

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

In the Matter of the Appeal of: ) OTA Case No. 21047595  
N. JAMALI, ) CDTFA Case ID: 1-271-875  
dba Zak’s Auto Body )  
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**OPINION**

Representing the Parties:

For Appellant: Robert L. Goldstein, Attorney  
For Respondent: Nalan Samarawickrema,  
Hearing Representative  
Christopher Brooks, Attorney  
Jason Parker, Chief of Headquarters Ops.

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

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, N. Jamali (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant’s administrative protest of a Notice of Determination (NOD) dated February 10, 2020.<sup>2</sup> The NOD is for tax of \$32,004, plus applicable interest, and a negligence penalty of \$3,200.39 for the period January 1, 2015, through December 31, 2017 (liability period).<sup>3</sup> During the oral hearing, CDTFA conceded to reduce the audit measure by \$1,484, which will reduce appellant’s tax liability.

<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> Under regulations promulgated by CDTFA, if a taxpayer files a petition for redetermination after the 30- day period authorized in R&TC section 6561 expires, CDTFA may accept it as an administrative (i.e., late) protest; however, such an appeal does not qualify as a valid petition for redetermination. (Cal. Code Regs, tit. 18, § 35019.)

<sup>3</sup> The NOD was timely because on September 10, 2019, appellant signed the most recent in a series of waivers extending the relevant statute of limitations to April 30, 2020.

Office of Tax Appeals (OTA) Administrative Law Judges Natsha Ralston, Andrew J. Kwee, and Keith T. Long held an oral hearing for this matter electronically, on September 21, 2023. At the conclusion of the oral hearing, the record was closed and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

### ISSUE

Whether any adjustments to the measure of unreported taxable sales are warranted.

### FACTUAL FINDINGS

1. Appellant, a sole proprietor, dba Zak's Auto Body, operates an automobile repair shop in South San Francisco, California. Appellant obtained his seller's permit with an effective start date of December 1, 1989. CDTFA previously audited appellant for the period January 1, 2008, through December 31, 2010.
2. During the liability period, appellant filed sales and use tax returns reporting total sales of \$1,435,091. Appellant claimed deductions of \$1,170,129 for nontaxable labor and \$22,492 for sales tax reimbursement included in reported total sales, which resulted in reported taxable sales of \$242,470. According to CDTFA's audit workpapers, appellant kept handwritten sales journals, which were used to prepare the business's sales and use tax returns.
3. Appellant did not provide a complete set of books and records for the audit. Instead, appellant provided the following: federal income tax returns for 2015, 2016, and 2017; sales journals for the liability period, excluding the first quarter of 2015 (1Q15) and 3Q17; incomplete vehicle repair job folders (job folders) for 3Q16 and 2Q17;<sup>4</sup> and bank statements for the liability period. CDTFA conducted an audit and revised audit of appellant.
4. For the audit, CDTFA compared the gross receipts reported on appellant's federal income tax returns (excluding sales tax reimbursement) to the total sales (excluding sales tax reimbursement) reported on appellant's sales and use tax returns and found no

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<sup>4</sup> Vehicle repair job folders are routinely used by automotive repair shops, and each job folder contains various documents related to a repair job, including but not limited to the repair estimate/repair orders, sales invoice, and associated parts purchase invoices.

differences. However, a comparison of the taxable sales that appellant reported on his sales and use tax returns to the total purchases that appellant reported on his federal income tax returns for the years 2015 through 2017 revealed an overall reported markup of negative 67.61 percent.<sup>5</sup>

5. CDTFA compared the total sales (excluding sales tax reimbursement) of \$1,412,599 that appellant reported on his sales and use tax returns for the liability period to appellant's reported taxable sales of \$242,470 for the liability period to find a taxable sales ratio of 17.16 percent, which CDTFA considered to be low. CDTFA performed a block test to verify appellant's taxable sales ratio.
6. For the revised audit, appellant provided incomplete job folders for 3Q16 and 2Q17. CDTFA compiled the sales invoices included in appellant's job folders and found recorded total sales (excluding sales tax reimbursement) of \$158,526, comprised of nontaxable labor of \$92,265, nontaxable parts sales of \$212, taxable parts sales of \$66,049, and sales tax reimbursement collected of \$6,064. CDTFA compared appellant's recorded taxable sales to appellant's recorded total sales to compute a taxable sales ratio of 41.66 percent ( $\$66,049 \div \$158,526$ ).<sup>6</sup>
7. CDTFA applied the audited taxable sales ratio of 41.66 percent to appellant's reported total sales (excluding sales tax reimbursement) of \$1,412,599 for the liability period to compute audited taxable sales of \$590,038. CDTFA compared audited taxable sales to reported taxable sales and found unreported taxable sales of \$347,568 ( $\$590,038 - \$242,470$ ).
8. Appellant disagreed with the taxable measure, and CDTFA agreed to review appellant's bank statements for 2016 to establish cost of goods sold. CDTFA compiled appellant's bank statements for 2016 and found total recorded parts purchases of \$231,654. CDTFA then used the jobs folders for 3Q16 and 2Q17 to calculate a markup of 42.81 percent by

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<sup>5</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 ( $0.30 \div 0.70 = 0.42857$ ). 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 ( $0.30 \div 1.00 = 0.30$ ).

<sup>6</sup> Initially, appellant did not provide job folders for 3Q16. CDTFA conducted the block test based on appellant's job folders for 2Q17 and calculated a taxable sales ratio of 43.15 percent.

matching the available parts purchase invoices to the available parts sales invoices. Next, CDTFA applied the markup rate to the recorded parts purchases and computed taxable sales of \$330,819 (rounded) for 2016. When compared to appellant's reported taxable sales for 2016 of \$104,075, CDTFA found an error ratio of 217.87 percent for 2016. CDTFA applied the 217.87 percent error ratio to appellant's reported taxable sales and found unreported taxable sales of \$538,360 for the liability period.

9. CDTFA concluded that the markup method results supported that reported taxable sales were understated; however, CDTFA also concluded that the block test of 3Q16 and 2Q17 used the best available information as the basis for determining a taxable sales ratio and establishing audited taxable sales and unreported taxable sales of \$347,568 for the liability period.
10. CDTFA issued the aforementioned NOD to appellant on February 10, 2020, for the liabilities disclosed in the revised audit. Appellant did not timely pay the tax liability or file a petition for redetermination of the NOD before it became final on March 11, 2020 and a finality penalty of \$3,200.40 was imposed pursuant to R&TC section 6565. By letter dated March 20, 2020, appellant filed an untimely petition for redetermination disputing the measure of unreported taxable sales, which CDTFA accepted as an administrative protest of the NOD.
11. On December 18, 2020, CDTFA issued a decision denying appellant's administrative protest.
12. Appellant timely appealed to OTA.<sup>7</sup>
13. During the oral hearing, CDTFA conceded to reduce the taxable measure by \$1,484. This concession is based on a mathematical error on CDTFA's audit schedule 1R-12A, in which CDTFA miscalculated audited taxable sales for 1Q15. The result of CDTFA's concession will reduce the measure of taxable sales by \$1,484 from \$43,137 to \$41,653 for 1Q15.

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<sup>7</sup> Appellant disputed the negligence penalty, finality penalty, and the collection cost recovery fee in his appeal with CDTFA. On appeal, appellant has not raised any contentions or disputed these items with OTA and they will not be discussed further.

## DISCUSSION

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 the audit. For the audit, CDTFA compared appellant's federal income tax returns to its sales and use tax returns and found no difference. Upon further review, CDTFA found other discrepancies that could not be explained. For example, a comparison of appellant's reported taxable sales to the purchases reported on appellant's federal income tax returns revealed a negative book markup. In other words, appellant reported selling tangible personal property at prices below their purchase cost. CDTFA also calculated a taxable sales ratio of 17.16 percent by comparing the reported taxable to total sales reported on appellant's sales and use tax returns. CDTFA noted that appellant's reported taxable sales ratio was low for this type of business. Moreover, the reported taxable sales ratio is directly contradicted by the taxable sales ratio recorded in appellant's job folders for 3Q16 and 2Q17. Upon review of the job folders, CDTFA calculated a taxable sales ratio of 41.66 percent. These discrepancies are sufficient reasons for CDTFA to doubt the accuracy of appellant's reported sales.

When CDTFA cannot compute taxable sales from appellant's records, it is appropriate to use an indirect method. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) To calculate the taxable measure, CDTFA used appellant's job folders for 3Q16 and 2Q17 to calculate a recorded taxable sales ratio of 41.66 percent. CDTFA then applied the recorded taxable sales ratio to appellant's total reported taxable sales to calculate audited taxable sales of \$590,038, which when compared to reported taxable sales reveals that appellant failed to report taxable sales measuring \$347,568. At the oral hearing, CDTFA conceded to an error in the calculation of appellant's audited taxable sales and agreed to a reduction of \$1,484.<sup>8</sup> This will reduce the measure of unreported taxable sales from \$347,568 to \$346,084.

For the revised audit, appellant provided a complete set of bank statements for 2016, from which CDTFA compiled appellant's parts purchases for that year. CDTFA calculated a markup on parts based on a comparison of appellant's available sales and purchase invoices of 42.81 percent. The markup method is a standard and accepted audit procedure. (*Appeal of Amaya*, 2021-OTA-328P.) CDTFA applied the 42.81 percent markup rate to appellant's recorded parts purchases for 2016 to calculate audited taxable sales based on the markup test of \$330,819. When compared to appellant's reported taxable sales for 2016 of \$104,075, CDTFA found an error ratio of 217.87 percent for 2016. CDTFA applied the 217.87 percent error ratio to appellants reported taxable sales for the liability period and found a deficiency measure of \$538,260. This represents an increase of \$190,692 to the taxable measure from the initial audit. Despite this fact, CDTFA did not rely on the revised audit. Instead, CDTFA determined that the initial audit used the best available evidence to calculate appellant's taxable sales. Nevertheless, the revised audit supports a finding that appellant failed to report all of his taxable sales.

Therefore, considering the foregoing, it was reasonable for CDTFA to use appellant's own records (i.e., job folders) and conduct a block test of 3Q16 and 2Q17 to calculate the deficiency measure and the calculation is reasonable. Accordingly, the burden of proof shifts to appellant to show that a reduction to the taxable measure is warranted. (*Appeal of Talavera, supra.*)

On appeal, appellant disputes the taxable sales ratio of 41.66 percent. Appellant asserts that the block test does not accurately account for nontaxable sales such as storage fees, smog

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<sup>8</sup> This reduction results from an inadvertent error in the calculation of audited taxable sales for the first quarter of 2015 from \$43,137 to \$41,653.

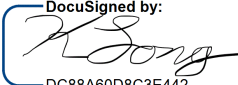
checks, and inspections performed for ride-share services. As such, appellant argues that the block test is not representative of the audit period. In support, appellant provides an incomplete set of invoices and estimates to show that the ratio of nontaxable sales should be reduced. However, appellant has not provided a complete set of invoices for any quarter of the liability period. Further, appellant has not provided any additional invoices from the block test period. As such, OTA cannot determine whether the taxable sales ratio calculated in the block test should be reduced. OTA also cannot evaluate whether the block test is representative of the liability period, because appellant has not provided a complete set of invoices for any quarter during the liability period. As a result, a different taxable sales ratio cannot be calculated. OTA cannot determine from appellant's selective submission that the taxable measure should be reduced beyond the amount conceded by CDTFA. Appellant has not met his burden of proof.

HOLDING

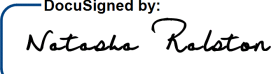
Appellant failed to establish that any further adjustments to the measure of unreported taxable sales are warranted, aside from the measure conceded by CDTFA during the oral hearing.<sup>9</sup>

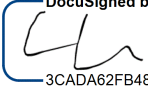
DISPOSITION

Reduce the taxable measure for 1Q15 by \$1,484, as conceded by CDTFA. Otherwise, CDTFA’s decision denying the administrative protest is sustained.

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Keith T. Long  
Administrative Law Judge

We concur:

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Natasha Ralston  
Administrative Law Judge

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Andrew J. Kwee  
Administrative Law Judge

Date Issued: 11/14/2023

<sup>9</sup> See footnote 7, *ante*, page 6.