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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **A. ABBASI**	OTA Case No. 230413043 CDTFA Case ID: 974-918

OPINION

Representing the Parties:

For Appellant: Patrick Finnegan, CPA

For Respondent: Jason Parker, Chief of Headquarters Ops.

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A. Abbasi (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on May 28, 2019.[2] The NOD is for tax of $36,761, plus interest, and a negligence penalty of $3,676.09, for the period April 1, 2015, through March 31, 2018 (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, (Regulation) section 30209(a).

ISSUES

1. Whether a reduction in the measure of unreported taxable sales is warranted.
2. Whether the negligence penalty was properly imposed.

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

[2] CDTFA timely issued the NOD because appellant waived the otherwise applicable three-year statute of limitations and extended the NOD issuance deadline to May 31, 2019. (See R&TC, §§ 6487(a), 6488.)

FACTUAL FINDINGS

1. Appellant, a sole proprietor, operated as a Metro T-Mobile dealer and a seller of cigarettes and tobacco products in Richmond, California, for the liability period.
2. Appellant reported total sales of $528,497, and claimed deductions totaling $45,227, resulting in reported taxable sales of $483,270 for the liability period.
3. CDTFA audited appellant for the liability period. During the audit, appellant provided federal income tax returns for 2015 and 2016, and incomplete purchase invoices for the second quarter of 2015 (2Q15) through 4Q17. Appellant did not provide purchase invoices for 1Q18. Appellant did not claim any bad debt deductions on his 2015 and 2016 federal income tax returns. CDTFA found appellant's books and records to be inadequate for sales and use tax purposes.
4. For the period of 2Q13 through 4Q17, CDTFA accepted appellant's recorded purchases, as well as incomplete purchase invoices, to compute audited taxable sales of $407,889 for cell phones and accessories. For 1Q18, appellant did not provide purchase invoices, so CDTFA computed an average quarterly purchase amount from appellant's purchase invoices for 2Q13 through 4Q17, resulting in audited taxable sales of $37,081 for 1Q18. In total, CDTFA computed $444,970 ($407,889 + $37,081) in audited taxable sales of cell phones and accessories for the liability period.
5. Appellant did not provide complete purchase invoices for cigarette and tobacco products. Therefore, CDTFA performed a vendor survey to establish audited cigarette and tobacco products purchases of $383,590 for the liability period (i.e., costs of goods that appellant sold in taxable retail sales). CDTFA estimated a markup of 12 percent which it applied to audited tobacco products and cigarette purchases, computing audited taxable tobacco products and cigarette sales of $429,620 for the liability period.
6. Next, CDTFA combined the audited taxable tobacco products and cigarette sales, and the audited taxable cell phones and accessories sales to compute total audited taxable sales of $874,590 ($429,620 + $444,970) for the liability period. Lastly, CDTFA compared the audited taxable sales ($874,590) to the reported taxable sales ($483,270) establishing unreported taxable sales of $391,320 ($874,590 – $483,270) for the liability period.
7. On May 28, 2019, CDTFA issued the NOD for $36,761 in tax, plus interest, and a 10 percent negligence penalty of $3,676.09.

8. Appellant filed a timely petition for redetermination (petition) dated May 31, 2019, disputing CDTFA's assessment of unreported taxable sales for cell phones and accessories.
9. By decision dated February 28, 2023, CDTFA denied appellant's petition.
10. This timely appeal followed.[3]

DISCUSSION

Issue 1: Whether a reduction in the measure of unreported taxable sales is warranted.

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

Gross receipts do not include the amount charged for merchandise returned by customers if: (1) the full sale price, including that portion designated as "sales tax," is refunded either in cash or credit; and (2) the customer, in order to obtain the refund or credit, is not required to purchase other property at a price greater than the amount charged for the property that is returned. (R&TC § 6012(c)(2); Cal. Code Regs., tit. 18, § 1655(a)(1).)

In general, a retailer is relieved from liability for sales tax or from liability to collect use tax insofar as the measure of the tax is represented by accounts found worthless and charged off for income tax purposes. (R&TC, § 6055(a); Cal. Code Regs., tit. 18, § 1642(a).) A retailer may claim a bad debt deduction provided that the sales tax, or amount of use tax, was actually paid to the state. (*Ibid*.) If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as interest, insurance, repair, or installation labor and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. (Cal. Code Regs., tit. 18, § 1642(b)(1).) In determining that amount, all payments and credits to the account may be applied ratably against the various elements comprising the amount the

[3] According to CDTFA's decision, appellant did not dispute the measure for unreported cigarette and tobacco products. On appeal, appellant does not specifically dispute, or provide argument against, the unreported cigarette and tobacco product sales ($429,620) and, as such, this Opinion does not discuss this item further.

purchaser contracted to pay (pro rata method), or may be applied as provided in the contract of sale (contract method), or may be applied by another method which reasonably determines the amount of the taxable receipts (alternative method). (*Ibid*.)

In support of deductions or claims for refund for bad debts, retailers must maintain adequate and complete records showing the date of original sale, the name and address of the purchaser, the amount the purchaser contracted to pay, the amount on which the retailer paid tax, the jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated, all payments or other credits applied to account of the purchaser, evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles, and the taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax. (Cal. Code Regs., tit. 18, § 1642(e).)

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*.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code. Regs., tit.18, § 30219(b).) That is, a party 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. (*Ibid*.) To satisfy the burden of proof, a taxpayer must prove that: (1) the tax assessment is incorrect; and (2) the proper amount of the tax. (*Ibid*.)

Audited taxable sales are based on information from appellant's own records. The recorded purchases and purchase invoices from appellant's books and records are evidence of appellant's taxable sales. Thus, CDTFA's use of appellant's recorded purchases and invoices to establish appellant's taxable sales is reasonable and rational. Therefore, OTA finds CDTFA has met its initial burden, and the burden of proof shifts to appellant to show that a result differing from CDTFA's determination is warranted.

Appellant contends that the audited unreported taxable measure for phones and accessories is overstated because CDTFA failed to account for a percentage of uncollectible

charges, or bad debts. Specifically, appellant argues that cell phone dealers in low-income areas, like the area where appellant's business is located, often incur significant bad debts due to what is known in the business as Negative Gross Adds (NGAs).[4] Appellant asserts that CDTFA should have provided, at a minimum, a 15 percent allowance for bad debts incurred from his NGAs.

Here, appellant did not claim a bad debt deduction on either of his 2015 or 2016 federal income tax returns (as transcribed in the audit working papers), and OTA has no record of appellant's federal income tax returns for 2017 or 2018. Moreover, there is neither evidence nor argument that appellant charged off the alleged bad debts using generally accepted accounting principles. Thus, there is no evidence before OTA that appellant complied with Regulation section 1642 regarding the alleged bad debts. (Cal. Code Regs., tit. 18, § 1642(e).)

Based on the foregoing, OTA concludes that appellant has failed to meet his burden of establishing that any further reduction to the measure of unreported taxable sales is warranted.

Issue 2: Whether the negligence penalty was properly imposed.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the 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.

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. (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 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. (Cal. Code Regs., tit. 18, § 1698(k).)

[4] Negative Gross Adds (NGA) refers to when a customer purchases a cell phone from a dealer and then fails to pay his or her second bill. In general, NGAs, also known as phantom accounts, are new activations that do not see a second month's payment because the customer had no intention of staying with the dealer or carrier from whom they bought the cell phone. Several examples include the following: some customers buy a cell phone to unlock it, and then resell it internationally; others buy a cell phone to use with another carrier's service; a tourist may buy a cell phone for temporary use; and a customer may buy a cell phone to use temporarily while their other cell phone is getting replaced.

Generally, a penalty for negligence or intentional disregard should not be added when the taxpayer has not been previously audited. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) However, if there is evidence 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, then such evidence could justify imposing the penalty for negligence when the taxpayer has not been previously audited. (Cal. Code Regs., tit. 18, § 1703 (c)(3)(A); see *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

Appellant makes no arguments regarding the negligence penalty and reiterates his arguments regarding the unreported taxable sales.

Although this is appellant's first audit, appellant understated his taxable sales by $391,320, representing more than 81 percent of reported taxable sales of $483,270 for the liability period ($391,320 ÷ $483,970). In addition, appellant failed to keep and maintain adequate books and records as required by law. All of these facts are evidence of negligence; and further, these facts cannot be attributed to a good faith and reasonable belief that appellant's bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law. Based on the foregoing, OTA finds that appellant was negligent, and the negligence penalty was properly imposed.

HOLDINGS

1. A reduction in the measure of taxable sales is not warranted.
2. Appellant was negligent, and the negligence penalty was properly imposed.

DISPOSITION

CDTFA's action in denying appellant's petition for redetermination is sustained.

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

Signed by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Keith T. Long
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

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