OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. DIMARUCUT,** **dba New Age Auto**	OTA Case No. 230513361 CDTFA Case IDs: 1-814-335 & 1-912-568

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Westley Marcelo, Attorney

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, M. Dimarucut, dba New Age Auto (appellant), appeals an April 20, 2023 Decision (Decision) issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a January 10, 2020 Notice of Determination (NOD).[2] The NOD was for tax of $121,848, plus applicable interest, and a negligence penalty of $12,185[3] for the period April 1, 2016, through December 31, 2017 (liability period).[4] The NOD was based on an audit, which determined a liability for unreported taxable sales of $1,479,143. During the appeal to the Office of Tax

[1] Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (board). In 2017, the California Legislature transferred most of the board's administrative (i.e., non-adjudicatory) functions to respondent effective July 1, 2017. (Gov. Code, § 15570.22.) When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to the board.

[2] The Decision also denied appellant's protective claim for refund.

[3] This Opinion rounds to the nearest dollar for simplicity only. Rounding may cause immaterial differences in some totals. It is not intended to alter the obligations of the parties.

[4] The NOD was timely issued for the period October 1, 2016, through December 31, 2017, because it was issued before expiration of the three-year statute of limitations. (R&TC, §§ 6487(a).) It was timely issued for the period April 1, 2016, through September 30, 2016, because on June 26, 2019, appellant signed a waiver of the statute of limitations allowing respondent until January 31, 2020, to issue an NOD for that period. (R&TC, §§ 6487(a), 6488.)

Appeals (OTA), respondent conducted a reaudit, which reduced the taxable measure by $52,200, from $1,479,143 to $1,426,943.[5]

OTA decides this appeal on the basis of the written record, pursuant to California Code of Regulations, title 18, section 30209(a), because appellant waived her right to an oral hearing.

ISSUES[6]

1. Are additional adjustments to the taxable measure warranted?
2. Is the negligence penalty warranted?

FACTUAL FINDINGS

1. Appellant was a sole proprietor that sold motor vehicles in California. According to respondent, appellant's seller's permit was closed out at the end of the liability period.
2. For the liability period, appellant reported total and taxable sales of $2,035,251.
3. Respondent audited appellant for the liability period. It was appellant's first audit. Appellant did not provide any books or business records for the audit, which prevented respondent from verifying amounts reported on appellant's sales and use tax returns (returns) using a direct audit method.[7]
4. Appellant reported at least some sales to the California Department of Motor Vehicles (DMV). Respondent obtained information from DMV regarding appellant's sales.[8] The data obtained from DMV indicate that appellant reported 226 vehicle sales made between May 12, 2016, and December 16, 2017. DMV data also included information about the

[5] The reaudit reduced the tax by $4,367, from $121,848 to $117,481, which resulted in a corresponding reduction of the 10 percent negligence penalty to $11,748.

[6] The only argument that appellant has made in this case is that "The audit liability is overstated because DMV data includes unwinds and other cancelled sales which do not pertain to taxable sales made by the business." Appellant has not specifically argued that the negligence penalty was unwarranted, and it is not clear that appellant continues to dispute the taxable measure now that respondent has made adjustments as a result of the reaudit. OTA addresses both issues out of an abundance of caution.

[7] A direct audit method is one that enables respondent to determine taxable sales directly from business records without estimates or extrapolation, such as by simple tabulation of taxable sales evidenced by sales invoices or cash register tapes. A direct audit approach based on complete and accurate business records is generally expected to be the most accurate.

[8] Respondent also obtained limited information regarding payments made to appellant by payment card (e.g., credit or debit cards) processing companies, but the information was incomplete and not used for the audit.

vehicles, the purchasers, and the sales prices.[9] Respondent noted differences between sales amounts reported to DMV and sales amounts reported on returns. For the second quarter of 2016 (2Q16) and 3Q16, appellant reported $5,638 and $29,356 more, respectively, on returns than appellant reported to DMV. For 4Q16 through 4Q17, the sales amounts appellant reported to DMV were significantly higher than those appellant reported on returns.[10]

5. Respondent accepted appellant's reported taxable sales for 2Q16 and 3Q16.[11] However, for the remainder of the liability period, respondent deducted appellant's reported taxable sales (totaling $1,507,657) from audited taxable sales (totaling $2,986,800) on a quarterly basis to calculate unreported taxable sales of $1,479,143 for the liability period, which is the taxable measure upon which the NOD was based.
6. Respondent issued the January 10, 2020 NOD, and appellant filed the petition for redetermination and protective claim for refund.
7. Respondent gave appellant an opportunity to participate in a February 1, 2023 appeals conference as part of respondent's internal appeals process, but appellant declined.
8. On April 20, 2023, respondent issued the Decision denying appellant's petition for redetermination and claim for refund.
9. This timely appeal followed.
10. Respondent subsequently conducted a reaudit to account for possible unwinds[12] and exempt interstate commerce sales. Respondent determined that possible unwinds totaled $38,000 and interstate commerce sales totaled $25,000, for a total of $63,000. However, respondent allowed a total adjustment of only $52,200, because one of the possible unwinds was a $10,800 transaction during 3Q16, a period for which the audit already determined that appellant reported more taxable sales on its return than she reported to DMV. Thus, respondent reduced the taxable measure from $1,479,143 to $1,426,943.

[9] Sales prices appear to have been based on vehicle license fee classification codes (VLF codes). A VLF code indicates a sales price within a $200 range. Appellant has not disputed respondent's estimated sales prices.

[10] The differences were between $117,799 and $410,588 for each quarter, and totaled $1,426,943 for the five quarters.

[11] Appellant made no argument in favor of, and provided no evidence to support, a different result.

[12] In this context, the term "unwind" generally refers to the cancellation of a sale before the customer takes possession of the vehicle.

DISCUSSION

Issue 1: Are additional adjustments to the taxable measure warranted?

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property in the 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, 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 by respondent. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If respondent is not satisfied with the amount of tax reported by the taxpayer, or when the taxpayer fails to file a return, respondent may determine the correct tax 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Appellant failed to provide any books or business records for the audit. Under the circumstances, respondent made the rational decision to look elsewhere for reliable data that would enable it to determine the accuracy of appellant's returns. Given that appellant was the source of the data obtained from DMV, it was reasonable for respondent to rely on that data to establish estimated taxable sales. OTA reviewed the calculations and finds that the determined measure ($1,426,943) is a reasonable estimate of unreported taxable sales.

Granting credit for the two quarters for which appellant reported a greater measure of taxable sales on the returns than appellant reported to DMV would require a partial grant of appellant's protective claim for refund. Appellant has the burden of proving entitlement to a refund. (*Honeywell, Inc. v. State Board of Equalization* (1982) 128 Cal.App.3d 739, 744; Cal. Code Regs., tit. 18, § 30219(a).) Because appellant did not prove such entitlement, OTA also finds that it was reasonable for respondent to deny a credit allowance for those two quarters. On the basis of the evidence, OTA finds that respondent met its initial burden to show that its

determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show additional adjustments are warranted.

Before the reaudit, appellant argued, without supporting evidence, that the audit liability was overstated because the DMV data upon which respondent relied included unwinds and other cancelled sales. Appellant has not addressed the reaudit, indicated which of the remaining transactions are in dispute, or provided any evidence to support additional adjustments. On that basis, OTA finds that appellant has not shown that additional adjustments are warranted.

Issue 2: Is the negligence penalty warranted?

As relevant here, if any part of a liability for which a deficiency determination is made is due to negligence, respondent must add a penalty equal to 10 percent of the amount of the determination. (R&TC, § 6484.) Although the term "negligence" is not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal. App. 5th 1129, 1157.) As previously stated, a taxpayer must maintain and make available for examination on request by respondent all records necessary to determine the correct tax liability under the Sales and Use Tax Law, and all records necessary for the proper completion of the returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: 1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; 2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and 3) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide (for audit) complete and accurate records is evidence of negligence and may result in imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 1698(k).) A negligence penalty also can be based on reporting errors. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323.)

Generally, a negligence penalty should not be added to deficiency determinations made in the first audit of a taxpayer. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) However, if the evidence establishes that any bookkeeping and reporting errors cannot reasonably be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations, the negligence penalty, even for a first-time audit, should be upheld. (*Ibid.*)

Appellant provided no records for the audit. That is evidence of negligence. The audit determined a percentage of error of 70.11 percent for the liability period.[13] If OTA looks only at the five quarters for which respondent determined deficiencies, the percentage of error is 94.65 percent. Appellant reported only about 51.37 percent of taxable sales during those five quarters. Appellant has offered no explanation for these bookkeeping and reporting practices. OTA therefore finds that the bookkeeping and reporting errors shown by the evidence cannot reasonably be attributed to appellant's good faith and reasonable belief that her bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. On that basis, OTA finds that appellant was negligent.

HOLDINGS

1. Additional adjustments to the taxable measure are not warranted.
2. The negligence penalty is warranted.

DISPOSITION

The taxable measure is reduced from $1,479,143 to $1,426,943, which will result in corresponding reductions to the penalty and interest, as determined in the reaudit, and respondent's action denying appellant's petition for redetermination and protective claim for refund is otherwise sustained.

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Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
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Lauren Katagihara
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 7/12/2024

[13] In this context, percentage of error is the ratio of unreported taxable sales ($1,426,943) to reported taxable sales ($1,507,657).