the manufacturing process. Also, here, there is no question that use of the gowns by the vendors resulted in significant depreciation in the value of the gowns.

Annotation 210.0068 arose from a question posed by a clothing manufacturer that was concerned about whether it owed tax in connection with its sale of clothing samples to its

[11] An annotation is a summary of a legal ruling by or opinion of respondent's legal department. Annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) Nevertheless, OTA may consider and afford some weight to an annotation. (See, e.g., *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.)

salespersons. The backup for the annotation[12] indicates that the salespersons eventually sold the samples to their customers, who resold the clothing in their retail stores. There is nothing in the annotation or the backup to suggest that the samples were used for anything other than display. There is nothing to suggest that the clothing was ever worn, nothing to suggest that the samples were damaged, degraded, or depreciated in any way, and nothing to suggest that there was anything that would have prevented the taxpayer's customers from selling the clothing at retail prices. These authorities are not persuasive support for respondent's position.

Based on the foregoing, OTA finds that the gowns consigned to appellant by the vendors were used when they came into appellant's possession. Appellant has thus rebutted the presumption that the proceeds from appellant's sale of alterations services were subject to tax, and OTA finds respondent's arguments to the contrary unpersuasive. OTA therefore finds that appellant correctly claimed that its charges for alterations and repairs to the gowns were properly excluded from taxable sales.

[12] The full legal opinion upon which an annotation is based is typically an opinion letter or a formal decision. These "backups" are not part of the annotation but they can provide context.

HOLDING

Appellant is entitled to a reduction of the measure of disallowed claimed nontaxable labor from $146,019 to zero.

DISPOSITION

Respondent's action denying the petition is reversed.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Andrea L.H. Long
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Andrea L.H. Long
Administrative Law Judge

Date Issued: 9/14/2023