OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 220610522
	CDTFA Case ID 2-050-621
NTENSE, INC.	

OPINION

Representing the Parties:

For Appellant:	Imad A. Hararah
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

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, NTENSE, Inc. (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 October 23, 2020.[2] The NOD is for tax of $13,461, and applicable interest, for the period April 1, 2016, through March 31, 2019 (audit period). On appeal, CDTFA agrees to relieve interest for October 2019 and March through September 2020.[3]

[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 on December 31, 2019, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period April 1, 2016, through June 30, 2017, which allowed CDTFA until October 31, 2020, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

[3] In response to appellant's request for interest relief, CDTFA agreed to relieve interest for October 2019, May 2020, July 2020, August 2020, and September 2020. CDTFA also granted automatic interest relief for COVID-19 impacted months, which are March 2020, April 2020, and June 2020.

Office of Tax Appeals (OTA) Administrative Law Judges Josh Lambert, Michael F. Geary and Sheriene Anne Ridenour held a virtual hearing for this matter on February 23, 2024. At the conclusion of the hearing the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether adjustments to the amount of unreported taxable sales are warranted.
2. Whether additional interest should be relieved.

FACTUAL FINDINGS

1. Appellant, a corporation, operated an auto repair shop with a smog check station located in San Francisco, California. Appellant's seller's permit opened with an effective start date of June 13, 2012.
2. For the audit period, appellant reported on its sales and use tax returns (SUTRs) total sales of $1,013,379, claiming deductions of $82,033 for nontaxable labor in the first quarter 2019 (1Q19), and $11,610 for sales tax reimbursement included in reported total sales in the 2Q18 and 4Q18 combined, resulting in reported taxable sales of $919,736. For the SUTRs applicable to the quarters other than those noted above, appellant's reported total sales and taxable sales were the same.
3. For the audit period, appellant used an auto parts sales software system to prepare estimates and invoice customers, and summarized the sales in worksheets (sales worksheets) used to prepare the SUTRs.
4. For audit, appellant did not provide complete sales source documents and invoices/journals for sales and purchases. Appellant provided federal income tax returns (FITRs) for 2017 and 2018; sales worksheets for the audit period; sales invoices for November 1, 2017, through November 30, 2017; and merchandise purchase invoices for November 1, 2017, through November 30, 2017.[4]
5. CDTFA compared taxable sales appellant reported on the SUTRs for 2017 and 2018 to the corresponding cost of goods sold (COGS) appellant reported on the FITRs, and

[4]Appellant asserts that CDTFA did not examine or request data from appellant's point of sale (POS) system. CDTFA asserts that appellant did not provide a POS download with all folders for the audit period. During the hearing, appellant stated that it could provide the POS data, but that it was not provided because CDTFA's audit does not have credibility.

computed book markups of 17.97 percent for 2017; 21.85 percent for 2018; and 19.89 percent for the two years combined.[5] Based on its experience in audits of similar businesses in appellant's area, CDTFA considered these SUTR book markups to be inadequate for appellant's business.[6]

6. Using the sales worksheets for the audit period, CDTFA compiled recorded sales tax reimbursement and taxable sales. CDTFA compared the recorded taxable sales from the sales worksheets to the reported taxable sales and noted the reported taxable sales exceeded the recorded taxable sales by $1,490 for 1Q17, $1,421 for 2Q17, and $29,267 for 4Q18, which appellant asserted were due to clerical errors. CDTFA also found that appellant did not record all its sales invoices in the sales worksheets for the audit period, averaging 100 missing per month.

7. CDTFA concluded additional testing was needed and decided to verify appellant's sales using the markup method.[7] Using sales invoices and merchandise purchase invoices appellant provided for November 2017, CDTFA completed a shelf test[8] and computed an audited markup of 50.67 percent.[9]

8. Appellant later provided copies of sale invoices, purchase invoices, and sales worksheets for October 2017, November 2017, December 2017, and January 2018. CDTFA did not perform a reconciliation of gross receipts reported on the FITRs to the corresponding total sales reported on the SUTRs because appellant reported only taxable sales on most of its SUTRs. CDTFA found 298 missing sales invoices for 4Q17 and another

[5] "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 markup amount divided by cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

[6] In its decision, CDTFA states that it expected to find a 30 percent to 80 percent markup for appellant based on CDTFA's experience auditing comparable businesses in appellant's area.

[7] CDTFA's Assignment Activity History entry for July 2, 2019, states: "Audit Note: Met with [C.] Leung. Reviewed records. Discussed mark-up method and preliminary findings."

[8] A shelf test is an accounting comparison of costs and selling prices used to compute markups.

[9] CDTFA noted two sales invoices where appellant did not charge the customer for an auto part. CDTFA concluded that appellant would owe use tax on the cost of these parts. CDTFA considered the amounts immaterial and did not compute a separate measure for self-consumed taxable merchandise in the audit. CDTFA advised appellant that merchandise withdrawn from resale inventory for use or given away is subject to use tax on the cost and should be reported in the future.

43 invoices were issued out of sequential order without explanation. CDTFA determined that the January 2018 purchase invoices did not include those from Worldpac, a major supplier of appellant, and that 10 sales invoices were missing from the sales worksheet for January 2018.

9. CDTFA also determined that using the records provided for the period October through December 2017 resulted in a higher markup than the audited markup using records from November 2017. According to the audit workpapers, appellant agreed to not expand the shelf test beyond November 2017.

10. CDTFA concluded that the best evidence of merchandise purchases was the FITRs. Using COGS reported on the 2017 FITR, CDTFA deducted supplies and tools to compute COGS of merchandise.[10] Based on the markup of 50.67 percent, CDTFA computed audited taxable sales of $375,864 for 2017. Upon comparison to reported taxable sales of $316,223, CDTFA computed unreported taxable sales of $59,641 for 2017. CDTFA also computed an error ratio[11] of 18.86 percent for 2017.

11. Using purchases reported on the 2018 FITR,[12] CDTFA deducted supplies and tools to compute cost of merchandise. Based on the markup of 50.67 percent, CDFTA computed audited taxable sales of $369,285 for 2018. Upon comparison to reported taxable sales of $321,759, CDTFA computed unreported taxable sales of $47,526 for 2018. CDTFA also computed a percentage of error of 14.77 percent for 2018. For 2017 and 2018 combined, CDTFA computed an error ratio of 16.80 percent.

12. CDTFA multiplied reported taxable sales for April 1, 2016, through December 31, 2017, by the 2017 error ratio of 18.86 percent. CDTFA multiplied reported taxable sales for 2018 by the 2018 error ratio of 14.77 percent. CDTFA multiplied reported taxable sales for January 1, 2019, through March 31, 2019, by the combined error ratio of 16.80 percent. In total, CDTFA computed unreported taxable sales of $158,743 for the audit period.

[10] Appellant provided details of supplies and tools purchases for 2017 and 2018, and CDTFA concluded that the items and amounts were reasonable.

[11] The "error ratio" is the percentage of unreported taxable sales to reported taxable sales.

[12] CDTFA decided to use reported purchases rather that COGS for 2018 because appellant did not report an ending inventory amount, and CDTFA concluded that COGS would be overstated because appellant would likely have some inventory on-hand at the end of 2018.

13. Based on the audit, CDTFA issued the above-mentioned NOD to appellant.
14. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
15. CDTFA issued a decision on April 25, 2022, denying the petition.
16. Appellant timely appealed to OTA.
17. On appeal, appellant submitted a written request signed under penalty of perjury for relief of all interest. CDTFA agreed to relieve interest for October 2019 and March through September 2020, but denied relief for remaining interest.

DISCUSSION

Issue 1: Whether adjustments to the amount of unreported taxable sales are warranted.

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.) Gross receipts do not include the price received for labor or services used in installing or applying the property. (R&TC, § 6012(c)(3).)

If the retail value of tangible personal property (typically, parts and materials) furnished in connection with repair work is more than 10 percent of the total charge, the repairperson is the retailer of the property furnished in connection with repair work and tax applies to the fair retail selling price of the property.[13] (Cal. Code Regs., tit. 18, § 1546(b)(1).) Under such circumstances, the repairperson must separately state on the invoice to the customer (and in the repairperson's records) the fair retail selling price of the parts and materials supplied and the labor charges for repair, installation, or other services performed. (*Ibid*.) Furthermore, all work performed by automotive repairpersons must be recorded on an invoice that separately lists labor charges, charges for tangible personal property, and the charge for sales tax reimbursement, and a copy of the invoice must be given to the customer. (Bus. & Prof. Code, § 9884.8.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts

[13] If the repairperson makes a separate charge for such property, tax applies regardless of whether the retail value of the property exceeds 10 percent of the total charge for the repair. (Cal. Code Regs., tit. 18, § 1546(b)(1).)

and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When 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*.) To satisfy its burden of proof, a taxpayer must prove both: (1) that the tax assessment is incorrect, and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.)

For the audit period, appellant did not provide a complete set of sales source documents or invoices/journals for sales and purchases. CDTFA was unable to compare reported total sales to gross receipts reported on the FITRs because appellant reported only taxable sales on its SUTRs until the last quarter of the audit period but reported all sales on its FITRs for 2017 and 2018. CDTFA also found discrepancies between reported taxable sales and appellant's sales worksheets, so CDTFA could not verify that all sales were recorded on the sales worksheets.[14] CDTFA also found that, when compared to similar businesses in appellant's area, appellant's book markups were lower than CDTFA expected, based on a comparison of taxable sales reported on the SUTRs for 2017 and 2018 to the corresponding COGS reported on the FITRs. Therefore, it was reasonable for CDTFA to question reported sales and use an indirect audit method as the basis for its determination.

CDTFA completed a shelf test using sales and purchase invoices appellant provided for November 2017, and computed an audited markup of 50.67 percent. Appellant argues that the markup method cannot be used because appellant's books and records are accurate and should be relied upon. However, as noted above, appellant's records are incomplete, and the sales worksheets are unreliable. Regardless, when books and records are provided, CDTFA may determine the amount of tax due based upon any available information, even if such books and

[14] CDTFA found that appellant did not record all its sales invoices in the sales worksheets for the audit period, averaging 100 missing per month.

records are comprehensive and internally consistent. (See R&TC, § 6481; *Riley B's, Inc. v. Bd. of Equalization* (1976) 61 Cal.App.3d 610, 614-615.) In addition, the markup method is a recognized and standard accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) Here, CDTFA relied on appellant's own records for November 2017 in calculating the audited markup, and appellant agreed not to expand the shelf test. Therefore, OTA finds that CDTFA met its initial burden to show that its determination was reasonable and rational, and the burden of proof shifts to appellant to show errors in the audit.

Appellant asserts that it could provide the missing Worldpac invoices but contends that providing the invoices would not be helpful because the audit lacks credibility. Appellant argues that the audit lacks credibility because the markup method was used to frivolously increase the hours logged by CDTFA's auditor, and the hours logged do not correspond to the amount of work required.[15] However, OTA found that CDTFA's determination was reasonable and rational, and appellant does not provide any arguments or evidence establishing that CDTFA made errors in its determination. Therefore, appellant has not met its burden to show that adjustments to the amount of unreported taxable sales are warranted.

Issue 2: Whether additional interest should be relieved.

There is no statutory right to interest relief. The law allows CDTFA, in its discretion, to grant relief of all or any part of the interest imposed on a person under the Sales and Use Tax Law in certain circumstances including, as relevant here, where the failure to pay the tax was due in whole or in part to an unreasonable error or delay by an employee of CDTFA acting in their official capacity. (R&TC, §§ 20, 6593.5(a)(1).) An unreasonable error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) When reviewing a denial of a request for interest relief, OTA generally examines the record to determine whether there was an abuse of discretion by CDTFA. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

[15] Appellant argues that CDTFA's auditor and management were working from home during the COVID-19 shelter-in-place and need an audit to log hours to, because they could not go into the field to audit other taxpayers. OTA notes that CDTFA's Assignment Activity History entry for July 2, 2019, states "Audit Note: Met with [C.] Leung. Reviewed records. Discussed mark-up method and preliminary findings." Thus, it appears that CDTFA proposed to use the markup method well before the COVID-19 pandemic began in March 2020.

Appellant provided a statement signed under penalty of perjury requesting interest relief under R&TC section 6593.5(c).[16] Appellant argues that it is unreasonable that CDTFA's auditor took two years to complete the audit and logged 75 hours of work to the audit, but only visited appellant's place of business for one day and sent a few emails. Appellant contends that there was a six-month delay between April 27, 2020, when appellant responded to a request from CDTFA, and October 7, 2020, when CDTFA took its next action.[17]

CDTFA agreed to relieve interest for eight months, October 2019 and March through September 2020, but otherwise denied appellant's request. CDTFA provides a timeline of activities related to the audit, which lasted from April 2019 to October 2020. CDTFA agreed to abate interest for the months in the timeline with no activity shown, other than August 2019, which had no activity due to a delay requested by appellant in order to gather records.[18] For the remaining months in that period until October 2020, CDTFA was working on the audit.

Appellant also asserts that the auditor continued to work on the case until January 2021. CDTFA's timeline includes activities that occurred after the audit, which includes appellant's filing of a Petition for Redetermination and acknowledgement of the appeal by CDTFA's Petitions Section in November 2020, a conference between appellant and CDTFA's San Francisco office in December 2020, and approval of CDTFA's staff recommendation and transfer of the case back to the Petitions Section in January 2021.[19] Therefore, for the period in which appellant asserts there were further delays after the conclusion of the audit, the evidence shows that CDTFA was consistently working on the case within reasonable periods of time.

The evidence does not establish an unreasonable error or delay by a CDTFA employee for the disputed period and the evidence does not show that CDTFA's denial of interest relief for the disputed period was an abuse of discretion. Therefore, there is no basis to relieve additional interest.

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[16] At the hearing, appellant also stated that it was requesting relief for "interest associated with this audit." The audit took place from April 2019 to October 2020. However, appellant's written request refers to dates in 2021. In addition, appellant's request for interest relief also states that it is requesting relief of "all interest assessed." Appellant provides no arguments or evidence to show a basis for interest relief for periods after completion of the audit, and CDTFA's timeline does not indicate any unreasonable errors or delays during that time.

[17] Appellant states October 7, 2021, but appears to have meant October 7, 2020.

[18] Interest was abated for most of the period that appellant asserts was a six-month delay.

[19] CDTFA's timeline also states that from December 2020 to February 2021, the case was accepted into the Settlement Program, but an agreement could not be reached.

HOLDINGS

1. No adjustment to the amount of unreported taxable sales is warranted.
2. Additional interest should not be relieved.

DISPOSITION

CDTFA's action is modified as conceded on appeal to relieve interest for October 2019 and March through September 2020.[20] CDTFA's action denying appellant's petition for redetermination is otherwise sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
For
Susana Seyller
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Sheriene Anne Ridenour
Administrative Law Judge

Date Issued: 5/20/2024

[20] As previously noted, CDTFA agreed to relieve interest for October 2019, May 2020, July 2020, August 2020, and September 2020, in response to appellant's request for interest relief. CDTFA also granted automatic interest relief for COVID-19 impacted months, which are March 2020, April 2020, and June 2020.