

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 20086569
PETER MARCO, LLC,)	CDTFA Case ID: 298-763
dba Peter Marco)	
)	
)	
)	

OPINION

Representing the Parties:

For Appellant:	Peter Voutsas, Owner Michael Shaff, Attorney Shirin Husnani, Accountant
For Respondent:	Jarrett Noble, Attorney Cary Huxsoll, Attorney Jason Parker, Chief of Headquarters Ops.

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Peter Marco, LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on June 4, 2018. The NOD is for tax of \$1,334,795, plus applicable interest, for the period July 1, 2013, through June 30, 2016 (liability period). During this appeal, CDTFA considered additional documentation and now concedes that the understated taxable measure should be reduced by \$12,052,602 from \$14,831,062 to \$2,778,460.

Office of Tax Appeals (OTA) Administrative Law Judges Josh Aldrich, Teresa A. Stanley, and Keith T. Long held an oral hearing for this matter in Cerritos, California, on October 10, 2023. At the conclusion of the oral hearing, the record was held open for the parties to submit additional briefing. Thereafter, the record was closed, and this matter was submitted

¹ 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.

on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

ISSUE

Whether additional adjustments are warranted to the measure of unreported sales subject to use tax.

FACTUAL FINDINGS

1. Appellant operates a high-end jewelry store in Beverly Hills, California. Appellant obtained a seller's permit with CDTFA effective March 15, 2010.
2. During the liability period appellant filed sales and use tax returns reporting total sales of \$20,507,385, and claimed nontaxable sales of \$19,540,713, resulting in reported taxable sales of \$966,672. Appellant's claimed nontaxable sales include the following: nontaxable sales for resale of \$1,253,164; nontaxable sales in interstate commerce of \$18,226,562; nontaxable labor sales of \$51,642; and "other" deductions of \$9,345 (consisting of shipping, freight, and miscellaneous items including gem certifications).
3. For the audit, appellant did not provide a complete set of books and records. Instead, appellant provided federal income tax returns for 2013 through 2015; sales and use tax returns; sales invoices and shipping documents for the third quarter of 2013 (3Q13), 4Q14, 3Q15, 4Q15, and 2Q16; bank statements and deposited check copies for the liability period.
4. CDTFA compared appellant's federal income tax returns to appellant's sales and use tax returns. The gross receipts recorded on appellant's federal income tax returns exceeded appellant's reported taxable sales by \$389,945 in 2013, \$1,621,744 in 2014, and \$982,918 in 2015. CDTFA determined that these differences represent unreported taxable sales of \$2,841,320. CDTFA added the unreported taxable sales to reported taxable sales to calculate audited taxable sales for the liability period of \$23,348,705.
5. A comparison of the gross receipts and the cost of goods sold reported on appellant's federal income tax returns revealed markups of 12.81 percent for 2013, 5.6 percent for

2014, and 16.67 percent for 2015.² CDTFA noted that appellant's reported markup was inconsistent from year to year.

6. To verify appellant's claimed nontaxable sales in interstate commerce, CDTFA performed a test of appellant's sales invoices for 3Q13, 4Q14, 3Q15, and 2Q16. Appellant's sales invoices were non-sequential and handwritten. As a result, appellant's sales invoices were incomplete and inadequate for testing nontaxable sales in interstate commerce.
7. CDTFA scheduled appellant's total bank deposits of \$27,490,575 for the period 3Q13 through 2Q16, including: non-electronic (i.e., cash and check) deposits of \$11,390,699; credit card deposits of \$8,987,741; and wire transfer deposits of \$6,980,685. CDTFA reconciled appellant's bank deposits to appellant's sales and use tax returns finding that any differences were supported by documentation.
8. CDTFA scheduled the deposited check copies, revealing sales paid by check of \$10,731,424 for the period 3Q13 through 2Q16 (the test period). CDTFA compared the total non-electronic deposits recorded in appellant's bank statements of \$11,390,699 and the deposits recorded in appellant's check copies of \$10,731,424 and found a difference of \$659,275. However, CDTFA noted that this difference was only 1 percent of the non-electronic deposits and was therefore immaterial and allowed the full amount as sales in interstate commerce. Using the deposited check copies, CDTFA also determined that appellant made sales of \$7,260,656 to known California residents, which were subject to use tax under R&TC section 6247. Appellant's audited sales to known California residents were 67.66 percent of the total deposited check copies ($\$7,260,656 \div \$10,731,424$).
9. CDTFA applied the 67.66 percent rate to audited taxable sales of \$23,348,705 for the liability period and found audited sales of \$15,797,734 to known California residents

² "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 ($0.30 \div 1.00 = 0.30$).

subject to use tax. CDTFA reduced this amount by reported taxable sales of \$966,672 for the liability period to find a deficiency measure of \$14,831,062.

10. On June 4, 2018 CDTFA issued the NOD.
11. Appellant filed a timely petition for redetermination.
12. On August 6, 2019, CDTFA issued a decision ordering a reaudit to recalculate the 67.66 percent ratio of sales to known California residents by excluding the following:
 - a. Specifically identified sales that CDTFA determined were unreasonably included in the measure because they were paid by cashier's check, and there was no additional information that would support a conclusion that the purchaser was a California resident that CDTFA determined were unreasonably included in the measure;
 - b. Sales paid by cashier's check, which CDTFA included in the taxable measure based solely on the customer's possession of a telephone number with a California area code; and
 - c. Five sales, which were to be removed from the taxable measure because appellant provided sufficient evidence that those sales were nontaxable sales in interstate commerce.

CDTFA ordered the recalculated ratio of sales to known California residents be applied to audited taxable sales to recompute the measure of unreported taxable sales to known California residents subject to use tax.

13. CDTFA performed a first and second reaudit to address the changes required by its decision. The reaudits reduced the taxable measure from \$14,831,062 to \$10,229,032.
14. By letter dated June 17, 2020, CDTFA informed appellant of the reaudit results. This timely appeal followed.
15. During the appeal to OTA, appellant provided additional documentation, which caused CDTFA to perform further reaudits. Appellant's documents include customer forms, which state, "Quality Export Sales Tax Exemption for California" and contain standardized language regarding the sale and delivery of merchandise.³ Specifically, CDTFA performed reaudits to reduce the ratio of sales to known California residents from the 67.66 percent calculated during the original audit to 16.04 percent, which

³ The relevant form language is discussed in greater detail below.

CDTFA calculated during the sixth reaudit. The sixth reaudit reduced the measure of sales made to known California residents subject to use tax at issue in this case to \$2,778,460.

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).)

The law creates a presumption that tangible personal property delivered outside this state to a person known by the retailer to be a California purchaser was purchased for storage, use, or consumption in this state. (R&TC, § 6247.) Objective indications of California residency include the maintenance of a family home in California, California bank accounts or business interests, California voting registration, the possession of a California driver's license, or the ownership of California real property. (*Appeal of Holiday World* (SBE Memo.) 2001 WL 1034735.)⁴ The retailer may rebut this presumption by taking a statement signed by the purchaser at the time of the sale that the property was purchased for use at a designated point outside this state. (R&TC, § 6247.) The use tax is imposed on the purchaser. (R&TC, § 6202.) A retailer engaged in business in this state must collect the use tax from the purchaser and remit it to the state. (R&TC, § 6203(a).)

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

⁴ A Memorandum Opinion is a precedential opinion adopted by OTA's predecessor, the Board of Equalization, that contains the findings of fact and conclusions of law that form the basis of the board's decision on an appeal. (R&TC § 40(d); Cal. Code Regs. tit. 18, § 5511(r), (w).)

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. CDTFA compared the gross receipts reported on appellant's federal income tax returns to the taxable sales reported on appellant's sales and use tax returns and found discrepancies, which could not be explained. Next, CDTFA tested appellant's sales invoices for the periods 3Q13, 4Q14, 3Q15 through 2Q16. However, CDTFA found that the sales invoices were incomplete and the claimed nontaxable sales in interstate commerce could not be verified. When CDTFA cannot compute taxable sales directly 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 reviewed copies of deposited checks and found that they substantially reconciled with appellant's bank statements. CDTFA's review also revealed that appellant made sales to known California residents, which were delivered outside of this state. Absent substantiating documentation that appellant's sales were intended for use outside of California, it was reasonable and rational for CDTFA to presume that appellant's sales were subject to the use tax. Upon reaudit, CDTFA removed certain transactions including those which it deemed to be based on an unreasonable audit method. For example, CDTFA excluded sales paid by cashier's checks when there was supporting documentation that the item was shipped out of state but no information such as a California address to support whether the purchaser was a California resident. CDTFA also excluded sales where the only basis for determining residency was the possession of a California telephone number.⁵ Moreover, CDTFA reduced the ratio of sales to known California residents subject to use tax pursuant to R&TC section 6247 where appellant provided additional substantiating documentation.

However, CDTFA did not remove the transaction identified on line 101⁶ for \$190,000 during the sixth reaudit. According to the audit workpapers, this sale was paid by a cashier's

⁵ Regarding telephone numbers, CDTFA's decision states in part "Unlike addresses, it may not be obvious to a retailer that an area code identifies a specific geographic area within California ... Further, in modern society, it is not unusual for a former California resident, who obtained a cellular telephone number listing a California area code, to move out of state while retaining the same telephone number, including area code."

⁶ Appellant refers to each transaction identified in the sixth revised audit schedule R6-12D by line number. Thus, to avoid confusion, OTA also refers to the transaction line number rather than the customer's name.

check issued by a California bank. In addition, there does not appear to be any dispute that the tangible personal property associated with this sale was shipped out of state. For example, CDTFA's sixth reaudit indicates that the tangible personal property was shipped to LJ West in New York by third party carrier. This is corroborated by a sworn statement provided by appellant's accountant, Shirin Husnani, which also indicates that appellant's customer was a Washington resident. As discussed in CDTFA's own decision "[i]t would not be feasible to expect that, at the time of sale, the sole fact that a customer paid for a sale with a cashier's check, regardless of whether or not it was obtained from a California bank branch, constitutes an indication to [appellant] that a customer was a known California resident when [CDTFA's] own audit methods demonstrate it was equally unsure in some cases." Considering the foregoing, CDTFA could not have reasonably concluded that the purchaser was a known California resident at the time of sale.

Therefore, OTA removes this sale for \$190,000 from the measure of disallowed claimed nontaxable sales during the test period. Based on this, CDTFA must recompute the ratio of sales to known California residents, which was calculated during the sixth reaudit. CDTFA must also adjust the taxable measure accordingly. Otherwise, each reaudit reduced the taxable measure based on the additional records provided by appellant, and the results appear to be reasonable. Thus, the burden of proof shifts to appellant to establish that a reduction is warranted. (*Appeal of Talavera, supra.*)

On appeal, appellant asserts that the taxable measure should be reduced. Appellant contends that the sixth reaudit includes 33 sales that should be allowed as nontaxable sales in interstate commerce. Appellant refers to each transaction by the reference line on which it appears in CDTFA's sixth reaudit workpapers schedule R6-12D.

First, appellant contends that the transaction recorded on line 16 represents a sale made to a California resident but shipped to a non-resident in California. Appellant asserts that the transactions identified on lines 20, 31, 37, 52, 53, 59, 65, 67, 70, 75, 124, 140, 145, 153, 156, and 169 were shipped out of state and are therefore validly claimed nontaxable sales in interstate commerce. Appellant asserts that several transactions identified sales that were paid by installment, including the following: the transactions identified on lines 24, 32, and 35; the transactions recorded on lines 19, 22, 29, and 42; the transactions identified on lines 27 and 34; the transactions identified on lines 33, 41, and 43; the transactions identified on lines 46 and 47;

the transactions identified on lines 66, 84, and 88; the transactions identified on lines 77 and 89; the transactions identified on lines 91, 92, 93, and 94; the transactions identified on lines 100, 104, 107, 111, 123, 137, 146, 170, and 177; the transactions identified on lines 127, 138, 143, 144, and 148;⁷ the transactions identified on line 154, 158, and 161, and 162; and the transactions identified on line 166, 167, and 168.

Appellant asserts that the transactions identified above are nontaxable sales that were erroneously disallowed for various reasons. For example, appellant argues that a customer might delay shipping if they were only visiting the area and needed to return home before delivery. Another example provided by appellant is that a shipment might be delayed if custom work was required. However, appellant's contentions are irrelevant with respect to whether there is a tax liability for the transaction. In each of these cases, CDTFA found that the purchaser was a known California resident because payment was made with a check bearing a California address. Possession of a California bank account is an objective indicator of residency in this state. (*Appeal of Holiday World, supra.*) Because this evidence indicates that the purchaser was a California resident, it is presumed that the purchase is for storage, use, or other consumption in this state even though the item was delivered out of state. (R&TC § 6247.) To overcome this presumption, appellant was required to take a statement signed by the purchaser at the time of the sale that the property was purchased for use at a designated point outside this state. (*Ibid.*)

During this appeal, appellant provided delivery instructions for out-of-state mailing forms for each sale. Each form contains the statement "Quality Export Sales Tax Exemption for California," and the following language:

For valuable consideration, the receipt and sufficiency of which is acknowledged, Peter Marco (Seller) and _____ (Buyer) agree that:

1. Buyer agrees to purchase _____ from Seller but only if delivery of such goods is made by seller to Buyer at above address
2. The sale is not made until Seller delivers such goods to Buyer at the above destination
3. The Risk of Loss is on the seller prior to delivery to Buyer at the above destination
4. It is the parties' intent, and the actuality, that title to and ownership of the goods does not pass to Buyer until delivery to buyer at the above destination

⁷ With respect to this sale, appellant asserts that its customer made a purchase which was shipped on August 5, 2013. Appellant asserts that it received checks written in 2013, but that the "13" was hastily written. Instead of 2013, the audit workpapers indicate that these checks were written in 2015. Appellant asserts that this is an error. However, OTA's review of these checks reveal that they were written and deposited in 2015. Thus, OTA finds no error by CDTFA with respect to this sale. Regardless, the date on these checks has no bearing on OTA's finding of whether this sale is subject to tax.

5. Buyer agrees to pay any Sales, Use, or other tax imposed by the state of the above destination and further agrees to indemnify Seller from having to pay same

OTA notes that, when the form is completed, the sale and purchase of tangible personal property is conditioned upon delivery outside of this state. On the other hand, the form does not contain language that the tangible personal property is intended for use outside of California.

Regardless, OTA need not determine whether this form's language meets the requirements of R&TC section 6247 because none of the relevant form language (as outlined above) was completed at the time of sale in any of the disputed transactions.

Next, appellant contends that the transaction identified on line 105 represents a refund of appraisal charges by the Gemological Institute of America, not a sale. However, appellant has not provided any evidence that this was not a sale. Similarly, appellant asserts that the transaction identified on line 74 was not a sale of tangible personal property, but instead a repair. In support of this contention, appellant provided an invoice and shipping label. The invoice describes a purchase of "Custom Rose Gold Dia Hoop Earrings" for \$3,000. There is no indication that the transaction is a repair rather than a purchase. Thus, appellant has not provided sufficient evidence to support the finding that this transaction represents a nontaxable repair.


In summary, OTA finds that a further reduction to the audited measure of unreported taxable sales is warranted. The transaction identified on line 101 of the sixth reaudit schedule R6-12D in the amount of \$190,000 must be removed from the measure of disallowed claimed nontaxable sales during the test period. CDTFA is directed to recalculate the ratio of sales to known California residents and the taxable measure. Otherwise, appellant has not met its burden of proving that further reductions are warranted.

HOLDING

A reduction to the measure of tax calculated during the sixth reaudit is warranted to reduce the measure of sales to known California residents during the test period by \$190,000 and recalculate the ratio of sales to known California residents.

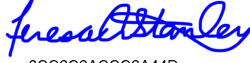
DISPOSITION

Reduce the measure of sales to known California residents during the test period as calculated in the sixth reaudit by \$190,000, recalculate the ratio of sales to known California residents, and apply the revised ratio to recalculate the taxable measure for the liability period. Otherwise, CDTFA’s decision to deny the petition for redetermination is sustained.


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Keith T. Long
Administrative Law Judge

We concur:

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0CC6C6ACCC6A44D...

Teresa A. Stanley
Administrative Law Judge

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Josh Aldrich
Administrative Law Judge

Date Issued: 3/20/2024