

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

S. SLATTERY) OTA Case No.: 231114706
) CDTFA Case ID: 0-034-080
)
)
)
)**OPINION**

Representing the Parties:

For Appellant:

James Dumler, CPA

For Respondent:

Amanda Jacobs, Attorney

For Office of Tax Appeals:

Oliver Pfost, Attorney

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, S. Slattery (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's timely petition for redetermination of a Notice of Dual Determination (NODD) issued on June 10, 2015. The NODD is based on CDTFA's determination that appellant is personally liable as a person responsible for unpaid sales taxes of \$65,991.48, plus applicable interest, and a negligence penalty of \$6,615.67 incurred by Pit Pro Cycle, Inc. (Pit Pro) for the period January 1, 2010, through December 31, 2012 (liability period).²

Appellant waived the right to an oral hearing; therefore, the matter is being decided on the written record.

ISSUE

Whether appellant is personally liable for the unpaid sales tax liability of Pit Pro under R&TC section 6829.

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

² Appellant's submissions to OTA and CDTFA's decision from which the present appeal was made do not address the negligence penalty. This Opinion, therefore, will not address whether penalty relief is warranted, as it does not appear to be in dispute.

FACTUAL FINDINGS

1. Pit Pro, a California corporation, operated a retail store in California that sold motorcycle and bicycle parts, accessories, and apparel. Pit Pro also provided repair services. Pit Pro used a point-of-sale system.³
2. Pit Pro obtained a seller's permit from CDTFA in 2001, and at Pit Pro's request, CDTFA closed the seller's permit effective December 31, 2012.⁴
3. California Secretary of State (SOS) Statement of Information (SOI) filed April 7, 2008, shows Pit Pro's corporate officers: appellant, who served as Pit Pro's secretary; appellant's father, R. Wageman, who served as Pit Pro's CEO; and appellant's mother, B. Wageman, who served as CFO. Appellant and her parents also served as the directors of Pit Pro. SOS SOI filed January 31, 2012, shows no change to the corporation's officers and/or directors. SOS records show the corporation was dissolved on February 11, 2013.
4. As an officer of Pit Pro, appellant spoke with CDTFA nine times between 2003 and 2009 concerning Pit Pro's sales tax compliance, including such matters as "missed" sales tax payments.
5. Appellant prepared and submitted the Sales and Use Tax returns (SUTRs) for the periods beginning third quarter 2008 (3Q08) through 1Q10, as well as the prepayment return for April 1, 2010, through April 30, 2010. R. Wageman submitted a prepayment return for the period May 1, 2010, through June 15, 2010. B. Wageman submitted the SUTRs for the periods beginning 2Q10 through 2Q13.⁵
6. CDTFA audited Pit Pro for the period January 1, 2010, through December 31, 2012. During the audit, Pit Pro provided CDTFA with the following records: federal income tax returns (FITRs) for 2010 and 2011, a profit and loss statement for 2011, invoices for

³ Pit Pro used a point-of-sale (POS) system that added sales tax to the sales of taxable items. POS systems typically can produce sales reports that are often used in the preparation of SUTRs.

⁴ Appellant notified CDTFA on March 26, 2013, that Pit Pro was no longer incorporated. However, the seller's permit was not closed until October 11, 2013, with an effective date of December 31, 2012.

⁵ Pit Pro continued to file SUTRs in 2013 under the corporation's seller's permit even after dissolving the corporation on December 21, 2012, with its February 11, 2013 SOS filing.

- online sales, and sales and purchase invoices for ten days in February 2013.⁶ Pit Pro did not provide other records for the audit. Pit Pro stated that its records were stolen.
7. Appellant participated in Pit Pro's audit (e.g., appellant discussed with the auditor the records available for the audit) and signed documents on Pit Pro's behalf, including a waiver of limitations, dated March 28, 2013, and a power of attorney, dated July 2, 2013.
 8. Pit Pro filed sales and use tax returns (SUTRs) for the liability period. Pit Pro reported taxable sales totaling \$181,482 for 2010, \$150,264 for 2011, and \$75,943 for 2012.
 9. For the 2010, 2011, and 2012 tax years, Pit Pro reported on its FITRs, cost of goods sold (COGS) of \$409,406, \$349,624, and \$282,050, respectively (\$1,041,080 in total).
 10. CDTFA compared the taxable sales reported on the SUTRs to the cost of goods sold reported on Pit Pro's 2010 federal income tax return (\$409,406) and Pit Pro's 2011 profit and loss statement (\$349,043) and determined Pit Pro had negative markups of 55.67 percent and 56.95 percent for 2010 and 2011, respectively.⁷ In other words, Pit Pro reported selling its merchandise for less than half of what it cost Pit Pro to purchase the merchandise from its suppliers, which led CDTFA to doubt the accuracy of the SUTRs and to conclude further testing was warranted.
 11. Due to a lack of adequate source documentation and the fact Pit Pro's reported taxable sales were significantly less than its COGS, CDTFA determined that the use of an indirect audit method, in this case a markup analysis, was necessary to examine Pit Pro's taxable sales.
 12. CDTFA performed a shelf test over a period of ten days in February 2013.⁸ The shelf test resulted in an audited markup of 21.86 percent. CDTFA applied the audited markup of 21.86 percent to the COGS reported on Pit Pro's 2010 FITR and its 2011 profit and loss statement, resulting in audited taxable sales of \$491,079 for 2010 and \$413,804 for 2011. CDTFA thereafter calculated an error percentage of 170.59 percent for 2010 and 175.38 percent for 2011.⁹

⁶ Pit Pro's recorded online sales to customers outside California totaled \$15,651 for the entire liability period, which CDTFA accepted without testing.

⁷ "Mark up" is the percentage by which the cost of merchandise is increased to set the retail price.

⁸ A "shelf test" is an accounting comparison of known costs and associated selling prices, used to compute markups.

⁹ The error percentage is calculated by dividing the amount of audited taxable sales by the reported taxable sales. For example, for 2010, Pit Pro reported taxable sales of \$181,482 and CDTFA determined audited taxable sales of \$491,079. The quotient is 2.7059, or 170.59 percent.

13. To determine unreported taxable sales for 2012, CDTFA applied an error percentage of 172.76 to the total taxable sales reported on the SUTRs for the period.¹⁰ CDTFA's audit indicated Pit Pro had taxable sales totaling \$1,112,026 during the liability period, which exceeded Pit Pro's reported taxable sales of \$407,689 by \$704,337, which is 63.3 percent of its audited total taxable sales ($\$704,338 \div \$1,112,027$). Reported taxable sales were \$633,391 less than Pit Pro's COGS.¹¹ In the 1Q10 SUTR, filed by appellant, audited taxable sales of \$96,775, exceeded reported taxable sales of \$35,764 by \$61,011, which is 170.59 percent error.
14. On October 10, 2013, CDTFA issued Pit Pro a Notice of Determination¹² (NOD) for tax of \$66,156.25 plus applicable interest, and a negligence penalty of \$6,615.67. Pit Pro filed a timely appeal of the NOD to CDTFA. CDTFA issued a decision denying the appeal. Pit Pro then appealed the decision to OTA, but appellant failed to file an opening brief. OTA dismissed the appeal for that reason. The NOD became final on or about April 24, 2018.
15. In February 2015, CDTFA opened an investigation into whether any person connected with Pit Pro could be held personally liable under R&TC section 6829 for Pit Pro's unpaid sales tax liabilities.
16. During the investigation, CDTFA determined Pit Pro terminated its business and that it had collected sales tax reimbursement during the liability period, which appellant concedes. Appellant also conceded she was a person responsible for Pit Pro's sales and use tax compliance.
17. Amid the investigation, CDTFA spoke with a CPA who prepared Pit Pro's FITRs and who was associated with the business from 2005 to 2013. Pit Pro's income tax return preparer stated that he mostly worked with R. Wageman and appellant, and occasionally with B. Wageman. He further stated that he did not prepare the SUTRs, but R. Wageman, B. Wageman, or appellant at times, would provide him with the records,

¹⁰ In the audit working papers, CDTFA states that due to the incompleteness of Pit Pro's records, the total percentage of error for 2012 was calculated by combining audited taxable sales for 2010 and 2011 ($491,079+413,804=904,882$), then comparing that number to reported taxable sales for 2010 and 2011 ($181,482+150,264=331,746$) to determine the difference. That difference was then divided by reported taxable sales to calculate the percentage of error ($573,136/331,746=172.76\%$) that was applied to reported taxable sales for the periods within 2012.

¹¹ COGS for 2010, 2011 and 2012 of \$409,406, \$349,624, and \$282,050, respectively (\$1,041,080 in total) exceeded reported taxable sales of \$407,689 by \$633,391.

¹² CDTFA did not provide a copy of Pit Pro's October 10, 2013 NOD. The NOD is described in CDTFA's Appeals Bureau Decision for Pit Pro.

including the SUTRs, that the CPA deemed necessary to prepare the federal income tax returns.

18. In response to a Responsible Person Questionnaire, appellant identified herself as a person authorized to sign Pit Pro's business checks. Appellant also stated that at the direction of R. Wageman, she filed all necessary paperwork for the business, but that R. Wageman had the final say on all reporting matters.
19. In response to a Business Operations Questionnaire, a former employee, Mr. Hammer, indicated that he was employed from November 2008 through July 2012 and that sales tax was charged to customers. In a follow-up conversation with CDTFA on February 18, 2015, Mr. Hammer identified appellant as an owner and one of the people who made financial decisions on behalf of the business, including making employee schedules, signing payroll checks, and addressing questions or concerns.
20. California Employment Development Department (EDD) records indicate Pit Pro reported employee wages totaling \$149,137 from the first quarter of 2010 to the second quarter of 2012. EDD records indicate Pit Pro reported \$0 employee wages for subsequent quarters.
21. Account information provided by Pit Pro's suppliers to CDTFA shows Pit Pro paid its suppliers approximately \$353,607.60 during the liability period.¹³ Pit Pro made purchases every quarter throughout the liability period.
22. CDTFA issued appellant an NODD on June 10, 2015, finding her personally liable as a responsible person under R&TC 6829 for Pit Pro's unpaid sales tax liability and negligence penalty.
23. Appellant pursued an appeal of the June 10, 2015 NODD through CDTFA's internal appeals process, requesting the NODD be redetermined to \$0 because appellant did not have actual knowledge that Pit Pro purportedly underpaid its sales tax. CDTFA issued a Decision denying appellant's appeal, and appellant timely filed this appeal of CDTFA's Decision to OTA.

¹³ Pit Pro's suppliers included Kawasaki, Flanders Company (Flanders), Western Power Sports (Western), Fox, and Parts Unlimited. Four of these suppliers provided evidence of the following purchases totaling \$113,758.38: (1) Fox \$27,377.97 for the liability period and \$2,040.84 for 1Q13 through 3Q13; (2) Western \$60,793.85 for the liability period; (3) Flanders \$5,730.49 for the liability period; and (4) Kawasaki \$17,815.23 for the liability period. Pit Pro's supplier Parts Unlimited provided purchase information of \$239,849.22 following the issuance of the NODD.

DISCUSSION

R&TC section 6829 provides that a person is personally liable for the unpaid tax, penalties, and interest owed by a corporation if all of the following elements are met: (1) the corporation's business has been terminated, dissolved, or abandoned; (2) the corporation collected sales tax reimbursement on its sales of tangible personal property and failed to remit such tax reimbursement to CDTFA; (3) the person had control or supervision of, or was charged with the responsibility for, the filing of returns or the payment of tax, or was under a duty to act for the corporation in complying with the Sales and Use Tax Law; and (4) the person willfully failed to pay taxes due from the corporation or willfully failed to cause such taxes to be paid. (R&TC, § 6829(a), (c); Cal. Code Regs., tit. 18, § 1702.5(a), (b).) CDTFA must prove these elements by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 1702.5(d).) CDTFA must establish that the circumstances it asserts are more likely than not to be correct. (*Appeal of Treyzon*, 2023-OTA-399P.)

Appellant concedes Pit Pro is dissolved and its business terminated, that Pit Pro collected sales tax reimbursement on its sales of tangible personal property during the liability period, and that appellant was a person responsible for Pit Pro's sales and use tax compliance during the liability period. Therefore, the only remaining issue is whether appellant willfully failed to pay, or cause to be paid, Pit Pro's tax liabilities.

"Willfully fails to pay or cause to be paid" means that the failure was the result of an intentional, conscious, and voluntary course of action. (R&TC, § 6829(d); Cal. Code Regs., tit. 18, § 1702.5(b)(2).) This failure may be willful even if it was not done with a bad purpose or motive. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).) In order to show willfulness, CDTFA must establish all of the following:

(A) On or after the date that the taxes came due, the responsible person had actual knowledge that the taxes were due, but not being paid.

(B) The responsible person had the authority to pay the taxes or to cause them to be paid: (i) on the date that the taxes came due and (ii) when the responsible person had actual knowledge as defined in (A). A responsible person who was required to obtain approval from another person prior to paying the taxes at issue and was unable to act on his or her own in making the decision to pay the taxes does not have the authority to pay the taxes or to cause them to be paid.

(C) When the responsible person had actual knowledge as defined in (A), the responsible person had the ability to pay the taxes but chose not to do so. (*Ibid.*)

Regarding the second requirement of willfulness, appellant concedes she had the authority to pay the taxes at issue on Pit Pro's behalf. Thus, the only remaining requirements of willfulness in dispute are actual knowledge and ability to pay.

Knowledge

Appellant contends she did not have actual knowledge that taxes were due but not being paid, and appellant argues that because she lacked actual knowledge, she could not have willfully failed to pay, or cause to be paid, the taxes due. CDTFA counters that as Secretary of Pit Pro, its bookkeeper and manager, and the individual who filed its sales and use tax returns, appellant knew at the time the quarterly taxes became due (i.e., the last day of the month following the quarterly period)¹⁴ that Pit Pro was underreporting its taxable sales due to appellant's involvement in the business and the size and consistency of the corporation's underreporting.

Appellant argues that although her duties as Pit Pro's Secretary, and the size of the understatement might suggest that appellant should have or could have known of the corporation's underreporting during the liability period, it is insufficient to establish that appellant had actual knowledge of the underreporting (i.e., that appellant must have known of the underreporting). In support of her position, appellant cites *Intel Corp. Investment Policy Committee, et al. v. Sulyma* (2020), 589 U.S. 178 (*Sulyma*), a United States Supreme Court decision which discusses the meaning of the phrase "actual knowledge" in the context of the Employee Retirement Income Security Act of 1974.

In the absence of a specific statutory definition, the United States Supreme Court concluded that to have actual knowledge of a piece of information, an individual must in fact be aware of it. (*Sulyma, supra*, 589 U.S. 178, 184.) Actual knowledge is distinguishable from constructive knowledge, which is knowledge imputed to an individual who fails to learn something a reasonably diligent person would have learned. (*Id.*, at p. 185.) However, the United States Supreme Court noted that nothing in its opinion foreclosed any of the "usual ways" to prove actual knowledge, such as inference from circumstantial evidence, or evidence of willful blindness. (*Id.*, at p. 189.) In California, circumstantial evidence is that which is applied to the principal fact, indirectly, or through the medium of other facts, from which the principal fact is inferred. (*People v. Goldstein* (1956) 129 Cal.App.2d 146, 152.)

¹⁴ R&TC section 6451 specifies that the quarterly sales and use taxes owed are due and payable on or before the last day of the month following each quarterly period.

Actual knowledge may be inferred from circumstantial evidence. (*Sulyma, supra*, 589 U.S. 178, 189.) To the extent appellant argues that actual knowledge cannot be inferred from circumstantial evidence, appellant's argument is without merit. CDTFA may satisfy its burden of proof by pointing to facts in the record which, when taken together, permit the inference of the principal fact it seeks to prove, namely, that appellant had actual knowledge Pit Pro's taxes were due but not being paid.

CDTFA provided evidence that on the seller's permit application in 2003 for Pit Pro, appellant was listed as manager and bookkeeper. As Pit Pro's bookkeeper, appellant not only had the authority to pay taxes due or, in this case, underpay the taxes as they became due. Appellant prepared and submitted as manager, Pit Pro's SUTRs for 3Q08 through 1Q10. The liability period includes 1Q10, where Pit Pro reported taxable sales of \$35,764 while CDTFA's audited measure was \$96,775. CDTFA spoke with a CPA who prepared Pit Pro's FITRs who stated that he did not prepare the SUTRs, but R. Wageman, B. Wageman, or appellant at times, would provide him with the records, including the SUTRs, that the CPA deemed necessary to prepare the federal income tax returns. The significant difference between recorded sales and audited sales is persuasive evidence that the preparer, in this case appellant, had actual knowledge that Pit Pro was underreporting its taxable sales for 1Q10. Additionally, during a telephone conversation in relation to an outstanding tax liability with CDTFA on February 4, 2015, R. Wageman stated that he would have his daughter, [appellant], call to discuss what we need done since she understands more. This is further evidence that appellant continued in her management role and was knowledgeable about the tax liability and financial matters of the corporation.

CDTFA provided evidence that appellant prepared and submitted Pit Pro's SUTRs and prepayments for the period July 1, 2008, through the April 30, 2010. CDTFA also provided evidence that appellant spoke with CDTFA nine times between 2003 and 2009 concerning Pit Pro's sales tax compliance, including on such matters as "missed" payments. CDTFA had a discussion with a former employee, Mr. Hammer, on February 18, 2015, who stated that he worked at Pit Pro from November 2008 through July 2012, where he confirmed that R. Wageman and appellant handled the financial decisions for the corporation and that appellant was the manager. As manager, appellant had access to POS sales reports as well as making purchases of inventory for the store. Evidence from Flanders, Pit Pro's supplier, shows that appellant ordered parts consistently throughout the liability period which shows that appellant had the authority to make financial decisions on behalf of the corporation even after appellant discontinued filing SUTRs for Pit Pro. There is also evidence appellant actively

participated in Pit Pro's audit, which commenced after the liability period. CDTFA contacted Pit Pro on March 26, 2013, at the telephone number for the business and asked to speak with appellant to discuss the audit. During the telephone call with appellant, CDTFA discussed the records needed for the audit, such as FITRs, bank statements, online sales information and credit card processor statement which appellant said could be made available. During the audit, appellant signed documents on behalf of Pit Pro, such as form BOE-82 Authorization for Electronic Transmission of Data dated September 24, 2012, form BOE-122 Waiver of Limitation dated March 28, 2013, and form BOE-392 Power of Attorney dated July 2, 2013.

Collectively, this evidence shows appellant played a consistent role in Pit Pro's financial matters and sales tax compliance from at least 2003 through 2013. Although there is evidence showing this role was not exclusive to appellant, appellant's other actions as the business manager and bookkeeper show that appellant had knowledge of Pit Pro's sales and expenses. In addition, Mr. Hammer, when asked about the role of B. Wageman, indicated that he had never had dealings with her during his employment. In other words, this evidence dispels the impression that appellant was not involved in sales tax matters during the liability period simply because she did not sign or submit the SUTRs after 1Q10.

Pit Pro's own records indicate it sold tangible personal property for significantly less than it cost Pit Pro to purchase that property from its suppliers during the liability period, and appellant or R. Wageman did not provide a credible explanation addressing this issue during the audit.¹⁵ Likewise, CDTFA's audited measure of taxable sales totaling \$1,112,026 for the liability period is significantly greater than Pit Pro's reported taxable sales of \$407,698 for the same period, indicating Pit Pro's underreporting was pervasive and not limited to 1Q10.

As a corporate officer, director and manager of a closely held family business, in conjunction with the evidence that appellant was consistently involved in the sales tax compliance of a business which CDTFA determined to have significantly underreported taxable sales, OTA considers it implausible that appellant would be unaware that Pit Pro underreported taxable sales during the liability period. In short, CDTFA has provided sufficient circumstantial evidence showing that it is more likely than not that appellant had actual knowledge that taxes were due but not being paid during the liability period.

¹⁵ Pit Pro contends the tax liability is overstated due in large part to additional disallowed sales in interstate commerce and sales for resale. However, Pit Pro only claimed deductions for nontaxable labor and sales tax included on its SUTRs for the liability period. Even so, CDTFA examined sales invoices and allowed a deduction for out of state shipments during the audit. Pit Pro did not maintain or provide additional shipping documents to document any additional exempt sales or claimed exempt sales for which it did not collect sales tax, beyond what has already been allowed.

Ability to Pay

Determining whether a responsible person had the ability to pay taxes usually turns on whether there is evidence the underlying business had funds available to pay the taxes as they became due. (See *Appeal of Treyzon*, *supra*; see also *Appeal of Eichler*, 2022-OTA-029P.) In response to a Responsible Person Questionnaire, appellant identified herself as a person authorized to sign Pit Pro's business checks. Appellant signed a Pit Pro check dated April 14, 2010, paid to Franchise Tax Board which illustrates that she had the ability to make payments on the corporation's behalf. Here, CDTFA obtained records from EDD showing Pit Pro reported wages totaling \$149,137¹⁶ from 1Q10 through 2Q12. CDTFA also obtained records from Pit Pro's suppliers indicating Pit Pro paid its suppliers approximately \$353,607 during the liability period. In addition, Pit Pro's Profit & Loss statement for 2011 shows purchases of \$349,043. These records show Pit Pro had funds available during the liability period to pay its tax liabilities. Accordingly, OTA finds appellant is personally liable under R&TC section 6829 for Pit Pro's unpaid tax liabilities for the period January 1, 2010, through December 31, 2012.

¹⁶ CDTFA's Request for 6829 Dual memo (dual memo) lists EDD wages of \$149,135.95. However, Exhibit N of the dual memo, lists EDD Wage History for Pit Pro which total \$149,137, the discrepancy appears to be due to rounding.

HOLDING

Appellant is personally liable for the unpaid sales tax liability of Pit Pro under R&TC section 6829

DISPOSITION

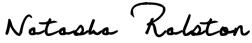
CDTFA's action is sustained.

Signed by:

4E8E740EDB984CD...

Kim Wilson
Hearing Officer

We concur:

Signed by:

25F8FE08FF50478...

Natasha Ralston
Administrative Law Judge

DocuSigned by:

1A9B52EF88AC4C7...

Michael F. Geary
Administrative Law Judge

Date Issued: 1/8/2025