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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. HILL,** **dba Lite Line Auto Repair**	OTA Case No.: 240215303 CDTFA Case ID: 3-757-042

OPINION

Representing the Parties:

For Appellant: M. Hill

For Respondent: Jason Parker, Chief of Headquarters Ops.

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, M. Hill dba Lite Line Auto Repair (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) partially denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on March 21, 2022. The NOD is for tax of $42,294, plus applicable interest, and a negligence penalty of $4,229.38 for the period October 1, 2018, through June 30, 2021 (liability period).[1] CDTFA based the tax on unreported taxable sales totaling $530,313. CDTFA subsequently prepared a reaudit that reduced unreported taxable sales by $60,112, which in turn reduced the tax to $37,498 and the negligence penalty to $3,749.85.

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).

ISSUES

1. Whether further adjustments to the unreported taxable sales are warranted.
2. Whether appellant was negligent.

[1] The NOD was timely issued because on January 12, 2022, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period October 1, 2018, through December 31, 2018, which allowed CDTFA until April 30, 2022, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

FACTUAL FINDINGS

1. Appellant, a sole proprietor, operates a used car dealership with an auto repair shop located in Clovis, California.
2. For the liability period, appellant reported on his sales and use tax returns (SUTRs) total and taxable sales of $38,350 and claimed no deductions. Appellant's reporting method was unknown to CDTFA. However, based on its discussion with appellant, CDTFA concluded that appellant only reported taxable sales of repair parts and did not report sales of vehicles on the SUTRs.
3. For audit, appellant provided a federal income tax return (FITR) for 2018, repair sales invoices where he did not add or collect sales tax reimbursement on the sale price, and purchase invoices where he did not pay tax at source for parts purchased for resale. He did not provide deal jackets,[2] profit and loss statements, or any reports that were used to prepare and file the SUTRs. Appellant claimed that his friends made the car sales on which he earned commissions. However, he could not verify if sales tax reimbursement was added to the sales price of the cars sold under his dealer license number.
4. CDTFA obtained Report of Sales (ROS) data from the California Department of Motor Vehicles (DMV) for January 1, 2019, through June 30, 2021;[3] DMV sales data for the liability period;[4] purchase data from CarMax auction house for dates covering January 30, 2019, through December 18, 2019; and purchase data from appellant's only vendors, O'Reilly Auto Parts and Car Quest Auto Parts, for the liability period.
5. CDTFA compared gross receipts reported on appellant's FITRs for 2018 to total sales reported on the SUTRs for the same year, found the former exceeded the latter by

[2] Deal jackets are routinely used by car dealers, and each jacket contains various documents related to a sale, including but not limited to the vehicle sales contract, vehicle purchase invoice, and the Report of Sales.

[3] In all instances, the DMV will issue licensed used car dealers Used Vehicle Report of Sale Books that dealers use to report sales of used vehicles to the DMV.

[4] CDTFA maintains a database from DMV of vehicles registered by licensed dealers. The information obtained from the DMV included the Vehicle Identification Number, License Plate number, year and make of the vehicle, vehicle registration date, and a two-letter Vehicle License Fee (VLF) code designating a range of sale prices in $200 increments. CDTFA considered the registration date to have occurred shortly after the actual date of sale, and thus CDTFA used the vehicle registration date to group the vehicles into quarterly periods in which the vehicles were sold. CDTFA used the VLF code to assign the lowest estimated sale price in the $200 range designated by a particular code. For example, VLF code "AC" designates that the sale price of the vehicle was between $200 and $399, and CDTFA would assign a sale price of $200 for sales involving VLF "AC". (See CDTFA's Audit Manual, § 0607.37 (March 2016).)

$5,000, and extended its examination to verify whether appellant reported all of his sales.

6. CDTFA, using a sample of appellant's repair sales invoices and purchase invoices, computed an overall markup factor[5] of 1.33 on auto parts associated with appellant's auto repair jobs.

7. CDTFA, using purchase data obtained from its only two vendors, compiled repair parts purchases of $62,324 for the liability period. CDTFA, using the markup factor of 1.33, computed audited taxable repair parts sales of $82,634 for the liability period. Then, CDTFA compared it to the reported taxable sales of $38,350, resulting in a difference of $44,284 and a 115.47 percentage of error. CDTFA applied the 115.47 percent of error to the taxable sales reported on appellant's SUTRs and computed unreported taxable repair parts sales of $44,286 for the liability period.

8. CDTFA, using the data obtained from DMV, compiled vehicle sales of $318,400 for the liability period. CDTFA could not verify the vehicle sale prices as appellant did not provide any vehicle sales documents such as deal jackets; therefore, CDTFA used an estimated 4 percent markup for taxable mandatory fees to compute audited vehicle sales of $331,136 ($318,400 x 104 percent) for the liability period. Appellant claimed that his friends made the vehicle sales and he only earned commissions. However, appellant did not provide any documentation to CDTFA to verify that the people who allegedly sold the vehicles reported the sales and properly remitted tax.

9. CDTFA compared the ROS data with the DMV sales data and found two vehicle sales totaling $5,350 that were not included in the DMV sales data. CDTFA marked up the $5,350 by 4 percent for taxable mandatory fees and computed audited taxable sales of $5,564 based on the ROS data.

10. CDTFA, using the data obtained from the auction house, compiled vehicle purchases of $149,325 in 2019. CDTFA found that the DMV sales data did not include any of these auction house purchases. In addition, appellant did not provide any documents that showed the sales were exempt. Therefore, CDTFA established unreported taxable vehicle sales of $149,325 based on auction house purchases subject to use tax.[6]

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[5] The markup factor is the factor by which cost of sales is multiplied to determine total sales (Cost of Goods Sold x Markup Factor = Sales). It is the percentage of markup plus 100 percent. (See CDTFA's Audit Manual, § 0490.00 (January 2000).)

[6] CDTFA used the cost price for the purchases made from the auction house since the vehicles were registered to appellant but were not reported to DMV. CDTFA assumed that appellant did not sell these vehicles but instead used them for his own purposes, thus imposing use tax on these transactions.

11. On March 21, 2022, CDTFA timely issued an NOD to appellant for tax of $42,294, plus applicable interest, and a 10 percent negligence penalty of $4,229.38 for the liability period. CDTFA based the NOD on a total taxable measure of $530,313, which was comprised of the following: (1) unreported taxable sales of repair parts of $44,286; (2) unreported taxable sales of $331,138 based on DMV sales data; (3) unreported taxable sales of $5,564 based on ROS; and (4) unreported auction house purchases of $149,325 subject to use tax.
12. On April 20, 2022, appellant filed a timely petition for redetermination contesting the NOD in its entirety. Upon petition, appellant provided additional documents (i.e., sales invoices) for sales made to McArron Manufacturing. CDTFA reached out to McArron Manufacturing and confirmed that 16 of the transactions obtained from the DMV sales data were nontaxable sales made to McArron Manufacturing for resale. Therefore, CDTFA prepared a reaudit dated January 10, 2023, to reduce unreported taxable sales based on DMV sales data by $60,112, from $331,136 to $271,024. This reduced the tax liability by $4,796, from $42,294 to $37,498, and the negligence penalty by $479.53, from $4,229.38 to $3,749.85.
13. Following the reaudit, CDTFA held an appeals conference and subsequently issued a decision on December 13, 2023, partially denying the petition for redetermination.
14. Appellant timely appealed to OTA.

DISCUSSION

Issue 1: Whether further adjustments to the unreported taxable sales are 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).)

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*.)

Here, the books and records appellant provided for audit were inadequate for sales and use tax audit purposes. Specifically, appellant failed to provide books and records such as deal jackets, vehicle sales invoices, sales journals and purchase journals, or sales tax worksheets used to prepare his SUTRs. Therefore, CDTFA used indirect audit methods to verify appellant's sales reported on his SUTRs. CDTFA obtained the amount of appellant's purchases of repair parts from appellant's vendors and used a markup to compute the unreported taxable sales of repair parts. In addition, CDTFA used DMV sales data and ROS data to calculate the unreported taxable sales of vehicles, which are reliable third-party sources of data. The markup method is a recognized and accepted accounting procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) CDTFA's audit method and the computed unreported taxable sales are reasonable and rational. Therefore, CDTFA has met its initial burden, and the burden of proof shifts to appellant to show errors in the audit.

In this appeal, appellant contends that the sales transactions are not his and that he mistakenly allowed a few people to use his DMV dealer's license number and that he is barely getting by. However, appellant did not submit any documentation that would support the sales transactions reported to DMV were not made by him.

Even if other people made the sales transactions, since these taxable sales transactions were made under his DMV dealer's license number, and the license holder is the ultimate responsible person for such sales transactions,[7] OTA finds appellant to be responsible for the unreported taxable sales in question. In addition, appellant did not provide any documentation to support that the people who allegedly sold the vehicles that were registered with the DMV under his dealer number had reported these sales and properly remitted tax. Therefore, as appellant is ultimately the responsible person, OTA does not have any basis to adjust the amount of unreported taxable sales.

Regarding appellant's financial hardship, OTA does not have the authority to address financial hardship. Accordingly, OTA lacks jurisdiction to further discuss appellant's financial hardship.

[7] The sales tax is imposed upon the retailer (R&TC, § 6051), who may collect sales tax reimbursement from their customer (see Civil Code, § 1656.1). However, pursuant to R&TC section 6275(b), the person holding the dealer's license is liable for sales tax on vehicle sales made using his or her dealer's license.

Given the above, OTA finds that CDTFA computed the unreported taxable sales based on the best available information and recognized audit procedure. Appellant has not identified errors in the audit or provided new documentation or other evidence in support of his contention from which a more accurate determination could be made. Therefore, OTA does not have a basis to recommend further adjustment to the unreported taxable sales.

Issue 2: Whether the negligence penalty was properly imposed.

Appellant has not explicitly disputed the negligence penalty in its appeal here. However, out of an abundance of caution, OTA will address the negligence penalty.

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 law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal. App. 4th 434, 447.) Generally, 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 its 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, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

A taxpayer shall 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 the sales and use tax return. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b).) All records required to be retained under this regulation must be preserved for a period of not less than four years. (Cal. Code Regs., tit. 18, § 1698(i).) 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 or other appropriate administrative action. (Cal. Code Regs., tit. 18, § 1698(k).)

Despite this being appellant's first audit, CDTFA imposed the negligence penalty because appellant was negligent in both its recordkeeping and in preparing its SUTRs. OTA finds that appellant's failure to maintain and make available books and records supporting the total taxable measure is evidence of negligence. Moreover, a comparison of the total taxable

measure of $470,201 (i.e., unreported taxable sales of parts, unreported taxable sales based on DMV sales data, unreported taxable sales of vehicles based on ROS, and unreported purchases subject to use tax) in the reaudit compared to reported taxable sales of $38,350 results in an error rate of 1226 percent ($470,201 ÷ $38,350). This large understatement and large error ratio are further evidence of negligence. Further, appellant admits that he allowed others to use his dealer license to make purchases.[8]

In light of the above, OTA finds that appellant did not have a good faith and reasonable belief that his bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law. OTA also finds that appellant did not exercise the care that a reasonable and prudent person would exercise under similar circumstances. Although this is appellant's first audit, OTA finds that the negligence penalty was properly imposed.

[8] See Factual Finding 3: "Appellant claimed that his friends made the car sales on which he earned commissions. However, he could not verify if sales tax reimbursement was added to the sales price of the cars sold under his dealer license number."

HOLDINGS

1. Further adjustments to the unreported taxable sales are not warranted.
2. Appellant was negligent and the penalty was properly imposed.

DISPOSITION

CDTFA's action to redetermine the audit liability based on the reaudit dated January 10, 2023, but otherwise denying the petition for redetermination is sustained.

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

We concur:

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Andrew Wong
Administrative Law Judge

Signed by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

Date Issued: 5/30/2025