OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:

DISCOTECA MAMA-RUMBA, INC.

OTA Case No.: 20086477
CDTFA Case ID: 1047070; 44-034

OPINION

Representing the Parties:

For Appellant: Jaime Tricerri, Representative

For Respondent: Kevin B. Smith, Attorney

S. KIM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Discoteca Mama-Rumba, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying in part appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on January 10, 2018, for tax of $93,206.80, plus applicable interest, and a negligence penalty of $9,320.66 for the period October 1, 2013, through September 30, 2016 (liability period).[2] Subsequently, CDTFA prepared a reaudit, which reduced the determined tax to $92,240 and will result in a corresponding reduction to the negligence penalty.

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).

[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] The NOD was timely issued because on December 29, 2016, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period October 1, 2013, through September 30, 2014, which allowed CDTFA until January 31, 2018, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

ISSUE

Whether further adjustments to the measure of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a corporation, operated two retail stores located in Pomona, California, primarily selling cellular telephones (cellphones) with prepaid wireless service, cellphone accessories, calling cards, and miscellaneous taxable items during the liability period.[3] Appellant's seller's permit was opened with an effective start date of January 1, 2008, and closed with an effective date of September 30, 2018.
2. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of $3,988,519 and claimed deductions of $3,625,594 for "other,"[4] resulting in reported taxable sales of $362,925. Appellant also reported purchases of $593 subject to use tax in the fourth quarter of 2013 (4Q13). In total, appellant reported a taxable measure of $363,518. Appellant's reporting method was unknown.
3. Upon audit, appellant provided federal income tax returns (FITRs) for calendar years 2014 and 2015; general ledgers for 4Q13, 2014, and 2015; sales tax summary worksheets for the liability period; and various merchandise purchase invoices for 2014 and 2015. Appellant did not provide any sales source documents.
4. CDTFA compared total sales reported on the SUTRs for 2014 and 2015 to the corresponding gross receipts, excluding sales tax reimbursement, reported on the FITRs. CDTFA noted material differences in both years, and appellant was unable to explain the reason for the differences.
5. CDTFA compared total sales recorded in the general ledgers for 4Q13 through 4Q15 to total sales reported on the corresponding SUTRs and noted no differences. CDTFA also compared sales tax reimbursement recorded in the general ledgers for 4Q13 through 4Q15 to sales tax reported on the corresponding SUTRs and noted no differences.
6. CDTFA compared taxable sales reported on the SUTRs for 2014 and 2015 to recorded cost of goods sold (COGS) for cellphones and accessories per the general ledgers for

[3] Appellant had four registered sublocations, but appellant stated that one location was never opened (CDTFA noted this location was empty and closed at the time of the audit) and that another was operated by a different business (CDTFA noted this location was registered to another seller's permit).

[4] Appellant stated that the "other" deductions were for prepaid mobile services.

2014 and 2015 and computed book markups[5] of -22.98 percent and -68.67 percent, respectively. CDTFA found that the negative book markups were unreasonable because they would indicate that appellant was selling merchandise for less than its cost. Thus, CDTFA determined that reported taxable sales were potentially understated and decided to verify appellant's reported taxable sales using an indirect audit method.

7. Using appellant's merchandise purchase invoices for 2014 and 2015, CDTFA compiled merchandise purchases of $671,630. CDTFA found that the total purchases from the merchandise purchase invoices exceeded purchases recorded in the general ledgers. Thus, CDTFA concluded that the general ledgers were understated and the merchandise purchase invoice totals were more complete. CDTFA allocated the total purchases from the merchandise purchase invoice between cellphones (84.52 percent) and accessories (15.48 percent) based on recorded purchases from the general ledgers for 2014 and 2015, to compute audited cellphone purchases and audited accessory purchases.

8. Appellant did not provide detailed sales information with which CDTFA could perform shelf tests[6] to compute markups for cellphones and accessories. Thus, CDTFA used an 18 percent markup as specified under Regulation section 1585(a)(4) to establish the fair retail selling price for cellphones and a 165.96 percent markup for accessories based on similar businesses in appellant's area. CDTFA added the 18 percent markup to the audited cellphone purchases for 2014 and 2015 to compute audited taxable cellphone sales. CDTFA reduced audited accessory purchases for 2014 and 2015 by 1 percent for breakage then added the 165.96 percent markup to the result to compute audited taxable accessory sales. CDTFA compared the audited taxable cellphone sales and the audited taxable accessory sales, combined, to taxable sales reported on the SUTRs and computed differences for each year. CDTFA also calculated percentages of error (error ratios) for each year and the two years combined.

9. CDTFA applied the 2014 error ratio to the quarterly taxable sales reported on the 2014 SUTRs, the 2015 error ratio to the quarterly taxable sales reported on the 2015 SUTRs,

[5] "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 one that is calculated from the retailer's records.

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

and the combined error ratio to reported taxable sales for 4Q13, and 1Q16 through 3Q16. In total, CDTFA computed unreported taxable sales of $1,030,630 for the liability period.[7]

10. CDTFA issued appellant the January 10, 2018 NOD.
11. Appellant timely filed a petition for redetermination disputing the NOD.
12. Subsequently, appellant argued that the markup on cellphones was not representative of the liability period. Appellant provided sales reports and merchandise purchase invoices for April 2016, and CDTFA performed a shelf test, which resulted in a markup on cellphones of 16.72 percent. CDTFA concluded that the 16.72 percent markup was reasonable, and a reaudit was warranted to recompute audited taxable cellphone sales.
13. CDTFA added the 16.72 percent markup to the audited cellphone purchases for 2014 and 2015 to compute audited taxable cellphone sales. No change was made to audited taxable accessory sales. CDTFA compared the audited taxable cellphone sales and the audited taxable accessory sales, combined, to taxable sales reported on the SUTRs and computed differences for each year and calculated error ratios for each year and the two years combined.
14. CDTFA applied the 2014 error ratio to the quarterly taxable sales reported on the 2014 SUTRs, the 2015 error ratio to the quarterly taxable sales reported on the 2015 SUTRs, and the combined error ratio to reported taxable sales for 4Q13, and 1Q16 through 3Q16. In total, CDTFA computed unreported taxable sales of $1,019,892 for the liability period.
15. On April 4, 2019, CDTFA issued a reaudit report, which reduced the measure of tax by $10,738 from $1,035,630.
16. During CDTFA's internal appeal process, appellant provided a "Rebate Transaction Report" from MetroPCS (a service provider) for February 2015, and a one-page excerpt purported to be from a contract between MetroPCS and another (unnamed) retailer. CDTFA issued a decision on July 7, 2020, ordering a reduction to the determined measure of tax in accordance with the reaudit but otherwise denying appellant's petition for redetermination.
17. Appellant timely filed this appeal.

---

[7] CDTFA also noted that appellant reported on its FITR a purchase of furniture and fixtures in 2014. Appellant failed to provide a purchase invoice to show it paid sales tax or use tax on any such purchase. Thus, CDTFA established a separate measure of tax for unreported purchases of fixed assets subject to use tax of $5,000. Appellant did not dispute this audit item; thus, OTA does not discuss it further.

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*.)

Generally, tax applies to the gross receipts from the retail sale of a wireless telecommunication device. (Cal. Code Regs., tit. 18, § 1585(b)(1).) Tax applies to the gross receipts from the retail sale of a wireless telecommunication device sold in a bundled transaction, measured by the unbundled sales price of that device. (Cal. Code Regs., tit. 18, § 1585(b)(3).) A "bundled transaction" is the retail sale of a wireless telecommunication device which contractually requires the retailer's customer to activate or contract with a wireless telecommunications service provider for utility service for a period greater than one month as a condition of that sale. (Cal. Code Regs., tit. 18, § 1585(a)(3).) A transaction is a bundled transaction if goods and services are sold as a single package, whether wireless telecommunication service is supplied to the customer by the retailer or by an independent service supplier. (*Ibid*.) In a bundled transaction, wireless devices may be sold at a discounted price as an inducement for the customer to enter into an extended service contract. (*Ibid*.) The unbundled sales price is the price at which the retailer has sold specific wireless telecommunication devices to customers who are not required to activate or contract for utility service with the retailer or with an independent wireless telecommunications service provider for utility service as a condition of that sale. (Cal. Code Regs., tit. 18, § 1585(a)(4).) If the retailer cannot establish an unbundled sales price to the satisfaction of CDTFA based upon its own sales records, the unbundled sales price of the device shall equal the fair retail selling price of that device. (*Ibid*.) If tax is reported and paid on an amount equal to the cost of the device plus a markup on cost of at least 18 percent, such amount shall be regarded as the fair retail selling price of the device. (*Ibid*.)

Retailers engage in rebate and incentive programs with manufacturers or other third parties that result in additional revenue for the retailer when certain conditions are satisfied. (Cal. Code Regs., tit. 18, § 1671.1(c)(3).) When a retailer enters into a contract with a third party that requires, on a transaction-by-transaction basis, a specific reduction in the retailer's selling price of specified products in exchange for a certain payment of a like amount from the contracting party, such payments received by the retailer are part of the taxable gross receipts or sales price of the sales. (Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).) For purposes of Regulation section 1671.1(c)(3)(A), it is rebuttably presumed that any consideration received by retailers from third parties related to promotions for sales of specified products is subject to tax until the contrary is established. (*Ibid*.)

Here, appellant failed to provide adequate books and records for audit. CDTFA's preliminary analysis disclosed unexplained differences between SUTRs and FITRs, and negative book markups, which were indications that reported taxable sales were understated. Thus, OTA finds that it was reasonable for CDTFA to question appellant's reported taxable sales and to use an indirect audit method, here the markup method, to verify appellant's reported sales. CDTFA's use of the markup method as the basis for its determination is a recognized and accepted accounting procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) CDTFA computed audited taxable sales based on the best available evidence—merchandise purchases based on appellant's merchandise purchase invoices and markup on cellphones based on appellant's sales reports (in the reaudit). Therefore, OTA concludes CDTFA has met its minimal initial burden to show that its determination is reasonable and rational, and accordingly, the burden shifts to appellant to show errors in CDTFA's audit and determination.

Appellant contends that the markup for cellphones using April 2016 as the sample period was not representative of the liability period. Appellant states that it sold cellphones at a discounted price (lower than the purchase cost) because it would receive a rebate from the carrier to cover the difference. Appellant argues that these rebates are not taxable and that its sales were not bundled transactions because the contracts were for short terms of less than 30 days. (See Cal. Code Regs., tit. 18, § 1585(a)(3).) Appellant also asserts that it has supporting documentation establishing that its cellphone markup was significantly lower than 16.72 percent CDTFA established. However, appellant has not provided any evidence or documentation to support a lower markup, to establish that its sales were not bundled transactions, or to explain the terms of its rebate agreement with its carriers/service providers. Accordingly, appellant has failed to rebut the presumption that any rebates received from third parties are subject to tax. (See Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).) Appellant has not identified any errors in CDTFA's computation of audited taxable sales or provided new documentation or other evidence from which a more accurate determination could be made. As appellant bears the burden of proof in this case, OTA concludes that no adjustments to the measure of tax are warranted.

HOLDING

Further adjustments to the measure of unreported taxable sales are not warranted.

DISPOSITION

CDTFA's action, decreasing the taxable measure by $10,738 (from $1,035,630 to $1,024,892) with a corresponding adjustment to the negligence penalty, but otherwise denying appellant's petition for redetermination, is sustained.

DocuSigned by:
Steven Kim
5DD7EF644397430...
Steven Kim
Administrative Law Judge

We concur:

Signed by:
Carol Williams For
6163EEBC3DA94BF...
Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

Date Issued: 6/9/2026