OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 20127066
	CDTFA Case ID 381-652
WORLD OF AWNINGS & CANOPIES	

OPINION

Representing the Parties:

For Appellant:	Abdul R. Lala, CPA Majdi Bitar, CEO Sahar Bitar, CFO
For Respondent:	Ravinder Sharma, Hearing Representative Randy Suazo, Hearing Representative Christopher Brooks, Attorney
For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, World of Awnings & Canopies (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated August 17, 2018.[2] The NOD is for tax of $108,472 and applicable interest for the period October 1, 2013, through September 30, 2016 (audit period), and is based on an audited deficiency measure totaling $1,211,612. Of that amount, appellant disputes only one audit item: unreported taxable manufacturing/fabrication labor. On appeal, CDTFA performed a reaudit, which reduced the

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes along with other business taxes and fees. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (BOE's adjudicatory functions transferred to the Office of Tax Appeals on January 1, 2018.) Thus, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

[2] CDTFA timely issued the NOD because appellant waived the otherwise applicable three-year statute of limitations and extended CDTFA's deadline for issuing the NOD. (See R&TC, §§ 6487(a), 6488.)

measure for unreported taxable manufacturing/fabrication labor by $54,474, from $287,789 to $233,315, leaving tax of $20,888 in dispute.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Josh Aldrich, and Richard Tay held an oral hearing for this matter in Cerritos, California, on September 13, 2023. At the conclusion of the hearing, the record was closed and this matter was submitted for an Opinion.

ISSUES

1. Whether the amount of unreported taxable sales of manufacturing/fabrication labor should be further reduced.
2. Whether appellant qualifies for relief of liability based on its claim of reliance on advice from CDTFA.

FACTUAL FINDINGS

1. Appellant has operated as a construction contractor manufacturing and installing custom awnings and canopies for commercial businesses and residential customers since January 6, 1998. During the audit period, appellant contracted on a lump-sum basis, and added sales tax reimbursement calculated on 55 percent of the lump-sum price for the contract.[3] On its sales invoices, appellant showed 55 percent of the lump-sum price as its charge for parts and materials, 45 percent as its charge for manufacturing and installation labor (combined), and the sales tax reimbursement. When discounts or additional charges were shown in the sales invoices for changes from the original contracts, the amount of sales tax reimbursement shown in the sales invoices was unchanged.
2. Prior to the audit period, in January 2011, staff from CDTFA's Statewide Compliance and Outreach Program (SCOP) visited appellant's business location and advised appellant to file amended sales and use tax returns for the fourth quarter of 2008 (4Q08) through 4Q10. On the amended returns filed for those quarters, appellant reported approximately half of its total sales as taxable sales.

[3] Appellant prepared a proposal for each job showing the proposed lump-sum price to complete the job and sales tax reimbursement computed on 55 percent of the lump-sum price. The proposals included a line for appellant's representative's signature and a line for the customer's signature. OTA's understanding is that these proposals are appellant's lump-sum contracts.

3. For the audit period, appellant reported total sales of $2,775,821, and claimed deductions of $20,780 for nontaxable sales for resale, $1,300,402 for nontaxable labor, and $53,627 for sales tax reimbursement included in reported total sales, which resulted in reported taxable sales of $1,401,012.
4. Upon audit, appellant provided its federal income tax returns (FITRs) for the years 2013, 2014, and 2015, sales invoices and some sales contracts for 3Q16, and its general ledger for 1Q16 through 3Q16.
5. Based on its examination of appellant's general ledger for 1Q16 through 3Q16, CDTFA compiled recorded taxable sales of $717,462, which exceeded appellant's reported taxable sales of $432,354 for those three quarters by $285,108, representing a reporting error rate of 65.94 percent ($285,108 ÷ $432,354). CDTFA applied the reporting error rate of 65.94 percent to appellant's reported taxable sales for the audit period to establish unreported taxable sales of $923,835 based on the difference between recorded and reported taxable sales.
6. CDTFA determined that appellant's recorded taxable sales were understated because appellant had excluded the taxable portion of its labor charges from its recorded taxable sales. Initially, CDTFA estimated that 50 percent of appellant's recorded sales of manufacturing and installation labor was subject to tax and computed unreported taxable manufacturing labor of $479,828. In total, CDTFA established unreported taxable sales of $1,403,663 ($923,835 + $479,828).
7. To verify that its estimate that 50 percent of appellant's recorded sales of labor was subject to tax was reasonable, CDTFA prepared an analysis in which it used the amounts reported on appellant's FITRs for the years 2013 through 2015 to compute audited costs of fixtures based on the aggregate of: (1) costs of materials; (2) direct labor, including fringe benefits and payroll taxes; (3) factory costs attributable to fixtures; and (4) a pro rata share of overhead attributable to manufacturing, estimated to be 25 percent of overhead costs. Based on its estimate that appellant's profit was 5 percent of the costs of fixtures, CDTFA computed audited sales of fixtures of $2,113,157 for the years 2013 through 2015, which exceeded appellant's reported taxable sales for those three years by $890,557. CDTFA compared audited sales with reported taxable sales for each year to compute reporting error rates, and applied the error rates to appellant's reported taxable

sales for the audit period to compute unreported taxable sales of $1,124,356 for purposes of the analysis.[4] CDTFA decided that its estimate regarding taxable sales of labor was excessive because unreported taxable sales of $1,403,663 ($923,835 + $479,828), based on the 50 percent estimate, substantially exceeded unreported taxable sales of $1,124,356 computed from the analysis of appellant's FITRs. Therefore, CDTFA revised its estimate and computed unreported taxable sales of manufacturing labor of $287,789 based on an estimate that 30 percent of appellant's recorded sales of manufacturing and fabrication labor were subject to tax.

8. CDTFA based the NOD, issued to appellant on August 17, 2018, on an aggregate deficiency measure of $1,211,624, which is composed of the $923,835 difference between recorded and reported taxable sales and unreported taxable sales of manufacturing labor of $287,789.

9. Appellant timely filed a petition for redetermination protesting the $287,789 measure for unreported taxable sales of manufacturing labor. At the appeals conference held on April 16, 2019, appellant specifically conceded the $923,835 deficiency measure for the difference between recorded and reported taxable sales.

10. In support of its argument that its costs of manufacturing labor already were included in its recorded taxable sales of parts and materials (and thus it should have no liability for unreported taxable sales in addition to the amount established for the difference between recorded and reported taxable sales), appellant provided its analysis of costs for 26 jobs shown in sales invoices for the period June 2016 through September 2016. According to appellant, its combined costs for materials, manufacturing labor, overhead (computed as 125 percent of costs of manufacturing labor), and a markup of 40 percent for those 26 jobs represented 43.72 percent of the total sales price for the jobs. Since appellant had included 55 percent of the total sales price for those jobs in its recorded taxable sales, appellant argued that it had overstated its taxable sales in its records.

11. However, CDTFA found that, in the absence of supporting documentation showing costs of materials, manufacturing labor hours, installation labor hours, and other relevant costs,

[4] On appeal, CDTFA acknowledges two computation errors in its analysis of appellant's FITRs. CDTFA computes that correcting both errors would result in a reduction of $22,635 to the amount of unreported taxable sales shown in the analysis, from $1,124,356 to $1,101,721. However, since this analysis was performed as a secondary method to verify that its estimates in the audit were reasonable, CDTFA states that correcting the errors would not impact the audit findings.

appellant's analysis did not support a reduction to the amount of unreported taxable manufacturing labor. In its Decision issued on February 24, 2020, CDTFA denied the petition.

12. By letter dated May 22, 2020, appellant filed an untimely request for reconsideration, arguing that CDTFA had failed to understand that its nontaxable costs for installation and other labor were substantial, its taxable costs of manufacturing labor were included in its recorded taxable sales, and it had reported 55 percent of its total sales as taxable in accordance with a recommendation from SCOP.

13. CDTFA addressed appellant's contentions in a Supplemental Decision issued on November 2, 2020, and continued to deny the appeal.

14. This appeal to OTA followed.

15. On appeal to OTA, appellant objected to CDTFA's dismissal of its analysis of 26 jobs. As support for its analysis, appellant provided payroll summary reports for the period June 2016 through September 2016 but did not provide purchase invoices showing costs of materials used to fabricate the fixtures, as requested. Appellant also offered to sign a statement under penalty of perjury requesting relief from the tax liability based on CDTFA's advice.

16. Upon further review on appeal, CDTFA noted that it had allowed 100 percent of appellant's charges for labor as nontaxable when the charges were clearly denoted as charges to repair existing awnings or canopies on appellant's invoices. However, examination of appellant's sample invoices showed 13 additional invoices on which appellant had described its jobs as repairs of existing awnings or canopies but had billed the charges for labor as "manufacturing and installation labor." CDTFA determined that it had incorrectly included 30 percent of these charges in its calculation of taxable manufacturing labor. Therefore, CDTFA performed a reaudit, which resulted in a reduction of $54,474 to the determined measure for unreported taxable sales of manufacturing labor, from $287,789 to $233,315.

17. Following a prehearing conference with the parties, OTA requested that appellant provide a written statement signed under penalty of perjury setting forth the facts on which it based its request for relief from the tax liability due to CDTFA advice, but appellant did not provide any such statement.

DISCUSSION

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of tangible personal property sold in this state, 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, it is presumed 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 any person, or if any person fails to make a return, CDTFA may compute and 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 Amaya*, 2021-OTA-328P.) If CDTFA carries its initial, minimal burden, then CDTFA's determination is presumed correct, and the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (See *Appeal of Talavera*, 2020-OTA-022P; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.)

The appellant bears the burden of proof as to all issues of fact unless the law specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence unless the law also specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(b).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Amaya*, *supra*.) 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.)

Issue 1: Whether the amount of unreported taxable sales of manufacturing/fabrication labor should be further reduced.

"Construction contract" means a contract to erect, construct, alter, or repair any building or other structure or other improvement on or to real property (Cal. Code Regs., tit. 18,

§ 1521(a)(1)(A)), and a "construction contractor" is any person who, for itself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. (Cal. Code Regs., tit. 18, § 1521(a)(2).)

In general, construction contractors are consumers of the materials they furnish and install when performing construction contracts, and they are retailers of fixtures they furnish and install when performing construction contracts. (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)1 & (B)1.) "Fixtures" means and includes items that are accessory to a building or other structure and do not lose their identity as accessories when installed. (Cal. Code Regs., tit. 18, § 1521(a)(5).) Regarding the sale price for a fixture furnished and installed pursuant to a construction contract, if the contract states the sale price at which the fixture is sold, tax applies to that price. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)2.a.) If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor. (*Ibid*.)

Generally, if a contractor purchases fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him or her. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)2.b.) However, here, appellant custom made the fixtures (awnings and canopies) that it furnished and installed pursuant to construction contracts. If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at which similar fixtures in similar quantities ready for installation are sold by the contractor to other contractors. (*Ibid*.) Because appellant did not sell the fixtures it manufactured to other contractors, the cost price is deemed to be the amount stated in appellant's price lists, bid sheets, or other records. (*Ibid*.) However, under circumstances such as those at hand, where CDTFA was unable to determine the sale price for appellant's fixtures because appellant did not sell the fixtures to other contractors and did not provide price lists, bid sheets, or other records showing its costs for the fixtures, the cost price is deemed to be the aggregate of the following: [1] cost of materials, including such items as freight-in and import duties; [2] direct labor, including fringe benefits and payroll taxes; [3] specific factory costs attributable to the fixture; [4] any manufacturer's excise tax; [5] pro rata share of all overhead attributable to the manufacture of the fixture; and [6] reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors. (*Ibid*.) Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture.

(*Ibid*.) Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property. (*Ibid*.)

As for repairs, if the retail value of parts and materials furnished in connection with repair work is more than 10 percent of the total charge, or if the person making the repairs makes a separate charge for such property, the repairperson is the retailer of the parts and materials, and tax applies to the fair retail selling price of the property. (Cal. Code Regs., tit. 18, § 1546(b)(1).) If such is the case, the repairperson must segregate on the invoices to its customers and in its records the fair retail selling price of the parts and materials from the charges for labor of repair, installation, or other services performed. (*Ibid*.)

Here, appellant contracted on a lump-sum basis. A lump-sum contract does not become a time-and-material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice. (Cal. Code Regs., tit. 18, § 1521(a)(8).) Because appellant's contracts did not separately state the sale price for the fixtures and the sale price for installation labor, the measure of tax for each job was appellant's cost price for the fixtures, as "cost price" is defined in California Code of Regulations, title 18, section 1521(b)(2)(B)2.b. CDTFA found that adding 30 percent of each of appellant's charges for labor to its charges for parts and materials approximated the cost price for the fixtures that CDTFA computed from an analysis of appellant's FITRs. Given that appellant failed to provide job cost sheets or similar records, OTA finds that CDTFA's method for establishing the measure of tax for appellant's sales of fixtures was reasonable and rational, and was based on the best information available. OTA also finds that CDTFA properly excluded nontaxable repair labor from its computation of the taxable measure by projecting from a sample of appellant's sales invoices. Therefore, the burden of proof shifts to appellant to establish with documentation or other evidence that an additional reduction to the amount of unreported taxable sales of fixtures, as measured by 30 percent of appellant's lump-sum charges for manufacturing and installation labor, is warranted.

On appeal, appellant contends that its taxable costs of manufacturing labor were included in the amounts it billed to customers for parts and materials, and that it erred when it described its charges for labor as "manufacturing and installation labor" on its sales invoices. According to appellant, each of its jobs required a significant amount of labor other than manufacturing or fabrication labor, such as setting appointments with customers, traveling to meetings with customers, preparing computer graphic designs, revisiting customers' premises to fine-tune

measurements and designs prior to manufacturing, and installation of the fixtures. Therefore, appellant argues that it was reasonable to record 45 percent of the total price for each job as a nontaxable charge for labor. Appellant points to its analysis of 26 jobs, which shows that the combined cost of materials, fabrication labor, overhead attributable to the manufacture of fixtures, and a reasonable markup was less than 55 percent of the total price for each job. Given that appellant had included 55 percent of the total price for each job in its recorded taxable sales, appellant contends that its recorded taxable sales exceed the taxable sale price for its fixtures, and thus, it has no liability in excess of the tax on its recorded taxable sales.

Regarding appellant's argument that each of its jobs required a significant amount of labor in addition to manufacturing or fabrication labor, OTA notes that costs of direct labor, including fringe benefits and payroll taxes, must be included in the taxable cost price for fixtures. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)2.b.[2].) With respect to retail sales by manufacturers, generally, the measure of tax is the gross receipts of, or sales price charged by, the manufacturer, from which no deduction may be taken on account of labor or service costs to create or produce the tangible personal property, or of any step in the manufacturing, producing, processing, or fabricating, including work performed to fit the customer's specific requirements, whether or not performed at the customer's specific request, or any other services that are a part of the sale. (R&TC, §§ 6011, 6012; Cal. Code Regs., tit. 18, § 1524(a).)

Here, while appellant seems to view its costs of labor to meet with customers, prepare designs, and other services required to make its sales as excludable from the taxable cost price of the fixtures it furnishes and installs, the costs of such direct labor, including fringe benefits and payroll taxes, must be included. With respect to the labor performed for each specific job, only appellant's costs of labor or services to install or apply the property sold are excluded from the measure of tax. Regarding labor performed at the jobsite, the costs of labor that may be excluded do not include the costs of labor to fabricate property in place. (Cal. Code Regs., tit. 18, § 1546(a).)

In its analysis of costs for 26 jobs shown in sales invoices for the period June 2016 through September 2016, appellant shows costs for materials, manufacturing labor, overhead, and a markup of 40 percent. However, while appellant's analysis shows its costs for sewing and framing labor, the analysis does not include appellant's other costs of direct labor, such as meeting with customers and preparing designs. Further, appellant did not provide its costs for

installation of the fixtures to show that its nontaxable sales of installation labor approximate 45 percent of the total sale price for each job. Therefore, OTA finds that appellant's analysis does not accurately reflect all the costs incurred by appellant to complete each of the 26 jobs.

On the other hand, CDTFA used the amounts reported on appellant's FITRs for the years 2013 through 2015 to compute audited sales of fixtures based on the aggregate of the following: (1) costs of materials; (2) direct labor, including fringe benefits and payroll taxes; (3) factory costs attributable to fixtures; (4) a pro rata share of overhead attributable to manufacturing, estimated to be 25 percent of overhead costs, and (5) a markup of 5 percent. Because CDTFA's analysis is based on all the costs reported on appellant's FITRs, OTA finds that the analysis reflects the cost price of fixtures furnished and installed in lump-sum contracts with reasonable accuracy. By adding 30 percent of appellant's recorded sales of manufacturing and installation labor to recorded sales of parts and materials, CDTFA approximated the audited sales of fixtures computed in its analysis of appellant's FITRs. CDTFA then determined that no tax applied to appellant's recorded sales of labor for those jobs that involved recovering awnings or other repairs and made appropriate adjustments.

Appellant has failed to provide price lists, bid sheets, or other documentation showing that CDTFA's computation of its sales of fixtures resulted in an overstatement of audited taxable sales. Further, appellant has provided no documentation or other evidence demonstrating that it was reasonable to charge 45 percent of the total price for each job for nontaxable installation labor only. OTA concludes that appellant has failed to meet its burden; thus, no reduction to the amount of unreported taxable sales of manufacturing labor is warranted.

Issue 2: Whether appellant qualifies for relief of liability based on its claim of reliance on advice from CDTFA.

If a person's failure to timely pay the sales or use tax is due to reasonable reliance on written advice from CDTFA (or, prior to July 1, 2017, the State Board of Equalization), the person may be relieved of the taxes, interest, and any penalties added thereto. (R&TC, §§ 20(a), 6596(a).) R&TC section 6596 requires the satisfaction of four conditions to grant relief. First, the person must have requested written advice regarding whether a particular activity or transaction is subject to tax, and the request must fully describe the specific facts and circumstances of the activity or transaction. (R&TC, § 6596(b)(1).) Second, CDTFA must have responded in writing, stating whether or not the described activity or transaction is subject to tax,

or stating the conditions under which the activity or transaction is subject to tax. (R&TC, § 6596(b)(2).) Third, the person must reasonably rely on CDTFA's written advice. (R&TC, § 6596(b)(3).) Fourth, the liability for taxes applied to a particular activity or transaction must have occurred before CDTFA rescinds or modifies the advice or a change in law renders CDTFA's earlier written advice no longer valid. (R&TC, § 6596(b)(4).) Any person requesting relief under R&TC section 6596 must file a statement under penalty of perjury setting forth the facts on which the claim for relief is based. (R&TC, § 6596(c)(2).)

Here, there is no dispute that CDTFA's SCOP staff visited appellant's business in January 2011, reviewed appellant's business operations, and concluded that appellant had overstated its claimed nontaxable sales of labor. Accordingly, the SCOP staff advised appellant to file amended sales and use tax returns (SUTRs).

During CDTFA's internal appeals process, appellant provided a worksheet showing its computation of additional taxable sales for its amended SUTRs for the period January 1, 2007, through December 31, 2009. CDTFA states that the worksheets showed additional sales tax due of $21,094 "AS PER BOE 55% TAXABLE MATERIAL & 45% LABOR." Appellant also provided bank records showing five payments totaling $21,721 made in 2011 to CDTFA, which appellant asserted were for the amended returns. Appellant contends that this provides indisputable evidence that SCOP recommended the 55 percent taxable ratio because, in the absence of such a recommendation from SCOP, appellant would not have filed the amended returns, and CDTFA would not have accepted the amended returns and payments. Appellant argues that ever since it filed the amended returns in 2011, it has continued to report approximately 55 percent of its total sales as taxable, as recommended by SCOP. Because it was following advice provided by SCOP, appellant contends that it should be relieved of the tax on unreported taxable sales of manufacturing labor. Appellant has offered to file a request for relief of liability signed under penalty of perjury, attesting to the advice provided to it by SCOP, but it has not done so.

There is no dispute that SCOP staff visited appellant's business in January 2011 and that appellant filed amended returns in 2011. However, relief based on a person's reasonable reliance on advice provided by CDTFA requires a showing that the person relied on *written* advice from CDTFA, not simply that CDTFA provided oral advice. (R&TC, § 6596(a); Cal. Code Regs., tit. 18, § 1705(a).) Here, there is no evidence that appellant received written advice from

CDTFA on which it relied. Given the lack of any evidence that SCOP provided advice *in writing* to appellant, there is no basis for adjustments pursuant to R&TC section 6596.

HOLDINGS

1. No further reduction to the amount of unreported taxable sales of manufacturing/fabrication labor is warranted.
2. Pursuant to R&TC section 6596, appellant does not qualify for relief of liability based on its claim of reliance on advice from CDTFA.

DISPOSITION

Sustain CDTFA's action in reducing the amount of unreported taxable sales of manufacturing/fabrication labor by $54,474, but otherwise denying appellant's petition.

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Andrew Wong
Administrative Law Judge

We concur:

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Josh Aldrich
Administrative Law Judge

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Richard Tay
Administrative Law Judge

Date Issued: 12/14/2023