OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 231114701
R. WAGEMAN	) CDTFA Case ID: 151-013
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	)
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	)

OPINION

Representing the Parties:

For Appellant: James Dumler, CPA

For Respondent: Amanda Jacobs, Attorney

For Office of Tax Appeals: Nguyen Dang, Attorney

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, R. Wageman (appellant) appeals a decision (the decision) issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a June 10, 2015 Notice of Dual Determination (NODD) for tax of $65,991,[2] plus applicable interest and a negligence penalty of $6,616 for the period January 1, 2010, through December 31, 2012 (liability period).[3] The NODD reflects respondent's determination that appellant is personally liable for the unpaid tax liabilities of Pit Pro Cycle Inc. (Pit Pro) for the liability period pursuant to R&TC section 6829.[4]

[1] Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (the 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] Dollar amounts referred to in this Opinion may be rounded, which may cause immaterial differences in some totals. Rounding is for ease of reference only and does not affect the rights and obligations of the parties.

[3] The NODD was timely issued under R&TC section 6829(f), and timeliness of the NODD is not in dispute.

[4] The NOD issued to Pit Pro was for $66,156 tax and a 10 percent negligence penalty of $6,616. It is not clear why the NODD issued to appellant is for tax of $65,991, but since the difference is in appellant's favor, OTA need not inquire further.

Appellant waived the right to an oral hearing and agreed to submit the matter to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, section 30209(a).

ISSUE

Is appellant personally liable for Pit Pro's unpaid tax liabilities for the liability period pursuant to R&TC section 6829?

FACTUAL FINDINGS

1. According to Pit Pro's website, accessed by respondent on February 2, 2015,[5] appellant founded the business in 1992 to provide services and parts to motocross enthusiasts. He operated the business as a sole proprietor, initially out of appellant's garage and a vehicle from which he sold motorcycle services and parts, then two years later from a retail location in Newhall, and approximately four years after that from a larger retail facility from which appellant and staff were able to supply more motorcycle parts and accessories.[6] Pit Pro also made online sales. According to a statement attributed to appellant, Pit Pro sold some parts, but it was minimal. Pit Pro's website, on the other hand, described "a full service shop offering professional suspension work and a storefront with a large showroom."
2. Appellant incorporated the business in January 2001. Appellant and his spouse owned Pit Pro in equal shares.
3. Pit Pro first applied for a seller's permit in May 2001, approximately nine years after appellant first began selling parts and accessories.
4. According to a statement attributed to appellant, he dropped out of school in the 8th grade, is not computer literate, and did not know how to operate a business. Appellant stated that he knew how to fix things, and he left everything else to his spouse and daughters, S. Slattery and H. Bland.[7] However, appellant also concedes that he was in charge of Pit Pro and his spouse and daughters did what he told them to do.

[5] The website with this history was still active years after appellant purportedly closed or sold the business.

[6] There are indications in the record that Pit Pro may have also sold bicycle repairs, parts, and accessories.

[7] S. Slattery was also a former officer of Pit Pro, and another person to whom respondent issued an NODD for the same liability. A similar NODD was issued to appellant's spouse. Respondent did not issue an NODD to H. Bland.

5. Appellant's spouse and both daughters stated in writing that appellant was responsible for Pit Pro's sales and use tax compliance.
6. Pit Pro purchased materials, parts, and accessories ex-tax from vendors and collected sales tax reimbursement from its customers on retail sales of parts and accessories.[8] Pit Pro's sales and use tax returns (SUTRs) filed for quarters within the liability period did not report any use tax due.[9]
7. Appellant concedes that he was Pit Pro's CEO and a person responsible for Pit Pro's sales and use tax compliance, with the authority and the ability to pay Pit Pro's sales and use tax liabilities when due.
8. On its 2010, 2011 and 2012 federal income tax returns (FITRs), all signed by appellant, Pit Pro reported cost of goods sold (COGS) of $409,406, $349,624, and $282,050, respectively ($1,041,080 in total); and gross receipts of $647,153, $533,988, and $427,553, respectively ($1,608,694 in total).[10]
9. On its SUTRs for 2010, 2011, and 2012, Pit Pro reported total sales of $647,153, $601,225, and $427,533 ($1,637,605 in total), nontaxable labor of $447,976, $436,997, and $344,942 ($1,229,915 in total), sales tax reimbursement included in reported total sales of 17,695, $13,964, and $6,648, and taxable sales of $181,482, $150,264, and $75,943 ($407,689 in total), respectively.
10. For the liability period, Pit Pro's reported taxable sales were $633,391 less than its COGS ($1,041,080 - $407,689).
11. By letter dated February 1, 2013, respondent notified Pit Pro that it had been selected for a routine audit. Ten days later, Pit Pro's directors (appellant and his spouse) filed a Certificate of Dissolution with the Secretary of State. The Certificate of Dissolution bears a signature date of December 21, 2012, and appellant asserts that he relied on his accountant to file the document in a timely fashion.

[8] By "ex-tax," this Opinion means without the payment of sales tax reimbursement or use tax to the vendor or use tax directly to respondent.

[9] The Automotive Repair Act (Business and Professions Code sections 9880, et seq.) applied to Pit Pro. (See Bus. & Prof. Code, §9880.1(h).) Pit Pro was required to issue invoices separately describing all service work performed and parts supplied, and separately stating sales tax reimbursement, if any, collected from customers. (See Bus. & Prof. Code, § 9884.8.) A February 25, 2013 Pit Pro invoice for a repair includes a $15 labor charge, a $4 charge for parts, and sales tax reimbursement measured by the price of the parts.

[10] Pit Pro's 2011 Profit and Loss Statement showed the same COGS and gross receipts.

12. After Pit Pro dissolved, appellant continued to operate the business as a sole proprietor until at least June 2014.
13. For the audit, Pit Pro provided its FITRs for 2010 and 2011, a Profit and Loss Statement for 2011, invoices pertaining to its online sales, and purchase and sales invoices for the first ten days of February 2013.[11]
14. Based, at least in part, on the evidence that Pit Pro reported taxable sales of parts and accessories that were less than 40 percent of Pit Pro's cost, respondent suspected that Pit Pro was substantially underreporting its taxable sales.
15. Due to a lack of adequate source documentation, respondent decided that it needed to use an indirect audit method, in this case a markup analysis, to estimate Pit Pro's taxable sales.
16. Based on an examination of Pit Pro's sales invoices for the first 10 days of February 2013, respondent established an audited markup of 21.86 percent, which Pit Pro agreed was reasonable.
17. For 2010 and 2011, respondent applied the audited markup factor to Pit Pro's reported COGS to compute audited taxable sales of $491,079 and $413,804 for 2010 and 2011, respectively. Respondent subtracted reported taxable sales of $181,482 and $150,264, respectively, to determine unreported taxable sales of $309,597 for 2010 and $263,540 for 2011. The resulting percentages of error (error rate)[12] for 2010 and 2011 were 170.59 percent and 175.38 percent, respectively, or an average error rate for the two years combined of 172.76 percent.
18. For 2012, respondent estimated Pit Pro's audited taxable sales by applying the average reporting error rate (172.76 percent) to Pit Pro's reported taxable sales for 2012 of $75,943 to determine unreported taxable sales of $131,201.
19. In summary, respondent determined that Pit Pro's audited taxable sales for the liability period were $1,112,027 and that Pit Pro had underreported its taxable sales for the liability period by $704,338 ($309,597 + $263,540 + $131,201). In other words, Pit Pro failed to report over 63 percent of its taxable sales ($704,338 ÷ $1,112,027).
20. Due to Pit Pro's failure to maintain and provide adequate records, and its substantial and consistent underreporting during the liability period, respondent imposed a 10 percent negligence penalty.

[11] Pit Pro reported that its business books and records were stolen.

[12] The reporting error rate is computed by dividing unreported taxable sales by reported taxable sales and multiplying by 100.

21. Respondent issued an NOD, which was based on the audit determination, to Pit Pro.
22. Pit Pro failed to timely pay or appeal the NOD, which became final (i.e., due and payable) on or about April 24, 2018.
23. Following the termination of Pit Pro's business and its failure to pay the determined liability, respondent investigated appellant and determined that he was personally liable for Pit Pro's unpaid tax liability pursuant to R&TC section 6829.
24. On June 10, 2015, respondent issued the NODD to appellant.
25. Appellant filed a petition for redetermination, and respondent issued the decision denying the petition.
26. This timely appeal followed.

DISCUSSION

As relevant here, individuals may be held personally liable for the unpaid sales and use tax, and the related penalties and interest, of a corporation if the following four conditions are met: (1) the corporation's business has been terminated, dissolved or abandoned; (2) the corporation collected and failed to remit sales tax reimbursement or use tax or failed to pay use tax on its consumption of tangible personal property; (3) the person against whom the liability is asserted (the responsible person) had control, supervision, responsibility or a duty to act on behalf of the corporation concerning its sales and use tax obligations; and (4) the responsible person willfully failed to pay (or willfully failed to cause others to pay) the corporation's tax liabilities. (R&TC, § 6829; Cal. Code Regs., tit. 18, § 1702.5.) Here, appellant concedes the first three conditions: (1) that the business of Pit Pro has ceased; (2) that Pit Pro collected sales tax reimbursement from its customers on retail sales; and (3) that appellant was a person responsible for Pit Pro's sales and use tax compliance. Therefore, the disposition of this appeal turns solely on whether appellant willfully failed to pay (or willfully failed to cause others to pay) Pit Pro's taxes.

To satisfy the willfulness requirement, respondent must establish by a preponderance of evidence that appellant's failure to pay the taxes (or to cause them to be paid) resulted from an intentional, conscious, and voluntary course of action. (R&TC, § 6829(d); Cal. Code Regs., tit. 18, § 1702.5(b)(2), (d).) Generally, this requires proof that the following three conditions existed when the taxes were due: (1) appellant had actual knowledge that the taxes were due but not being paid; (2) appellant had the authority to pay the taxes or to cause them to be paid; and (3) appellant had the ability – usually determined by reference to Pit Pro's available funds –

to pay the taxes but chose not to do so.[13] (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(A)-(C).) Appellant concedes the second and third conditions, authority and ability to pay when taxes became due for the liability period. Consequently, the appeal turns on the question of knowledge.

Appellant argues that respondent has failed to prove that, when appellant had both the authority and the ability to pay the Pit Pro's taxes, appellant also had actual knowledge that Pit Pro's taxes for the liability period were not being paid. Appellant asserts that unpaid taxes were not determined until after respondent completed its audit and that this did not occur until long after the corporation had been dissolved, and after appellant's authority and ability to pay Pit Pro's tax liabilities had ended.[14]

OTA finds appellant's arguments regarding knowledge to be lacking in several respects. Appellant views the liability, determined in this matter by audit, as if it came into existence only after respondent determined the deficiency amount. Appellant specifically argues that "a finding of willful failure is not a matter of knowledge of a tax liability as it is incurred, [apparently referring to issuance of an NOD,] but rather on or after the date the taxes became due." What this statement fails to recognize is that when respondent determines a liability for a period long since past, it is not creating the liability; it is identifying the liability that the taxpayer in fact incurred but failed to report in the past.

Citing *Intel Corp. Investment Policy Committee, et al. v. Sulyma* (2020) 589 U.S. 178 (*Sulyma*), appellant has gone to some effort to persuade OTA that "actual knowledge" means just that. OTA is not aware that there has ever been a real dispute regarding the meaning of that term or the required proof in this context. Nor should there be any dispute that a finding of actual knowledge can be based on circumstantial evidence or evidence of willful blindness. (*Sulyma*, *supra*, at pp. 189-190, citing *Global-Tech Appliances, Inc. v. SEB S. A.* (2011) 563 U.S. 754, 769, for the proposition that a person cannot escape liability "by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances.") The question here is simply whether a preponderance of the evidence, circumstantial or otherwise, shows that appellant knew, in the literal sense, that Pit Pro was not

[13] A failure to pay a tax liability (or to cause it to be paid) may be willful even though such failure was not with a bad purpose or motive. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).)

[14] Appellant also relies on (and provided copies of) several of respondent's decisions and OTA's non-precedential opinions that pertain to unrelated taxpayers, arguing that these are deserving of OTA's consideration. OTA decides factual issues based on the evidence submitted in the appeal. It decides legal issues according to the dictates of the law, including precedent. These documents have no apparent relevance to the factual issues presented; they do not constitute precedent; and none of them contain persuasive analyses of value in this appeal. This Opinion will not discuss them further.

paying all of its taxes when appellant also had the authority and ability to pay them or to direct that they be paid.

The evidence shows that appellant was Pit Pro's CEO, having founded the company in 1992 and having been the person who made financial decisions for the business, before and after it was incorporated. It was appellant's decision to sell parts and accessories for years without the required seller's permit. It was appellant's decision to incorporate and to apply for a seller's permit several months later. Appellant and the other family members who were owners and operators of the business agree that appellant made the financial decisions; and he was responsible for sales and use tax compliance. The evidence shows that appellant's statement that he just "fixed things" is not entirely true. He managed everything, usually relying on his spouse and daughters to handle the paperwork but ultimately making the decisions. Appellant knew that Pit Pro spent considerable sums of money to acquire parts and accessories for resale. He signed Pit Pro's FITRs, which clearly showed Pit Pro's COGS of $409,406, $349,624, and $282,050 in 2010, 2011, and 2012, respectively, which is inconsistent with appellant's characterization of Pit Pro's parts sales as "minimal." People who are the founders of businesses, who are the CEOs that make the financial decisions, often rely on others to do the paperwork; but those people make decisions on the basis of facts. OTA is persuaded that appellant knew about the obvious underreporting of taxable sales.

There is also the question of the timing of the corporate dissolution, just 10 days after respondent mailed a letter to Pit Pro about the planned audit.[15] Although OTA's conclusion that appellant knew that the taxes at issue were not being paid does not rely on the timing of the corporate dissolution, that timing is certainly consistent with that conclusion.

Respondent used a recognized and appropriate audit method (the markup method) to determine Pit Pro's tax liability (see *Appeal of Amaya*, 2021-OTA-328P), and appellant has not challenged the validity or accuracy of the audit findings or the imposition of the negligence penalty. The record does not contain an explanation of how appellant calculated and reported Pit Pro's tax liability; and, finally, the evidence shows that, even on the basis of the limited records provided, Pit Pro substantially underreported taxable sales for the liability period, and it is more likely than not that this fact was apparent to appellant.

On the basis of this evidence, OTA finds that appellant, at a time when he had both the authority and the ability to pay Pit Pro's taxes, also had actual knowledge that Pit Pro was not

[15] While the document itself bears a December 21, 2012 signature date, there is no independent evidence to support appellant's assertion that he and his spouse signed the Certificate of Dissolution weeks before respondent mailed its audit notification.

paying its taxes, and that all conditions precedent to the imposition of personal liability on appellant for the unpaid liabilities of Pit Pro pursuant to R&TC section 6829 have been satisfied.

HOLDING

Appellant is personally liable for Pit Pro's unpaid tax liabilities for the liability period pursuant to R&TC section 6829.

DISPOSITION

Respondent's action denying appellant's petition for redetermination is sustained.

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Michael F. Geary
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

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Greg Turner
Administrative Law Judge

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