OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. ZARRABI**	OTA Case No. 19064928 CDTFA Case IDs: 259-104, 259-105, 259-106

OPINION

Representing the Parties:

For Appellant: David J. Elbaz-Deckel, Attorney

For Respondent: Sunny Paley, Attorney
Stephen Smith, Attorney
Jason Parker, Chief of Headquarters Ops.

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, J. Zarrabi (appellant) appeals a July 6, 2018 decision and a May 22, 2019 supplemental decision issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a January 22, 2014 Notice of [Dual] Determination (NODD).[2] The NODD was for tax of $74,365,[3] plus applicable interest, and penalties totaling $14,911 for the period January 1, 2007, through November 30, 2010

[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 document issued to appellant was entitled Notice of Determination. This Opinion refers to it as a Notice of Dual Determination or NODD to distinguish it from the Notice of Determination or NOD issued to Nu Print.

[3] 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.

(liability period).[4] The NODD is based on respondent's determination that appellant is personally liable as a person responsible for unpaid sales taxes, plus applicable interest, and penalties incurred by Nu Print & Graphics Inc. (Nu Print).

Office of Tax Appeals (OTA) Administrative Law Judges Natasha Ralston, Steven Kim, and Michael F. Geary held an oral hearing for this matter in Cerritos, California, on October 9, 2024. At the conclusion of the oral hearing, OTA closed the record, and this matter was submitted pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

ISSUES

1. Are further adjustments to Nu Print's tax liability warranted?
2. Did respondent properly impose the negligence penalty on Nu Print?
3. Did respondent timely issue the NODD to appellant?
4. Is appellant personally responsible for the unpaid tax liabilities of Nu Print?

FACTUAL FINDINGS

1. Nu Print, a California corporation, owned and operated a printing business with locations, at various times, in Glendale, Studio City, and Northridge.
2. As appellant concedes, at all relevant times he was a person responsible for Nu Print's sales and use tax compliance.
3. Nu Print began its existence as appellant's sole proprietorship. Appellant filed Nu Print's Articles of Incorporation on January 2, 1996. On February 14, 1996, appellant signed Nu Print's application for a seller's permit (doing business as Nu Print at a location in Studio City only), identifying himself as president and treasurer, and J. Zarrabi 2 as vice president.[5] Respondent issued Nu Print's seller's permit with an effective date of March 1, 1996.
4. Nu Print was audited for the period January 1, 1998, through September 30, 2001. As a result of that audit, respondent determined a tax deficiency totaling $14,884, which was

[4] The penalties consisted of the following: (1) a negligence penalty ($7,437) imposed on Nu Print for the period January 1, 2007, through December 31, 2009; (2) prepayment penalties for October 2010 and November 2010, totaling $36; and (3) a penalty ($7,437) imposed under R&TC section 6565 for Nu Print's failure to timely appeal the issuance or pay the amount of the Notice of Redetermination (that followed issuance of the decisions) before it became final (finality penalty). Respondent has now agreed to delete the prepayment penalties with no conditions, and to delete the finality penalty on the condition that the liability be paid in full within 30 days of the liability becoming final. Consequently, the prepayment and finality penalties are no longer at issue.

[5] "J. Zarrabi 2" refers to a person with the same first initial and last name as appellant.

based on a measure totaling $183,258, consisting of the following items: (1) unreported taxable sales of $77,995, due to cash basis reporting; (2) printing aids costing $67,205, subject to use tax; (3) other purchases totaling $31,942, subject to use tax; and (4) disallowed sales for resale totaling $6,116, due to invalid resale certificates. These amounts are referenced in a November 19, 2001 audit report, which indicates that Nu Print's business and mailing address was in Northridge.[6]

5. Nu Print opened its Glendale location in 2003.

6. On February 4, 2009, appellant filed a Statement of Information with the Secretary of State, identifying himself as Nu Print's CEO, president, secretary, and director, and J. Zarrabi 2 as Nu Print's CFO and the only other director, with the business address in Studio City. On June 28, 2010, appellant filed a Statement of Information with the Secretary of State, identifying himself as Nu Print's sole officer and director, with a business address in Northridge.

7. Nu Print closed its Glendale location in 2008.

8. On August 13, 2009, an investigator with respondent's Statewide Compliance and Outreach Program (SCOP) visited Nu Print's Studio City location. The resulting Memorandum of Possible Tax Liability states that Nu Print's sales and use tax returns (SUTRs) claimed that more than 60 percent of its sales were sales for resale, which seemed excessive to respondent. By letter dated September 16, 2009, respondent informed Nu Print that it appeared there may be a discrepancy in taxable sales reported. The letter requested Nu Print to review its SUTRs for the period July 1, 2006, through June 30, 2009, and to file amended SUTRs by September 30, 2009, if Nu Print determined that the originally filed SUTRs were incorrect. In subsequent communications, respondent instructed appellant to either file amended SUTRs for Nu Print or provide records to support its claimed sales for resales. Appellant provided Nu Print's federal income tax returns (FITRs) and some bank statements, and on November 23, 2009, he delivered copies of March 2009 invoices and related resale certificates to respondent, apparently to support claimed sales for resale.[7]

9. In a February 12, 2010 Asset Purchase Agreement, Nu Print transferred assets used to operate its Studio City location, including its real property lease, to Nu Color Printing, Inc. for $12,000.

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[6] The evidence does not establish when this audit report was printed or whether the business address was automatically updated at that time.

[7] The records were returned on March 11, 2010.

10. On or about February 18, 2010, SCOP referred Nu Print to respondent's audit staff to conduct an audit of Nu Print's business for the period January 1, 2007, through December 31, 2009 (audit period). The audit did not include a visit to any Nu Print location.

11. For the audit period, Nu Print reported total sales of $7,295,112, deductions totaling $5,093,297, and taxable sales of $2,201,815. The deductions were for: (1) sales for resale ($4,308,953); (2) sales in interstate commerce ($415,520); (3) sales tax reimbursement included in reported total sales ($185,857); (4) returns ($15,104); (5) discounts ($52,805); (6) bad debts ($42,066); and (7) "other" ($72,992).[8]

12. On March 3, 2010, appellant delivered to respondent a Notice of Business Change, (respondent's Form 345) updating the business and mailing addresses from the Studio City location to 8664 Lindley Avenue, Northridge (the Northridge address). Respondent thereafter issued an updated seller's permit to Nu Print, mailing it to the Northridge address, which appears from a photograph to have been in a retail strip mall.

13. For the audit, Nu Print initially provided only bank statements for 2008. Respondent initially found a $34,792 deficiency based on an estimated $412,170 in unreported taxable sales determined by a bank deposit analysis.[9]

14. On March 11, 2010, during an exit conference,[10] appellant informed respondent that Nu Print sold fixtures and equipment for $12,000 by the time the Glendale location closed in September 2008, and that he would provide the "bill of sale."[11] Appellant requested that the business address be changed to the Northridge address, effective March 1, 2010. Respondent updated Nu Print's business and mailing addresses, and sent an email to appellant asking him to provide copies of the bill of sale, proof of valid sales for resale, and proof of bank deposits that appellant asserted were not revenue from sales.

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[8] "Other" is not further explained by the evidence.

[9] Generally, a bank deposit analysis presumes all deposits into the business bank accounts constitute revenue from sales unless evidence establishes otherwise. To be useful for estimating taxable sales, all revenue must have been deposited into the account(s), and respondent must be able to segregate deposits from nontaxable sales revenue, tips, sales tax reimbursement, loans, and possibly other sources.

[10] Exit conferences provide an opportunity for respondent and taxpayers to discuss audit results and clarify any disputed items.

[11] There is no evidence of a $12,000 bill of sale. As explained below, appellant eventually provided a $65,000 bill of sale for equipment that was used at the Glendale location that closed in 2008.

15. On March 16, 2010, appellant sent an email to respondent, which states, in part, that he was trying to locate documents (apparently, to show that some of the deposits into the bank account were loans from shareholders), but he was unable to get the documents because the account was closed.
16. On May 17, 2010, appellant stated that he would fax a copy of a September 23, 2008 bill of sale for equipment ($65,000) to respondent.
17. On May 18, 2010, respondent called appellant and left a message informing him that appellant's sale of equipment is a taxable transaction subject to sales tax.
18. A May 19, 2010 entry in respondent's Assignment Activity History indicates that respondent explained the audit findings to appellant, "including excess bank deposits, sales of equipment at close-out, eliminating disallowed sales for resale and negligence penalty."
19. A May 24, 2010 entry in the Assignment Activity History indicates that respondent received the fax of the lease contract with Wells Fargo Bank. Respondent reviewed the contract and informed appellant that respondent would remove audit item 2 (sales of equipment) from the assessment.
20. On June 28, 2010, appellant filed a Statement of Information with the Secretary of State, identifying himself as Nu Print's sole officer and director, and changing the address of Nu Print to the Northridge address.
21. On August 19, 2010, respondent issued the first field billing order (FBO), which was based on the bank deposit analysis.[12] On August 23, 2010, respondent mailed the FBO to the Northridge address.
22. On October 6, 2010, respondent issued a Notice of Determination (NOD) to Nu Print for $34,792 tax, plus accrued interest, and a $3,479 negligence penalty.
23. Nu Print filed a timely petition for redetermination.
24. On January 18, 2011, appellant informed respondent that Nu Print had ceased doing business in March 2010. When respondent asked why appellant had not notified respondent of the business closure earlier, appellant stated that he did give notice.
25. According to a "Receipt for Books & Records of Account," signed by respondent on January 20, 2011, appellant delivered the following business records to respondent: sales journals for 2007;[13] sales invoices for 2006 and 2007 (most for July through

[12] A field billing order is often used by respondent to notify a taxpayer regarding an additional tax liability or refund determined using procedures other than a completed audit (e.g., when a taxpayer declines to grant additional time to complete an audit).

December 2007); canceled checks for 2006 and 2007; and a summary of payments received in 2007. The same document indicates the records were returned to appellant on February 1, 2011.

26. Respondent reviewed the additional records, comparing taxable sales recorded in Nu Print's sales journal to taxable sales reported on Nu Print's SUTRs for 2007 and 2008 and finding that recorded taxable sales exceeded reported taxable sales by $59,770 for 2007 and $647,642 for 2008. Respondent calculated an average error rate for those two years of 40.01 percent, which it applied to 2009 reported taxable sales to calculate unreported taxable sales of $173,570 for 2009. Respondent thus determined unreported taxable sales for the liability period of $880,982 ($59,770 + $647,642 + $173,570), which was $468,812 more than the $412,170 deficiency that respondent originally determined.

27. According to respondent, Nu Print's sales journals were generally consistent with available sales invoices for October 2007 and with Nu Print's California income tax returns for 2007 and 2008.[14]

28. On February 10, 2011, respondent issued an adjusted FBO to Nu Print increasing the audit measure from $412,170 to $880,982. On May 31, 2011, respondent issued a timely Notice of Increase of the tax liability from $34,792 to $74,365.[15] The increased tax caused a proportionate increase to the negligence penalty.

29. On March 9, 2011, after confirming that Nu Print was not doing business at the Northridge address, respondent closed Nu Print's seller's permit, with an effective closeout date of December 31, 2010.

30. On April 1, 2011, respondent received Nu Print's SUTR for the fourth quarter of 2010 (4Q10) indicating that the business closed. Nu Print's corporate status was dissolved on or about September 16, 2011.

31. On September 16, 2011, Nu Print filed a certificate of dissolution with the Secretary of States's office. The certificate is signed by appellant as president on June 30, 2011.

32. On November 30, 2011, respondent issued its decision recommending that the taxable measure be redetermined in accordance with the adjusted FBO and otherwise denying

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[13] It appears from the evidence that Nu Print provided sales journals for 2007 and 2008.

[14] The California income tax returns are not in evidence.

[15] As relevant here, respondent may increase the amount of the NOD provided that a claim for the increase is asserted: 1) at or before an OTA hearing; and 2) within three years after the NOD is issued, or within three years after the time tax records requested by respondent were made available, whichever is later. (Rev. & Tax. Code, § 6563,(a), (a)(1).)

Nu Print's petition for redetermination. Respondent conducted a reaudit and, on January 31, 2012, issued a Notice of Redetermination consistent with the adjusted FBO. After Nu Print failed to timely respond to the Notice of Redetermination, respondent imposed the finality penalty.

33. After an investigation, respondent found that: (1) Nu Print ceased doing business in 2010; (2) Nu Print collected sales tax reimbursement from its customers on its retail sales of tangible personal property (TPP); (3) appellant was a person responsible for Nu Print's sales and use tax compliance; and (4) appellant willfully failed to pay, or failed to cause Nu Print to pay, sales and use tax when due.[16] Based on those findings, respondent concluded that appellant was personally liable for Nu Print's unpaid sales tax liabilities.

34. Retail invoices provided by Nu Print show that Nu Print collected sales tax reimbursement in connection with retail sales of TPP.

35. Nu Print's SUTRs claim deductions for sales tax reimbursement included in gross receipts for the period 3Q08 through 4Q10.

36. Employment Development Department (EDD) records list appellant as Nu Print's president effective April 1, 1996.

37. Appellant signed or electronically filed Nu Print's SUTRs and prepayment forms as president before and during the liability period.

38. Appellant also signed:[17]

    a. Nu Print's December 22, 1995 articles of incorporation;
    b. Nu Print's February 14, 1996 seller's permit application;
    c. Nu Print's February 4, 2009, and June 28, 2010 Statements of Information filed with the Secretary of State;
    d. Nu Print's March 17, 2010 waiver of the statute of limitations for respondent to issue an NOD to Nu Print for the period January 1, 2007 through June 30, 2007;
    e. Nu Print's September 16, 2011 Certificate of Dissolution filed with the Secretary of State;
    f. Nu Print's March 25, 2010 power of attorney; and
    g. Nu Print checks issued to the Los Angeles Department of Water and Power in 1Q10.

[16] Findings 1 and 3 are not in dispute in this appeal.

[17] Appellant signed the documents described below as an officer (president, secretary, treasurer, CEO, and/or CFO) or director.

39. Nu Print paid wages totaling $1,956,880 during the period 1Q07 through 4Q10. EDD records indicate that Nu Print paid wages of $59,150, $40,275, and $10,800 during 2Q10, 3Q10, and 4Q10, respectively.

40. Nu Print's FITRs for 2007 and 2008 report cost of goods sold (COGS) totaling $2,898,817. Respondent indicates Nu Print's COGS for 2009 and 2010 total $705,307.

41. Los Angeles Department of Water and Power records show Nu Print payments totaling $55,508 between January 17, 2007, and March 17, 2010.

42. On January 22, 2014, respondent issued the NODD to appellant.

43. Appellant filed his petition for redetermination, which respondent denied. Appellant then filed a request for reconsideration, arguing that: (1) respondent failed to allow for discounts, returns, and bad debts recorded in the journals; (2) a more accurate determination could be made by calculating a taxable sales ratio (i.e., the ratio of taxable sales to total sales) from the journals and applying that ratio to Nu Print's 2019 FITR;[18] and (3) that an average error rate should not be used to calculate the deficiency for 2009 because of the large difference between the error ratios for 2007 and 2008.

44. Respondent considered the arguments and agreed to recalculate the deficiency measure for 2009 using a different method, but not using the method appellant wanted. Respondent rejected the method proposed by appellant because taxable sales increased in 2008 while gross receipts decreased, which is why the taxable sales ratio was 27.11 percent for 2007 and 62.32 percent for 2008. Respondent indicated it would need to use the latter ratio for 2009, if appellant's proposed method was used. Respondent stated that it would also need to verify amounts reported on appellant's 2009 FITR.

45. In the second reaudit, respondent started with the $203,119 in sales tax reimbursement collected by Nu Print from its customers in 2007 and 2008 and divided that amount by the applicable tax rate during the 2007 and 2008 reporting periods to calculate audited taxable sales of $2,462,051. Respondent then deducted reported taxable sales of $1,768,016 to determine unreported taxable sales of $694,035. This resulted in an average error rate of 39.26 percent, which respondent then used to determine unreported taxable sales for 2009 of $170,288. This reduced the deficiency from $880,981 to $864,323.

[18] Appellant proposed that respondent divide recorded taxable sales for 2007 and 2008 per the sales journals ($2,475,428) by the gross receipts reported in the FITRs for 2007 and 2008 ($6,171,108), for a ratio of taxable sales-to-gross receipts of 40.11 percent; multiply that percentage by the gross receipts reported in the 2009 FITR ($1,143,752), for taxable sales of $458,795 for 2009.

46. The average error rate calculated in the second reaudit was 40.01 percent. The error rates for the four quarters of 2008 were 90.5 percent for 1Q08, 80.19 percent for 2Q08, 57.11 percent for 3Q08, and 85.55 percent for 4Q08. For those consecutive quarters, appellant reported 52.5 percent, 55.5 percent, 62.77 percent, and 53.89 percent, respectively, of the sales tax reimbursement it collected from its customers.
47. On May 22, 2019, respondent issued its supplemental decision, which reduced the deficiency measure to $864,323 and deleted the finality penalty on the condition that appellant pay Nu Print's liability in full within 30 days of mailing the final notice of decision in the appeal.[19]
48. This timely appeal to OTA followed.
49. Respondent agreed at the hearing to relieve the prepayment penalties.

DISCUSSION

Issue 1: Are further adjustments to Nu Print's tax liability warranted?

California imposes sales tax on a retailer's retail sales of TPP 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 an SUTR, 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*.)

Ultimately, respondent determined the liability on the basis of Nu Print's records, first comparing taxable sales recorded in Nu Print's 2007 and 2008 sales journals with reported amounts to calculate underreported taxable sales for those years, and then calculating an

[19] This appeal will be final at the conclusion of this appeal to OTA.

average error rate for those years and applying that rate to Nu Print's reported taxable sales for 2009. The determinations for 2007 and 2008 are based on a direct audit method, the results of which are generally the most reliable.[20] While the determination for 2009 was based on an indirect audit method, OTA finds that the projection of an error rate calculated from the prior two years is a rational way to reasonably estimate sales. Here, respondent based the 2009 error rate on Nu Print's recorded sales for the immediately preceding two years, which was a rational approach given the lack of adequate 2009 sales information. In fact, considering that the calculated error rate for 2007 was only 6.31 percent, while the calculated error rate for 2008 was 78.92 percent, using the 40.01 percent average error rate was conservative and likely to benefit Nu Print. On these bases, OTA finds that respondent's determination was reasonable and rational, and that the burden of proving error in respondent's determination and a more accurate deficiency shifts to appellant.

Appellant alleges that he has been unable to confirm the journal amounts upon which respondent relies, and that the sales data contained in Nu Print's 2007 and 2008 journals was incomplete and inaccurate. Appellant argues that respondent's determination was wrong, as evidenced by respondent's concessions shown in the second reaudit, which reduced the deficiency measure from $880,981 to $864,323.[21] Appellant also contends that the determination fails to consider cash discounts, returns, and bad debts. Finally, appellant argues the evidence indicates that respondent had records for 2009 but simply chose not to consider them, and that, if an extrapolation must be used, a more "equitable" audit approach—apparently implying that it is one that would produce a more accurate result—would be to use a 40.75 percent taxable sales ratio to determine the deficiency for 2019.[22]

There is no evidence in the record that calls into question the journal entries upon which respondent relied. These were Nu Print's business records and, while not necessarily beyond question, they are not susceptible to challenge based only on appellant's unsupported assertions. (*Appeal of Talavera*, *supra*.)

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[20] A direct audit method is one that enables respondent to determine taxable sales directly from the taxpayer's business records. Generally, a direct audit involves a simple tabulation of taxable sales evidenced by sales invoices, cash register tapes, or a taxpayer's recorded taxable sales. A direct audit approach based on complete and accurate business records is generally expected to be the most accurate.

[21] Appellant apparently implies that there must be other as yet unidentified errors.

[22] Appellant also is critical of respondent's failure to inquire regarding the cause of the substantial discrepancy between taxable sales in 2007 and 2008. It is unclear how such a circumstance, even if shown by the evidence, would have any real bearing on the issues. This argument will not be discussed further.

The fact that respondent decided to conduct a second reaudit using a different methodology is not evidence that the method used in, or the findings from, the original audit or first reaudit were incorrect, much less that those changes show that there are errors in the second reaudit, upon which the liability is based. As stated above, appellant is required to actually prove error. (*Ibid*.; see also *Appeal of AMG Care Collective*, 2020-OTA-173P.)

Appellant's argument that respondent could and should have examined Nu Print's 2009 sales on an actual basis is based on a November 23, 2009 note by respondent, which indicates that appellant delivered copies of March 2009 invoices and resale certificates. The evidence refers to invoices and resale certificates for one month. It appears from the evidence that Nu Print was trying to establish the basis for its claimed sales for resale, but there is no evidence that respondent retained copies of, or scheduled, the March invoices, which, in any event, would not have been material to any of the three audit methods used by respondent or the one proposed by appellant.

As stated above, Nu Print took deductions for cash discounts, returns, and bad debts. When such deductions are at issue, the taxpayer has the burden of proving entitlement to the deductions. (*Appeal of Owens-Brockway Glass Container, Inc.*, 2019-OTA-158P.) Appellant did not do that. But perhaps more importantly, those deductions are not relevant. None of the parties' audit methods depend upon claimed exemptions or exclusions.

Finally, the evidence does not support appellant's argument that a more accurate deficiency could be determined by using the average taxable sales ratio to calculate the liability for 2009. Nu Print's sales were drastically reduced after it closed one of its locations. Gross receipts reported on Nu Print's FITR for 2008 were 36 percent lower than what it reported for 2007; and while Nu Print's 2009 FITR is not in evidence, total sales reported to respondent for 2009 were 48 percent lower than the prior year. At the same time, Nu Print reported (to respondent) taxable sales ratios for 2007, 2008, and 2009 of 24.49 percent, 34.83 percent, and 34.47 percent, respectively. The audited taxable sales ratios for 2007 and 2008 were 27.11 percent and 62.32 percent, respectively. Consequently, OTA finds that appellant's proposed use of an average taxable sales ratio from 2007 and 2008 would not produce a more accurate result.

On the basis of the foregoing, OTA finds that further adjustments to Nu Print's tax liability are not warranted.

Issue 2: Did respondent properly impose the negligence penalty on Nu Print?[23]

Generally, if any part of a liability for which a deficiency determination is made is due to negligence, respondent must add a penalty equal to 10 percent of the determined tax deficiency. (R&TC, § 6484.) Although the term "negligence" is not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined as a failure to act as a reasonable and prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal.App.5th 1129, 1157-1158.) Here, the "similar circumstances" would include appellant's substantial business experience and Nu Print's prior audit experience. Failure to maintain and provide complete and accurate records is evidence of negligence and may result in imposition of a negligence penalty.[24] (Cal. Code Regs., tit. 18, § 1698(k).) A negligence penalty also can be based on reporting errors. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-323.)

Respondent imposed the negligence penalty because of Nu Print's failure to provide adequate records and its consistent and substantial underreporting. The evidence supports both bases.

Appellant contends that Nu Print's records were destroyed without Nu Print's knowledge or consent, that the documents provided by his former representatives were their unsupported workpapers, not Nu Print's business records, and that Nu Print provided records for 2009 but respondent chose not to use those records.

OTA has already rejected appellant's arguments regarding Nu Print's failure to provide records and his contentions discrediting the journals upon which respondent's determination is based. These were matters for appellant to prove. He did not prove them. Furthermore, there is no evidence that Nu Print provided sufficient records for an audit of the 2009 tax year. The evidence indicates that Nu Print provided some records for March 2009 only, records that pertained to Nu Print's claimed sales for resale and had no relevance to the audit methods proposed by either party.

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[23] While the evidence indicates that early in the audit process respondent informed Nu Print that the negligence penalty would be deleted, the penalty was included in Nu Print's final liability.

[24] A taxpayer must maintain and make available for examination on request by respondent 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 the returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to, the following: 1) the 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).)

Regarding Nu Print's reporting, appellant argues that the prior audit in 2001 found only minor deficiencies and confirmed the reliability of Nu Print's tax compliance processes, and that Nu Print had a bona fide belief in the accuracy of its SUTRs. Appellant asserts that a large deficiency does not by itself necessarily establish negligence, and he opines that "procedural or operational problems" could have caused the deficiencies. He argues that he was unable to support Nu Print's arguments because Nu Print's records had been lost.

The prior audit in 2001 determined a tax deficiency totaling almost $15,000 based on a measure of over $183,000. While the audit items are not the same as, and the measures are substantially less than, those under consideration here, that audit alerted Nu Print to the importance of maintaining records and accurately reporting sales and deductions.

Accordingly, OTA concludes from the evidence that respondent properly imposed the negligence penalty.

Issue 3: Did respondent timely issue the NODD to appellant?

An NODD issued under R&TC section 6829 must be mailed within three years after the last day of the calendar month following the quarterly period in which respondent obtains actual knowledge, through its audit or compliance activities, or by written communication by the business or its representative, of the termination, dissolution, or abandonment of the business of the corporation, or within eight years after the last day of the calendar month following the quarterly period in which the corporation's business was terminated, dissolved, or abandoned, whichever period expires earlier. (R&TC, § 6829(f); Cal. Code Regs., tit. 18, § 1702.5(c)(2).) Termination of the business of a corporation includes discontinuance or cessation of all business activities for which the corporation was required to hold a seller's permit.[25] (Cal. Code Regs., tit. 18, § 1702.5(b)(3).)

If respondent first gained actual knowledge of the cessation of Nu Print's business on or after October 1, 2010, the NODD was timely issued to appellant. Appellant contends that it is respondent's burden to prove that the NODD was timely issued to appellant, apparently meaning that respondent must prove that it did not first gain actual knowledge of the cessation of Nu Print's business until on or after October 1, 2010. Appellant also argues that, regardless of respondent's burden of proof, the evidence establishes that respondent had actual knowledge that Nu Print had ceased all business operations before October 1, 2010, and,

[25] Later references in this Opinion to the cessation of business activities should be read as referring to the discontinuance or cessation of all business activities for which Nu Print was required to hold a seller's permit.

therefore, the NODD was barred by the statute of limitations. Appellant bases the argument on the following evidence.

Appellant refers to an Asset Purchase Agreement, which is in the record. The agreement appears to transfer the assets of Nu Print's Studio City location to another entity on February 12, 2010, for the price of $12,000. Appellant testified at the hearing that he told respondent that the business was closed, sent respondent an email confirming that information, and faxed "the purchase and sales agreement" to respondent.[26] Appellant asserts that he knew nothing about the potential for responsible person liability and therefore would have had no reason to falsely assert during his conversation with respondent on January 18, 2011, that he had given notice of the business closure. To further support his argument, appellant relies on parts of respondent's Assignment Activity History, emails between the parties, notes made in respondent's records by compliance and collections staff which purport to document communications between appellant and respondent, the fact that respondent did not visit any Nu Print location during the audit, and the fact that Nu Print did not file SUTRs reporting sales for any period after 1Q10.

OTA accepts the fact that appellant informed respondent in January 2011 that he had reported Nu Print's cessation of business at about the time that it occurred. However, OTA rejects appellant's argument that his statement is entitled to greater credibility because, at the time, appellant was unaware of the potential for responsible person liability. Appellant has not proved (and OTA cannot assume) that appellant was not aware of his potential personal liability, particularly given the fact that respondent's March 11, 2010 email to appellant specifically refers to that potential liability.

Appellant did not provide most of Nu Print's business records, asserting that the records were lost when Nu Print's landlord at the Northridge location threw them away. Appellant testified that the records were moved to the Northridge location before the audit began, that Nu Print conducted no commercial activity (i.e., sales) at that location, and that the premises were otherwise empty. Appellant testified that his business computers were transferred with the other assets, but he kept his personal computer. He claims that he was unable to retrieve emails that he sent to respondent. Appellant asked respondent to provide records pertaining to the liability, and respondent provided some records, but appellant asserts that respondent did not provide all records, at least suggesting that respondent held records back or destroyed records that were not favorable to its position. On the bases of these arguments and citing *Appeal of Cookston*,

[26] Appellant makes essentially the same statements in written declaration, but he refers to the document as "the bill of sale."

1983 WL 15434 (*Cookston*), appellant asks OTA to apply what he refers to as the *Cookston* rule to respondent. Apparently, appellant contends that, prior to the hearing, respondent failed to provide evidence within its control that would prove that appellant informed respondent before October 1, 2010, that Nu Print had ceased business operations. Appellant argues that on that basis, OTA should essentially presume that the alleged communications did, in fact, occur.

Appellant is mistaken regarding the burden of proof. While R&TC section 6829(c) and Regulation section 1702.5(a) specifically state that respondent has the burden of proving the factual elements that warrant imposing liability on a corporate officer (for example) for the unpaid tax liabilities of the corporation, there is nothing in the statute or regulation that requires respondent to show that the NODD was filed within the three-year limitations period. Generally, an assertion that the statute of limitations bars an action is considered an affirmative defense that must be pleaded and proved by the party against whom the action is asserted. (*Minton v. Cavaney* (1961) 56 Cal.2d 576, 581.) Nothing in the Sales and Use Tax Law warrants application of a different rule here. The burden of proving that the NODD was barred by the statute of limitations rests with appellant. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of evidence. (Cal. Code Regs., tit. 18, § 30219(b).) Thus, to prove that the NODD was barred, appellant must prove that on or before September 30, 2010, respondent had actual knowledge that Nu Print had ceased business activities.

The U.S. Supreme Court considered the meaning of the term “actual knowledge” in *Intel Corp. Investment Policy Committee, et al. v. Sulyma* (2020), 589 U.S. 178 (*Sulyma*). *Sulyma* states that use of the term “actual” to describe a type of knowledge signals that the person 's knowledge must be more than “potential, possible, virtual, conceivable, theoretical, hypothetical, or nominal.” (*Sulyma*, *supra*, at p.185.) The question is not what respondent should have known or might have known; the question is what respondent did know. (See *Sulyma*, *supra*, at p. 186.) It is important to note, however, that *Sulyma* allows proof of actual knowledge in all the “usual ways,” including inference from circumstantial evidence (*Sulyma*, *supra*, at p.189), and it does not preclude a finding of actual knowledge based on evidence of “willful blindness.” (*Sulyma*, *supra*, at p.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.”)

Regarding appellant’s *Cookston* argument, Evidence Code section 412 states that when weaker and less satisfactory evidence is offered when it was within the power of the party to produce stronger and more satisfactory evidence, the evidence offered should be viewed with

distrust. This statute is a basis for a jury instruction to the same effect. (See Judicial Council of California, Civil Jury Instructions (2024 Ed.) CACI No. 203.) That instruction is not to be given absent evidence that the party producing inferior evidence had the power to produce superior evidence. (*Hansen v. Warco Steel Corp.* (1965) 237 Cal.App.2d 870, 876.) In its prior adjudicatory capacity (a function now performed by OTA), respondent decided *Cookston*. *Cookston* was an income tax appeal. The taxpayer filed no SUTR, refused to cooperate with the Franchise Tax Board, essentially argued that he had no obligation to pay income taxes, and provided no evidence. The *Cookston* opinion discusses the presumption in favor of an assessment and the taxpayer's burden of proving the assessment was wrong, stating, "In reaching this conclusion, the courts have invoked the rule that the failure of a party to introduce evidence which is within his control gives rise to the presumption that, if provided, it would be unfavorable."

OTA concludes that *Cookston* does not apply to respondent under the facts shown by the evidence. It appears that appellant's *Cookston* argument is a veiled attempt to improperly shift the burden of proof to respondent, and that *Cookston* would be more appropriately applied to appellant. As stated above, 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)), and a failure to comply is evidence of negligence (Cal. Code Regs., tit. 18, § 1698(k)). When a taxpayer wants to be relieved of that responsibility, it is incumbent on the taxpayer to establish a factual basis for the requested relief. Appellant's testimony that Nu Print left its business records, *and only its business records*, at the retail space in Northridge, and that the landlord disposed of those records without giving Nu Print an opportunity to retrieve them is not credible. The record is devoid of evidence to support that assertion. A landlord is required to give a tenant written notice of the landlord's intent to dispose of personal property. (Code Civ. Proc., §§ 1993 et seq.) There is no credible or independent evidence that Nu Print's records were lost or destroyed. OTA will next examine the evidence pertinent to the notice issue.

Appellant testified that: (1) he specifically informed respondent in writing prior to October 1, 2010, that Nu Print had ceased business activities; and (2) he provided a copy of the Asset Purchase Agreement. The evidence is not sufficient to establish either of these facts. Appellant essentially argues that the evidence shows various communications over a period of several months, which, when taken together, prove that respondent had actual knowledge before October 1, 2010, that Nu Print had ceased business activities. The evidence does not prove actual knowledge. There is insufficient evidence to show that respondent ever received

the Asset Purchase Agreement; but even if there was such evidence, the evidence shows that respondent believed, at least until the site visit in 2011, that Nu Print was conducting business at the Northridge location. It is not surprising that respondent would think that. Appellant notified respondent that Nu Print had changed its address to the Northridge location, which was in a retail strip mall. People usually lease space in a retail strip mall to conduct a retail business, not to store business records.

Appellant's belief that a single reference by respondent to a "close out" was a reference to Nu Print's cessation of business is unfounded.[27] It is at least as likely than not that note was referring to close out of one of Nu Print's locations, particularly when one considers the fact that the person who made the note took no action that would suggest actual knowledge that Nu Print had ceased business activities. Appellant's statement that a bank account was closed also was not enough to convey actual knowledge. Businesses open and close accounts without ceasing business activities. It also is not uncommon for businesses to fail to file SUTRs for consecutive reporting periods. Such failures do not indicate the cessation of operations; nor does respondent's failure to do a site visit during the audit indicate that there was no business location to visit. Respondent clearly did not interpret appellant's communications as a notice of business cessation. Respondent issued a seller's permit showing the Northridge address and did not close the seller's permit until after it confirmed that Nu Print was not conducting business at that address. OTA finds that the evidence does not prove that respondent had actual knowledge prior to October 1, 2010, that Nu Print ceased business activities. On that basis, OTA finds that the NODD was timely issued to appellant.

Issue 4: Is appellant personally responsible for the unpaid tax liabilities of Nu Print?

R&TC section 6829 provides, in pertinent part, that a corporate officer (for example) can be held 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 TPP and failed to remit such tax reimbursement to respondent when due; (3) the person had control or supervision of, or was charged with the responsibility for, the filing of SUTRs or the payment of tax, or had 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).)

[27] Appellant attempted to reinforce the validity of this belief by references to the purported opinions of unidentified consultants. OTA gives no weight to such opinions.

Respondent must prove these elements by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 1702.5(d).)

Termination

The "termination" of the business of a corporation includes the cessation of all business activities. (Cal. Code Regs., tit. 18, § 1702.5(b)(3).) The parties agree that Nu Print's ceased business activities prior to issuance of the NODD. Therefore, the termination requirement has been satisfied.

Collection of Sales Tax Reimbursement

As relevant here, personal liability can be imposed only to the extent the corporation collected tax reimbursement on its sales of TPP in this state. (R&TC, § 6829(c); Cal. Code Regs., tit. 18, § 1702.5(a).) There appears to be no dispute regarding appellant's collection of sales tax reimbursement in connection with its retail sales to customers in California. Appellant's argument is that it would not have collected sales tax reimbursement in connection with the disputed taxable sales because those sales are not real; appellant contends they are the product of respondent's unreasonable reliance on incorrect data and ill-conceived audit methods. OTA has rejected this argument above, finding that no adjustment to the determined liability is warranted, and it rejects the argument here. The deficiency is solidly based on Nu Print's recorded amounts of sales tax reimbursement collected from customers for 2007 and 2008. OTA finds that the evidence is sufficient to prove that Nu Print collected sales tax reimbursement in connection with the disputed sales. Therefore, this requirement has been satisfied.

Responsible Person

Personal liability can be imposed only on a responsible person. (R&TC, § 6829(b).) In this context, "responsible person" means any person having control or supervision of, or who was charged with the responsibility for, the filing of SUTRs or the payment of tax or who had a duty to act for the corporation in complying with any portion of the Sales and Use Tax Law when the taxes became due. (*Ibid*.; Cal. Code Regs., tit 18, § 1702.5(b)(1).) As relevant here, personal liability applies only if, when the person was a responsible person for the corporation, the corporation sold TPP and collected sales tax reimbursement on the selling price of the property and failed to remit such tax reimbursement when due. (Cal. Code Regs., tit. 18, § 1702.5(a).)

Appellant concedes that he was a person responsible for Nu Print's sales and use tax compliance for the liability period. Appellant states that Nu Print was dissolved in September 2011, that the NODD was not issued to him until January 31, 2012, that the NODD was addressed incorrectly, and that appellant did not learn of the liability until August 2013. On these bases, appellant argues that he was not a person responsible for Nu Print's sales and use tax compliance when he first learned of determined liability, and, therefore, he cannot be liable.

Appellant misunderstands the nature of the liability at issue here. Respondent determined that Nu Print failed to accurately report its tax liability for the liability period, a period for which appellant concedes he was responsible. However, as is discussed above, the law would not allow respondent to impose Nu Print's unpaid liabilities on appellant until Nu Print ceased doing business. If persons who would otherwise be deemed responsible for sales and use tax compliance could avoid liability under R&TC section 6829 simply by terminating the business, the remedy provided by section 6829 would disappear. Appellant's argument appears to be directed more toward the knowledge element of the willfulness requirement, discussed below. On the basis of the evidence, OTA finds that the responsible person requirement has been met.

Willfulness

The final requirement is that the evidence must establish that appellant willfully failed to pay taxes due or willfully failed to cause such taxes to be paid. In this context, "willfully fails to pay or to 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).) A failure may be found willful even if it was not done with a bad purpose or motive. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).) To show willfulness here, the evidence must establish that on or after the date that the taxes came due, appellant had actual knowledge that the taxes were due, but not being paid and, at the same time, appellant had the authority and the ability to pay the taxes or to cause them to be paid. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).)

The first requirement for willfulness is that the responsible person had actual knowledge that the taxes were due, but not being paid. (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(A); *Appeal of Eichler*, 2022-OTA-029P.) Appellant was a person responsible for Nu Print's sales and use tax compliance for the liability period. He signed and filed at least some of Nu Print's SUTRs. Nu Print's sales journals clearly show the amounts of sales tax reimbursement collected from customers; and yet, Nu Print consistently underreported and failed to remit an average of 40 percent of those amounts. Not once did Nu Print overreport sales tax collected from its

customers. On the basis of the evidence, OTA finds that appellant had actual knowledge that Nu Print was not paying the taxes at issue.

The second requirement is that the person responsible had authority to pay the taxes or to cause them to be paid. (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(B).) This authority must coincide with the first requirement, knowledge, meaning that the person must have the authority to pay the taxes actually known to be due. (*Ibid*.) The evidence described above shows that appellant controlled Nu Print during the time in question and had authority over day-to-day operations, including reporting and paying sales and use tax. In addition, the evidence shows that appellant had the authority to sign checks drawn on Nu Print's checking account. On these bases, OTA finds that appellant had the authority to pay the taxes when due.

The third requirement for willfulness is that when the responsible person had actual knowledge that taxes were due and the authority to pay the taxes, that person also had the ability to pay the taxes but chose not to do so. (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(C).) This issue is usually resolved on the basis of funds available to pay taxes. The evidence shows that Nu Print deposited over $1.9 million dollars in its bank account during 2008. The smallest amount deposited in any given month that year was over $117,000. In May 2008, Nu Print deposited over $203,000. In 2Q08, Nu Print reported total sales of $739,321. In 2Q07, Nu Print reported total sales of $883,938, over $144,000 more than in the same period for the following year. Sales during 2009 produced far fewer gross receipts, but as stated earlier, the determined liability is based on sales tax reimbursement collected by Nu Print. The record also shows that Nu Print paid wages to its officers and employees during the entire liability period, including 2Q10 through 4Q10. The lowest quarterly amount paid in wages during 2007 was over $146,000. The lowest quarterly amount paid in 2008 was over $111,000.[28] In 3Q10, Nu Print reported paying wages of over $40,000 to four employees in August and September (an average of $5,000 per employee per month) and another $10,000 to four employees in October and November 2010.[29] Also, according to the evidence, Nu Print's COGS was over $2.89 million for 2007 and 2008 combined, and over $705,000 for 2009 and 2010. Therefore, while Nu Print may have been a business, OTA finds that it was also a business that had funds to pay the its taxes when due but simply chose to use those funds, including the funds collected from customers for the specific purpose of paying sales tax, for other things. Consequently, the

[28] The highest quarterly amount of wages paid during the entire liability period was $227,400, for 1Q08.

[29] Nu Print reported no wages paid in July 2010 or December 2010.

third and final requirement to support a finding of willfulness has been met. Based on the above, OTA finds appellant willfully failed to pay the taxes or cause them to be paid when due.

In summary, OTA finds that the evidence establishes all of the elements required for the imposition of liability on appellant as a person responsible for the unpaid liabilities of Nu Print under R&TC section 6829.

HOLDINGS

1. Further adjustments to Nu Print's tax liability are not warranted.
2. Respondent properly imposed the negligence penalty on Nu Print.
3. Respondent timely issued the NODD to appellant.
4. Appellant is personally responsible for the unpaid tax liabilities of Nu Print.

DISPOSITION

Respondent's actions reducing the deficiency measure from $880,981 to $864,323, declining to delete the negligence penalty, and holding appellant personally responsible for the unpaid tax liabilities of Nu Print are sustained. The prepayment penalties for October and November 2010 are deleted from the liability, and the finality penalty will be deleted from the liability on the condition that appellant pays the remaining liability in full within 30 days of the date the final opinion in this appeal is issued.

DocuSigned by:
Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Steven Kim
3DD7EF644387430...
Steven Kim
Administrative Law Judge

Date Issued: 1/15/2025