

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
) OTA Case No. 230312847
OVERSEAS GARAGE INC.) CDTFA Case IDs: 3-693-807, 3-697-520
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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

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Overseas Garage Inc. (appellant) appeals a California Department of Tax and Fee Administration (respondent) decision denying appellant’s timely petition for redetermination of a Notice of Determination (NOD) and appellant’s corresponding protective claim for refund.¹ On March 22, 2022, respondent issued the NOD for tax of \$31,823, plus applicable interest, for the period January 1, 2018, through December 31, 2020 (liability period).²

Appellant waived the right to an oral hearing, so the Office of Tax Appeals (OTA) decides this matter on the written record.

ISSUE

Whether any adjustments to the amount of unreported taxable sales are warranted.

¹ A taxpayer will sometimes file both a petition for redetermination and a claim for refund to protect its right to claim a refund or credit for overpayments discovered either in an audit or during the taxpayer’s appeal of an NOD. This type of claim is frequently referred to as a “protective claim for refund.”

² Respondent timely issued the NOD because appellant waived the three-year statute of limitations and allowed respondent until April 30, 2022, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

FACTUAL FINDINGS

1. Appellant, a corporation, operated an automotive repair shop in Long Beach, California.
2. Appellant's seller's permit was open from January 1, 2018, until December 31, 2020, when appellant sold its business.
3. For the liability period, appellant reported the following on its sales and use tax returns (SUTRs): total sales of \$1,064,298; deductions of \$488,172 for nontaxable labor; and taxable sales of \$576,126. For the fourth quarter 2020 (4Q20), appellant also reported taxable sales of fixtures and equipment for \$30,000 from the sale of the business. Thus, for the liability period, appellant reported a total taxable measure of \$606,126.
4. For audit, appellant provided the following books and records: federal income tax returns (FITRs) for 2018 and 2019; financial statements for 2020; bank statements from two business accounts for the liability period; general ledgers for the liability period; sales invoices and merchandise purchase invoices for April 2019; and vendor reports for the liability period.
5. Respondent compared total sales reported on the SUTRs for 2018 and 2019 to the corresponding gross receipts reported on the FITRs and found no material unexplained differences.
6. Upon examining appellant's bank statements from two business accounts, respondent compiled bank deposits from sales proceeds of \$1,231,993 (\$1,455,193 total bank deposits - \$223,200 transfers between bank accounts) for the liability period.³ Upon comparing bank deposits from sales proceeds of \$1,231,993 to reported total sales (excluding the sale of fixtures and equipment) of \$1,064,298, respondent computed a difference of \$167,695. Appellant could not explain the reason for the difference.
7. Respondent compared taxable sales reported on the SUTRs to the corresponding cost of goods sold (COGS) recorded in the general ledgers and computed book markups of

³ Bank deposits are not gross receipts. (R&TC, § 6012(a).) However, where, as here, a retailer is engaged in the business of making retail sales of tangible personal property, the retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of tangible personal property. Respondent uses this evidence to determine audited taxable sales when it cannot accurately establish sales using a direct approach because of a lack of adequate records.

53.79 percent for 2018, 61.84 percent for 2019, and 48.99 percent for 2020.⁴ Based on its experience auditing similar businesses in appellant's geographic area, respondent found that the book markups were too low, and appellant was potentially underreporting its sales. Respondent decided to perform a shelf test to verify the reasonableness of the book markups.⁵

8. Using appellant's sales invoices and merchandise purchase invoices for April 2019, respondent performed a shelf test and computed an audited taxable parts markup of 140.55 percent. Respondent found this audited taxable parts markup reasonable for appellant's type of business and decided to compute taxable sales using the markup method.
9. Respondent obtained vendor purchase data for the liability period from three of appellant's primary parts suppliers. Respondent compared the three vendors' purchase data on appellant to merchandise purchases recorded in appellant's general ledgers and noted minor differences. Respondent concluded that appellant's recorded merchandise purchases were reliable.
10. From appellant's general ledgers, respondent compiled merchandise purchases of \$372,297 for the liability period. Respondent deducted an allowance of 1 percent for pilferage. Afterwards, respondent applied the audited taxable parts markup of 140.55 percent to the merchandise purchases and computed audited taxable sales of \$886,604 for the liability period. Upon comparison to reported taxable sales of \$576,126, respondent computed unreported taxable sales of \$310,478 for the liability period.
11. Respondent issued the NOD to appellant.
12. Appellant timely petitioned for redetermination and filed a protective claim for refund.
13. Respondent denied appellant's petition for redetermination and protective claim for refund by decision dated February 23, 2023.
14. This timely appeal to OTA followed.

⁴ "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is the markup amount divided by cost. In this example, the markup percentage is 42.86 percent ($\$0.30 \text{ markup} \div \$0.70 \text{ cost} = 0.4286$). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

⁵ A shelf test is an accounting comparison of known costs to known selling prices, which is used to compute markups.

DISCUSSION

California imposes upon all retailers a sales tax measured by the retailer's gross receipts from the retail sale of tangible personal property 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 respondent is not satisfied with the tax returns or the amount of tax required to be paid to the state by any person, respondent may compute and determine the amount required to be paid on the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) If any person fails to make a return, respondent will estimate the gross receipts of the person based upon any information within its possession or that may come into its possession. (R&TC, § 6511.)

In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Las Playas #10*, 2021-OTA-204P.) If respondent's determination is not reasonable and rational, then the determination should be rejected. (See *Appeal of Praxair, Inc.*, 2019-OTA-301P; see also *In re Renovizor's, Inc.* (9th Cir.) 282 F.3d 1233, 1237, fn. 1.) If respondent's determination is reasonable and rational, then the determination is presumed correct. (See *In re Renovizor's, Inc.*, *supra*, 282 F.3d at 1237, fn. 1; see also *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 445 (*Paine*).) The burden of overcoming this presumption is on the taxpayer. (*Paine*, *supra*, 137 Cal.App.3d at 445.)

Generally, appellant bears the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Las Playas #10, Inc.*, *supra*.) To satisfy its burden of proof, a

taxpayer must prove both that the tax assessment is incorrect and what the proper amount of tax should be. (*Appeal of AMG Care Collective, supra.*)

Here, respondent's preliminary analysis found an unexplained difference of \$167,695 between reported sales on appellant's SUTRs and appellant's bank deposits from sales proceeds. Coupled with low book markups, these findings indicated to respondent that appellant potentially underreported its sales. Given respondent's findings, OTA finds that it was reasonable and rational for respondent to question the accuracy of appellant's reported sales and examine appellant's reported sales by using an indirect audit method to compute appellant's sales. For this determination, respondent used the markup method, which is a recognized and standard accounting procedure. (See *Appeal of Amaya, 2021-OTA-328P.*) However, the markup method is only effective and reliable if respondent has sufficient information to establish a reasonable markup and the cost of taxable merchandise sold. (*Ibid.*) Here, respondent used the sales invoices and merchandise purchase invoices that appellant provided for April 2019 to establish an audited taxable parts markup of 140.55 percent. Respondent also used appellant's own general ledgers to establish appellant's audited merchandise purchases. Given respondent's use of appellant's own books and records, OTA finds that respondent had sufficient information to establish audited taxable sales using the markup method. Therefore, OTA concludes that respondent has established that its determination was reasonable and rational, and the burden of proof shifts to appellant to show error in the audit.

On appeal, appellant contends that unreported taxable sales are overstated because the audited taxable parts markup of 140.55 percent is not representative of its business. In addition, appellant argues that audited merchandise purchases should be reduced for non-inventory items that OTA understands to be items that appellant did not purchase for purposes of resale. However, appellant has not indicated what it believes is a representative taxable parts markup nor identified the non-inventory items allegedly included in audited merchandise purchases. Furthermore, appellant has not provided any verifiable documentary evidence supporting its contentions. Accordingly, OTA has no basis on which to recommend any adjustments.

In summary, OTA finds that respondent's determination is reasonable and rational because respondent used a standard and acceptable audit method as well as appellant's own books and records to compute its determination. However, appellant has failed to carry its


burden of proving that respondent’s determination is incorrect. Accordingly, OTA concludes that no adjustments to the amount of unreported taxable sales are warranted.

HOLDING


Adjustments to the measure of unreported taxable sales are not warranted.


DISPOSITION

Respondent’s action denying appellant’s petition for redetermination and protective claim for refund is sustained.

DocuSigned by:

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:

48745BB806914B4...
Josh Aldrich
Administrative Law Judge

Signed by:

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Natasha Ralston
Administrative Law Judge

Date Issued: 10/8/2024