OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **A & A INDUSTRIAL SUPPLIES**	OTA Case No.: 240817047 CDTFA Case IDs: 4-342-481, 4-348-808, 4-354-702 & 4-358-212

OPINION

Representing the Parties:

For Appellant: Gilbert Deleon, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

G. TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A & A Industrial Supplies (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of two Notices of Determination (NODs) issued on October 28, 2022.[1] Combined the NODs are for tax of $299,910, less credits of $12,806, plus applicable interest, and penalties in the amount of $62,755.26 ($16,816.91 for failure to file, $10,520.75 for negligence, and $35,417.60 for failure to remit tax reimbursement collected) for the period January 1, 2018, through December 31, 2020 (liability period).

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, section 30209(a).

[1] CDTFA issued two NODs on October 27, 2022, due to a limitation within their system for imposing both a negligence penalty and a failure to remit tax reimbursement collected penalty for the same periods. The NODs were timely issued because on June 22, 2022, Petitioner signed the latest in a series of waivers of the three-year statute of limitations, which extended until October 31, 2022, the time within which the CDTFA could issue the NODs for the periods 1Q2018 through 4Q2018. (R&TC, §§ 6487(a), 6488.)

ISSUES

1. Whether adjustments to the measure of unreported taxable sales are warranted relating to disallowed sales in interstate commerce and disallowed sales for resale.[2]
2. Whether the failure to file penalty was properly imposed.
3. Whether the negligence penalty was properly imposed.
4. Whether the 40 percent failure to remit penalty was properly imposed.

FACTUAL FINDINGS

1. Appellant is a retailer of new and used storage racks and material handling equipment in Lodi, California.
2. Appellant has not been previously audited. Appellant was selected for audit by CDTFA and provided various documents for that examination, including: federal income tax returns (FITRs) for the liability period; depreciation schedules; sales and use tax returns (SUTRs) along with the related worksheets; and sales tax liability reports and sales reports for the liability period.
3. Although the audit covered periods 1Q18 through 4Q20, appellant only filed SUTRs for periods first quarter 2018 (1Q18) through 4Q18. For periods 1Q18 through 4Q18, appellant reported gross sales of $91,393 while claiming deductions for sales for resales of $40,718 and nontaxable labor of $22,581, resulting in reported taxable sales of $28,094.
4. Gross receipts reported by appellant on its FITRs exceeded the total sales reported on its SUTRs by $786,057 for 2018, $753,142 for 2019, and $835,719 for 2020, for a total difference of $2,374,918 for the three years combined.
5. Total sales recorded on the sales reports exceeded total sales reported on SUTRs by $2,290,349 for the liability period.
6. For the liability period, appellant claimed sales in interstate commerce of $1,055,673 which CDTFA disallowed for lack of substantiation.
7. CDTFA also disallowed claimed sales for resale of $40,718, ex-tax purchases of fixtures and equipment of $22,000, and claimed consumable supplies purchased of $48,808 for lack of substantiation.
8. CDTFA imposed a 10 percent failure to file penalty for 2019 through 2020 because appellant did not file any return during this period while the business was in operation.

[2] On appeal, appellant does not challenge CDTFA's denial of adjustments for ex-tax purchases of fixtures and consumables. Consequently, OTA shall not address those issues.

9. CDTFA imposed a 10 percent negligence penalty for appellant's failure to maintain adequate records.
10. For 2Q18 through 4Q20, CDTFA imposed a 40 percent penalty for failure to remit tax reimbursement collected based on appellant's records.
11. CDTFA issued two NODs on October 28, 2022.
12. Appellant timely appealed both NODs on November 26, 2022. Appellant also asserted a claim for refund.
13. On July 9, 2024, CDTFA issued a decision denying appellant's petition for redetermination and claim for refund.[3]
14. This timely appeal followed.

DISCUSSION

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

Issue 1: Whether adjustments to the measure of unreported taxable sales are warranted, relating to disallowed sales in interstate commerce and disallowed sales for resale.

OTA finds CDTFA's use of appellant's sales records as the foundation of their determination is sufficient to meet their initial burden of showing the determination was

[3] On appeal, appellant does not challenge the denial of its claim for refund. Thus, OTA does not discuss this item further.

reasonable and rational. (*Appeal of Talavera*, *supra*.) Consequently, the burden of proof shifts to the taxpayer to establish the determination erroneous. (*Ibid*.) On appeal, appellant asserts that audited taxable sales erroneously include nontaxable sales in interstate commerce. If by "sales in interstate commerce" appellant means gross receipts from the sale of tangible personal property which, pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer's facilities or by common carrier, customs broker, or forwarding agent, appellant is correct that such sales are exempt from the sales tax. (R&TC, § 6396; Cal. Code Reg., tit. 18, § 1620(a)(3)(B).) However, it is appellant's burden to establish entitlement to the exemption. (R&TC, § 6091, *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443 (*Paine*).) For sales in interstate commerce, that evidence might include bills of lading, invoices, sales contracts, or the like, evidencing the sale and its shipment to points outside the state. Here, appellant has provided no such documentation to substantiate the disallowed sales in interstate commerce. A mere allegation that sales are exempt or excluded is insufficient to meet appellant's burden. (*Paine*, *supra*, at p. 442.)

Appellant also asserts that audited taxable sales erroneously include nontaxable sales for resale. However, the law presumes that all gross receipts are subject to tax unless the seller timely takes from the purchaser a certificate to the effect that the property is purchased for resale. (R&TC, § 6091; Cal. Code Regs., tit. 18, § 1668(a).) A certificate will be considered timely if it is taken at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or at any time prior to delivery of the property to the purchaser. (Cal. Code Regs., tit. 18, § 1668(a).) Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a resale certificate with respect to the sale of the property described in the document if it contains all of the following essential elements: (1) the signature of the purchaser, purchaser's employee or authorized representative of the purchaser; (2) the name and address of the purchaser; (3) the number of the seller's permit held by the purchaser; (4) a statement that the property described in the document is purchased for resale; and (5) the date of execution of the document. (Cal. Code Regs., tit. 18, § 1668(b)(1).)

If the seller does not timely obtain a valid resale certificate, the seller is relieved of liability only where the seller shows that the property: (1) was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business; (2) is being held for resale by the purchaser and has not been used for any purpose other than retention, demonstration, or display, while being held for sale in the regular course of business; or (3) was consumed by the

purchaser, and tax was reported to CDTFA by the purchaser on the purchaser's returns or in an audit of the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).)

In the absence of a timely obtained and valid resale certificate, a seller may validate actual sales for resale with XYZ letters. (Cal. Code Regs., tit. 18, § 1668(f).) XYZ letters, sent to customers in a form approved by CDTFA, inquire as to the purchaser's disposition of the property purchased from the seller; however, a response to an XYZ letter is not equivalent to a timely and valid resale certificate, and CDTFA is not required to relieve a seller from liability for sales tax or use tax collection based on a response to an XYZ letter. (Cal. Code Regs., tit. 18, § 1668(f)(3).)

Appellant, however, has provided no evidence to substantiate the claimed sales for resale. When, as here, the right to exemption from tax is involved, the taxpayer carries the burden of proving the right to the exemption. (*H.J. Heinz Company v. State Bd. of Equalization* (1962) 209 Cal.App.2d 1, 4.) Any taxpayer seeking exemption from the tax must establish that right using the evidence specified by the authorizing statute or regulation. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 766 (*Standard Oil*).)[4] A mere allegation that sales are exempt from tax is insufficient to meet appellant's burden. (*Appeal of Adventures by the Sea, Inc.*, 2023-OTA-284P.) Also, 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).)

OTA finds that appellant has not provided any documentation to warrant any adjustments to the audited taxable measure with respect to either disallowed sales in interstate commerce or disallowed sales for resale.

Issue 2: Whether the failure to file penalty was properly imposed.

Any taxpayer who fails to file a return by the due date shall pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required. (R&TC, §§ 6511, 6591.) The penalty may be relieved if the taxpayer proves that the failure to make a timely return or payment was due to reasonable cause and circumstances beyond the taxpayer's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. (R&TC, § 6592.)

[4] "Statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. [citations] The taxpayer has the burden of showing that he clearly comes within the exemption. [citations] An exemption will not be inferred from doubtful statutory language [citations] the statute must be construed liberally in favor of the taxing authority, and strictly against the claimed exemption [citations]." (*Standard Oil*, *supra*.)

Here, appellant failed to file returns for the periods 1Q19 through 4Q20. On appeal, appellant makes no argument and presents no evidence of why the penalty was erroneously imposed. OTA finds the penalty was properly imposed, and appellant has provided no cause for it to be abated.

Issue 3: Whether the negligence penalty was properly imposed.

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).) Taxpayers are 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 sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to, the following: (a) normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep 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).) A taxpayer's failure to report numerous transactions is evidence of negligence. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323 (*Independent Iron Works*).)

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 their bookkeeping and reporting practice 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, supra*, at p. 321-324.)

Here, the audit results found significant differences between appellant's books and records and their SUTRs. Appellant failed to report ex-tax purchases of fixed assets and consumable supplies for the audit period. Appellant was unable to support its claimed sales for

resales and claimed sales in interstate commerce. For the periods in which appellant filed SUTRs, they underreported taxable sales by an average of 97.90 percent.

Given the inadequacy of the records provided for audit, the inability to substantiate the claimed exclusions or exemptions, and the magnitude of the reporting errors, OTA finds that appellant's bookkeeping and reporting errors cannot be attributed to its 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. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Based on the foregoing, OTA finds that appellant was negligent, and the negligence penalty was properly imposed.

Issue 4: Whether the 40 percent failure to remit penalty was properly imposed.

The R&TC provides, in pertinent part, that any person who knowingly collects sales tax reimbursement and who fails to timely remit it to the state shall be liable for a penalty of 40 percent of the amount not timely remitted. (R&TC, § 6597(a)(1).) The penalty does not apply if the person's liability for unremitted sale tax reimbursement averages $1,000 or less per month or does not exceed 5 percent of the total amount of the tax liability for which the sales tax reimbursement was collected for the period in which the tax was due, whichever is greater. (R&TC, § 6597(a)(2)(A).) A showing of fraud or intent to evade payment of tax is not required in order to impose the 40 percent penalty. (*Appeal of Finnish Line Motorsports, Inc.*, 2019-OTA-138P.)

If a person's failure to make a timely remittance of sales tax reimbursement is due to reasonable cause or circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person shall be relieved of the 40 percent penalty. (R&TC, § 6597(a)(2)(B).) "Reasonable cause or circumstances beyond the person's control" includes, but is not limited to, any of the following: (1) the occurrence of a death or serious illness of the person or the person's next of kin that caused the person's failure to make a timely remittance; (2) the occurrence of an emergency, as defined in Government Code section 8558, that caused the person's failure to make a timely remittance; (3) a natural disaster or other catastrophe directly affected the business operations of the person that caused the person's failure to make a timely remittance; (4) CDTFA failed to send returns or other information to the correct address of record, that caused the person's failure to make a timely remittance; (5) the person's failure to make a timely remittance occurred only once over a three-year period, or once during the period in which the person was engaged in business, whichever time period is shorter; or (6) the person voluntarily corrected errors in remitting tax or tax

reimbursement that were made in previous reporting periods and remitted payment of the liability owed as a result of those errors prior to being contacted by CDTFA regarding possible errors or discrepancies. (R&TC, § 6597(b)(1).)

Here, CDTFA found that appellant's own records and sales tax liability reports showed the collection of sales tax reimbursement for sales throughout the liability period. Consequently, CDTFA concluded that appellant knew sales tax reimbursement was being collected and failed to remit those sums as required by law. Further, appellant's unremitted sales tax reimbursement was more than $1,000 per month and more than 5 percent of the net recorded sales tax reimbursement collection for the periods 2Q18 through 4Q20 and imposed the penalty only for those periods.

Finding no errors in CDTFA's imposition of the 40 percent penalty, and appellant providing no argument or evidence as a basis for challenging the imposition, OTA finds the 40 percent penalty properly imposed and no basis for abatement.

HOLDINGS

1. Appellant has not established that adjustments are warranted to the measure of unreported taxable sales relating to disallowed sales in interstate commerce and disallowed sales for resale.
2. The failure to file penalty was properly imposed.
3. The negligence penalty was properly imposed.
4. The 40 percent failure to remit penalty was properly imposed.

DISPOSITION

CDTFA's action in denying appellant's petition and claim for refund is sustained in full.

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

We concur:

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Teresa A Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

Date Issued: 6/17/2025