OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **D. ORDUBADI,** **dba Air 1 Communication**	OTA Case No. 18053164 CDTFA Case ID: 916088

OPINION

Representing the Parties:

For Appellant: D. Ordubadi

For Respondent: Jason Parker, Chief of Headquarters Operations

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

J. ALDRICH, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, D. Ordubadi (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated July 30, 2015. The NOD is for $16,334.88, plus applicable interest, for the period January 1, 2010, through December 31, 2012 (audit period).[2]

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

[1] Sales and use 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 this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

[2] The NOD was timely issued because appellant signed waivers of the otherwise applicable statute of limitations, which extended the period for issuing an NOD until July 31, 2015. (R&TC, §§ 6487(a), 6488.)

ISSUES

1. Whether adjustments are warranted to the audited understatement of reported taxable sales.
2. Whether adjustments are warranted to the disallowed claimed nontaxable labor charges.

FACTUAL FINDINGS

1. Appellant began operating as a retailer of automobile accessories, such as stereos, televisions, alarm systems, and sound systems, on July 1, 1992. Appellant also installed automobile accessories and provided a service of tinting car windows.
2. Appellant reported her sales on an annual basis. During the audit period, appellant reported total sales of $377,347, claimed deductions of $360,849 for nontaxable labor and $1,271 for sales tax reimbursement included in reported total sales, which resulted in reported taxable sales of $15,227.
3. For audit, appellant provided her federal income tax returns (FITRs), sales and use tax returns, monthly sales journals, bank statements for the audit period, purchase invoices, and sales invoices for January 2012 and June 2012. Appellant reported merchandise purchases of $185,563 on her FITRs for the audit period.[3] CDTFA considered appellant's reported taxable sales of $15,227 to be unreasonable since her merchandise purchases substantially exceeded taxable sales. Also, CDTFA analyzed appellant's purchases as reported on her FITRs, which rendered a negative markup of 91.79 percent. CDTFA decided that further investigation was warranted.
4. Based on its examination of appellant's sales journals, in which transactions were segregated into two categories, "Sales and Services" and nontaxable "Sales for Resale," CDTFA accepted appellant's recorded nontaxable sales for resale. However, CDTFA found that appellant's "Sales and Services" category included nontaxable sales of labor and taxable sales.
5. CDTFA compiled appellant's sales invoices for June 2012, and computed total sales of $19,048, which exceeded the total sales recorded in appellant's sales journal for that month by $1,777, representing a recording error rate of 10.29 percent. CDTFA applied

[3] CDTFA found that the reported purchases included personal purchases, but CDTFA was unable to segregate purchases due to the lack of detail provided by appellant.

the recording error rate to "Sales and Services" of $297,879 recorded in the sales journals for the audit period to establish audited labor and retail sales of $328,531. CDTFA determined that 65.60 percent of the recorded transactions represented charges for labor and 34.40 percent represented taxable retail sales based on appellant's June 2012 sales invoices. Accordingly, CDTFA applied 65.60 percent to audited labor and retail sales to calculate total nontaxable labor and then subtracted that amount from audited labor and retail sale to calculate audited taxable sales (labor of $215,935, and audited taxable sales of $112,596). Audited taxable sales of $112,596 exceeded appellant's reported taxable sales of $15,227 for the audit period by $97,369.

6. Regarding appellant's claimed nontaxable labor charges, CDTFA examined appellant's sales invoices for January 2012 and June 2012, which showed total recorded nontaxable labor charges of $15,288. Based on its examination, CDTFA found that appellant had erroneously recorded 63 transactions as nontaxable sales of labor even though appellant had sold tangible personal property as all or as part of the transactions. CDTFA computed a total sales price of $7,395 for the tangible personal property included in the 63 transactions, which represented an error rate of 48.37 percent ($7,395/$15,288). CDTFA applied the error rate to appellant's labor charges of $215,935 for the audit period, which resulted in disallowed claimed nontaxable charges for labor of $104,448.
7. The NOD issued to appellant on July 30, 2015, is based on unreported taxable sales of $97,369 and disallowed claimed nontaxable charges for labor of $104,448.
8. Appellant timely filed a petition for redetermination disputing the entire liability.
9. CDTFA contacted appellant to discuss her appeal and to request additional documentation. Appellant provided sales invoices from October 2010 and November 2011 for examination. However, CDTFA questioned the reliability of these sales invoices after it found that they did not contain any of the errors reflected in the sales invoices for January 2012 and June 2012 (e.g., lump sum charges). CDTFA called customers whose phone numbers were shown on the sales invoices, and left messages to call back. One of the customers called back and informed CDTFA that he had paid appellant $1,200 in cash for the purchase and installation of several automobile accessories. Because the invoice to that customer showed a cash sale of $60 instead of

$1,200, CDTFA determined that the invoices for October 2010 and November 2011 were not sufficiently reliable to warrant any adjustments to the audit liability.

10. CDTFA held an appeals conference with appellant on October 4, 2017. At the conference, appellant provided sales invoices for January 2012 with a request that those invoices be included with the sales invoices for June 2012 in the computation of the audited recording error rate and the audited ratios of labor charges and taxable sales to total sales. However, CDTFA noted that some of the sales invoices appellant provided at the appeals conference had been altered from the versions appellant originally provided. For example, while several of the original invoices lacked line-item descriptions of the items being sold, the new versions contained line-item descriptions indicating that the transactions were nontaxable. Additionally, while customers were billed on a lump-sum basis in the original invoices, the new invoices showed separate charges for tangible personal property and for nontaxable labor. Therefore, CDTFA found that the invoices provided at the appeals conference were not sufficiently reliable to be used in reaudit computations.

11. On January 30, 2018, CDTFA issued a Decision denying the petition for redetermination in full. This appeal to the Office of Tax Appeals (OTA) followed.

DISCUSSION

Issue 1: Whether adjustments are warranted to the audited understatement of reported taxable sales.

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.) When sales tax does not apply, 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.) 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.) If CDTFA meets 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, the merchandise purchases of $185,563 reported on appellant's FITRs substantially exceeded her reported taxable sales of $15,227 for the audit period. Also, CDTFA's analysis rendered a negative markup of 91.79 percent. When CDTFA examined appellant's sales invoices for June 2012, it found that the amount of sales shown in the invoices exceeded the amount of sales recorded in appellant's sales journal for that month. Given this discrepancy in appellant's records, OTA finds that it was reasonable and rational for CDTFA to project the results of its tests of the available sales invoices for June 2012 to establish audited taxable sales. Therefore, the burden shifts to appellant to establish by documentation or other evidence that a reduction to the amount of unreported taxable sales is warranted.

Although appellant attempted to satisfy her burden by providing another set of January 2012 sales invoices for inclusion in the audit tests, CDTFA asserts that the newly provided invoices were altered and were not the same as the invoices originally examined during the audit. CDTFA and OTA provided appellant with an opportunity to explain the differences between the two sets of invoices, but appellant failed to do so. Hence, OTA finds that the sales invoices appear to have been altered; and thus, are not sufficiently reliable to be included in the audit tests.

OTA has examined the audit computations and procedures and has found no errors, other than CDTFA's failure to assess use tax on the cost of the window tinting materials, which

benefits appellant.[4] In the absence of sufficient documentation to support a reduction to the amount of unreported taxable sales, OTA concludes that no adjustment is warranted.

Issue 2: Whether adjustments are warranted to the disallowed claimed nontaxable labor charges.

Persons engaged in the business of rendering service are consumers, not retailers, of the tangible personal property which they use incidentally in rendering the service. (Cal. Code Regs., tit. 18, § 1501.) Tax, accordingly, applies to the sale of the property to them. (*Ibid.*) If in addition to rendering service they regularly sell tangible personal property to consumers, they are retailers with respect to such sales and they must obtain permits, file returns and remit tax measured by such sales. (*Ibid.*)

The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. (*Culligan Water Conditioning v. State Bd. of Equalization* (1976) 17 Cal.3d 86, 96; *Appeal of Thomas Conglomerate*, 2021-OTA-030P.) If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred. (*Ibid.*) However, when a transaction is regarded as a sale of tangible personal property, tax applies to the gross receipts from the furnishing thereof, without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property. (Cal. Code Regs., tit. 18, § 1501.)

Here, CDTFA's examination of appellant's sales invoices for January 2012 and June 2012 showed that appellant had erroneously recorded 63 transactions as nontaxable labor charges even though appellant had sold tangible personal property as all or as part of the transactions. The January 2012 invoices are for the period that immediately followed the end of the audit period, and the June 2012 invoices (i.e., six months later) were still relatively recent. OTA finds that it was reasonable and rational for CDTFA to apply the error rate computed from

[4] Regarding the window tinting performed by appellant, appellant is regarded as the consumer of the materials used in providing the window tinting service, and therefore, sales of window tinting materials are not included in audited taxable sales. (Cal. Code Regs., tit. 18, § 1546; see also CDTFA's Sales and Use Tax Annotation 315.0330 (08/25/91).) The audit comments, however, indicate that appellant purchased the window tinting materials without the payment of tax, and therefore, owes use tax on the cost of the materials. CDTFA did not assess use tax on those costs in the audit.

its examination to appellant's labor charges for the audit period to establish disallowed claimed nontaxable charges for labor.

On appeal, appellant contends that her business primarily is focused on providing installation labor and tinting windows. Appellant states that generally, customers bring their own equipment for installation into their automobiles. Because providing labor was a substantial portion of her business, appellant believes that the amounts she claimed as deductions for nontaxable labor are accurate. In support, appellant provided the sales invoices for January 2012 with her request that they be re-examined.

Appellant's argument that the business primarily was focused on providing installation labor is unsupported by the evidence. OTA notes that appellant reported merchandise purchases of $185,563 on her FITRs, which indicates that sales of tangible personal property represented a significant portion of appellant's business. Moreover, in CDTFA's test of appellant's sales invoices for January 2012 and June 2012, CDTFA only disallowed those portions of appellant's claimed nontaxable sales attributable to sales of tangible personal property, and those charges for which no description of the transaction was included on the sales invoice. Because all of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise (R&TC, § 6091), OTA finds that it was reasonable for CDTFA to conclude that tax applied to the sale prices shown on sales invoices that were missing descriptions of the transactions. The second set of January 2012 sales invoices that appellant provided were found to be unreliable because they appeared to have been altered in appellant's favor, in part, by the addition of line-item descriptions to sales invoices that previously were lacking descriptions. OTA finds that the new descriptions added to the January 2012 invoices lack credibility, and concludes that the original, unaltered sales invoices provided for examination during the audit represent the best available evidence of appellant's sales during the audit period.

Based on OTA's finding that appellant has failed to provide any reliable documentation or other competent evidence from which a more accurate determination may be made, OTA concludes that no reduction to the amount of disallowed claimed nontaxable sales of labor is warranted.

HOLDINGS

1. Appellant has failed to establish that a reduction to the amount of unreported taxable sales is warranted.
2. Appellant has failed to establish that a reduction to the amount of disallowed claimed nontaxable sales of labor is warranted.

DISPOSITION

CDTFA's action in denying the petition for redetermination is sustained.

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
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Keith T. Long
Administrative Law Judge

DocuSigned by:
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Teresa A. Stanley
Administrative Law Judge

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