OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **ICC COLLISION CENTERS 1, INC.**	OTA Case No. 231014534 CDTFA Case ID: 2-543-589

OPINION

Representing the Parties:

For Appellant:	Steven R. Mather, Attorney James Mather, Attorney Hamid Hojati, President/Owner
For Respondent:	Nalan Samarawickrema, Hearing Representative Christopher Brooks, Attorney Jason Parker, Chief of Headquarters Ops.

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, ICC Collision Centers 1, Inc. (appellant) appeals respondent California Department of Tax and Fee Administration's (CDTFA's) decision to partially deny appellant's timely petition for redetermination of a Notice of Determination (NOD). On January 25, 2021, CDTFA timely issued the NOD for a tax liability of $288,404, plus applicable interest, a 10 percent negligence penalty, and a failure-to-file penalty for the period October 1, 2017, through September 30, 2020 (liability period).[1] CDTFA based the NOD's tax liability on unreported taxable sales of $3,419,825, which CDTFA determined upon audit.

Subsequently, during its internal appeals process, CDTFA reduced the amount of unreported taxable sales by $1,015,785, from $3,419,825 to $2,404,040, correspondingly reduced the negligence penalty, and deleted the failure-to-file penalty. While this appeal was pending before the Office of Tax Appeals (OTA), CDTFA further reduced the amount of unreported taxable sales by $112,870, from $2,404,040 to $2,291,170, which also correspondingly reduced the negligence penalty.

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes as well other business taxes and fees. On July 1, 2017, most of BOE's administrative (i.e., non-adjudicatory) functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" refers to the BOE.

OTA Administrative Law Judges Andrew Wong, Steven Kim, and Teresa A. Stanley held an oral hearing for this matter in Cerritos, California, on February 11, 2025. At the conclusion of the oral hearing, OTA closed the record, and the parties submitted this matter for an Opinion on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

ISSUES

1. Whether the amount of unreported taxable sales should be further reduced.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. During the liability period, appellant, a California corporation, operated an automobile repair shop in Santa Ana, California.
2. Appellant filed sales and use tax returns (SUTRs) for the quarterly reporting periods fourth quarter 2017 (4Q17) through 4Q19, reporting total sales of $15,403,607, and claiming deductions for nontaxable sales totaling $10,948,381 (consisting of storage, warranty, towing, nontaxable food, and nontaxable labor), resulting in reported taxable sales of $4,455,226. Appellant did not file SUTRs for the period 1Q20 through 3Q20.
3. CDTFA initiated the audit in August 2019. Upon audit, appellant did not provide any books or records. This was appellant's first audit.
4. CDTFA obtained a copy of appellant's 2018 federal income tax return (FITR), which reported parts purchases of $2,948,018. Using an estimated markup rate of 20 percent, CDTFA calculated audited taxable sales of $3,537,622 (rounded) (parts purchases of $2,948,018 x 120 percent) for 2018.[2] Subtracting reported taxable sales of $2,297,763 from audited taxable sales of $3,537,622 resulted in unreported taxable sales of $1,239,859, from which CDTFA calculated an error rate of 53.96 percent (rounded) (unreported taxable sales of $1,239,859 ÷ reported taxable sales of $2,297,763).
5. Multiplying appellant's reported taxable sales of $4,455,226 for the period 4Q17 through 4Q19 by the error rate of 53.96 percent resulted in unreported taxable sales of $2,404,040 (rounded) ($4,455,226 x .5396) for that period.

[2] "Markup" is the amount by which a retailer increases the cost of merchandise to set the retail price. For example, if the retailer's cost is $0.70 and it charges customers $1.00, the markup is $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.4286).

6. For the period 1Q20 through 3Q20 (for which appellant did not file SUTRs), CDTFA first multiplied appellant's reported taxable sales of $219,924 for 4Q19 by the error rate of 53.96 percent, resulting in a markup of $118,671 (rounded) for that quarter. CDTFA then added the markup of $118,671 for 4Q19 to reported taxable sales of $219,924 for that same quarter and multiplied the sum by three (i.e., the number of quarters for which appellant did not file SUTRs—1Q20, 2Q10, and 3Q20), resulting in unreported taxable sales of $1,015,785 ([reported taxable sales of 219,924 + markup of $118,671] x 3 quarters).
7. Thus, CDTFA established total unreported taxable sales of $3,419,825 ($2,404,040 + $1,015,785) for the liability period.
8. CDTFA concluded that appellant was negligent in its recordkeeping and reporting for the following reasons: appellant provided no books and records during the audit; appellant underreported its taxable sales by more than 76 percent during the liability period (unreported taxable sales of $3,419,825 ÷ reported taxable sales of $4,455,226); and, for 2018, reported parts purchases of $2,948,018, which exceeded appellant's reported taxable sales of $2,297,763 for that year.
9. On January 25, 2021, CDTFA timely issued the NOD to appellant for the following liabilities: a tax liability of $288,404, plus accrued interest, for the liability period; a 10 percent negligence penalty of $19,444.29 for the period 4Q17 through 4Q18; and a failure-to-file penalty of $9,396.10 for the period 1Q20 through 3Q20.
10. Appellant timely filed a petition for redetermination and requested relief of the failure-to-file penalty.
11. On March 1, 2023, CDTFA recommended deleting the failure-to-file penalty.
12. On April 21, 2023, CDTFA further recommended deleting unreported taxable sales of $1,015,785 for the period 1Q20 through 3Q20 because those sales had been reported to CDTFA under a different seller's permit account. Accordingly, CDTFA recommended reducing the amount of unreported taxable sales for the liability period to $2,404,040.
13. On September 1, 2023, CDTFA's Appeals Bureau issued its decision, which ordered a reaudit to reduce the amount of unreported taxable sales by $1,015,785, from $3,419,825 to $2,404,040, and deleted the failure-to-file penalty. Otherwise, CDTFA denied appellant's petition for redetermination.
14. Appellant filed the instant appeal with OTA.

15. During briefing, appellant submitted two general ledgers for 2018 showing purchases of original equipment manufacturer (OEM) parts totaling $2,252,716 and sublet fees of $271,634.

16. While preparing for the oral hearing before OTA, CDTFA obtained and analyzed a copy of appellant's 2017 FITR, which reported parts purchases of $3,079,230. Using an estimated markup rate of 20 percent, CDTFA calculated audited taxable sales of $3,695,076 (parts purchases of $3,079,230 x 120 percent) for 2017. Subtracting reported taxable sales of $2,530,912 from audited taxable sales of $3,695,076 resulted in unreported taxable sales of $1,164,164, from which CDTFA calculated an error rate of 46 percent (rounded) (unreported taxable sales of $1,164,164 ÷ reported taxable sales of $2,530,912) for 2017.

17. CDTFA applied the error rate of 46 percent for 2017 to reported taxable sales of $604,305 for 4Q17, resulting in unreported taxable sales of $277,980 for that quarter. CDTFA applied the error rate of 53.96 for 2018 to total reported taxable sales of $2,297,763 for that year, resulting in unreported taxable sales of $1,239,873 for 2018. CDTFA then averaged the error rates of 46 percent for 2017 and 53.96 percent for 2018 and applied the resulting average error rate of 49.79 percent to total reported taxable sales of $1,553,158 for 2019, resulting in unreported taxable sales of $773,317 for 2019. Thus, for the liability period, CDTFA redetermined that appellant made unreported taxable sales totaling $2,291,170 ($277,980 for 4Q17 + $1,239,873 for 2018 + $773,317 for 2019). Accordingly, via a second reaudit, CDTFA further reduced the amount of unreported taxable sales by $112,870, from $2,404,040 to $2,291,170, which correspondingly reduced the negligence penalty to $18,506.83.

18. During the appeals hearing before OTA, H. Hojati, appellant's president and sole shareholder, testified to the following:
    a. Through various corporations, H. Hojati owned, and subsequently sold, seven auto repair shops in Los Angeles and Orange Counties.
    b. Appellant's shop was H. Hojati's last remaining repair shop when appellant sold its assets, including its computerized accounting system, to a buyer in late 2019.
    c. Following the sale of appellant's assets, neither appellant nor H. Hojati retained any of appellant's books and records for the liability period and, during the audit, did not ask the buyer for these books and records.

19. H. Hojati had also been the CEO of Platinum Equity Partners, Inc. (PEPI), which operated four auto body repair shops in the Los Angeles area from December 2003

through the end of 2008. CDTFA audited PEPI for the period April 1, 2004, through March 31, 2007, and, on October 10, 2008, issued to it an NOD for both a tax liability and a negligence penalty. CDTFA imposed the negligence penalty on PEPI for failing to maintain adequate books and records and underreporting its sales by 72 percent.

20. PEPI ultimately appealed to OTA, and, on December 13, 2022, OTA held an appeals hearing at which H. Hojati testified on PEPI's behalf. Ultimately, OTA concluded that PEPI had been negligent and sustained the negligence penalty via Opinion dated March 7, 2023.[3]

DISCUSSION

Issue 1: Whether the amount of unreported taxable sales should be further reduced.

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, § 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 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 p. 445.)

Generally, the appellant bears the burden of proof as to all issues of fact. (Cal. Code

[3] See the non-precedential Opinion of *Appeal of Platinum Equity Partners, Inc.* (2023-OTA-225).

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 taxpayer 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*.)

Upon audit, appellant provided no books and records, so CDTFA employed an indirect audit method, the markup method, for its determination. The markup method is a recognized and accepted accounting procedure and is effective and reliable if CDTFA has sufficient information to establish the cost of taxable merchandise sold and a reasonable markup. (*Appeal of Amaya*, 2021-OTA-328P.) Here, CDTFA used the amounts of parts purchases appellant self-reported to the IRS on its 2017 and 2018 FITRs, which OTA finds to be a reliable and sufficient source of information for the cost of taxable merchandise sold. To the parts purchases, CDTFA applied a 20 percent markup to calculate error rates, which CDTFA then used to determine the amount of appellant's unreported taxable sales for the liability period. Appellant does not dispute the 20 percent markup and described it as "reasonable" in various submissions to OTA. Accordingly, OTA finds that CDTFA has met its initial burden to show that its determination was reasonable and rational; therefore, CDTFA's determination is presumed correct. The burden of proof shifts to appellant to establish by a preponderance of the evidence that a different result is warranted.

On appeal, appellant asserts that the reported amounts on its SUTRs are correct and those on its 2017 and 2018 FITRs are not accurate for sales and use tax reporting purposes. Specifically, appellant contends that CDTFA erroneously applied the 20 percent markup to the amounts of parts purchases reported on the 2017 and 2018 FITRs, which included nontaxable items such as "labor, sublet fees, non-parts purchases and other items that were not related to taxable sales." In other words, appellant contends that CDTFA grossly overstated audited taxable sales because it applied the 20 percent markup to nontaxable items included in the reported parts purchases. In support, appellant submitted two general ledgers for 2018 showing purchases of OEM parts totaling $2,252,716 and sublet fees of $271,634. Appellant also asserts that CDTFA should delete the deficiency measure for late 2019 for the same reason CDTFA deleted the deficiency measure for 2020 (i.e., appellant alleges it was a baseless estimate).

Appellant's arguments are unavailing. First, the general ledgers submitted by appellant are not supported by any source documentation such as purchase invoices, the lack of which renders the information unverifiable. Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Las Playas #10, Inc.*, *supra*.) Unless appellant provides source documentation to substantiate its OEM parts purchases, appellant has not met its burden of proving the information is sufficiently accurate or verifiable to warrant additional adjustments to CDTFA's determination. Second, the OEM parts purchases and sublet fees reflected on the 2018 ledgers total $2,524,350 (OEM parts purchases of $2,252,716 + sublet fees of $271,634), which is still less than the parts purchases of $2,948,018 reported on appellant's 2018 FITR. In other words, there is a difference of $423,668 in purchases or fees payable for which appellant has not accounted. Without complete records and source documentation, the two general ledgers provided are of little evidentiary value and, on their own, fail to overcome the presumption that CDTFA's determination is correct.

As for appellant's contention that the deficiency measure for the latter part of 2019 should be reduced for the same reason that CDTFA deleted the measure for 2020 (i.e., because it was a baseless estimate), it also lacks merit. CDTFA deleted the 2020 deficiency measure because it discovered that taxable sales for 2020 had been reported under a seller's permit account other than appellant's. Unless appellant can show that its reported taxable sales for late 2019 were reported elsewhere (i.e., not under the account at issue), OTA finds no basis for reducing the measure for late 2019.

For the reasons described, OTA finds appellant has not satisfied its burden of proving that additional adjustments to the measure of taxable sales are warranted. Thus, OTA concludes that the amount of unreported taxable sales should not be further reduced.

Issue 2: Whether appellant was negligent.

If any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) 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.)

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to determine the correct tax liability under the Sales and Use Tax

Law and all records necessary for the proper completion of SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (1) normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) All records required to be retained under Regulation section 1698 must be preserved for at least four years unless CDTFA authorizes otherwise in writing. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a negligence penalty should not be added to a deficiency determination 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); see also *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

Here, CDTFA imposed the negligence penalty for the following reasons: (1) appellant provided no books or records upon audit; (2) appellant substantially understated its taxable sales for the liability period (by more than 76 percent per the original audit and by approximately 50 percent per the second reaudit); and (3) appellant reported more parts purchases on its FITR for 2018 ($2,948,018) than taxable sales reported on its contemporaneous SUTRs ($2,297,763).

On appeal, appellant contends that the negligence penalty should be abated for the following two reasons: (1) this was appellant's first audit; and (2) the buyer of appellant's business rendered most of the records missing or unusable, which was beyond appellant's control.

Here, OTA finds appellant's failure to provide any books and records for the audit to be strong evidence of negligent recordkeeping given appellant's background. Although this was technically appellant's first audit as a business entity, it was not the first audit for its owner/president. At the hearing before OTA, appellant's president testified that he had owned and operated six other auto repair shops via separate corporations. One of those corporations, PEPI, owned four auto repair shops in the Los Angeles area and had been audited by CDTFA for the period April 1, 2004, through March 31, 2007. In the NOD that CDTFA issued to PEPI

on October 10, 2008 (nearly nine years before the liability period at issue began on October 1, 2017), CDTFA imposed a negligence penalty because of inadequate recordkeeping and excessive underreporting. Appellant's shared ownership/leadership with PEPI suggests that appellant was more familiar with the recordkeeping and reporting requirements of the Sales and Use Tax Law and authorized regulations than the average taxpayer undergoing an audit for the first time.

One of those authorized regulations mandates that taxpayers must preserve and retain necessary sales and use tax records for at least four years unless CDTFA authorizes otherwise in writing. (See Cal. Code Regs., tit. 18, § 1698(i).) However, appellant failed to retain any books and records related to the liability period upon selling its assets (including its computerized accounting system) to a buyer, and nothing in the record indicates that CDTFA waived the four-year retention requirement for appellant. At the OTA hearing, when OTA asked appellant why it failed to retain the relevant books and records, it acknowledged that this "was not a wise decision" in hindsight but appellant's owner was getting out of the business and retaining the records did not seem important at the time. Appellant's president also testified that he did not ask the buyer for these records after the audit commenced in August 2019. OTA finds that, under these circumstances, such inaction would not be the course that a reasonable and prudent person would take. Further, despite its claim that the buyer had caused the books and records to go missing and rendered them unusable, appellant has not provided any evidence that this was the case or shown that such loss of records was due to factors beyond its control. Absent such evidence, and given appellant's background, OTA finds that appellant's failure to maintain books and records, together with its substantial underreporting (nearly 50 percent for the liability period per the second reaudit), cannot be attributed to its good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the Sales and Use Tax Law and authorized regulations.

Accordingly, OTA concludes that appellant was negligent, and CDTFA properly imposed the negligence penalty upon appellant.

HOLDINGS

1. The amount of unreported taxable sales should not be further reduced.
2. Appellant was negligent.

DISPOSITION

CDTFA's decision to reduce the amount of unreported taxable sales to $2,291,170 (with a corresponding reduction to the 10 percent negligence penalty) and to delete the failure-to-file penalty, but to otherwise deny the appeal, is sustained.

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Andrew Wong
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 5/7/2025