OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **1 STOP COMMUNICATIONS, LLC, dba One Stop Wireless**	OTA Case No. 230914292 CDTFA Case ID: 173-011

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, 1 Stop Communications, LLC, doing business as One Stop Wireless, (appellant) appeals a Decision issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's timely petition for redetermination of a Notice of Determination (NOD) and a corresponding protective claim for refund for any sales or use tax overpaid for the period covered by the NOD. The NOD was issued on April 3, 2018, for tax of $141,721.02, plus applicable interest, and a negligence penalty of $14,172.13 for the period January 1, 2014, through December 31, 2016 (liability period).[2]

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

[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 respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "respondent" shall refer to the board.

[2] The NOD was timely issued because on September 6, 2017, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations, which allowed respondent until April 30, 2018, to issue an NOD for the period January 1, 2014, through December 31, 2014. (See R&TC, §§ 6487(a), 6488.)

ISSUES

1. Whether adjustments to the measure of tax, which is based on an error rate that respondent calculated in a prior audit of appellant, are warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant, a limited liability company, was a Metro PCS authorized dealer with multiple retail stores in California,[3] selling cellular telephones, accessories, and wireless service plans during the liability period. Appellant's seller's permit was opened with an effective start date of December 1, 2006.
2. Respondent previously audited appellant for the period July 1, 2008, through June 30, 2011 (the prior audit). Appellant filed a petition for redetermination with respondent, disputing the prior audit's results. On August 12, 2016, respondent issued a decision recommending a reaudit, which reduced the taxable measure in that case from $1,888,910 to $1,608,087.[4] Thereafter, appellant appealed that earlier decision to OTA, asserting that commissions MetroPCS paid to appellant should be excluded from the taxable measure.
3. In an Opinion dated July 15, 2022, OTA denied appellant's appeal. OTA concluded that commissions MetroPCS paid to appellant should not be excluded from the taxable measure. OTA also held that no further reductions to the prior audit measure were warranted.
4. For the liability period, appellant filed sales and use tax returns reporting total sales of $1,634,622, and claiming no deductions, which resulted in reported taxable sales of $1,634,622. Appellant did not provide books and records for the audit.

[3] Over the liability period, appellant operated 14 locations in the cities of Anderson, Chico, Corning, Elk Grove, Oroville, Red Bluff, Redding (4 locations), Shasta Lake, Williams, and Willow (2 locations).

[4] The prior audit measure was based on the following audit items: additional sales based on a markup of cost; purchases from out-of-state vendors subject to tax; unreported commissions and rebates; unreported taxable sales based on an error rate; and unreported taxable sales based on a difference between recorded taxable sales and reported taxable sales.

5. Respondent obtained Form 1099-K[5] data that showed payments made to appellant for the period 2011 through 2016. Respondent found that the credit card sales reported on the Form 1099-Ks exceeded the total sales reported on appellant's sales and use tax returns for each year (2011-2016).[6] For the liability period, respondent compiled recorded credit card sales of $4,321,319, which exceeded total sales of $1,634,622 reported on appellant's sales and use tax returns by $2,686,697. Respondent could not compute a credit-card-sales ratio for the liability period because appellant did not provide books and records (such as bank statements) from which it could verify appellant's cash sales.
6. Respondent noted that appellant's reported taxable sales for the liability period were similar to appellant's reported taxable sales during the prior audit period. Respondent acknowledged that appellant's reported taxable sales increased from one audit period to the next but attributed the difference to the fact that appellant operated additional locations during the liability period at issue in this appeal. Based on the reported amounts, respondent concluded that appellant did not change its reporting method from one audit period to the next. Thus, respondent utilized the results of the prior audit to calculate an error rate, which it used to determine unreported taxable sales for the liability period.
7. Respondent divided appellant's unreported taxable sales of $1,608,087 for the prior audit period by appellant's reported taxable sales of $1,398,219 for the prior audit period, which revealed an error rate of 115.0097 percent.

[5] Form 1099-K is an IRS Form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant (here, appellant) by a bank, credit card company, or third party network, during a given time period. Form 1099-K includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

[6] Respondent's Audit Assignment History indicates that respondent was unsure whether the Form 1099-K data was complete. The audit is not based on the Form 1099-K data; however, if the data is incomplete, and appellant made additional credit card sales, this would tend to increase the measure of appellant's unreported taxable sales.

8. Respondent applied the error rate to appellant's reported taxable sales of $1,634,622 for the liability period to compute unreported taxable sales of $1,879,974 and audited taxable sales of $3,514,596 ($1,634,622 + $1,879,974) for the liability period.[7]

9. Next, respondent divided appellant's audited taxable sales of $3,514,596 by the total operating months for each location during the liability period (319 months) to calculate average monthly taxable sales per location of $11,018 ($3,514,596 ÷ 319 months).[8] Respondent then compared audited average monthly taxable sales per location for the current liability period of $11,018 to the audited average monthly taxable sales per location for the prior audit period of $10,737.[9] Based on this comparison, respondent concluded that the audit measure for the current liability period was reasonable and in line with the prior audit.

10. On April 3, 2018, respondent issued an NOD to appellant for a tax of $141,721.02, plus applicable interest. Respondent also imposed on appellant a negligence penalty of $14,172.13, because appellant failed to provide adequate books and records for audit. Appellant filed a timely petition for redetermination disputing the NOD and filed a protective claim for refund, which respondent denied.

11. Appellant timely appealed to OTA.

DISCUSSION

Issue 1: Whether adjustments to the measure of tax, which is based on an error rate that respondent calculated in a prior audit of appellant, 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

[7] Respondent noted that appellant operated a location in Elk Grove, California, beginning on May 1, 2015, which is subject to the Sacramento County Transportation Authority (STAT) district tax. Because appellant failed to pay any STAT district taxes, respondent established a separate deficiency measure of $81,000 for reported sales at the Elk Grove location subject to the additional STAT district tax. Appellant does not dispute this audit item, respondent did not address it in its Decision, and OTA will not discuss it further.

[8] This, and other calculations throughout the Opinion, are rounded to the nearest dollar.

[9] The audited average monthly sales for the prior audit period were calculated by dividing audited taxable sales per the prior audit of $3,006,306 by the total number of operating months for all locations of 280. Although the liability period at issue in this case and the prior audit period were both three-year periods, appellant operated additional locations during the current liability period, which increased the number of operating months for all locations from 280 to 319 months.

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. (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 in the case of a failure to file a return, respondent may determine the amount required to be paid on the basis of any information in its possession or that 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*.)

Here, upon audit, appellant did not provide any books and records for the liability period. As a result, respondent was unable to verify the accuracy of appellant's sales and use tax returns using a direct audit method (that is, compiling audited sales directly from appellant's records). Additionally, a review of appellant's Form 1099-K data revealed that appellant made credit card sales of $4,321,319 during the liability period, which exceeded appellant's reported total sales of $1,634,622 for the liability period by $2,686,697. This represents an error rate of 164 percent ($2,686,697 ÷ $1,634,622). Thus, it was reasonable for respondent to conclude that appellant's taxable sales were understated.

To calculate the taxable measure, respondent used the results of a prior audit of appellant to compute an error rate of 115.0097 percent,[10] which respondent then applied to appellant's reported taxable sales for the liability period. Respondent also tested the reasonableness of the audit method by calculating appellant's audited average monthly sales per store and found that they were substantially similar to the audited average monthly sales per store from the prior audit period. Considering the complete lack of books and records, OTA finds that it was rational for

[10] In light of the differences between the credit card sales recorded in the Form 1099-K data and appellant's reported total sales, this error rate appears to be conservative.

respondent to use the results of a prior audit to calculate appellant's audited taxable sales and the results are reasonable. Accordingly, the burden shifts to appellant to show error in the audits.

On appeal, appellant contends that the prior audit deficiency includes nontaxable commissions for the sale of wireless service, which respondent should not have assessed. Appellant argues that the audit measure for the current liability period is overstated because it is based on the prior audit's percentage of error.

However, OTA previously considered the issue of whether nontaxable commissions for the sale of wireless service were properly included in the prior audit. In a July 15, 2022 Opinion, OTA determined that commissions paid to appellant by MetroPCS were properly included in the taxable measure. Appellant had the opportunity to file a petition for rehearing within 30 days of the issuance of OTA's Opinion. (See Cal. Code Regs., tit. 18, §§ 30505, 30602.) Because appellant failed to do so, the July 15, 2022 Opinion became final 30 days later in accordance with Regulation 30505. Thus, any consideration of appellant's contention would not result in a change to the prior audit.

With respect to this appeal, appellant bears the burden of establishing that a result different from respondent's determination is warranted. (See *Appeal of Talavera, supra*.) However, appellant has not provided any evidence or substantive information to show that the proposed tax assessment for the current liability period should be adjusted or was calculated improperly. Appellant's unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) Accordingly, OTA finds no basis to adjust the taxable measure.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal.App.4th 434, 447.)

A taxpayer is required to maintain and make available for examination on request by respondent all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (R&TC, §§ 7053, 7054;

Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (1) 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 of working papers used in connection with the preparation of tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence. (Cal. Code Regs., tit. 18, § 1698(k).)

Here, appellant has been previously audited. Therefore, appellant must have been aware of the recordkeeping requirement. Despite this, appellant did not provide any books and records for the audit. Appellant's failure to maintain sufficient books and records is evidence of negligence. Moreover, the audit revealed that appellant underreported its taxable sales by $1,879,974, which is a substantial difference. Considering the foregoing, OTA finds that the understatement cannot be attributed to appellant's bona fide and reasonable belief that its bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (See *Independent Iron Works, Inc. v. State Bd. of Equalization*, *supra*, 167 Cal.App.2d at 321-324.) Thus, OTA finds that appellant was negligent and concludes that respondent properly imposed the negligence penalty.

HOLDINGS

1. No adjustments to the measure of tax based on a prior audit percentage are warranted.
2. Appellant was negligent.

DISPOSITION

Respondent's action in denying appellant's petition for redetermination and related protective claim for refund is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

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Michael F. Geary
Administrative Law Judge

Date Issued: 7/25/2024