

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: <b>NAZIR GROUP,</b> <b>dba 7 Day Tire</b>	) ) ) ) ) )	OTA Case No. 21057819 CDTFA Case ID: 130-014
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**OPINION**

Representing the Parties:

For Appellant: Waseem Nazir, President

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Nazir Group (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated January 26, 2018.<sup>2</sup> The NOD is for a tax of \$188,496.85, plus applicable interest, and a negligence penalty of \$18,849.69 for the period April 1, 2014, through March 31, 2017 (liability period). In its decision, CDTFA ordered a reaudit to reduce audited excess sales tax reimbursement collected on taxable sales measuring \$42,905.00 for the first quarter of 2017 (1Q17). This will reduce appellant’s liability.

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

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

<sup>2</sup> The NOD was issued timely because appellant signed a series of waivers of the otherwise applicable three-year statute of limitations. The most recent waiver, signed on July 13, 2017, which extended until January 31, 2018, the time within which CDTFA could issue an NOD for the period April 1, 2014, through September 30, 2014. (R&TC, §§ 6487(b), 6488.)

ISSUES<sup>3</sup>

1. Whether appellant has demonstrated that the amount of unreported taxable sales established in the audit should be reduced.
2. Whether a reduction to the amount of unreported purchases of consumable supplies and fixed assets subject to use tax is warranted.

FACTUAL FINDINGS

1. Appellant operates three automotive repair shops specializing in tire and wheel sales. Two of appellant's repair shops are located in Sacramento on Mack Road and 47th Avenue, respectively. Appellant's third repair shop is located in Roseville.
2. During the liability period, appellant reported total sales of \$7,316,470, and claimed deductions of \$1,256,361 for nontaxable sales for resale, \$2,348,405 for nontaxable sales of labor, \$254,769 for sales tax reimbursement included in reported total sales, and \$265,534 for "other nontaxable sales," which resulted in reported taxable sales of \$3,191,401.
3. For the audit, appellant did not provide a complete set of books and records. Instead, appellant provided the following: federal income tax returns for 2014 and 2015; a depreciation schedule for 2015; purchase reports for the Mack Road and Roseville locations for 2015; an incomplete set of quarterly sales summary reports;<sup>4</sup> and an incomplete set of sales invoices from 4Q15 for the Mack Road and Roseville locations.<sup>5</sup>
4. Upon audit, CDTFA compared appellant's federal income tax returns for 2014 and 2015 to appellant's sales and use tax returns for those years. For 2014, CDTFA found no difference between the gross receipts reported on appellant's federal income tax return and the taxable sales reported on appellant's sales and use tax returns. For 2015, CDTFA found that the taxable sales reported on appellant's sales and use tax returns exceeded the gross receipts reported on appellant's federal income tax returns by \$14,776.

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<sup>3</sup> The measure of excess sales tax reimbursement was reduced by \$2,038 from \$19,898 to \$17,860, pursuant to a reaudit. On appeal to OTA, appellant does not dispute this item.

<sup>4</sup> Appellant did not provide a quarterly summary report for 3Q16.

<sup>5</sup> CDTFA found gaps in the sales invoices sequential numbering and determined that appellant failed to provide 76 invoices for the Mack Road location and 146 invoices for the Roseville location.

5. CDTFA compared appellant's reported sales of merchandise<sup>6</sup> with the cost of goods sold that appellant reported on its federal income tax returns and found book markups<sup>7</sup> of 6.17 percent for 2014, 12.38 percent for 2015, and 9.13 percent for the two years combined. CDTFA's audit workpapers indicate that appellant's vendors did not provide CDTFA with sufficient information to verify appellant's purchases. Appellant's book markups were inconsistent and lower than CDTFA expected.
6. CDTFA also performed a shelf test<sup>8</sup> based on some of appellant's sales for 4Q15, which revealed a markup of 38.9 percent. CDTFA noted the difference between the shelf test results and the book markups, but CDTFA did not perform a complete shelf test because appellant's purchases could not be verified.
7. CDTFA reviewed appellant's 4Q15 sales invoices for the Mack Road and Roseville locations and found total recorded sales of \$374,043, and taxable sales of \$242,753 for those combined locations. Based on this information, CDTFA found that appellant's taxable sales represented 64.90 percent of its total sales ( $\$242,753 \div 374,043$ ). CDTFA applied the 64.90 percent taxable sales ratio to the total sales (excluding sales tax reimbursement) recorded in appellant's 4Q15 sales summaries for the Mack Road and Roseville locations, to compute combined audited taxable sales for 4Q15 of \$324,427.
8. CDTFA compared the combined audited taxable sales to the sales that appellant recorded in the Mack Road and Roseville quarterly sales summaries for 4Q15 of \$242,753 and found an error rate of 62.78 percent. CDTFA applied the 62.78 percent error rate to the total taxable sales that appellant recorded in its quarterly sales summaries for all three

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<sup>6</sup> This consists of appellant's reported taxable sales plus appellant's claimed nontaxable sales for resale.

<sup>7</sup> "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 \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is  $\text{markup amount} \div \text{cost}$ . In this example, the markup percentage is 42.86 percent ( $.30 \div .70 = 0.42857$ ). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is  $\text{profit amount} \div \text{sales price}$ . In the above example, the gross profit margin is 30 percent ( $.30 \div 1.00 = 0.3$ ).

<sup>8</sup> A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

locations of \$3,188,393 for the liability period<sup>9</sup> to establish unreported taxable sales of \$2,001,673 for the liability period.

9. During the review of appellant's federal income tax returns, CDTFA noted that appellant claimed deductions for tools and supplies expenses totaling \$72,601 for 2014 and 2015, or \$36,301 annually. CDTFA applied the annual tools and supplies expense of \$36,301 to 2016 and established audited tools and supplies purchases of \$108,902 (\$72,601 + \$36,301). Appellant did not provide purchase invoices to show that it paid sales tax reimbursement to vendors. Therefore, CDTFA estimated that 50 percent of appellant's purchases were made without payment of tax (ex-tax) and computed unreported purchases of tools and supplies subject to use tax of \$54,451.
10. Appellant's 2015 depreciation schedule indicated that appellant purchased fixed assets totaling \$40,500 during 2015. Appellant's purchases included two tire machines, tire balancers, and tire compressors. Each equipment set cost \$17,500. Because appellant operated three locations, and two sets of equipment were purchased in 2015, CDTFA found that appellant likely purchased another tire machine, tire balancer, and tire compressor for the third location during 2016. Based on this assumption, CDTFA established audited purchases of fixed assets of \$58,000 (\$40,500 + \$17,500) for the liability period. In the absence of purchase invoices showing that appellant had paid sales tax reimbursement to its vendors for its purchases of fixed assets, CDTFA established unreported purchases of fixed assets subject to use tax of \$58,000.
11. During CDTFA's review of appellant's invoices from 4Q15, it was determined that appellant collected excess sales tax reimbursement of \$19,898 at its Roseville location.
12. On January 26, 2018, CDTFA issued the aforementioned NOD for a tax of \$188,496.85, plus applicable interest, and a negligence penalty of \$18,849.69. Appellant filed a timely petition for redetermination, disputing the NOD.
13. On December 12, 2019, CDTFA issued a decision ordering a reaudit to remove the measure of excess sales tax reimbursement collected for 1Q17. CDTFA also deleted the negligence penalty. Otherwise, CDTFA denied the petition for redetermination.

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<sup>9</sup> Appellant did not provide quarterly sales summaries for 3Q16. For that quarter, CDTFA applied the 62.78 percent error rate to the taxable sales reported on appellant's sales and use tax return. CDTFA noted that the differences between appellant's reported taxable sales and the taxable sales recorded in appellant's quarterly summaries were otherwise immaterial.

14. Appellant filed a timely request for reconsideration continuing to dispute the NOD.
15. On February 22, 2021, CDTFA issued a supplemental decision ordering no additional adjustments to appellant's liability.
16. This timely appeal followed.

### DISCUSSION

#### Issue 1: Whether appellant has demonstrated that the amount of unreported taxable sales established in the audit should be reduced.

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.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) 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, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide a complete set of books and records. For example, appellant did not provide a sales journal, general ledger, or complete sets of sales or purchase invoices. Appellant provided sales invoices for 4Q15; however, these invoices were also incomplete and for only two of appellant's three shops. CDTFA compared appellant's federal income tax returns to appellant's sales and use tax returns and found only minor differences in the reported sales amounts. CDTFA then used these same documents to calculate appellant's markups of 6.17 percent for 2014, 12.38 percent for 2015, and 9.13 percent for the two years

combined, which were lower than expected and inconsistent with each other. The book markups were also inconsistent with the markup that CDTFA calculated during the short shelf test, of 38.9 percent. These discrepancies could not be explained, and it was reasonable for CDTFA to continue the audit.

To calculate the taxable measure, CDTFA used the available invoices to compute appellant's audited taxable sales for the Mack Road and Roseville locations during 4Q15. CDTFA then used the difference between appellant's audited taxable sales for 4Q15 and the taxable sales recorded in appellant's 4Q15 sales summary to calculate an error ratio, which it applied to the recorded taxable sales for all three locations. In the absence of a complete set of source documentation, CDTFA was unable to verify the taxable sales that appellant reported on its sales and use tax returns using a direct audit method. Thus, it was appropriate for CDTFA to use an indirect approach to calculate the taxable measure. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) Considering the foregoing, it was reasonable and rational for CDTFA to rely on appellant's sales invoices and summaries to find an error rate and calculate appellant's audited taxable sales. Accordingly, the burden of proof shifts to appellant to show that adjustments are warranted.

On appeal, appellant asserts that the taxable measure should be reduced. Appellant contends that CDTFA's use of 4Q15 to calculate an error rate for the liability period is unreliable because that quarter is not representative of the liability period. Appellant argues that CDTFA's calculations included voided sales during 4Q15. Appellant also contends that CDTFA's calculations are inaccurate because CDTFA only tested two of appellant's three locations. Appellant asserts that it should have been allowed to submit its bank statements for the audit period because an analysis of its bank deposits would not substantiate more than \$2,000,000 in additional sales. However, appellant has not provided any evidence to support the argument that the taxable measure should be reduced. Appellant's unsupported assertions are insufficient to meet its burden of proof. (*Appeal of Talavera, supra.*)

As to whether CDTFA should have made use of additional books and records, a review of the *Assignment Activity History* prepared by CDTFA during the audit indicates that CDTFA made repeated requests for records from the time the audit was initiated in May 2017 until January 2018, when the NOD was issued. This includes requests for sales records from all three locations. CDTFA also specifically requested appellant's bank statements for all three locations

on August 15, 2017. As discussed in detail above, CDTFA used the books and records that appellant provided to calculate the taxable measure, and the resulting calculations are reasonable. Appellant has not shown that the measure of unreported taxable sales should be reduced.

Issue 2: Whether a reduction to the amount of unreported purchases of consumable supplies and fixed assets subject to use tax is warranted.

Use tax applies to the storage, use, or other consumption of tangible personal property purchased from any retailer for storage, use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (R&TC, §§ 6201, 6401.) Every person storing, using, or otherwise consuming tangible personal property from a retailer in this state is liable for the use tax. (R&TC, § 6202(a).) That person's liability is not extinguished until the use tax has been paid to this state, unless a retailer engaged in business in this state issues a receipt showing taxes paid. (R&TC, § 6202(a).) It is presumed that tangible personal property sold by any person for delivery in this state is sold for storage, use, or other consumption in this state until the contrary is established. (R&TC, § 6241.)

During the audit, CDTFA found that appellant made purchases of tools and supplies in 2014 and 2015 totaling \$72,601. However, appellant failed to provide purchase invoices or other documents substantiating that it paid sales tax reimbursement to its vendors. In the absence of such evidence, OTA finds that it was reasonable for CDTFA to estimate that appellant failed to pay sales tax on half of the tools and supplies reported on appellant's federal income tax returns for 2014 and 2015.

Similarly, CDTFA found that appellant made purchases of fixed assets totaling \$40,500 in 2015. Appellant also failed to provide purchase invoices or other documents to demonstrate that it paid sales tax reimbursement to its vendors on its purchases of fixed assets during 2015. Thus, OTA finds that it was reasonable for CDTFA to conclude that appellant was liable for use tax on its purchases of fixed assets during 2015. However, appellant's purchases in one year are not sufficient to indicate a pattern of purchases in another year. CDTFA could not reasonably conclude that appellant made purchases of fixed assets in 2016 without further evidence. As such, OTA finds that the CDTFA's findings for that year are not reasonable, and the measure of use tax must be reduced by the audited purchases of fixed assets for 2016 (\$17,500).

Appellant contends that it should have been allowed to submit purchase contracts showing that sales tax reimbursement was paid to its vendors on its purchases of equipment.


OTA is unaware of any circumstances that prevented appellant from providing its purchase contracts either during the audit process or during the appeals process. Because appellant has continually failed to provide documentation to support its contentions, there is no basis to support any further reduction to the audit liability.

HOLDINGS

1. Appellant has not demonstrated that the amount of unreported taxable sales established in the audit should be reduced.
2. A reduction to the use tax measured by audited fixed asset purchases of \$17,500 is warranted. No other reduction to the amount of unreported purchases of consumable supplies and fixed assets subject to use tax is warranted.

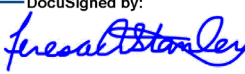
DISPOSITION

Reduce the measure of use tax measured by audited fixed asset purchases of \$17,500. Otherwise, CDTFA’s decision to reduce excess sales tax reimbursement measured by taxable sales of \$42,905, to delete the negligence penalty, and to otherwise deny the petition for redetermination is sustained.

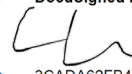
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Keith T. Long  
Administrative Law Judge

We concur:

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Teresa A. Stanley  
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Andrew J. Kwee  
Administrative Law Judge

Date Issued: 10/9/2023