

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No.: 230914401
ISLANDS COLLISIONS REPAIRS, INC.,)	CDTFA Case ID: 3-322-822
dba Fairgrounds Collision Repair Center)	
)	
)	

OPINION

Representing the Parties:

For Appellant: Sanjesh Singh, Chief Executive Officer

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Corin Saxton, Attorney

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Islands Collissions Repairs, Inc. dba Fairgrounds Collision Repair Center (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 November 17, 2021. The NOD is for tax of \$150,374, plus applicable interest, and a negligence penalty of \$15,037.36² for the period April 1, 2017, through March 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).

ISSUE

Whether appellant has shown further adjustments to the deficiency measure are warranted.

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 As discussed below, CDTFA has removed the negligence penalty, and it is not in dispute.

FACTUAL FINDINGS

1. Appellant operates an autobody repair shop in San Jose, California.
2. For the liability period, appellant reported total sales of \$496,527 and claimed deductions of \$301,437 for nontaxable labor charges, deductions of \$21,866 for nontaxable sales of food,³ and deductions of \$1,476 for sales tax reimbursement included in gross receipts, which resulted in reported taxable sales of \$171,748.⁴
3. Upon audit, appellant provided federal income tax returns (FITRs) for fiscal years (FYs) 2016, 2017, and 2018,⁵ bank statements for the liability period, purchase invoices for the fourth quarter of 2019 (4Q19), sales summaries for 4Q19,⁶ and purchase invoices for August 2020 and September 2020.
4. Gross receipts reported on the FITRs exceeded the total sales reported on appellant's sales and use tax returns by \$715,798 for FY 2016, by \$544,197 for FY 2017, and by \$636,262 for FY 2018.
5. Bank deposits net of sales tax exceeded total sales reported on appellant's sales and use tax returns by \$2,036,077 for the liability period.
6. CDTFA compared the taxable auto part and paint sales of \$102,175 recorded in appellant's 4Q19 purchase invoices and sales summaries with the taxable sales of \$14,292 reported on appellant's 4Q19 return,⁷ which revealed a difference of \$87,883 between recorded and reported taxable sales for 4Q19. Based on this discrepancy, CDTFA created an error ratio and projected audited taxable sales for the liability period. However, CDTFA found that this methodology resulted in a markup that was unreasonably low for appellant's type of business, and CDTFA instead chose to

³ Appellant mistakenly claimed deductions of \$21,866 as nontaxable food sales, which should have been claimed as nontaxable labor charges.

⁴ Appellant also reported purchases of \$14,307 subject to use tax.

⁵ FY 2016 is September 1, 2016, to August 31, 2017; FY 2017 is September 1, 2017, to August 31, 2018; and FY 2018 is September 1, 2018, to August 31, 2019.

⁶ CDTFA's audit reports state that appellant provided "sales data" for 4Q19, and, based on the comments in audit Schedule 12D-2, it appears this sales data consists of sales summaries.

⁷ Based on the transactions listed in the sales summaries, CDTFA found that the purchase invoices appellant provided for 4Q19 were incomplete (i.e., the summaries listed transactions for which no purchase order was provided), and, based on the purchase orders appellant provided, CDTFA found the sales summaries were incomplete (i.e., appellant provided purchase invoices for transactions that were not listed in the sales summaries).

- compute audited taxable sales for the liability period using a markup analysis of the cost of goods sold (COGS) reported on appellant's FITRs.
7. Appellant's FITRs list COGS of \$613,546 for FY 2016, \$505,677 for FY 2017, and \$438,587 for FY2018. CDTFA found the COGS includes amounts not associated with the sale of tangible personal property⁸ totaling \$3,695 for FY 2016, \$26,890 for FY 2017, and \$104,935 for FY 2018. Therefore, CDTFA computed COGS for taxable transactions (adjusted COGS) of \$609,851 for FY 2016, \$478,787 for FY 2017, and \$333,652 for FY 2018.
 8. CDTFA performed a purchase segregation test of appellant's 2019 purchase invoices to determine that appellant's taxable sales of auto parts constitute 71.01 percent of appellant's total sales and that appellant's taxable sales of paint constitute 14.26 percent of appellant's total sales.⁹
 9. CDTFA applied the purchase segregation ratios of 71.01 percent for auto parts sales and 14.26 percent for paint sales to the adjusted COGS of \$609,851 for FY 2016, \$478,787 for FY 2017, and \$333,652 for FY 2018 to compute the cost of auto parts and paint of \$519,987 for FY 2016, \$408,236 for FY 2017, and \$284,487 for FY 2018.
 10. CDTFA then applied a markup percentage of 52.34 percent¹⁰ to the cost of auto parts and paint to compute a markup on auto parts and paint of \$272,161 for FY 2016, \$213,671 for FY 2017, and \$148,901 for FY 2018. As a result, CDTFA calculated audited taxable sales of \$792,149 for FY 2016, \$621,907 for FY 2017, and \$433,388 for FY 2018. CDTFA compared audited taxable sales for these fiscal years to the taxable sales appellant reported during similar periods,¹¹ which resulted in deficiencies of \$734,303 for FY 2016, \$559,445 for FY 2017, and \$372,241 for FY 2018. When

⁸ CDTFA refers to these amounts as "other non-resold items."

⁹ CDTFA treated appellant's charges for supplies, subcontracting, and shipping as nontaxable.

¹⁰ Although CDTFA refers to this ratio as a "weighted" average markup, appellant did not provide CDTFA with the documentation needed for a shelf test of paint sales. As a result, CDTFA computed the costs and retail selling prices for auto parts recorded on merchandise purchase invoices for August 2020 and September 2020, and CDTFA used this markup percentage for appellant's sales of paint. CDTFA found this approach to be beneficial to appellant because, in CDTFA's experience, the markup on paint is typically higher than the markup on auto parts.

¹¹ Appellant reported sales and use tax on a quarterly basis. Appellant's FITR fiscal year ran September through August. Thus, for example, CDTFA compared audited taxable sales for FY 2017 (i.e., September 1, 2017, through August 31, 2018) to the taxable sales appellant reported on its sales and use tax returns for 4Q17, 1Q18, 2Q18 and 3Q18. CDTFA found it insignificant that the periods of comparison did not completely align.

compared to reported taxable sales, these deficiencies represent error rates of 1269.41 percent, 895.66 percent, and 608.76 percent for FY 2016, FY 2017, and FY 2018, respectively. CDTFA applied these error rates to appellant's reported taxable sales in each period,¹² to compute unreported taxable sales of \$1,606,007 for the liability period (audit item 1).

11. CDTFA's audit also established a deficiency measure for unreported taxable sales subject to district tax (audit item 2),¹³ and the audit imposed a 10 percent negligence penalty.
12. On November 17, 2021, CDTFA issued an NOD for the liability disclosed in the audit.
13. Appellant filed a timely petition for redetermination, and on March 7, 2022, CDTFA issued a reaudit report which reduced the deficiency measure for unreported taxable sales by \$271,817, from \$1,606,007 to \$1,334,190. In the reaudit, CDTFA maintained the same methodology for audit item 1 but increased the adjustment for amounts not associated with the sale of tangible personal property that were included in the COGS as reported on the FITRs.¹⁴ This adjustment reduced audit item 1 by \$271,817 to \$1,334,190.
14. During CDTFA's appeals process, the parties agreed to expand the test period to 1Q20. Appellant provided a purchase journal for 1Q20, listing purchases of \$122,340. Based on this information, CDTFA calculated an error rate of 718.87 percent, which, when applied to the liability period, resulted in unreported taxable sales of \$1,337,494. However, CDTFA disregarded this test to appellant's benefit because it exceeded the results of the first reaudit.
15. Following CDTFA's analysis of appellant's post conference submissions,¹⁵ CDTFA issued a decision in this matter, which upheld the results of the first reaudit and removed the negligence penalty. On August 18, 2023, CDTFA issued the second reaudit report, which removed the negligence penalty and incorporated the results of the first reaudit.
16. This timely appeal followed.

¹² For 4Q19 and 1Q20, CDTFA used an average of the three error rates.

¹³ This audit item is not in dispute.

¹⁴ CDTFA applied the FY 2018 percentage of these amounts to FY 2016 and FY 2017.

¹⁵ Based on the date of the second reaudit schedules, it appears CDTFA finished its examination of appellant's 1Q20 records in April of 2023.

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.*) To satisfy its burden of proof, a taxpayer must prove both: 1) that the tax assessment is incorrect, and 2) the proper amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

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 the 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: (a) the 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 or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).)

Here, appellant provided incomplete records upon audit, and CDTFA was unable to verify sales reported on appellant's sales and use tax returns for the liability period using a direct audit method (i.e., computing audited taxable sales directly from appellant's records). Furthermore, the unexplained differences between amounts reported for income tax and sales tax purposes and the unexplained differences between bank records and reported sales are indicative of sales tax reporting errors. Given these discrepancies and appellant's incomplete

records, OTA finds that it was reasonable for CDTFA to verify appellant's taxable sales via an indirect audit method. CDTFA used the markup audit approach, which is a well-established audit method that has been shown effective and reliable if based on sufficient information to establish a reasonable markup and cost of taxable merchandise sold. (*Appeal of Amaya*, 2021-OTA-328P.) In this case, CDTFA used appellant's FITRs for three years to compute appellant's COGS; CDTFA used appellant's 2019 purchase invoices to compute the taxable percentage of these COGS; and CDTFA used purchase invoices for August 2020 and September 2020 to compute a markup factor. Given the inadequacy of the records provided and given that audit item 1 is lower than the deficiency CDTFA computed with appellant's second reaudit records, OTA finds that CDTFA has shown that the first reaudit was reasonable and rational. Thus, appellant has the burden of establishing that further adjustments are warranted.


Appellant argues that CDTFA's calculation of audited taxable sales includes nontaxable labor charges. Appellant appears to argue that nontaxable labor charges comprise 70 percent of its reported total sales, which, appellant asserts, are between \$150,000 to \$200,000 each quarter. Appellant has provided no support for this assertion. In addition, CDTFA made adjustments for nontaxable labor charges in its calculation of the COGS (based on FITRs) and in its calculation of taxable sales ratios (based on the segregation test). As appellant has not identified any errors in these calculations, and as none are apparent from OTA's review of the audits, OTA finds this argument lacks merit.

HOLDING


Appellant has not shown further adjustments to the deficiency measure are warranted.

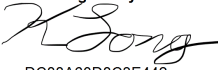
DISPOSITION

CDTFA's action is sustained.

Signed by:

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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:

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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:

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Keith T. Long
Administrative Law Judge

Date Issued: 2/27/2025