OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **METROCOM-DBC,** **dba Metrocom**	OTA Case No. 230613694 CDTFA Case IDs: 001-580-482, 001-796-339

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, Metrocom-DBC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) that denied in part appellant's timely petition for redetermination of a Notice of Determination (NOD) and denied in full a corresponding protective claim for refund.[1] CDTFA issued the NOD on October 17, 2019, for tax of $843,154, plus applicable interest, for the period April 1, 2015, through March 31, 2018 (liability period).[2] As a result of its decision, CDTFA reduced the determined tax liability by $286,323, from $843,154 to $556,831, pursuant to a reaudit CDTFA completed on January 19, 2022.

Appellant waived the right to an oral hearing, so this matter was submitted to the Office of Tax Appeals (OTA) for an opinion based on the written record.

[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 during an audit or that may be discovered during the taxpayer's appeal of the NOD. (See R&TC, § 6901(a).) Such claims are frequently referred to as "protective claims for refund."

[2] CDTFA timely issued the NOD because appellant waived the statute of limitations and extended CDTFA's deadline to issue the NOD to October 31, 2019. (See R&TC, §§ 6487(a), 6488.)

ISSUE

Whether further adjustments to the determined tax liability are warranted.

FACTUAL FINDINGS

1. During the liability period, appellant, a corporation doing business as Metrocom, was an authorized dealer for wireless service provider MetroPCS and had 12 retail stores located in California. Appellant sold cellular telephones (cellphones), accessories, and wireless service plans.
2. For the liability period, appellant claimed no deductions and reported total and taxable sales of $11,706,751.
3. For audit, appellant's first, appellant provided the following books and records to CDTFA: federal income tax returns for 2015 and 2016; X-reports for the liability period;[3] monthly sales invoice listings for 2016 (except March 2016) for three locations; and sample purchase invoices for July 4, 2017, through August 8, 2017. CDTFA found that appellant did not provide complete books and records for the audit.
4. Upon audit, CDTFA computed unreported taxable sales totaling $10,775,863, which was composed of the following two audit items: (1) unreported taxable sales of $1,029,508 based on a comparison of reported taxable sales to taxable sales recorded in X-reports;[4] and (2) additional unreported taxable sales of $9,746,355 based on an error ratio derived from comparing monthly sales invoice listings for 2016 to corresponding X-reports.[5]
5. Based on the results of this audit, CDTFA issued the NOD to appellant.
6. Appellant filed a timely petition for redetermination and a protective claim for refund, disputing the NOD in its entirety.

[3] An X-report is appellant's monthly sales summary of amounts collected on a sale (i.e., sales price less discounts plus sales tax reimbursement) categorized by product.

[4] Appellant does not dispute this audit item.

[5] Based on its review of the monthly sales invoice listings and X-reports, CDTFA concluded that taxable sales recorded in the X-reports reflected only a discounted amount paid by the customer to appellant. In addition, appellant reported other income for 2015 and 2016, which CDTFA determined was related to third-party rebates paid to appellant in exchange for selling cellphones at a discount. Although appellant reported tax to CDTFA based on the discounted selling price, appellant collected sales tax reimbursement based on the non-discounted selling price of the phones. As explained below, this second audit item was superseded in a reaudit.

7. On July 15, 2020, CDTFA held a discussion of audit findings with appellant, and appellant provided information from its supplier regarding the cost of cellphones sold.
8. CDTFA prepared a reaudit to calculate audited taxable sales based on the markup method using this information.
9. Based on the supplier cost information, CDTFA compiled cellphone purchases of $14,356,225 for the liability period.
10. Based on the cellphone purchase invoices for July 4, 2017, through August 8, 2017, CDTFA compiled cellphone purchases of $528,954, and nontaxable freight, insurance, and overpack fees and surcharges totaling $7,440, for a total purchase invoice amount of $536,394 ($528,954 + $7,440) for that period. CDTFA calculated a 1.39 percent ratio of nontaxable freight, insurance, and overpack fees and surcharges to the total purchase invoice amount ($7,440 ÷ $536,394).
11. Using detail and summary information for cellphone sales and costs for October 2016 through December 2016 (sales of $279,069 from X-reports and costs of $228,215 from supplier information), CDTFA computed a markup factor of 1.223 ($279,069 sales ÷ $228,215 cost).
12. Using the monthly sales invoice listings for 2016 for three locations, CDTFA compiled taxable sales of cellphones of $958,354 and total taxable sales of $1,103,826 for 2016. Using these two amounts, CDTFA computed an 86.82 percent ratio of cellphone sales to total sales ($958,354 ÷ $1,103,826).
13. Using information from a third party, CDTFA verified that appellant made nontaxable sales for resale to other retailers and compiled sales for resale of $517,182 for the liability period.
14. With this information, CDTFA then applied the markup method. First, CDTFA reduced cellphone purchases of $14,356,225 by 1.39 percent for nontaxable freight, insurance, and overpack fees and surcharges; added beginning inventory and subtracted ending inventory amounts provided by appellant; and reduced cellphone purchases by two percent for pilferage to compute cellphone cost of goods sold (COGS). CDTFA then applied the audited markup factor of 1.223 to cellphone COGS, computing audited

cellphone sales of $15,350,955 for the liability period.[6] CDTFA then divided audited cellphone sales of $15,350,955 by the 86.82 percent ratio of cellphone sales to total sales to compute audited total sales (cellphones and accessories) of $17,681,143 (rounded). CDTFA then deducted audited nontaxable sales for resale of $517,182, computing audited taxable sales of $17,163,961. Comparing this to recorded taxable sales of $12,736,261 per the X-reports, CDTFA computed unreported taxable sales of $4,427,701 (rounded).

15. CDTFA issued a first reaudit report dated February 11, 2021, reflecting a total taxable measure of $5,457,209 ($1,029,508 + $4,427,701) for the liability period.

16. CDTFA subsequently initiated a second reaudit to adjust cellphone COGS for additional purchases identified by appellant's vendor. Using the markup method (as explained above), CDTFA computed audited taxable sales of $18,822,704. Upon comparing this to recorded taxable sales of $12,736,261 per the X-reports, CDTFA computed unreported taxable sales of $6,086,445 (rounded).

17. CDTFA issued a second reaudit report dated January 19, 2022, reflecting a total taxable measure of $7,115,953 ($1,029,508 + $6,086,445) for the liability period.

18. On February 22, 2023, CDTFA held an appeals conference (at which appellant did not appear) and subsequently issued a decision dated June 7, 2023, ordering a reaudit. As a result of its decision, CDTFA reduced the determined measure of tax by $3,659,910, from $10,775,863 to $7,115,953, pursuant to the second reaudit report dated January 19, 2022; otherwise, CDTFA denied appellant's petition and protective claim for refund.

19. Appellant timely appealed to OTA.

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,

[6] For April 1, 2015, through June 30, 2016, CDTFA applied a markup factor of one because CDTFA noted that appellant was only charging tax on the cost of the cellphones (i.e., no additional markup) for that period.

§ 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).)

Generally, tax applies to the gross receipts from the retail sale of a wireless telecommunication device. (Cal. Code Regs., tit. 18, § 1585(b)(1).) The retailer of the wireless telecommunication device is required to report and pay the tax. (*Ibid*.) Regarding bundled transactions (i.e., goods and services sold as a single package), tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction, measured by the unbundled sales price of that device. (Cal. Code Regs., tit. 18, § 1585(b)(3).) The retailer of the wireless telecommunication device is required to report and pay tax measured by the unbundled sales price of the device and may collect tax or tax reimbursement from its customer measured by the unbundled sales price. (*Ibid*.) Tax does not apply to the charges in excess of the unbundled sales price made for telecommunication services. (*Ibid*.)

Under certain conditions, payments received by the retailer in the form of rebates or other types of payments for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product. (Cal. Code Regs., tit. 18, § 1671.1(a).) When a retailer enters into an oral or written contract with a manufacturer or other third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products in exchange for a certain payment of a like amount from the contracting party (e.g., a payment that is not contingent upon selling a particular amount of the specified products), such payments received by the retailer are part of the taxable gross receipts or sales price of the sales. (Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).) It is rebuttably presumed that any consideration received by retailers from third parties related to promotions for sales of specified products is subject to tax until the contrary is established. (*Ibid*.)

When an amount represented by a person to a customer as constituting reimbursement for taxes due under this part is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid shall be returned by the person to the customer or paid to the state. (R&TC, § 6901.5.)

If CDTFA is not satisfied with the tax returns or the amount of tax required to be paid to the state by any person, CDTFA 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.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Las Playas #10*, 2021-OTA-204P.) If CDTFA'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 CDTFA'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, the taxpayer 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, CDTFA found the books and records appellant provided for audit were incomplete. CDTFA's initial analysis, comparing taxable sales recorded in appellant's own X-reports to amounts reported on its sales and use tax returns (a direct audit method), disclosed unreported taxable sales upon which sales tax was collected from the customers.[7] Accordingly, it was reasonable for CDTFA to question the accuracy of reported sales and further perform a markup analysis (an indirect audit method) to compute appellant's total sales. The markup method is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) However, the markup method is only effective and reliable if CDTFA has sufficient information to establish the cost of taxable merchandise sold and a reasonable markup. (*Ibid*.) Here, appellant itself provided CDTFA with information regarding the costs of cellphones sold (from appellant's suppliers) from which CDTFA established audited sales. As for the markup, CDTFA used

[7] See footnote 5, *ante*, page 2.

information from appellant's own books and records (X-reports and supplier information regarding costs of cellphones sold) to compute the markup factor of 1.223. Given CDTFA's use of books, records, and information provided by appellant, OTA finds that CDTFA had sufficient information to establish audited taxable sales using the markup method. Therefore, OTA concludes that CDTFA 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 were overstated because the COGS included purchases made by other businesses. However, appellant has not identified the purchases allegedly made by other businesses. Furthermore, appellant has not provided any verifiable documentary evidence supporting this contention. Accordingly, OTA finds no basis for further adjustments.

In summary, OTA finds that CDTFA's determination is reasonable and rational because CDTFA used a standard and acceptable audit method as well as books, records, and other information supplied by appellant upon audit, to compute its determination. Appellant has not identified any errors in CDTFA's computation of audited taxable sales nor provided any documentation or other evidence from which a more accurate determination could be made. Because appellant has not carried its burden of proof in this case, OTA concludes that further adjustments to the determined tax liability are not warranted.

HOLDING

Further adjustments to the determined tax liability are not warranted.

DISPOSITION

CDTFA's action reducing the determined tax liability to $556,831 but otherwise 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:

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Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
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Teresa A. Stanley
Administrative Law Judge

Date Issued: 11/20/2024