

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:	)	OTA Case No. 231214880
<b>ACRE GARDEN SUPPLY,</b>	)	CDTFA Case ID: 3-847-947
<b>dba Green Acres Hydroponics</b>	)	
	)	
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**OPINION**

Representing the Parties:

For Appellant:	Manny Almeida, Representative
For Respondent:	Ravinder Sharma, Hearing Representative Chad Bacchus, Attorney Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Crystal Spratley, Business Taxes Specialist III

G. TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Acre Garden Supply (appellant) appeals a decision, sustained by a supplemental decision, issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant’s timely petition for redetermination of a Notice of Determination (NOD)<sup>1</sup> issued on April 29, 2022. The NOD is for tax of \$1,639,830, plus applicable interest, and a penalty of \$163,983.05 for the period July 1, 2018, through June 30, 2021 (liability period).

Office of Tax Appeals (OTA) Administrative Law Judges Greg Turner, Steven Kim, and Teresa A. Stanley held an oral hearing for this matter in Cerritos, California, on December 11, 2024. At the conclusion of the oral hearing, the record was closed, and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

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<sup>1</sup> The NOD was timely issued because on March 4, 2022, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period July 1, 2018, through June 30, 2019, which allowed CDTFA until October 31, 2022, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

### ISSUES

1. Whether further adjustments to the measure of appellant's unreported taxable sales are warranted relating to certain sales for resale and sales exempt under Regulation section 1588.
2. Whether the negligence penalty was properly imposed.

### FACTUAL FINDINGS

1. Appellant, a corporation doing business as Green Acres Hydroponics, operates a retail gardening and hydroponic supply store located in Chatsworth, California. Appellant was issued its seller's permit with an effective start date of August 1, 2012, which remains active.
2. For the liability period, appellant reported total sales of \$2,627,079, claiming no deductions, resulting in reported taxable sales of the same amount. Appellant used a point-of-sale system to record sales. Appellant stated that it did not report total sales less total nontaxable transactions but instead reported only the "net taxable sales" as total sales on the sales and use tax returns (SUTRs).
3. Appellant provided the following books and records for the audit: federal income tax returns (FITRs) for 2018, 2019, and 2020; sales summary reports for the liability period; customer detail report for the liability period; and profit and loss statements for the liability period. For the audit, appellant did not provide CDTFA any valid resale certificates<sup>2</sup> to support any nontaxable sales for resale during the liability period. CDTFA found the books and records provided were incomplete and inadequate for sales and use tax audit purposes. Appellant had not been previously audited by CDTFA.
4. CDTFA compared the gross receipts, ex-tax,<sup>3</sup> on appellant's FITRs to its reported total sales, ex-tax, on appellant's SUTRs and noted material differences of \$5,809,959 for 2018, \$6,653,059 for 2019, and \$10,782,868 for 2020. The differences were determined

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<sup>2</sup> To meet the requirements of a resale certificate, a document must contain 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).)

<sup>3</sup> As used in this Opinion, "ex-tax" refers to gross receipts excluding sales tax reimbursement.

- to be due to appellant reporting only taxable sales on its SUTRs, instead of reporting gross receipts and claiming deductions for nontaxable sales for resale.
5. CDTFA compared FITR gross receipts for 2018, 2019, and 2020 to the corresponding cost of goods (COGS) reported on the FITRs and computed FITR book markups<sup>4</sup> of 31.69 percent for 2018, 34.20 percent for 2019, 26.21 percent for 2020, and 29.80 percent for the three years combined. CDTFA considered the FITR book markups to be reasonable markups for this type of business.
  6. CDTFA scheduled and compared reported taxable sales of \$2,627,079 from the SUTRs to recorded taxable sales of \$2,627,066 from the sales summary report provided, which resulted in immaterial differences for the liability period. CDTFA also compared reported sales tax of \$249,575 to recorded sales tax collected of \$249,339 from the electronic sales summary report provided, resulting in an immaterial difference of \$236 for the liability period.
  7. CDTFA compared recorded total sales, ex-tax, of \$19,276,684 for 2019 and 2020, combined, using appellant's sales summary reports, to reported gross receipts, ex-tax, of \$19,084,364 for 2019 and 2020, combined, from appellant's FITRs, and found that recorded taxable sales were higher than reported FITR gross receipts, ex-tax, by \$6,307 in 2019 and \$186,013 in 2020. Based on this analysis, CDTFA accepted as complete appellant's recorded total sales, ex-tax, of \$29,614,975 for the liability period.
  8. Because appellant did not initially provide any valid resale certificates to support nontaxable sales for resale during the liability period, CDTFA relied upon an alternative audit method to arrive at audited taxable sales for the liability period. CDTFA and appellant's representative agreed to use appellant's sales for the first quarter of 2021 (1Q21) as a test period to verify appellant's total sales and nontaxable sales.
  9. Appellant provided a customer list that included resale and non-resale customers and included seller's permit numbers for resale customers. CDTFA researched the customers

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<sup>4</sup> 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  $\text{markup amount} \div \text{cost}$ . 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. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is  $\text{profit amount} \div \text{sales price}$ . In the above example, the gross profit margin is 30 percent ( $0.30 \div 1.00 = 0.30$ )

in CDTFA's internal database and found that some customers had missing or incorrect seller's permit numbers or had permits that were closed at the time the customer made their purchase. Since appellant did not maintain or provide any resale certificates for audit, appellant was given the opportunity to support questioned sales for resale using the "XYZ" letter procedure;<sup>5</sup> however, appellant did not submit any XYZ responses from its customers. Thus, CDTFA reviewed a total of 26,744 sale items from appellant's sales data for the test period of 1Q21 on an actual basis.

10. The taxability of each sale item for the test period was determined based on the analysis of the items sold, research of customers' line of business, review of customers' profiles and SUTRs filed via CDTFA's Centralized Revenue Opportunity System (CROS), and a review of the customer list provided by appellant, which consisted of both resale and non-resale customers.
11. CDTFA allowed as nontaxable sales for resales: (1) sales to customers that were in the business of selling gardening supplies, even if the customers' businesses were inactive or closed at the time of purchase; and (2) sales to customers who were in the business of growing food items, flowers, or cannabis products, except consumable supplies, such as gloves, gardening tools, and fertilizers.<sup>6</sup> CDTFA concluded, based on its analysis of each line item in the test period, that total sales were \$3,367,953, taxable sales were \$2,269,156 and nontaxable sales were \$1,098,797. Based on this analysis, CDTFA calculated the percentage of audited taxable sales to be 67 percent of total sales for the 1Q21 test period ( $\$2,269,156 \div \$3,367,953$ ).
12. The percentage of audited taxable sales, 67 percent, calculated for the test period of 1Q21, was applied to recorded total sales, ex-tax, of \$29,614,975 for the remainder of the liability period, to arrive at audited taxable sales of \$19,842,032. CDTFA then compared audited taxable sales of \$19,842,032 to reported taxable sales of \$2,627,079 to arrive at unreported taxable sales of \$17,214,953.
13. CDTFA reviewed appellant's purchases of fixtures and equipment and verified that sales tax was paid on all of them except for one item: the purchase of an ice pelletizer for

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<sup>5</sup> An XYZ letter is a letter in a form approved by CDTFA that a seller may send to its customer inquiring as to the disposition of the property purchased from the seller. (Cal. Code Regs., tit. 18, § 1668(f).)

<sup>6</sup> CDTFA performed research online as well as on its CROS system, to determine appellant's customers' types of business during the test period.

- \$46,432 which was subject to use tax in 1Q19. This item is not disputed; therefore, OTA does not discuss this further.
14. The unreported taxable sales of \$17,214,953 per the 67 percent taxable sales ratio was added to purchases of \$46,432 subject to use tax to arrive at a total taxable measure of tax of \$17,261,385 for the liability period.
  15. CDTFA issued the NOD on April 29, 2022.
  16. Appellant filed a timely petition for redetermination dated May 5, 2022.
  17. CDTFA held an appeals conference with appellant on January 31, 2023, at which time appellant provided nine resale certificates and screenshots of CDTFA's website showing a search of two seller's permits.
  18. CDTFA issued a Decision on June 2, 2023, finding no adjustments were warranted.
  19. Appellant filed a Request for Reconsideration (RFR) dated June 26, 2023, in response to the Decision issued by CDTFA on June 2, 2023. On October 26, 2023, CDTFA issued a Supplemental Decision continuing to find that no adjustments were warranted.
  20. Appellant timely appealed to OTA.
  21. During the course of this appeal, OTA requested additional briefing (AB) from appellant to provide supporting documentation and/or items in appellant's opening brief that were not previously provided. In reply, appellant provides its June 26, 2023 RFR letter that appellant had submitted to CDTFA, along with an Excel spreadsheet containing three tabbed worksheets titled: "Additional per 1588," "Additional Resales," and "Resales in fact" (Resale spreadsheet). The arguments in the RFR are the same as expressed in appellant's opening brief to OTA. No additional contentions, explanations, or supporting documentations were provided.
  22. CDTFA responds to appellant's AB submission and states that there was no new evidence provided. Additionally, CDTFA notes that no supporting documentation was provided with appellant's Excel spreadsheet.

### DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property (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.) "Sale" means and includes any transfer of title or possession, in any manner or by any means whatsoever, of TPP for a

consideration. (R&TC, § 6006.) Generally, a sale for resale is not subject to sales tax. (R&TC, § 6007; Cal. Code Regs., tit. 18, § 1668(a).) Additionally, as relevant here, tax does not apply to sales of fertilizer to be applied to land or in foliar application<sup>7</sup> the products of which are to be: (1) used as food for human consumption; (2) used as feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption; or (3) sold in the regular course of the purchaser's business. (R&TC, § 6358(d); Cal. Code Regs., tit. 18, § 1588(b)(2).) The term "fertilizer" includes commercial fertilizers, agricultural minerals, manure, and carbon dioxide. (Cal. Code Regs., tit. 18, 1588(b)(1).)

Issue 1: Whether further adjustments to the measure of appellant's unreported taxable sales are warranted relating to certain sales for resale and sales exempt under Regulation section 1588.

For purposes 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 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

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<sup>7</sup> The "in foliar" application of fertilizer means fertilizer applied directly to plants as opposed to the soil.

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).)

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 Board 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.<sup>8</sup> A mere allegation that sales are exempt is insufficient. (*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).) 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.)

Here, appellant reported only "net" taxable sales, meaning instead of reporting total gross receipts and itemizing claimed deductions, such as sales for resale, appellant included only the net amount subject to tax and no deductions. Appellant, however, did not collect resale certificates from any of its customers who allegedly purchased goods for resale. During the audit, appellant's representative informed CDTFA that appellant did not know what a resale certificate was and never collected any from its resale customers. Appellant also was unwilling or was unable to provide XYZ letters from its customers to substantiate sales for resale after the

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<sup>8</sup> The courts have concluded that statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. The taxpayer has the burden of showing that they qualify for the exemption. An exemption will not be inferred from doubtful statutory language; the statute must be construed liberally in favor of the taxing authority, and strictly against the claimed exemption. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 766.)

fact. Consequently, given the volume of transactions during the liability period, CDTFA proposed, and appellant agreed, to use a “block sample,” an audit technique that examines records from a chosen time period. In this instance, one calendar quarter, out of the 12 quarters for the liability period, was used to ascertain a taxable to nontaxable sales ratio for that quarter, which was then applied across the entire liability period to derive taxable sales. Examining the agreed upon 1Q21 sample period, CDTFA determined that of appellant’s total reported sales for that quarter, 67 percent were taxable sales. The unreported sales were due almost entirely to unsubstantiated sales for resale. Ultimately, CDTFA declined to exclude sales identified by appellant as sales for resale because appellant lacked records in the form of resale certificates, was unable to produce XYZ letters from customers it identified as resellers, and CDTFA’s efforts to corroborate appellant’s claims proved futile. Applying the determined taxable sales ratio to the reported total sales for the period resulted in total taxable sales of \$19,842,032, which after reduction for reported taxable sales of \$2,627,079, CDTFA established unreported taxable sales of \$17,214,953.

At the appeals conference, appellant supplied CDTFA with nine resale certificates and screenshots of two seller permit numbers to support their sale for resale argument. One identified reseller had already been acknowledged by CDTFA and accounted for in the audit. CDTFA rejected the remaining resale certificates as either untimely or lacking sufficient information to support their veracity.

OTA’s initial task is to determine whether CDTFA’s determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Given appellants’ volume of sales and lack of records supporting their claimed nontaxable sales, OTA finds it was reasonable for CDTFA to utilize an alternative method for estimating appellants taxable versus nontaxable sales. A block sample method, as described above, is a reasonable audit method, particularly when agreed to by the parties. In light of the audit methodology together with the absence of valid resale certificates or other evidence, OTA finds CDTFA’s determination to be reasonable and rationale. Accordingly, the burden of proof shifts to appellant to establish sales were not at retail. (Cal. Code Regs., tit. 18, § 1668(a); *Appeal of Talavera*, *supra*.)

Appellant makes three contentions: (1) resale allowances are understated and more should have been allowed in the audit with respect to 11 alleged resale certificates provided to CDTFA and not allowed; (2) transactions valued at \$30,000 or more should automatically be

deemed for resale regardless of the fact that there may not be a resale certificate or XYZ letters provided; and (3) Regulation section 1588 exemptions were incorrectly included in the audited taxable measure. OTA will address each contention separately and respond accordingly.

### Sales for Resale

Appellant contends that transactions included in the taxable measure should have been accepted as exempt and excluded from the audited taxable measure as they were transactions that qualify as sales for resale. Appellant further contends that CDTFA did not accept resale certificates they submitted.

The contention that resales “in fact” are exempt and should reduce taxable sales, while true,<sup>9</sup> is not what is at issue here, which is whether appellant has presented sufficient evidence to establish that sales to certain customers were in fact sales for resale. That did not happen here.

CDTFA reviewed each of the 11 alleged resale certificates supplied by appellant, conducted research in CDTFA’s CROS, along with online research of each company/customer. CDTFA had previously accepted sales to a customer identified in one of the alleged resale certificates as sales for resale. CDTFA rejected the remaining documents alleged as resale certificates for various reasons: five resale certificates were completed by cannabis growers who are not in the business of selling gardening supplies; one resale certificate was completed by a pawn shop; one business made no purchases during the test period; one business closed its business prior to the test period; and two documents were not resale certificates at all, but screenshots of CDTFA’s website showing seller’s permit searches.

Discrepancies between a stated business purpose on a resale certificate and seller’s apparent actual business, standing alone, is not a sufficient basis to reject the resale certificate. However, in light of appellant’s stated history of not collecting timely resale certificates, the similarities among the alleged certificates, and the inability of CDTFA to independently validate the certificates with any of the purchasers, CDTFA’s rejection of each is reasonable under the circumstances. OTA finds that appellant has not provided sufficient documentation to warrant any adjustments to the audited taxable measure with respect to a sale for resale.

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<sup>9</sup> A resale “in fact” is a term used to describe sales made that can be established as sales for resale by evidence other than a resale certificate. (Cal. Code Regs., tit. 18, § 1668(e)(1).

### Transactions Valued at \$30,000 or More

Appellant also contends that sales made to customers that exceed \$30,000 should be allowed as sales for resale, even without a resale certificate, an XYZ letter, or other evidence corroborating that the sales were resales in fact. Appellant asserts that transactions of this magnitude, scope, and nature could not be for personal use since a customer would not be able to consume that volume of materials; therefore, these transactions should be accepted as sales for resale and not included in the taxable measure. Appellant contends that all transactions over \$10,000 would fall into this category but it chose the \$30,000 threshold at random as a reasonable threshold that should be allowed.

While appellant's argument bears some attractive conceptual logic, the threshold dollar amount is essentially arbitrary. Moreover, OTA has no evidence to suggest that sales of the volume identified could not be consumed by a small or large business. There is little evidence in the record to evaluate the nature of specific goods sold or the intended usage of those goods by the purchaser. The Sales and Use Tax Law is structured to avoid such a potentially subjective evaluation. R&TC section 6091 presumes *all* gross receipts are subject to tax. In the absence of a timely and valid resale certificate, the seller bears the burden of proving by a preponderance of evidence that sales were in fact sales for resale, whether through XYZ letters or other evidence. (Cal. Code Regs., tit. 18, § 1668(e), (f).) For OTA to speculate that sales in excess of an arbitrary threshold are sales for resale without any evidence supporting such a conclusion would not be consistent with the statutory framework.

As discussed above, CDTFAs' audit approach was reasonable and rational. Appellant has not provided any evidentiary basis for OTA to conclude that sales in excess of the arbitrarily established \$30,000 threshold were more likely than not for resale. Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*) In the absence of such evidence, R&TC section 6091's presumption of taxability prevails.

### Regulation Section 1588 Exemptions

Appellant contends in its appeal to OTA that items classified as exempt according to Regulation section 1588 were erroneously included in the taxable measure. Additionally, appellant contends that some clearly excluded items were included in the taxable measure because appellant lacked a resale certificate which, under Regulation section 1588, is not necessary.

R&TC section 6358 exempts from sales and use tax certain agriculture-related products when used by the purchaser for specified purposes. For example, seeds and plants are exempt when the products of which ordinarily constitute food for human consumption. Another example is fertilizer, which is exempt when applied to land or in foliar application the products of which are to be used as food for human consumption. Regulation section 1588 further clarifies the types of exempt items when used by the purchaser in an approved manner. While some exempt items are of a type that their only regular use is in an exempt manner,<sup>10</sup> other items might be used for an exempt or non-exempt purpose by the purchaser. In keeping with the presumption that all gross receipts are subject to sales tax, where an exemption is dependent on the use that a purchaser makes of property purchased, Regulation section 1667 requires the seller to obtain a certificate from the purchaser confirming the intended exempt use. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 440.) Whether the purchaser is purchasing a product for resale or an exempt use under R&TC section 6358, as implemented by Regulation section 1588, the certificate ensures that the seller has sold exempt goods intended to be used by the purchaser for an exempt purpose.

CDTFA reviewed 26,744 sale items from appellant's sales data sample period, 1Q21, and determined whether to accept each as exempt or not based on whether the items were sold to a purchaser that provided either a resale certificate or an exemption certificate showing an exempt use. During the appeals process, appellant provided a list of transactions CDTFA conceded were exempt as sold to verified customers with valid seller's permits (a more permissive standard than strictly required). However, the adjustment to the period under examination amounted to only \$974.62 which, while exempt, was immaterial with respect to changing the taxable sales ratio applied to arrive at the unreported taxable sales.

Though appellant alleges additional sales should have been treated as exempt regardless of the existence of an exemption or resale certificate, without specific evidence of the nature of the items sold, OTA lacks a basis to overcome CDTFA's presumption of correctness. (*Appeal of*

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<sup>10</sup> See e.g., CDTFA Business Taxes Law Guide Annotation 510.1590 (4/25/80)— a fertilizer suggested or recommended for an exempt use is exempt without regard to whether the purchaser has supplied the retailer with a certificate stating that those products are purchased for application to land the products of which are to be used as food for human consumption. CDTFA's Annotations are not law and OTA is not required to follow them. (*Appeal of Eldar*, 2023-OTA-520P.) However, OTA may look to them as examples of how CDTFA interprets the applicable law, and OTA will independently determine the weight, if any, to afford the Annotations. (*Appeal of Martinez Steel Corporation*, 2020-OTA-074P.)

*Talavera, supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

In summary, OTA finds that CDTFA completed the audit using a reasonable and rational audit approach. Appellant has not furnished documentation to support any adjustments to the taxable sales ratio applied. Additionally, appellant has not identified any specific errors in CDTFA's computation of audited taxable sales or provided new documentation or other evidence in support of its contentions from which a more accurate determination might be made. Further, appellant did not provide any new documentation or evidence that was not already reviewed by CDTFA and included in the audit report. Additionally, no new arguments or contentions were provided with the Resale spreadsheet, which lacked documentary support. As appellant bears the burden of proof, OTA concludes that no adjustments are warranted.

Issue 2: Whether application of the negligence penalty is warranted.

R&TC section 6484 provides that, “[i]f any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of this part or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto.” Regulation 1703(c)(3)(A) further clarifies that “[g]enerally, a penalty for negligence or intentional disregard should not be added to a deficiency determination 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 practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations.”

While R&TC section 6484 is generally referred to as the “negligence penalty,” the statute presents two circumstances in which the penalty is warranted. The first is where the deficiency is due to the negligence of the retailer. The second is where the deficiency is a product of the retailer's intentional disregard of the law or authorized rules and regulations. CDTFA does not contend that appellant intentionally disregarded the law or authorized rules and regulations.

Negligence occurs when the taxpayer fails to exercise the care that a reasonable and prudent businessperson would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court* (2016) 248 Cal.App.4th 434, 447.) Taxpayers are required to maintain and make available for examination 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)(1).) Such records include, but are not limited to, the following: (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 supporting the entries in the books of account; 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. (Cal. Code Regs., tit. 18, § 1698(k).)

Here, appellant reported taxable sales on a “net” basis. While CDTFA’s examination essentially accepts as accurate appellant’s reported sales (when adjusted from “net” to reflect gross sales), the failure to accurately report total gross receipts and exempt sales contributes to a finding that appellant failed to exercise reasonable care because taxpayers are required to report total sales and claimed deductions on the SUTRs and it masks the volume of receipts relative to the claimed exemptions reported on the returns.

Appellant’s failure to maintain exemption certificates or otherwise substantiate claimed nontaxable sales is express evidence of negligence. (Cal. Code Regs., tit. 18, § 1698(k).) Generally, CDTFA does not impose the negligence penalty on a taxpayer’s first audit unless the evidence establishes that any bookkeeping or 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. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Appellant not only failed to provide timely accepted valid resale certificates but also failed to establish resales “in fact” by way of XYZ letters or any other available means. CDTFA consequently examined appellant’s sales data over a test period on an actual basis, which even for the test period constituted thousands of transactions. A comparison between audited and reported taxable sales disclosed an error rate in excess of 600 percent due substantially to appellant’s lack of supporting records for claimed exempt sales.

OTA finds that the large understatement (both in total dollars and relative to reported gross receipts) was significantly attributed to appellant’s failure to substantiate claimed exempt sales with timely and valid exemption certificates or post-sale evidence such as XYZ letters. Appellant failed to establish evidence of a good faith or reasonable belief that their failure to maintain *any* resale certificates or obtain post-sale evidence of resales was in substantial

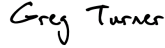
compliance with the requirements of the Sales and Use Tax Law. Appellant’s failure to maintain any exemption certificates was a failure to exercise the care that a reasonable and prudent person would exercise under similar circumstances. Although this is appellant’s first audit, OTA finds that appellant was negligent, and the negligence penalty was properly imposed.

HOLDINGS


1. Appellant has not shown that additional adjustments to unreported taxable sales are warranted.
2. The negligence penalty was properly imposed.

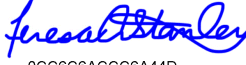
DISPOSITION

CDTFA’s action denying the petition for redetermination is sustained.

Signed by:  
  
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 Greg Turner  
 Administrative Law Judge

We concur:

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 Steven Kim  
 Administrative Law Judge

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 Teresa A. Stanley  
 Administrative Law Judge

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