

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
THE VAPE LOUNGE INC.

) OTA Case No.: 240415981
) CDTFA Case ID: 4-491-153
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)
)

OPINION

Representing the Parties:

For Appellant:

Danny Seo, CPA
Marino M. Younan, Representative

For Respondent:

Sunny Paley, Attorney
Jason Parker, Chief of Headquarters Ops.
Chad T. Bacchus, Attorney

G. TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, The Vape Lounge Inc. (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 Determination (NOD) issued on December 28, 2022. The NOD is for tax of \$36,305, plus applicable interest, and a 40 percent unremitted tax reimbursement collected (UTC) penalty of \$11,214 for the period October 1, 2016, through September 30, 2019 (liability period).

Office of Tax Appeals (OTA) Panel Members Greg Turner, Steven Kim, and Josh Aldrich held a virtual oral hearing for this matter on January 14, 2025. At the conclusion of the oral hearing, the record was closed and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, section 30209(b). Appellant has conceded the assessment as to unpaid taxes and accumulated interest and therefore OTA does not consider those issues further.

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.

ISSUE

Whether the UTC penalty was properly imposed and if so, whether the penalty should be relieved.

FACTUAL FINDINGS

1. Appellant, a California corporation, is a tobacco products retailer in San Marcos, California, that sells tobacco, vapes, related products, and accessories.
2. CDTFA selected appellant's business for a routine audit for the period of October 1, 2016, through September 30, 2019.
3. Appellant supplied point of sale (POS) reports and federal income tax returns (FITRs) for 2017 and 2018. CDTFA performed a total sales reconciliation with appellant's sales and use tax returns, noting differences of \$315,388 for 2017 and \$187,038 for 2018.
4. CDTFA performed a markup analysis² using the gross receipts and cost of goods sold (COGS) figures reported in appellant's FITRs to establish a markup of 121.95 percent for 2017 and 165.02 percent for 2018, which the auditor considered low for the type of business appellant operates.
5. In comparing the POS reports to reported taxable sales, and accounting for certain valid claimed credits, CDTFA determined that appellant underreported taxable sales in the amount of \$401,722 for the liability period.
6. CDTFA's examination of the POS reports established that appellant separately stated sales tax charges on all sales and collected sales tax reimbursement from the customers at the time of sale. Thus, CDTFA determined that appellant failed to remit sales tax reimbursement it had collected on the unreported taxable sales of \$401,722.
7. CDTFA determined that unremitted sales tax exceeded \$1,000 per month on average and 5 percent of the total amount of the tax liability for which the sales tax reimbursement was collected for 4Q16 through 4Q17, but not the remaining quarters during the liability period.
8. On December 28, 2022, CDTFA timely issued the NOD for \$36,305 in tax, plus accrued interest, and a UTC penalty of \$11,214 for the liability period. Appellant was credited \$2,398.90 for payments made.

² A "markup analysis" is an indirect audit technique used to estimate a taxpayer's expected total sales from cost of goods sold. By comparing gross receipts to cost of goods sold, the auditor can establish an expected sales price as a percentage of costs. That "markup" can be used in comparison to similarly situated businesses to evaluate the veracity of the taxpayer's reported gross receipts.

9. On January 3, 2023, appellant timely filed a petition for redetermination with CDTFA disputing the NOD in its entirety.
10. At the appeals conference, appellant provided additional sales reports showing that the measure of unreported taxable sales was overstated due to many transactions representing inter-store transfers of stock.³ Upon re-examination, CDTFA agreed to reduce the measure of unreported sales by \$78,404, to \$323,318. The original tax deficiency of \$36,305 was reduced to \$30,225 and the UTC penalty was reduced from \$11,214 to \$8,706.
11. Appellant conceded the remaining liability for tax and applicable interests but continued to dispute imposition of the UTC penalty.
12. This timely appeal followed.

DISCUSSION

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 excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For 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 CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Any person who knowingly collects sales tax reimbursement and fails to timely remit it to the state is liable for a penalty of 40 percent of the amount not timely remitted if the failure to remit exceeds certain thresholds. (R&TC, § 6597(a)(1).) The penalty does not apply if the

³ Appellant operated more than one retail location and periodically transferred product between stores recording those transfers through their POS system as retail sales.

person's liability for unremitted sales tax reimbursement averages \$1,000 or less per month or does not exceed five percent of the total amount of the tax liability for which the sales tax reimbursement was collected for the period in which the tax was due, whichever is greater. (R&TC, § 6597(a)(2)(A).)⁴ In order for OTA to sustain CDTFA's imposition of the 40 percent UTC penalty, CDTFA must establish that: (1) appellant knowingly collected sales tax reimbursement from its customer(s); (2) appellant failed to timely remit the sales tax for which it collected the reimbursement to the state; and (3) the amount of sales tax collected but not remitted exceeds the applicable threshold. (R&TC, § 6597(a)(1)-(2).) The applicable standard of proof is by a preponderance of the evidence. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.)

The evidence shows that all requirements for imposition of the 40 percent UTC penalty under R&TC section 6597(a) have been met. Appellant separately stated tax reimbursement on its sales receipts during the liability period. Appellant's POS reports show appellant collected sales tax reimbursement on all sales. Therefore, appellant knowingly collected sales tax reimbursement from its customers. (See R&TC, § 6597(a)(1).) Appellant did not remit to the state all the sales tax reimbursement that it collected. (*Ibid.*) Finally, the unremitted sales tax reimbursement averages more than \$1,000 per month during the penalty period and is more than five percent of the recorded collected sales tax reimbursement per quarter for 4Q16 through 4Q17. (See R&TC, § 6597(a)(2)(A).) Therefore, the requirements for imposition of the 40 percent UTC penalty under R&TC section 6597(a) have been met. Accordingly, CDTFA correctly imposed the 40 percent UTC penalty.

If a person's failure to make a timely remittance of sales tax reimbursement is due to reasonable cause or circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person shall be relieved of the 40 percent penalty. (R&TC, § 6597(a)(2)(B).) "Reasonable cause or circumstances beyond the person's control" includes, but is not limited to, any of the following: (1) the occurrence of a death or serious illness of the person or the person's next of kin that caused the person's failure to make a timely remittance; (2) the occurrence of an emergency, as defined in Government Code section 8558, that caused the person's failure to make a timely remittance; (3) a natural disaster or other catastrophe directly affected the business operations of the person that caused the person's failure to make a timely remittance; (4) CDTFA failed to send returns or other information to the correct address of record, that caused the person's failure to make a timely remittance; (5) the person's failure to make a timely remittance occurred only once over a

⁴ The thresholds for R&TC section 6597 were revised by Senate Bill 1528 for determinations made on or after January 1, 2025.

three-year period, or once during the period in which the person was engaged in business, whichever time period is shorter; or (6) the person voluntarily corrected errors in remitting tax or tax reimbursement that were made in previous reporting periods and remitted payment of the liability owed as a result of those errors prior to being contacted by CDTFA regarding possible errors or discrepancies. (R&TC, § 6597(b)(1)(A)-(F).) R&TC section 6597 does not establish a procedure for requesting relief.⁵ OTA interprets R&TC section 6597 to require the taxpayer or its designee to request relief and prove a factual basis for the request.

Appellant contends their newly formed and operating company had experienced difficulties in properly implementing their new POS system which was at times operated improperly. Appellant asserted as evidence the inter-store transfers of inventory being treated as sales upon which sales tax reimbursement was recorded as having been charged and collected.⁶ Appellant additionally notes the collection and remittance errors occurred early during the liability period but not after additional controls and staff training were implemented.

Appellant has not alleged facts sufficient to establish any of the six non-exclusive, express examples of “reasonable cause” in R&TC section 6597(b)(1). Therefore, appellant must show that the failure to remit collected reimbursement occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessperson to have acted under similar circumstances. (*Appeal of Finnish Line Motorsports, Inc.*, 2019-OTA-138P.) In order for appellant to be eligible for relief, the evidence must show that their failure to remit collected reimbursement was not the product of their own neglect, willful or otherwise. (*Ibid.*) Here, appellant has failed to establish that it is eligible for relief with such evidence. While appellant’s actions may have been unintentional, that does not speak to the limited grounds upon which the statute affords relief. It was appellant’s responsibility to maintain their POS system and reconcile that system’s recording of collected tax reimbursement with its returns. Appellant’s failure to remit collected tax reimbursement shown by its own POS system, unintentional as it might have been, fails to establish grounds for relief under the statute. OTA finds that appellants have failed to establish

⁵ R&TC section 6592 establishes a procedure for requesting relief of some penalties when an untimely return of payment is due to reasonable cause and circumstances beyond the person’s control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. Taxpayers requesting relief under R&TC section 6592 are required to by file a statement under penalty of perjury setting forth the facts upon which the person bases the claim for relief. (R&TC, § 6592(b).)

⁶ It should be noted that CDTFA adjusted for these inter-store transfers, and they are not included in the liability or the calculation of the UTC penalty.

grounds upon which relief of the 40 percent UTC penalty under R&TC section 6597 can be granted.

HOLDING

Appellant has not established a basis for relief of the UTC penalty.

DISPOSITION

CDTFA's action denying appellant's protest for relief from the UTC penalty is sustained.

Signed by:

Greg Turner

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Greg Turner
Administrative Law Judge

We concur:

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Steven Kim

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Steven Kim
Administrative Law Judge

DocuSigned by:

Josh Aldrich

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Josh Aldrich
Administrative Law Judge

Date Issued: 4/8/2025