OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 230814043
	CDTFA Case ID: 03-765-537
DELTA COOLING TOWERS, INC.	

OPINION

Representing the Parties:

For Appellant: John Flaherty, President

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Steven Kim, Attorney

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Delta Cooling Towers, Inc. (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 April 1, 2022.[2] The NOD is for tax of $59,943, plus applicable interest, and a failure-to-file penalty of $4,357.43 for the period July 1, 2012, through December 31, 2020 (liability period).[3]

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 (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.

[2] CDTFA timely issued the NOD to appellant because appellant signed a series of waivers of the otherwise applicable eight-year statute of limitations when a person fails to file a return, which extended the deadline for issuing an NOD to April 30, 2022. (R&TC, §§ 6487(a), 6488.)

[3] Appellant does not dispute the failure-to-file penalty.

ISSUE

Whether an adjustment is warranted to the taxable measure.

FACTUAL FINDINGS

1. Appellant is a New Jersey corporation operating as a manufacturer, retailer, and installer of cooling towers. Appellant also performs repair services of cooling towers in California. Relevant to the liability period, appellant did not have any physical locations in California, but appellant had its own sales representatives and third-party sales representatives who solicited sales throughout California. Appellant shipped its products from out-of-state to its California customers using common carriers. Appellant applied for a Certificate of Registration – Use Tax in July 2012.
2. Appellant did not file any sales and use tax returns from July 2012 through December 2018, and for the third quarter of 2019 (3Q19), 4Q19, and 3Q20. Appellant did not collect any tax or tax reimbursement on sales to California customers during the liability period because it believed it was not required to do so.[4] Appellant filed $0 returns for 1Q19, 2Q19, 1Q20, 2Q20, and 4Q20.
3. CDTFA audited appellant for the liability period. Appellant submitted its sales information for the liability period. CDTFA examined appellant's sales on an actual basis. Appellant recorded $2,016,064 in sales of cooling towers to California customers.[5]
    a. For sales supported by valid resale certificates on file, CDTFA allowed those sales as nontaxable sales for resale.
    b. For the remaining sales without resale certificates on file, appellant issued XYZ letters[6] to the customers. Some customers responded to the XYZ letters, stating

[4] Appellant voluntarily registered for and maintained a Certificate of Registration – Use Tax with CDTFA and, as such, was obligated to collect and remit the use tax regardless of whether it had sufficient nexus with California to otherwise impose a tax collection obligation. (Cal. Code Regs., tit. 18, § 1684(e)(2).) In addition, maintenance of an agent within this statute for purpose of conducting selling activities is sufficient to establish a tax collection obligation. (R&TC, § 6203(c)(2).) Because the measure and application of tax in this appeal would otherwise be the same regardless of whether the applicable tax is sales or use, this Opinion does not specifically address whether the applicable tax is a sales or use tax.

[5] CDTFA found that appellant's sales of cooling towers were taxable sales of fixtures. (Cal. Code Regs., tit. 18, § 1521.) Appellant does not dispute that sales of cooling towers are taxable sales in California.

[6] XYZ letters are letters in a form approved by CDTFA which are sent to some or all of the seller's purchasers inquiring as to the purchaser's disposition of the property purchased from the seller. (Cal. Code Regs., tit. 18, § 1668(f).)

that they self-assessed and remitted use tax. CDTFA also identified some customers as California retailers with valid seller's permits who made retail sales of the products purchased from appellant and allowed sales to those customers as nontaxable sales for resale.

c. For sales including a shipping and handling charge, CDTFA estimated that 6 percent of the charge was a taxable handling fee based on available freight bills, and the balance was allocable to nontaxable shipping expenses. Thus, CDTFA considered 94 percent of total shipping and handling charges as nontaxable.[7]

d. CDTFA considered any sales transaction under $200 as nominal and did not include these transactions as taxable sales.

e. After allowing for these adjustments, CDTFA established unreported taxable sales of $714,770.

4. CDTFA issued appellant the April 1, 2022 NOD.

5. On April 28, 2022, appellant timely filed a petition for redetermination disputing the NOD.

6. On July 6, 2023, CDTFA issued a decision denying the petition.

7. Appellant timely filed this appeal.

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.) A retail sale is a sale for any purpose other than resale in the regular course of business. (R&TC, § 6007.) 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.) The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless the person takes from the purchaser a certificate to the effect that the property is purchased for resale. (*Ibid*.) The certificate relieves the seller from liability for the tax only if taken in good faith from a person who is engaged in the

[7] Tax does not apply to "separately stated" charges for transportation of property from the retailer's place of business or other point from which shipment is made "directly to the purchaser," provided the transportation is by other than facilities of the retailer, such as by common carrier. (Cal. Code Regs., tit. 18, § 1628(a).)

business of selling tangible personal property and who holds a valid seller's permit. (R&TC, § 6092.)

When sales tax does not apply, such as when property is shipped into this state by an out-of-state retailer, use tax is imposed on the sales price of property purchased from a retailer for the storage, use, or other consumption inside this state. (R&TC, §§ 6201, 6401.) 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.) The use tax is imposed on the person storing, using, or otherwise consuming the property. (R&TC, § 6202.) A retailer engaged in business in this state or registered to collect use tax in this state is required to collect the use tax from the purchaser. (R&TC, § 6203(a).) Holders of Certificate of Registration-Use Tax are required to collect and remit use tax in the same manner as retailers engaged in business in this state in the same manner as retailers engaged in business in this state. (Cal. Code Regs., tit. 18, § 1684(e)(2); see also *Appeal of B & D Litho, Inc.* (SBE Memo.) 2001 WL 1034733.)

A sale for resale is not subject to sales or use tax. (Cal. Code Regs., tit. 18, § 1668(e).) A person who purchases property for resale and who subsequently uses the property owes tax on that use. (*Ibid*.) If the seller does not timely obtain a resale certificate, the seller will be relieved of liability for the tax only where the seller shows that the property: (1) was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business; (2) is being held for resale by the purchaser and has not been used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business; (3) was consumed by the purchaser and tax was reported directly to CDTFA on the purchaser's sales and use tax return; or (4) was consumed by the purchaser and tax was paid to CDTFA pursuant to an assessment or audit against the purchaser. (*Ibid*.)

A seller who does not timely obtain a resale certificate may use any verifiable method of establishing that it should be relieved of liability for tax. (Cal. Code Regs., tit. 18, § 1668(f).) One method to show the sale was for resale or that tax was paid is the use of XYZ letters. (*Ibid*.) When there is no response to an XYZ letter, CDTFA shall consider whether it is appropriate to

use an alternative method to ascertain whether the seller should be relieved of tax for the questioned or unsupported transactions.[8] (Cal. Code Regs., tit. 18, § 1668(f)(4).)

Here, appellant did not report any taxable sales during the liability period. CDTFA audited appellant on an actual basis and found that appellant sold tangible personal property to California customers during the liability period. For sales supported by valid resale certificates on file, CDTFA allowed those sales as nontaxable sales for resale. For the unsupported sales, appellant issued XYZ letters to its customers. For the sales to customers who responded to the XYZ letter providing resale certificates or stating that the customer self-assessed and remitted use tax, CDTFA allowed those sales as nontaxable sales for resale. For the remaining customers who did not respond to the XYZ letters, CDTFA investigated whether the customers held valid seller's permits and were retailers of the type of products purchased from appellant, and allowed sales to those customers as nontaxable sales for resale. CDTFA also made additional adjustments for nontaxable transportation charges and transactions that it considered nominal. For the remaining unsupported sales to California customers, CDTFA determined that appellant failed to rebut the presumption that they were taxable transactions.

Appellant was required to collect use tax on sales of tangible personal property for storage, use, or other consumption in California, and to remit that tax to CDTFA. (See R&TC, § 6203(a); Cal. Code Regs., tit. 18, § 1684(e).) In addition, 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.) Therefore, appellant has the burden to show that, for the remaining unsupported sales, the property was not sold for storage, use, or other consumption in this state. (*Ibid*; see also Cal. Code Regs., tit. 18, § 30219(a).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, 2020-OTA-022P.)

Appellant argues that approximately 80 percent of customers who were sent an XYZ letter responded, either providing a resale certificate or stating that use tax was self-assessed and

[8] CDTFA's Audit Manual states that XYZ non-responses should not automatically be considered errors or non-errors, and that CDTFA audit staff should make every effort to determine the taxability of the questioned sale by alternative methods, such as by determining whether the customer has a seller's permit, reviewing the quantity and type of items sold to see if they were sold for resale or consumption, reviewing a subsequent resale certificate but for similar purchases, or examining other types of items sold to the customer. (CDTFA Audit Manual, § 0409.51.) CDTFA's Audit Manual does not provide binding legal authority; however, OTA may look to it for guidance. (See *Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

remitted. Thus, appellant asserts that, of the customers who did not respond to XYZ letters, 80 percent of those transactions should be considered nontaxable and only 20 percent taxable. Appellant states that it does not maintain a relationship with most of its customers, who rarely buy appellant's products more than once, and that these customers have ignored appellant's attempts to contact them. Appellant asserts that it tried diligently for several months to collect the necessary information from its customers, and there was nothing more that could be done to facilitate responses from customers.

Appellant has not provided any evidence, such as valid resale certificates or XYZ letter responses from the remaining customers, establishing that the disputed sales were nontaxable sales for resale or that the customers for the disputed sales paid use tax to CDTFA. (See Cal. Code Regs., tit. 18, § 1668(e).) Furthermore, appellant has not rebutted the presumption that the remaining sales were not for storage, use, or other consumption in California; therefore, appellant was required to collect and remit use tax on those sales. (R&TC, §§ 6241, 6203(a).) As a result, appellant has not shown that an adjustment to the taxable measure is warranted.

HOLDING

No adjustment is warranted to the taxable measure.

DISPOSITION

CDTFA's action is sustained.

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Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
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Keith T. Long
Administrative Law Judge

Date Issued: 6/12/2024