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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:

RV'S-4-LESS, INC.

OTA Case No. 220510435
CDTFA Case ID: 2-026-617

OPINION

Representing the Parties:

For Appellant: Joseph J. Doerr, Attorney

For Respondent: Amanda Jacobs, Attorney
Chad Bacchus, Attorney
Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, RV's-4-Less, Inc. (appellant) appeals a January 10, 2022 decision (Decision) issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated August 20, 2020. The NOD is for tax of $440,223, plus applicable interest, and a negligence penalty of $44,022,[2] for the period January 1, 2016, through December 31, 2018 (liability period).[3] Subsequent to the issuance of the NOD, respondent completed several reaudits, which ultimately resulted in a reduction of $80,640 to the tax deficiency, from $440,223 to $359,583, and a reduction of $8,064 to the negligence penalty, from $44,022 to $35,958.

[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] Amounts are rounded to the nearest dollar.

[3] The NOD was timely issued because on March 30, 2020, appellant signed the last in a series of consecutive waivers of the otherwise applicable three-year statute of limitations, which allowed respondent until October 31, 2020, to issue an NOD for the period January 1, 2016, through June 30, 2017. (R&TC, §§ 6487(a), 6488.)

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Josh Aldrich, and Teresa A. Stanley held an oral hearing for this matter in Fresno, California, on October 18, 2023. At the conclusion of the hearing, the parties submitted the matter and OTA closed the record.

ISSUE

Did respondent correctly impose the negligence penalty?

FACTUAL FINDINGS

1. Appellant operates as a recreational vehicle (RV) dealer with locations in Clovis and Madera, California. Appellant sells RVs, truck campers, accessories, and parts, and provides repair services. Appellant also leases RVs and camping equipment. Appellant is owned by D. Kuehne and operated by D. Kuehne and his daughter, D. Kuehne-Sullins.
2. Prior to the audit at issue in this appeal, respondent audited appellant for the period January 1, 2012, through December 31, 2014. That audit showed unreported taxable sales of $1,361,456 based on a comparison of recorded versus reported taxable sales.
3. For the liability period at issue, appellant reported total sales of $15,331,454, and claimed deductions of $81,377 for exempt sales in interstate or foreign commerce, $1,857,965 for nontaxable labor charges, and $14,954 for nontaxable sales for resale, which resulted in reported taxable sales of $13,377,158.
4. D. Smith, CPA, testified that his firm handled appellant's income tax compliance for years, both before and after the liability period, and may also have worked on sales and use tax compliance to a limited degree. The witness testified that RV sales accounting is complicated, difficult, and time consuming, and that it is difficult to find CPAs and attorneys who are qualified to handle accounting and legal issues that typically arise in connection with RV sales. According to D. Smith, appellant sold 200 to 300 units per year, with about $10 million in annual sales.
5. For audit, appellant provided its federal income tax return (FITR) for 2016, and its profit and loss statements (P&Ls), sales invoices, purchase invoices, deal jackets, and dealer inventory logs for the liability period. Appellant did not provide sales and use tax worksheets or any other documents to explain appellant's reporting methodology.

6. According to the testimony of D. Kuehne-Sullins, she and her father hired people to handle appellant's sales and use tax compliance, including maintaining and providing adequate business records and filing timely and accurate sales and use tax returns (SUTRs). D. Kuehne-Sullins testified that she and her father were not involved in any aspect of appellant's sales and use tax compliance and did not supervise the employees who were involved, which is why she also could not explain appellant's reporting methodology.
7. Respondent found that the gross receipts reported on appellant's FITR for 2016 exceeded the total sales reported on its SUTRs for the same period by $286,483. Additionally, respondent found that the sales recorded in appellant's P&Ls for the liability period exceeded the total sales reported on its SUTRs by $2,873,712. Respondent used the P&Ls to compile recorded taxable vehicle sales of $14,063,139, recorded taxable rentals of $1,714,565, recorded taxable parts sales of $234,852, and recorded miscellaneous income of $7,000. Respondent found that taxable sales of $16,019,556 ($14,063,139 + $1,714,565 + $234,852 + $7,000) recorded in appellant's P&Ls exceeded appellant's reported taxable sales for the liability period by $2,642,398.
8. Respondent used vehicle identification numbers to trace appellant's recorded vehicle sales to corresponding Department of Motor Vehicle (DMV) records. Respondent was able to trace 701 recorded taxable vehicle sales valued at $15,401,864 to corresponding DMV records but found no DMV records corresponding to appellant's recorded sales of 52 vehicles valued at $843,013. Respondent disallowed claimed exempt sales in interstate or foreign commerce in the absence of supporting documentation and added taxable rentals and taxable parts sales to establish audited taxable sales of $18,624,981, which exceeded appellant's reported taxable sales by $5,247,823. The error ratio for the instant audit was greater than the error ratio for the prior audit.
9. Respondent issued an NOD to appellant based on unreported taxable sales of $5,247,823, vehicles used for other than demonstration or display measured by $83,200, and unreported district taxes measured by $3,832,673. Respondent also added a negligence penalty. Appellant timely filed a petition for redetermination specifically contesting audited taxable rentals.

10. After appellant filed its petition and provided additional business records, respondent performed reaudits to adjust unreported taxable sales based on additional documentation provided by appellant, and to correct an error in the allocation of district taxes. These reduced the amount of unreported taxable sales by $983,723, from $5,247,823 to $4,264,100. Because respondent allowed the differences (between audited taxable sales and reported taxable sales) for the first six quarters of the liability period as timing differences, all of the unreported taxable sales were found in the third quarter of 2017 (3Q17) through 4Q18. The only taxable measure established for earlier periods was an $83,200 measure of use tax for a Jaguar automobile that appellant had purchased in 4Q16, without the payment of sales or use tax, apparently for use by appellant's owner or his daughter.
11. On August 25, 2021, the parties participated in an appeals conference as part of respondent's internal appeals process. Appellant disputed the disallowance of four claimed sales in interstate or foreign commerce and provided additional business records to support its argument. Appellant also contested the imposition of the negligence penalty. Based on its review of the additional business records, respondent agreed to allow two of the four claimed sales in interstate or foreign commerce, but argued that the negligence penalty was warranted.
12. On January 10, 2022, respondent issued its Decision, allowing an additional $45,470[4] reduction to the measure of unreported taxable sales, in addition to the earlier adjustments referred to above, but otherwise denying the petition.[5] Respondent found that the negligence penalty was warranted because appellant failed to maintain and provide business records to document and explain its reporting methodology and because it substantially underreported taxable sales after a prior audit revealed similar practices and errors.
13. This timely appeal followed.

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[4] The Decision ordered an adjustment totaling $44,995, but the actual adjustment was $45,470.

[5] The adjustments referred to in the Opinion included: the $983,723 reduction in the taxable measure referred to in an August 14, 2020 Audit Report Letter; the reallocation of District taxes; and the allowance of the additional $44,995 reduction to the measure of unreported taxable sales. These reduced the measure of unreported taxable sales to $4,218,630, all having occurred in the last six quarters of the liability period, 3Q17 through 4Q18. Due to an apparent oversight, the Decision's final "Conclusion" does not mention the allowance of the $983,723 reduction to unreported taxable sales.

DISCUSSION

California imposes sales tax on all of a retailer's retail sales of tangible personal property (TPP) in this state, unless the sale is exempt or excluded from tax. (R&TC, § 6051.) The sales tax is imposed upon retailers for the privilege of selling TPP at retail in this state (R&TC, § 6051), although the retailer may collect sales tax reimbursement from the purchaser if the contract of sale so provides (Civ. Code, § 1656.1(a).) Sales tax is measured by a retailer's gross receipts, and all gross receipts are presumed taxable until proven otherwise, unless the retailer timely and in good faith takes from the purchaser a certificate to the effect that the property is purchased for resale. (R&TC, §§ 6051, 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).)

When sales tax does not apply, use tax applies to the storage, use, or other consumption of TPP purchased from any retailer for storage, use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (R&TC, §§ 6201, 6401.) Retailers engaged in business in this state have an obligation to collect use tax from the purchaser on sales of property for use, storage, or other consumption in this state. (R&TC, § 6203(a).)

Generally, 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 determined tax deficiency. (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, 1157-1158.) Here, the "similar circumstances" include the fact that appellant was a retail business that sold 200 to 300 units per year with annual gross sales of $10 million and the fact that appellant is presumed to know the law. (*Diaz v. Grill Concepts Services, Inc.* (2018) 23 Cal.App.5th 859, 869.)

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, the following: 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 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, 321-323.)

The law imposes sales or use tax, and the recordkeeping and reporting responsibilities pertaining to sales and use tax, on the retailer (or seller) or on the person who stores, uses, or otherwise consumes the tangible personal property in this state. (R&TC, §§ 6051, 6201, 6452, & 7053.) There is no provision in the Sales and Use Tax Law that allows a retailer to avoid liability for noncompliance by simply delegating these responsibilities to an employee, competent or otherwise. On the contrary, negligence of employees in the scope and course of their employment is imputed to the employer. (Civ. Code, § 2338.) An employer can also be liable for the fraudulent and deceitful acts of its employees, even when the employer receives no benefit from the wrongful acts or omissions. (*Gift v. Ahrnke* (1951) 107 Cal.App.2d 614, 622.)

Some of the relevant facts regarding appellant's sales and use tax compliance include that appellant knew that it had already failed to report over $1.36 million in sales during the prior liability period. Those were sales that were recorded in appellant's books, but not reported to respondent. In addition, the accounting firm that represented appellant was of the opinion that it was difficult to even find CPAs and attorneys competent to manage sales and use tax compliance. OTA thus concludes that appellant was aware that sales and use tax compliance was one of appellant's important responsibilities and not something to be taken or entrusted lightly.

Against this backdrop, OTA heard D. Kuehne-Sullins describe the steps that she and her father took to ensure compliance with the Sales and Use Tax Law. In essence, appellant hired bookkeepers who it judged to be capable of handling all the bookkeeping functions, including entering sales data in QuickBooks, handling and keeping track of money, managing the bank accounts, and doing payroll.[6] According to D. Kuehne-Sullins, if an applicant told appellant that he or she was knowledgeable regarding sales and use tax compliance, appellant accepted the applicant's representation and did not take any additional steps (e.g., requesting and checking references) to verify the person's actual experience or skills. There was no evidence regarding

[6] The bookkeeper did not handle RV financing.

how or by whom these bookkeepers were trained, and D. Kuehne-Sullins testified that neither she nor her father supervised the bookkeeper's sales and use tax compliance work.

In addition to arguing that appellant was not negligent because it delegated responsibility to employees that it reasonably believed to be competent in sales and use tax compliance, appellant also argues that one of its bookkeepers was actually engaged in criminal activity that may have had an impact on appellant's sales and use tax reporting.

The first question is whether any part of the liability was due to negligence. Appellant could not explain how it reported its sales and use tax liability, and it did not provide business records to explain how it calculated and reported those liabilities. Even without considering appellant's documented history of noncompliance, both failures are persuasive evidence of negligence. Considering that history, the evidence of negligence is compelling.

Respondent determined that appellant registered the Jaguar automobile in 2016 and that appellant used the car for at least a year for other than demonstration or display while holding it for resale. Appellant did not argue otherwise. The law required appellant to pay sales tax reimbursement to the vendor, if authorized to collect sales tax, or use tax, measured by appellant's cost, with its SUTR for the first reporting period during which appellant made a taxable use of the car. Appellant, who is presumed to know the Sales and Use Tax Law, offered no explanation for its failure to pay the tax or tax reimbursement. On the basis of the evidence, OTA finds that appellant's failure to pay the tax was at least negligent.

Appellant failed to report $4,218,630 in taxable sales during the last six quarters of the liability period. All of these sales were recorded in its books. The lowest underreported amount was $45,273 for 3Q17. The highest underreported amount was $1,389,696 for 4Q18. The average quarterly underreported amount for the six months was $703,105. Appellant reported taxable sales of $6,835,421 during the same period. This means that appellant failed to report approximately 38 percent of its recorded taxable sales for those six quarters. This is persuasive evidence of negligence, evidence that appellant did not refute or explain. Furthermore, the instant audit revealed an error ratio that was higher than the error ratio from the prior audit. In other words, the increased error ratio suggests that the prior audit liability had no noticeable impact on appellant's sales and use tax compliance. On these bases, OTA finds that appellant's failure to accurately report its sales and use tax liabilities for 4Q16 and 3Q17 through 4Q18 was at least negligent.

Based on the foregoing, OTA finds that respondent correctly imposed the negligence penalty. This finding is dispositive. However, OTA will address appellant's argument that its employees were responsible for its underreporting.

Appellant is a corporation. It can only act through its employees and agents. All the subject SUTRs were prepared and filed by appellant's employees. Appellant delegated responsibility for sales and use tax compliance to at least four different employees during the time the underreporting occurred, and as discussed above, no one in management had any involvement in sales and use tax compliance. This suggests a systemic problem that goes far beyond a careless bookkeeper.

Regarding appellant's allegations that the understatement of reported taxable sales for some of the liability period resulted from fraud or criminal activity by an employee, J. Corcoran, other than some vague accusations and innuendo during the testimony of D. Kuehne-Sullins, the evidence does not show that J. Corcoran committed fraud, much less any crime. Four of the six SUTRs at issue were for periods prior to appellant's hiring of J. Corcoran, and while there is an uptick in the amount of underreported taxable sales for the last three quarters of the liability period, there is nothing in the evidence to specifically tie that uptick to J. Corcoran, other than D. Kuehne-Sullins' testimony that J. Corcoran was responsible.

The evidence reflects that appellant failed to take its obligations under the Sales and Use Tax Law seriously. OTA is not persuaded by the testimony of D. Smith that it was difficult for appellant to find qualified and competent people to handle sales and use tax compliance for a retailer of vehicles. There are many tax professionals who regularly perform such work. The prior audit findings should have put appellant on notice that it had a serious problem with sales and use tax compliance and that it needed to delegate compliance tasks to competent people and to provide them with accurate information. It is clear from the evidence that appellant failed to hire people who had the necessary skills and failed to provide adequate training and supervision to these people. These failures were negligent.[7]

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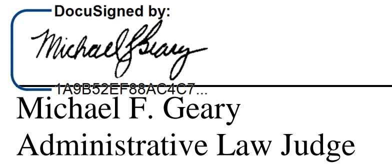
[7] OTA cannot rule out the possibility that the employees to whom appellant delegated sales and use tax compliance did not have access to accurate information. If they did not have such access, that, too, would have been the result of a failure by appellant that was at least negligent.

HOLDING

Respondent correctly imposed the negligence penalty.

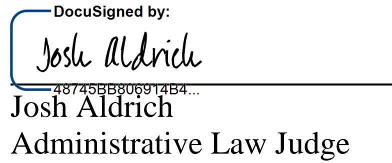
DISPOSITION

OTA sustains respondent's actions reducing the measure of unreported taxable sales from $5,247,823 to $4,218,630, correcting its error in the allocation of district taxes, and otherwise denying the petition.

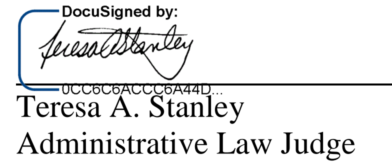


Michael F. Geary
Administrative Law Judge

We concur:



Josh Aldrich
Administrative Law Judge



Teresa A. Stanley
Administrative Law Judge

Date Issued: 1/24/2024