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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **A. FLORES, dba Rolling Tires and Wheels #1**	OTA Case No.: 231214889 CDTFA Case ID: 2-994-685

OPINION

Representing the Parties:

For Appellant: Raul Carrega, CPA

For Respondent: Ravinder Sharma, Hearing Representative
Chad Bacchus, Attorney
Jason Parker, Chief of Headquarters Ops.

S. KIM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A. Flores dba Rolling Tires and Wheels #1 (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 July 2, 2021. The NOD is for tax of $215,171, plus applicable interest, and penalties of $21,517.08[2] for the period April 1, 2018, through December 31, 2020 (liability period).

Office of Tax Appeals (OTA) Panel Members Josh Lambert, Andrew Wong, and Steven Kim held an oral hearing for this matter in Cerritos, California, on September 9, 2025. 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, section 30209(b).

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[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] Respondent imposed a 10-percent negligence penalty of $16,730.41 for the second quarter of 2018 (2Q18) through 2Q20, and a 10-percent failure-to-file penalty of $4,786.67 for 3Q20 through 4Q20.

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ISSUES[3]

1. Whether respondent timely issued the NOD.
2. Whether any adjustment to the measure of unreported taxable sales is warranted.

FACTUAL FINDINGS

1. Appellant, a sole proprietorship, operated a retail tire shop located in Harbor City, California. Appellant made retail sales of tires and wheels, and provided installation and related services. Appellant obtained a seller's permit effective May 1, 2015.
2. For the liability period, appellant filed sales and use tax returns (SUTRs) reporting total sales of $2,048,051 and claiming deductions for nontaxable labor of $1,493,724 and for sales tax reimbursement of $48,092 included in total sales, resulting in reported taxable sales of $506,235. Appellant did not file SUTRs for third quarter of 2020 (3Q20) and 4Q20. Appellant used bank statements to prepare SUTRs, but appellant's method for determining the amount of nontaxable labor was unknown.
3. Respondent audited appellant for the liability period. For audit, appellant provided federal income tax returns (FITRs) for calendar years 2018 and 2019, and bank statements for the liability period. Respondent requested additional records for the liability period, such as sales invoices and merchandise purchase invoices, but appellant did not provide any source documentation. Respondent found that appellant's records were incomplete and inadequate for sales and use tax audit purposes.
4. Based on the bank statements, respondent compiled total bank deposits of $2,048,052 from sales proceeds, which reconciled with total sales reported on the SUTRs.
5. Respondent compared total sales reported on the SUTRs for 2018 and 2019 to corresponding gross receipts reported on the FITRs, which revealed that reported gross receipts exceeded reported total sales by $21,295 in 2018, and $98,563 in 2019. Appellant was unable to explain the reason for the difference.

[3] At the oral hearing, appellant confirmed that he was not making separate arguments against the negligence and failure-to-file penalties. Appellant only argues that these penalties should not apply because no additional tax is due.

6. Respondent compared taxable sales reported on the SUTRs to the corresponding cost of goods sold (COGS) reported on the FITRs and computed book markups[4] of -68.83 percent for 2018, and -68.67 percent for 2019. Respondent noted that a negative markup would mean appellant was selling merchandise for less than cost. Therefore, respondent determined that appellant's reported taxable sales were understated and that an indirect audit method was needed to verify appellant's sales.
7. Respondent obtained Form 1099-K[5] data and compiled credit card sales of $1,554,431 for 2Q18 through 4Q19. Respondent computed credit card sales excluding sales tax reimbursement (ex-tax) of $1,419,572 for 2Q18 through 4Q19, which it compared to ex-tax reported total sales of $1,579,802 for the same period, to compute a credit card sales ratio of 89.86 percent. Based on its experience in audits of similar businesses in appellant's area, respondent believed the 89.86 percent credit card sale ratio was too high, and that a 50 percent credit card sales ratio was more reasonable.
8. Respondent divided ex-tax credit card sales of $1,416,824[6] by the estimated credit card sales ratio of 50 percent to compute estimated total sales of $2,833,648 for 2Q18 through 4Q19. Respondent then estimated a taxable sales ratio of 80 percent to compute estimated taxable sales of $2,266,919 for 2Q18 through 4Q19. Based on appellant's reported taxable sales of $397,173 for the same period, respondent computed additional taxable sales of $1,869,746 for 2Q18 through 4Q19. Respondent found that this estimation was further indication that appellant underreported its taxable sales.
9. Respondent used the markup method to compute appellant's taxable sales. Because appellant did not provide purchase journals, respondent concluded that the COGS

[4] "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 ÷ 0.70 = 0.4286). A "book markup" (sometimes referred to as an "achieved markup") is a markup 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 profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (0.30 ÷ 1.00 = 0.30).

[5] Form 1099-K is an IRS form titled "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third party network, during a given time period. Form 1099-K includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

[6] This amount is different from the previously computed amount of $1,419,572 because respondent used an incorrect sales tax rate for two quarters in its computation. Using the correct amount of $1,416,824, the credit card sales ratio would have been 89.68 percent.

amounts reported on appellant's FITRs were the best available evidence of merchandise sold. Appellant did not provide any sales invoices with corresponding merchandise purchase invoices, so respondent was unable to perform a shelf test[7] to calculate appellant's markup. Based on its experience in audits of similar businesses in appellant's area, respondent considered a 40 percent markup to be reasonable. Respondent applied the estimated 40 percent markup to COGS for 2018 and 2019 to compute audited taxable sales of $1,009,177 for 2018, and $1,032,662 for 2019. Compared to reported taxable sales on appellant's SUTRs, respondent computed unreported taxable sales of $784,502 for 2018, and $801,582 for 2019, with error percentages of 349.17 percent and 346.89 percent for 2018 and 2019, respectively, and 348.01 percent for the two years combined.

10. Respondent applied the error percentages to appellant's reported taxable sales[8] to compute unreported taxable sales of $1,761,087. Respondent computed audited taxable sales of $2,267,322 ($506,235 reported + $1,761,087 unreported) for 2Q18 through 2Q20, and calculated average quarterly taxable sales of $251,925 ($2,267,322 ÷ 9 quarters). For 3Q20 and 4Q20, the periods for which appellant did not file SUTRs, respondent computed unreported taxable sales of $503,850 ($251,925 × 2 quarters). In total, respondent calculated unreported taxable sales of $2,264,937 for the liability period.
11. Respondent issued appellant the July 2, 2021 NOD.
12. Appellant timely filed a petition for redetermination disputing the NOD.
13. Respondent issued a decision ordering a reaudit to allow appellant the opportunity to provide additional documentation to support an adjustment to the estimated markup used in the audit.
14. Appellant provided 20 sales invoices purporting to be from 2020, and a schedule computing a markup of 9 percent. Appellant did not provide merchandise purchase invoices or other documentation to support its costs of the items sold, and respondent was unable to verify the accuracy of appellant's 9 percent markup. Respondent concluded that no adjustments were warranted.
15. Appellant timely filed this appeal.

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[7] A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

[8] The error percentage for 2018 was applied to 2Q18 through 4Q18, the error percentage for 2019 to 1Q19 through 4Q19, and the combined error percentage to 1Q20 through 2Q20.

16. In its opening brief, respondent reexamined its markup method. Respondent obtained gross profit percentages for the liability period (except 2Q20) for the retail tire industry from CSIMarket.com[9] and computed industry markups of 27.62 percent for 2018, 25.66 percent for 2019, and 25.06 percent for 2020. Respondent also obtained appellant's 2020 FITR. Respondent applied the industry markups to appellant's COGS (less 1 percent for shrinkage) for 2018, 2019, and 2020, and computed audited taxable sales of $910,738 for 2018, $917,620 for 2019, and $1,197,730 for 2020. Upon comparison to reported taxable sales, respondent computed unreported taxable sales of $686,063 for 2018, $686,540 for 2019, and error percentages of 305.36 percent and 297.1 percent for 2018 and 2019, respectively. Respondent applied the error percentages to reported taxable sales for the corresponding years and computed unreported taxable sales of $1,193,720 for 2Q18 through 4Q19. For 2020, respondent calculated unreported taxable sales of $1,088,668 ($1,197,730 - $109,062 reported taxable sales). In total, respondent calculated unreported taxable sales of $2,282,388 ($1,193,720 + $1,088,668) for the liability period. Because the original measure of unreported taxable sales ($2,264,937) was lower than the measure using the industry markups, respondent concluded that the original audit measure was reasonable and that no adjustments were warranted.

DISCUSSION

Issue 1: Whether respondent timely issued the NOD.

R&TC section 6487(a) provides that, except in the case of fraud or intent to evade, every NOD shall be mailed within three years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined or within three years after the return is filed, whichever period expires later.

Here, the liability period is from April 1, 2018, through December 31, 2020. An NOD for the earliest quarterly period of the liability period, April 1, 2018, through June 30, 2018, is timely if issued on or before July 31, 2021. Respondent issued the NOD on July 2, 2021. Therefore, despite appellant's argument that respondent tried to "circumvent the statute of limitations," respondent timely issued the NOD for the entire liability period.

[9] CSIMarket is an independent digital financial media company and provider of integrated financial information and analytical applications. CSIMarket compiles financial data and provides financial ratios for various industries.

Issue 2: Whether any adjustment to 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, including but not limited to the following: (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. (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.*)

Appellant provided limited books and records for audit, and did not provide any source documents supporting his purchases or sales during the liability period. As such, respondent was unable to verify appellant's reported sales for the liability period using a direct audit method. In addition, respondent's preliminary analysis disclosed unexplained differences between total sales reported on the SUTRs and gross receipts reported on the FITRs, as well as negative book markups, suggesting that appellant was underreporting his sales. Therefore, OTA finds that it was reasonable and rational for respondent to question appellant's reported sales and to use an indirect audit method to compute appellant's sales.

Respondent utilized the markup method to compute appellant's unreported taxable sales. Respondent's use of the markup method as the basis for its determination is a recognized and accepted auditing procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) But the markup method is only effective and reliable if respondent has sufficient information to establish a reasonable markup and cost of taxable merchandise sold. (*Ibid.*) Here, respondent

sourced information about appellant's COGS from his FITRs and estimated a markup based on respondent's experience in audits of similar businesses in appellant's area. Respondent later calculated an industry average markup based on information sourced from an independent third-party website, which was lower than respondent's estimated markup. However, using the industry markup and information reported on appellant's 2020 FITR (which was unavailable at the time of the original audit) would have resulted in a larger measure of unreported taxable sales. Consequently, respondent continued to use the original measure derived from the estimated markup. Based on the foregoing, OTA concludes that respondent has established a reasonable and rational basis for its determination, and thus, the burden shifts to appellant to prove that a different determination is warranted.

On appeal, appellant contends that respondent's reaudit established a markup of 9 percent, but that respondent refused to honor the reaudit results. Appellant asserts that he offered to provide books and records to respondent, but that respondent ignored such books and records. Appellant argues that respondent used a "side door" by relying on *Maganini v. Quinn* (1950) 99 Cal.App.2d 1 (*Maganini*) to conduct an audit based on estimates instead of using appellant's records. Thus, appellant argues that respondent's audit and appeals process was fraudulent.

Although appellant has submitted 20 sales invoices and a schedule computing a markup of 9 percent, appellant has not provided supporting documentation to establish the cost of the items sold on the sales invoices. In computing the 9-percent markup, appellant deducted sales tax from all 20 sales, but only two invoices showed an amount for sales tax.[10] Respondent did not accept appellant's 9-percent markup or conduct a reaudit to make any adjustments to the original audited tax liability. Regarding appellant's assertion that he offered to provide additional records but respondent refused to accept them, the evidence shows that appellant had ample opportunities to provide records during respondent's audit and appeals process, and on appeal before OTA. Yet, appellant has failed to produce any additional records to support an adjustment to the audited measure. Moreover, respondent's reliance on *Maganini* is justified, as respondent is entitled to look beyond a taxpayer's records and use indirect audit methods to verify reported amounts, especially where, as is the case here, a taxpayer's records are found to be insufficient or unreliable. (*Maganini*, 99 Cal.App.2d 1; see also *Riley B's v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610.) Finally, there is nothing in the record to support appellant's claim that respondent's audit and appeals process were fraudulent. Accordingly,

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[10] None of the 20 sales invoices included any labor charges, 14 invoices did not identify a customer, and 13 invoices are not dated.

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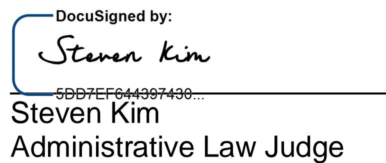
appellant has not established that a result differing from respondent's determination is warranted.

HOLDINGS

1. Respondent timely issued the NOD.
2. An adjustment to the measure of unreported taxable sales is not warranted.

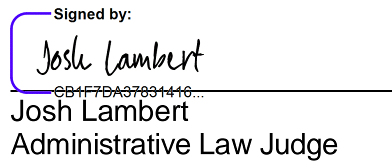
DISPOSITION

Respondent's action denying appellant's petition for redetermination is sustained.

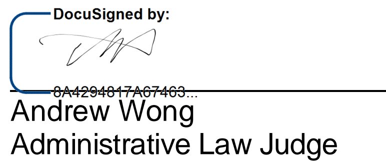


Steven Kim
Administrative Law Judge

We concur:



Josh Lambert
Administrative Law Judge



Andrew Wong
Administrative Law Judge

Date Issued: 12/2/2025