

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
MC CARTY AND COMPANY INC.

) OTA Case No.: 240415992
) CDTFA Case IDs: 2-931-094, 5-712-933
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)
)

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative
For Respondent: Jason Parker, Chief of Headquarters Ops.

G.TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, MC Carty and Company Inc. (appellant) appeals a Decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on June 11, 2021,² and a protective claim for refund.³ The NOD is for tax of \$113,056,⁴ plus applicable interest, and penalties of \$11,305.57⁵ for the period April 1, 2017, through March 31, 2020 (liability period).

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

² The NOD was timely issued because on June 30, 2020, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period April 1, 2017, through March 31, 2018, which allowed respondent until July 31, 2021, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

³ A taxpayer will sometimes file a petition for redetermination and a claim for refund to protect its right to claim a refund or credit for overpayments discovered in an audit or that may be discovered during the taxpayer's appeal of the NOD. Such claims are frequently referred to as protective claims for refund.

⁴ Tax liability of \$116,612 less a \$3,556 tax credit for bad debts.

⁵ Respondent applied a 10-percent negligence penalty of \$7,891.32 to the tax liability for the second quarter of 2017 (2Q17) through 1Q19 and a 10-percent failure-to-file penalty of \$3,414.25 to the tax liability for the 2Q19 through 1Q20. Appellant has not disputed the penalties; thus, OTA does not discuss them further.

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).

ISSUE

Whether adjustments to the measure of unreported taxable sales for bad debts are warranted.

FACTUAL FINDINGS

1. Appellant, a corporation, operated a Snap-On Tools franchise selling tools, toolboxes, and other related accessories direct from appellant's mobile store (i.e., truck). Appellant was based in La Habra Heights, California, but made sales and deliveries at its customers' locations in Los Angeles County. Appellant's seller's permit was opened with an effective start date of April 1, 2017, and closed with an effective date of March 31, 2020, when the business was reorganized.
2. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of \$219,659 and claimed no deductions resulting in reported taxable sales of the same amount. Appellant did not file SUTRs for the second quarter of 2019 (2Q19), through 1Q20. Appellant stated it used the Snap-On Tools Accounting System to record sales and reported sales on the SUTRs from Snap-On Tools Franchisee Management Reports.
3. For audit, appellant provided federal income tax returns (FITRs) for calendar years 2017, 2018, and 2019; Snap-On Tools Franchisee Management Reports for the liability period; and various sales invoices to support write-offs (bad debts). Respondent found the books and records inadequate for sales and use tax audit purposes.
4. Respondent compared total sales reported on the SUTRs to the corresponding purchases recorded in the Snap-On Tools Franchisee Management Reports and computed book markups of -60.44 percent for 2017; -77.24 percent for 2018; and -81.39 percent for 2019.⁶ Appellant did not provide documentation to verify

⁶ "Markup" is the amount by which the cost of merchandise is increased 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 ($0.30 \div 0.70 = 0.42857$). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

- purchases of merchandise. Respondent believed the negative markups⁷ indicated that reported sales were potentially understated and additional testing was warranted.
5. Respondent compared total sales reported on the SUTRs for 2017, 2018, and 2019, to the corresponding gross receipts (excluding sales tax reimbursement) reported on the FITRs noting gross receipts greatly exceeded total sales by \$424,344 in 2017, \$353,423 in 2018, and \$334,333 in 2019. Appellant could not explain the reason for the differences nor did appellant provide original transactional information or worksheets used to prepare the SUTRs. Respondent concluded that the differences represented unreported taxable sales. Respondent computed average quarterly unreported taxable sales of \$106,086 for 2017, \$88,356 for 2018, and \$83,583 for 2019. Respondent calculated unreported taxable sales of \$1,089,597 $((\$106,086 \times 3 \text{ quarters in 2017}) + (\$88,356 \times 4 \text{ quarters in 2018}) + (\$83,583 \times 5 \text{ quarters for January 1, 2019, through March 31, 2020}))$ for the liability period.
 6. Respondent obtained Franchisee California Tax Authority Reports (franchisor data) from Snap-On Inc. (franchisor) for the liability period and compiled taxable sales of \$1,451,036. Based on the franchisor data, respondent determined that appellant's taxable sales were greater than the amount established using appellant's FITRs. Therefore, respondent compared the taxable sales of \$1,451,036 from the franchisor data for the liability period to appellant's reported taxable sales of \$219,659 and computed a difference of \$1,231,377. Then, respondent deducted the unreported taxable sales of \$1,089,597 computed in the comparison of reported taxable sales to gross receipts reported on the FITRs and computed unreported taxable sales of \$141,779 (rounded).
 7. Respondent compared audited taxable sales to the corresponding purchases recorded in the Snap-On Tools Franchisee Management Reports and computed audited markups of 28.59 percent for 2018; 176.99 percent for 2019; and 67.96 percent for the two years combined. Appellant stated that the inconsistent markups between the years were due to timing differences between purchases and sales, but appellant did not provide documentation to verify purchases of merchandise. Respondent concluded that the 67.96 percent markup for the two years appeared reasonable based on its experience in audits of similar businesses in appellant's area, and therefore, audited taxable sales were reasonable.

⁷ A negative markup would mean that appellant was selling merchandise for less than its cost of the merchandise.

8. Appellant did not claim any deductions for bad debts on its SUTRs. However, appellant stated that it had bad debt losses from unsecured installment sales. Respondent obtained from the franchisor write-off reports for the liability period. Respondent examined the franchisor write-off data and sales invoices for write-offs, provided by appellant, and concluded that an adjustment for bad debts was warranted in accordance with Regulation section 1642. Respondent compiled an allowable bad debt deduction on taxable sales of \$37,744 (credit measure) for the liability period, which represented a tax credit of \$3,556.
9. Respondent issued an NOD to appellant on June 11, 2021, based on the above-mentioned audit.
10. Appellant filed a timely petition for redetermination arguing the allowance for bad debts should be greater.
11. Respondent held an appeals conference with appellant, and subsequently issued a Decision on April 10, 2024, denying the petition.
12. Appellant timely appealed to OTA.

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 respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

A retailer is relieved from liability for sales tax that became due and payable, insofar as the measure of tax is represented by accounts that have become worthless and charged off for income tax purposes by the retailer or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles. (R&TC, § 6055(a); Cal. Code Regs., tit. 18, § 1642(a).) 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).) When there is a repossession, a bad debt deduction is allowable only to the extent that the retailer sustains a net loss of gross receipts upon which tax has been paid. (Cal. Code Regs., tit. 18, § 1642(f)(1).) This will be when the amount of all payments and credits allocated to the purchase price of the merchandise, including the wholesale value of the repossessed article, is less than the purchase price.

In support of deductions for bad debts, retailers must maintain adequate and complete records showing: 1) the date of original sale; 2) the name and address of purchaser; 3) the amount the purchaser contracted to pay; 4) the amount on which the retailer paid tax; 5) the jurisdiction(s) where the local taxes and, when applicable, district taxes were allocated; 6) all payments or other credits applied to the account of the purchaser; 7) 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 8) 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).)

Here, respondent's comparison of sales reported on the SUTRs to gross receipts reported on the FITRs and to sales per franchisor data found unexplained differences, which indicated that reported taxable sales were potentially understated. The limited books and records that appellant provided were inadequate for sales and use tax audit purposes. Appellant did not provide any original transaction information or worksheets used to prepare the SUTRs showing taxable sales or bad debt losses. Thus, OTA finds that it was reasonable for respondent to use indirect audit methods to compute appellant's sales. Respondent's use of appellant's own FITRs is a recognized and standard accounting procedure. (See *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613.) Respondent also obtained sales data and write-off data from a third party (franchisor). Franchisor data is evidence of appellant's sales and is a reliable source of data from which to establish audited sales.

Therefore, OTA concludes that respondent has established that its determination is reasonable and rational, and accordingly, the burden shifts to appellant to show errors in the audit.

Appellant contends that the audit fails to properly account for all of its bad debts. However, appellant has not identified the amount of bad debts on taxable sales that occurred during the liability period or provided verifiable evidence of a greater allowance for bad debts. Appellant's unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *Appeal of Talavera, supra.*) To satisfy its burden of proof, a taxpayer must prove both: 1) that the tax assessment is incorrect; and 2) the proper amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

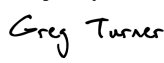
In summary, OTA finds that respondent computed audited taxable sales based on the best-available evidence, which is a reasonable and rational method. Appellant has not identified any errors in respondent's computation of the bad debts allowance or provided documentation or other evidence in support of its contentions from which a more accurate determination could be made. As appellant bears the burden of proof in this case, OTA concludes that no adjustments are warranted.

HOLDING

No adjustments to the measure of unreported taxable sales for bad debts are warranted.

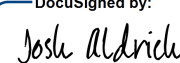
DISPOSITION

Respondent's action denying appellant's petition and protective claim for refund is sustained.


Signed by:

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Greg Turner
Administrative Law Judge

We concur:

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Josh Aldrich
Administrative Law Judge

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Andrew Wong
Administrative Law Judge

Date Issued: 7/2/2025