

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

| | | |
|---|-----------------------|--|
| In the Matter of the Appeal of: 1 STOP CHASSIS AND TRAILER REPAIR, INC. |))))) | OTA Case No. 230814022 CDTFA Case ID: 2-536-773 |
|---|-----------------------|--|

OPINION

Representing the Parties:

| | |
|----------------------------|--|
| For Appellant: | Nader Shahatit, Representative |
| For Respondent: | Jason Parker, Chief of Headquarters Ops. |
| For Office of Tax Appeals: | Ada Kassa, Business Taxes Specialist |

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, 1 Stop Chassis and Trailer Repair, Inc. (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on January 26, 2021. The NOD is for tax of \$37,808, plus applicable interest, and a 10-percent negligence penalty of \$3,780.78 for the period July 1, 2016, through June 30, 2019 (liability period).²

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

ISSUES

1. Whether any adjustments to the amount of unreported taxable sales are warranted.
2. Whether appellant was negligent.

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

² The NOD was timely issued because on March 26, 2020, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period July 1, 2016, through June 30, 2017, which allowed respondent until July 31, 2021, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

FACTUAL FINDINGS

1. Appellant, a California Corporation, operated a repair shop in Fontana, California, specializing in the repair of commercial trucks and vehicles, which included selling vehicle parts such as tires. Appellant also provided related roadside assistance services, which included furnishing parts in connection with such work. Appellant's seller's permit was opened with an effective start date of September 14, 2014.
2. This was appellant's first audit. For the liability period, appellant filed its sales and use tax returns (SUTRs) on a fiscal year basis (beginning July 1 and ending June 30). For the liability period, appellant reported total sales of \$2,185,198 and claimed deductions for nontaxable labor sales of \$2,147,056, resulting in reported taxable sales of \$38,142 (\$2,185,198 - \$2,147,056). Appellant's method for reporting sales on its SUTRs is unknown.
3. For audit, appellant provided respondent with the following records: (1) federal income tax returns for 2016, 2017, and 2018; (2) profit and loss statements for the third quarter 2016 (3Q16) through 4Q18; (3) sales tax liability reports for 3Q16 through 2Q17, 4Q17 through 4Q18, and 2Q19; (4) total sales reports for the fiscal years ending June 30, 2017, June 30, 2018, and June 30, 2019; (5) a sales by customer detail report for fiscal year ending June 30, 2019; (6) 46 sales invoices dated between October 2, 2020, and October 9, 2020; and (7) seven purchase invoices dated between September 30, 2020, and October 6, 2020. Respondent also obtained Form 1099-K³ statements for the period April 1, 2017, through December 31, 2019.
4. Respondent compiled recorded taxable sales of \$306,360⁴ for the liability period using appellant's Sales Tax Liability reports. After comparing appellant's recorded taxable sales of \$306,360 to the reported taxable sales of \$38,142,⁵ respondent computed unreported taxable sales of \$268,218 (\$306,360 - \$38,142) for the liability period. Due to limitations in respondent's operating system, respondent recomputed the unreported

³ Form 1099-K is an IRS form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third party network, during a given time period. Form 1099-K data includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

⁴ This amount consists of recorded taxable sales of: (1) \$91,176 for fiscal year ending June 30, 2017; (2) \$158,796 for fiscal year ending June 30, 2018; and (3) \$56,388 for fiscal year ending June 30, 2019.

⁵ This amount consists of reported taxable sales of: (1) \$10,809 for fiscal year ending June 30, 2017; (2) \$11,735 for fiscal year ending June 30, 2018; and (3) \$15,598 for fiscal year ending June 30, 2019.

taxable sales to account for a local district tax rate correction for the city of Pico Rivera for sales made between July 1, 2016, and December 31, 2016. Based on the local district tax rate correction, respondent calculated \$269,299 in unreported taxable sales for the liability period (audit item 2).

5. With respect to appellant's other transactions, respondent verified the accuracy by examining appellant's sales data using a block sample⁶ for the period fiscal year ending June 30, 2019. During the examination, respondent identified two unsupported sales for resale and multiple instances where appellant failed to add sales tax reimbursement in connection with retail sales of tangible personal property, including tires and parts included in lump sum charges for road service calls, for a total of \$59,322 in disallowed claimed nontaxable sales.
6. Respondent divided the test errors of \$59,322 by the recorded total sales of \$837,883 (excluding tax) for the fiscal year ending June 30, 2019, and computed an error ratio of 7.08 percent ($\$59,322 \div \$837,883$). Respondent applied the 7.08 percent of error to recorded total sales of \$2,178,570 for the liability period, resulting in additional unreported taxable sales of \$154,242 for the liability period. Respondent recomputed the unreported taxable sales to account for a local district tax rate correction for the city of Pico Rivera for sales made between July 1, 2016, and December 31, 2016. Based on the local district tax rate correction, respondent calculated unreported taxable sales of \$154,730 for the liability period (audit item 1).
7. On January 26, 2021, respondent timely issued appellant the aforementioned NOD. The NOD is based on a taxable measure of \$424,029 for the liability period.⁷
8. Appellant filed a timely petition for redetermination protesting the total liability.
9. Respondent held an appeals conference with appellant, and subsequently issued a decision on July 25, 2023, denying the petition.
10. Appellant timely appealed to OTA.

⁶ A block sample is a generally accepted audit tool which examines transactions from a representative portion of an audit period and applies the findings to the audit period. This basis assumes that the differences disclosed in the test period, which are audited in detail, will occur in the same proportion in the balance of the audit period.

⁷ The taxable measure of \$424,029 is comprised of the following audit items: (1) unreported taxable sales of \$154,730 based on a block sample test of recorded taxable sales; and (2) unreported taxable sales of \$269,299 based on differences between reported and recorded taxable sales.

DISCUSSION

Issue 1: Whether any adjustments to the amount of unreported taxable sales are warranted.

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 purpose of 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 respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

If the retail value of tangible personal property (typically, parts and materials) furnished in connection with repair work is more than 10 percent of the total charge, the repairperson is the retailer of the property furnished in connection with repair work and tax applies to the fair retail selling price of the property. (Cal. Code Regs., tit. 18, § 1546(b)(1).) Under such circumstances, the repairperson must separately state on the invoice to the customer (and in the repairperson's records) the fair retail selling price of the parts and materials supplied and the labor charges for repair, installation, or other services performed. (*Ibid.*) Furthermore, all work performed by automotive repairpersons must be recorded on an invoice that separately lists labor charges, charges for tangible personal property, and the charge for sales tax reimbursement, and a copy of the invoice must be given to the customer. (Bus. & Prof. Code, § 9884.8.) 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).)

For claimed sales for resale, the burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a resale

certificate from the purchaser that the property is purchased for resale. (R&TC, § 6091.) If the seller does not timely obtain a valid and complete resale certificate, the seller will be relieved of liability for the tax only where the seller shows that the property: (1) was in fact resold by the purchaser prior to an intervening taxable use; (2) is being held for purposes of resale by the purchaser and there has been no intervening taxable use; or (3) was consumed by the purchaser and tax was reported by the purchaser directly to respondent on the purchaser's returns, or assessed in an audit of the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).)

During the audit, respondent found unexplained differences between the sales appellant recorded in its own Sales Tax Liability reports and amounts appellant reported on its SUTRs. Accordingly, OTA finds it reasonable for respondent to question the accuracy of appellant's reported sales. The use of a block sample to examine a series of transactions or other items within a test period is a generally recognized and accepted audit sampling process, and a reasonable alternative to statistical sampling. Here, OTA finds that a block test of 12 months is a sufficiently large enough sample of appellant's sales to establish a representative error ratio. Moreover, appellant has not provided sufficient argument or evidence to the contrary, such as evidence indicating that the sample is not representative. Therefore, OTA concludes that respondent has established that its determination was reasonable and rational; accordingly, the burden shifts to appellant to show error in the audit.

Appellant contends that the unreported taxable sales of \$424,029 for the liability period was based on wrong data for the period July 1, 2017, through March 31, 2019. However, respondent used appellant's own sales records to establish audited taxable sales for the liability period. Furthermore, appellant has neither explained how its records were "wrong" nor provided additional, verifiable evidence establishing error in respondent's determination. Appellant's unsupported assertions are not sufficient to meet its burden of proof. (*Appeal of Talavera, supra.*) Accordingly, OTA finds that no adjustment is warranted on this basis.

Appellant also contends that the error ratio of 7.08 percent was overstated because the two claimed sales for resale that respondent disallowed in the block test were valid sales for resale. Respondent examined recorded total sales based on a block sample test period of the fiscal year ending June 30, 2019. Respondent identified numerous claimed nontaxable sales totaling \$59,322 that were taxable transactions, including unsupported sales for resale. OTA

notes that the 7.08 percent error ratio⁸ was not based only on disallowed claimed sales for resale. Nonetheless, with respect to the disallowed sales for resale, appellant has not provided any verifiable evidence, such as XYZ letters, to substantiate the claimed nontaxable sales for resale.⁹ (See Cal. Code Regs., tit. 18, § 1668.) Accordingly, OTA finds that no adjustment is warranted on this basis.

In summary, OTA finds that respondent computed audited taxable sales based on the best available evidence. Appellant has not substantiated any asserted errors in respondent's computation of audited taxable sales or provided new documentation or other evidence in support of its contentions. As appellant bears the burden of proof, OTA finds that no adjustments are warranted.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides that if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal.App.4th 434, 447.)

Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Respondent imposed the negligence penalty due to finding appellant was negligent in its large underreporting of sales and finding that appellant did not substantiate that it had a bona fide and reasonable belief it was substantially reporting its taxable sales.

⁸ Respondent used appellant's total recorded sales for the fiscal year as the basis for the block sample; therefore, OTA finds that respondent's application of the error rate to the total recorded sales for the liability period was done properly. There was no duplicate or double taxing of sales (included in audit item 2) because the taxable sales were accounted for and determined to have been properly recorded in the remaining \$778,561 of the \$837,883.

⁹ XYZ letters are respondent-approved forms and sent to the seller's customers inquiring as to the disposition of the property purchased. (Cal. Code Regs., tit. 18, § 1668(f).)

Appellant argues that it was not negligent. Appellant, noting that this was its first audit, contends that it timely filed its returns and paid its taxes, and that it was compliant with the requirements of the Sales and Use Tax Law.¹⁰

For the liability period, appellant reported taxable sales of \$38,142, despite having recorded taxable sales of \$307,441 in its books and records, for a total of \$269,299 in recorded but unreported taxable sales. Additionally, appellant underreported its taxable sales as compared to its recorded taxable sales during each of the three reporting fiscal year periods in the liability. For fiscal year ending June 30, 2017, appellant recorded taxable sales of \$91,176 but reported \$10,809, for a difference of \$80,367 in unreported taxable sales. For fiscal year ending June 30, 2018, appellant recorded taxable sales of \$158,796 but reported \$11,735, for a difference of \$147,061 in unreported taxable sales. For fiscal year ending June 30, 2019, appellant recorded taxable sales of \$56,388 but reported \$15,598, for a difference of \$40,790 in unreported taxable sales. Based on appellant's recorded and reporting differences, appellant reported approximately only 11.9 percent ($\$10,809 \div \$91,176$), 7.4 percent ($\$11,735 \div \$158,796$), and 27.7 percent ($\$15,598 \div \$56,388$) of its recorded taxable sales for fiscal year ending June 30, 2017, 2018, and 2019, respectively. For the liability period as a whole, appellant reported approximately only 12.5 percent ($\$38,142 \div \$306,360$) of its recorded taxable sales. OTA finds that the substantial and consistent discrepancies between appellant's underreporting of taxable sales, as compared to taxable sales recorded in appellant's books and records, are evidence that appellant failed to exercise due care in reporting its taxes.

Furthermore, the additional unreported taxable sales of \$154,730 were due primarily to appellant not charging sales tax reimbursement on retail sales of tires and parts furnished in connection with roadside assistance services. Thus, despite specializing in vehicle repair and roadside assistance, which included selling and furnishing vehicle parts and tires, appellant failed to exercise due care in determining whether the transactions are subject to tax even though such transactions were a major part of appellant's day-to-day business. Appellant also failed to provide resale certificates to substantiate the claimed nontaxable sales for resale.

Moreover, appellant reported taxable sales of \$38,142 for the liability period but did not report taxable sales of \$424,029, which is equivalent to a 1,111.71 percent reporting error rate ($\$424,029 \div \$38,142$). OTA finds that such an egregiously large reporting error rate is evidence of appellant's negligence or intentional disregard of the Sales and Use Tax Law.

Although this was appellant's first audit, OTA finds that appellant could not have had a good faith and reasonable belief that its bookkeeping and reporting practices were in substantial

¹⁰ OTA notes that timeliness penalties were not imposed and therefore not at issue.

compliance with the requirements of the Sales and Use Tax law since appellant: substantially underreported taxable sales compared to its recorded taxable sales; failed to properly report and remit sales tax reimbursement on its retail sales of tires as well as parts furnished in connection with repair work or roadside assistance; failed to maintain and provide resale certificates; and had a substantial reporting error rate. Furthermore, appellant has not offered a reasonable explanation for any of the above instances. Accordingly, OTA concludes that appellant was negligent and respondent's addition of the negligence penalty to the liability was warranted.

HOLDINGS

1. Appellant has not shown that adjustments to unreported taxable sales are warranted.
2. Appellant was negligent.

DISPOSITION

Respondent's denial of appellant's petition is sustained.

DocuSigned by:

Sheriene Anne Ridenour

67F043D83EF547C...

Sheriene Anne Ridenour
Administrative Law Judge

We concur:

DocuSigned by:

Michael F. Geary

1A9B52EF88ACAC7

Michael F. Geary
Administrative Law Judge

DocuSigned by:

Keith T. Long

DC88A60D8C3E442...

Keith T. Long
Administrative Law Judge

Date Issued: 4/17/2025