OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **GATEWAY MOTORS INC.**	OTA Case No.: 240315677 CDTFA Case ID: 275-058, 2-089-765

OPINION

Representing the Parties:

For Appellant:	Hamidullah Tarin, Representative
For Respondent:	Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Crystal Spratley, Business Taxes Specialist

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Gateway Motors Inc. (appellant) appeals a decision[1] issued by respondent California Department of Tax and Fee Administration (CDTFA)[2] denying, in part, appellant's timely petition for redetermination of two Notices of Determination (NODs) issued on April 3, 2018 (NOD-1),[3] and October 15, 2020 (NOD-2)[4]. NOD-1 is for tax of $197,191.86, plus applicable interest for the period October 1, 2012, through December 31, 2016 (liability

[1] CDTFA issued one decision covering both liability periods. Both liability periods are for the same CDTFA seller's permit and were billed under two separate Notices of Determination.

[2] 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.

[3] CDTFA timely issued NOD-1 because on September 14, 2017, appellant waived the otherwise applicable three-year statute of limitations by signing a series of waivers, which gave CDTFA until July 31, 2018, to issue the NOD for the period of October 1, 2012, through March 31, 2015. (R&TC, §§ 6487(a), 6488.)

[4] CDTFA timely issued NOD-2 because on March 16, 2020, appellant waived the otherwise applicable three-year statute of limitations by signing a series of waivers, which gave CDTFA until October 31, 2020, to issue the NOD for the period of January 1, 2017, through September 30, 2017. (R&TC, §§ 6487(a), 6488.)

period-1) and NOD-2 is for tax of $98,779, plus applicable interest, and a negligence penalty of $9,895.05 for the period January 1, 2017, through December 31, 2019 (liability period-2).[5]

CDTFA's decision ordered a reaudit of liability period-2 and no adjustments to liability period-1. Pursuant to the decision, CDTFA completed a subsequent reaudit on liability period-2. The reaudit, dated April 30, 2021, resulted in a decrease to the determined tax by $19,960, from $98,779 to $78,819, as well as a corresponding decrease to the penalties and interest.

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).

ISSUES

1. Whether adjustments are warranted to the unreported taxable sales of used vehicles.
2. Whether the negligence penalty was properly imposed for liability period-2.

FACTUAL FINDING

1. Appellant, a corporation, operates a used car dealership in Hayward, California, with its seller's permit effective October 1, 2010. Appellant offers in-house financing services.

NOD-1

2. For liability period-1, appellant reported total sales of $2,752,851 and claimed no deductions, resulting in reported taxable sales of $2,752,851 on its sales and use tax returns (SUTRs).
3. Upon audit, appellant provided limited records as follows: incomplete sales contracts for years 2013 and 2015; federal income tax returns (FITRs) for 2012, 2013, and 2014; and bank statements for 2013, 2014, and 2015. CDTFA obtained Department of Motor Vehicles (DMV) sales reports for 2012, 2013, 2014, 2015, and 2016 along with DMV purchase records for liability period-1 from the DMV. Additionally, CDTFA obtained copies of sales documents for selected sold vehicles from the DMV.

[5] NOD-2 shows total credits of $22,235, consisting of a $20,332 tax credit from district tax reallocation and a $927 tax credit for tax-paid gasoline purchases resold but not originally claimed. The sales tax rate for this period was 9.75 percent, while gasoline had a 5 percent sales tax rate (2.25 percent plus 2.75 percent district taxes) due to a partial motor vehicle fuel exemption. The calculation for the $927 gasoline credit is comprised of a $1,903 ($19,513 x 9.75 percent) full credit, with an adjustment for the partial motor vehicle fuel exemption of $976 ($19,513 x 5 percent), resulting in a net tax credit of $927. NOD-2 therefore includes the full credits of $20,332 and $1,903, amounting to the disclosed tax credit of $22,235.

4. CDTFA reviewed and compared the SUTRs with FITRs for 2012, 2013, and 2014, and found that the SUTRs reported more gross receipts than the FITRs. Due to incomplete records, CDTFA could not verify total sales and determined that additional testing was warranted.
5. CDTFA reviewed bank statements provided from January 2013, through September 2015 and determined that there were excess deposits[6] and that more analysis was needed.
6. CDTFA reviewed and compared the sales data received from appellant for 2013 and 2015 with DMV sales obtained from CDTFA's Data Analysis Section and concluded that there were $927,837 in appellant's sales data that were not already accounted for in the DMV sales data.
7. Based on the DMV sales data, appellant had sales totaling $4,966,771.13[7] for liability period-1, including purchases from the auction houses of $1,360,450.
8. CDTFA disallowed claimed repossessions due to insufficient supporting documentation. Additionally, CDTFA reviewed bad debt deductions in the amount of $143,475 and allowed $110,212.
9. CDTFA compared audited taxable sales per the DMV report of $4,966,771, disallowed a bad debt claim of $32,358, to arrive at total audited taxable vehicle sales in the amount of $4,999,129. CDTFA then subtracted reported taxable sales of $2,752,851, to arrive at unreported taxable sales of $2,246,278.
10. On April 3, 2018, CDTFA issued NOD-1 to appellant for $197,191.86 in tax, plus applicable interest for liability period-1.
11. On April 23, 2018, appellant filed a timely petition for redetermination disputing NOD-1 in its entirety.

NOD-2

12. For liability period-2, appellant reported total sales of $2,755,688 and claimed no deductions resulting in reported taxable sales of $2,755,688 on its SUTRs.

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[6] Deposits were comprised of credit card deposits only; no cash deposited were included in the scheduled amounts.

[7] CDTFA added and estimated amount for the additional taxable charges of smog fees and document fees as the DMV data did not include this information.

13. Upon audit, appellant provided limited records as follows: sold vehicle sales jackets[8] for the first quarter of 2018 (1Q18), 2Q18, 3Q19, and 4Q19 and vehicle sales jackets for claimed repossessed vehicles; FITRs for 2017 and 2018; bank statements for liability period-2; and DMV sales data for liability period-2. CDTFA obtained DMV purchase records for liability period-2 from the DMV.

14. CDTFA reviewed and compared SUTRs with FITRs for 2017 and 2018 and found that gross receipts reported on the SUTRs were more than those reported on the FITRs in 2018. Due to incomplete records, CDTFA could not verify total sales, and determined that additional testing was warranted.

15. CDTFA used the FITR data to calculate recorded markups[9] of 73.17 percent for 2017, 60.91 percent for 2018, and 67.32 percent for both periods combined. CDTFA concluded this was a reasonable markup for this type of business. CDTFA requested purchase information from appellant to confirm the cost of goods sold; however, no records regarding purchases were provided. CDTFA obtained purchase data provided by the auction houses.

16. CDTFA calculated markups using recorded auction house purchases and reported taxable sales per SUTRs for 2017 and 2018. The markups were inconsistent, ranging from 61.67 percent to 811.64 percent, with an overall markup of 190.25 percent. Additionally, CDTFA deemed the markups unusually high in some periods for this type of business in this area.

17. Appellant provided CDTFA with a list of 43 vehicles appellant claimed to be bad debt repossessions without supporting documentation and stated that appellant never actually received any of the repossessed vehicles. Therefore, CDTFA reviewed the list provided, analyzed it for those that had multiple sales per DMV sales data, and found that four of the vehicles were in fact resold. Due to the lack of substantiation for payments made on the claimed vehicles, CDTFA was unable to accurately determine the repossessed value of the vehicles. Additionally, appellant did not claim bad debts on

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[8] Sales jackets or a vehicle deal jacket is a folder a dealer creates and maintains containing all the documents related to the purchase and sale of a vehicle.

[9] "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 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

its FITRs for the years 2017 and 2018. Based on this information, CDTFA concluded that no bad debt would be allowed for the repossessed vehicles.

18. CDTFA reviewed and compared taxable sales per DMV sales data for liability period-2 totaling $3,258,200 with reported taxable sales per SUTRs in the amount of $2,755,688 to calculate a material difference of $502,512. CDTFA determined that additional testing was warranted.

19. To check the audited figures for reasonableness, CDTFA used the percentage of errors[10] (POEs) calculated using the vehicle sales jackets and DMV sales data and applied them to recorded DMV sales of $3,258,200 to arrive at the additional DMV sales of $542,549, for a total of $3,800,659 total audited DMV sales. CDTFA then compared the total audited DMV sales of $3,800,659 to reported taxable sales of $2,755,688 to calculate audited additional taxable sales of $1,084,873.[11] CDTFA used this as a reference to support audited amounts assessed on NOD-2.

20. CDTFA conducted a separate block test[12] using the same periods as the prior block test, but this time comparing audited taxable sales of $1,304,603 to reported taxable sales and calculated an overall POE of 34.30 percent.[13] CDTFA accepted returns as filed for the periods of 3Q19 and 4Q19.

21. CDTFA applied the POEs calculated in the block test to each of their respective periods (1Q18, 2Q18, 3Q19, and 4Q19), and for periods not included in the block test, CDTFA applied the overall POE of 34.30 percent (1Q17 through 4Q17, and 3Q18 through 2Q19). In doing this, CDTFA calculated additional taxable sales of $985,140.

22. In total, CDTFA assessed $965,627 in measure for a total tax liability of $98,779.[14]

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[10] The “error ratio” is the percentage of unreported taxable sales to reported taxable sales.

[11] This amount does not include the credit amounts calculated for 3Q19 and 4Q19.

[12] A block sample is a generally accepted audit tool which examines transactions from a representative portion of an audit period and applies the findings to the audit period. It is typically used when complete records are not available for the entire audit period.

[13] Individual period POEs: 136.37 percent for 1Q18, 41.65 percent for 2Q18, -10.65 percent for 3Q19, and -3.99 percent for 4Q19.

[14] This includes additional taxable sales of $985,140 in measure or $99,706 in tax for error 1, and a tax paid purchases resold credit of -$19,513 in measure or -$927 in tax.

23. On October 15, 2020, CDTFA issued NOD-2 to appellant for $121,014 in tax, plus applicable interest, with a credit in the amount of $22,235 and a negligence penalty in the amount of $9,895.05 for liability period-2.[15]
24. Appellant filed a petition for redetermination which CDTFA accepted as timely disputing NOD-2 in its entirety.

Both liability periods

25. On February 20, 2024, CDTFA issued a decision that denied appellant's petition for redetermination as to liability period-1 and ordered a reaudit of liability period-2.
26. CDTFA made the changes as ordered in the decision issued for liability period-2. Specifically, the reaudit changed from an indirect audit methodology of POE based on block testing to a direct method (reconciliation between recorded and reported data) and from an indirect method (DMV sales data) to an actual computation of the unreported taxable sales. Consequently, the reaudit reduced the tax by $19,960, from $98,779 to $78,819, as well as a corresponding decrease in penalties and interest.
27. This timely appeal followed.

DISCUSSION

Issue 1: Whether adjustments are warranted to the unreported taxable sales of used vehicles.

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

[15] See footnote 5.

result differing from CDTFA's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

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).). 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).)

NOD-1

For liability period-1, appellant failed to provide normal books of account, such as sales journals and purchase journals, or sales tax worksheets used in connection with the preparation of the SUTRs. Thus, appellant's books and records provided for audit were inadequate for sales and use tax audit purposes. In the absence of reliable records, OTA finds that it was reasonable for CDTFA to use an indirect audit method to compute appellant's sales. CDTFA used DMV data as the basis for its determination, which is a recognized and standard accounting procedure. OTA finds that DMV sales data is the best evidence of appellant's taxable sales because that data is based on sales that appellant reported to DMV on report of sales forms. It is standard audit practice for CDTFA to obtain and use sales data from DMV's database to reconcile reported sales. Specifically, CDTFA's Compliance Policy and Procedures Manual (CPPM) and Audit Manual set forth CDTFA's policies and procedures for a field auditor to obtain this information from DMV and use it in an audit.[16] (CPPM, § 645.120; CDTFA Audit Manual, § 0607.35.) CDTFA's use of POE projections, as the basis for its determination, is also a recognized and accepted accounting procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) OTA finds CDTFA's audit method and the results computed from the DMV data 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; and, more specifically, appellant must show errors in the DMV data.

On appeal, appellant claims that the DMV data CDTFA used had errors that were not considered and corrected. However, appellant did not identify any specific sale or transaction

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[16] While CDTFA's audit and procedure manuals provide relevant information to the public and OTA may look to them for guidance, they are not law and do not have the force or effect of law. (*Appeal of Micelle Laboratories*, 2020-OTA-290P.)

from the audit that it believes is erroneous or otherwise nontaxable. In other words, appellant has not identified any errors in CDTFA's computation of audited taxable sales or provided any new documentation or other evidence in support of the contention from which a more accurate determination could be made. Appellant's unsupported assertion fails to meet the burden to show that a reduction to the measure of unreported taxable sales is warranted. (*Appeal of Talavera, supra.)* Furthermore, CDTFA made reasonable efforts to ensure the accuracy of its determination by adding in estimated amounts for smog fees and document fees and subtracting out the amounts appellant reported on the SUTRs to arrive at the audited measure of unreported taxable sales. OTA did not find any errors in CDTFA's calculations. As appellant bears the burden of proof in this case, OTA concludes that no adjustments are warranted.

NOD-2

As with liability period-1, appellant's books and records provided for audit were inadequate for sales and use tax audit purposes, and therefore CDTFA was unable to verify the accuracy of appellant's reported amounts. Again, in the absence of reliable records, OTA finds the use of an indirect audit method to compute appellant's sales to be reasonable. During reaudit, CDTFA used DMV data as the basis for its determination, which, for the reasons discussed above, is a recognized and standard accounting procedure. (See *Appeal of Amaya, supra.)* Moreover, the DMV data is recorded and maintained at the time the sales were made by an independent government agency (i.e., DMV) and is more reliable than appellant's incomplete documents and current recollection of events that occurred many years ago. CDTFA's audit method and the results computed from the DMV data are reasonable and rational. Therefore, OTA finds CDTFA has met its initial burden, and the burden of proof shifts to appellant to show errors in the audit; and, more specifically, appellant must show errors in the DMV data.

On appeal, appellant claims that the DMV data CDTFA used had errors that were not considered and corrected. Additionally, appellant contends that CDTFA improperly used data from a quarter that was not accurate and applied it to the entire liability period-2.

CDTFA's reaudit changed from an indirect audit method of projecting the percentage of error to a combination of the direct method (a reconciliation between recorded and reported) and an indirect method (DMV sales data) to compute the unreported taxable sales based on the available data for each period. As a result, the audit basis is no longer a projection of a calculated POE applied to liability period-2; therefore, appellant's argument that CDTFA improperly projected the POE from a block sample to the entire audit period is unpersuasive.

As with liability period-1, appellant has not identified any specific sale or transaction based on DMV data that it believes is erroneous or otherwise nontaxable. Appellant's unsupported assertion fails to meet the burden to show that a reduction to the measure of unreported taxable sales is warranted. (*Appeal of Talavera, supra.)*

OTA did not find any errors in CDTFA's calculations. As appellant bears the burden of proof in this case, OTA concludes that no adjustments are warranted.

Issue 2: Whether the negligence penalty was properly imposed for liability period-2.

Generally, if any part of a liability for which a deficiency determination is made is due to negligence, CDTFA must add a penalty equal to 10 percent of the determined tax deficiency. (R&TC, § 6484.) Although the term "negligence" is not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined in this context as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc*. (2017) 7 Cal.App.5th 1129, 1157-1158.) The law imposes recordkeeping and reporting responsibilities pertaining to sales and use tax, on the retailer (or seller). (R&TC, §§ 6051, 7053.) A taxpayer must maintain and make available for examination on request by respondent 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 returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide accurate records is evidence of negligence and may result in imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 1698(k).) Imposition of a negligence penalty is warranted where errors are continued from one audit to the next. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-323.)

Although appellant did not explicitly state its disagreement with the negligence penalty in its appeal to OTA, out of an abundance of caution, OTA will discuss appellant's arguments from its petition with CDTFA's Appeals Bureau. Appellant contends that it has made a conscious effort to report the taxable sales correctly and that the high percentage of error is the result of CDTFA's excessive computation of unreported taxable sales.

CDTFA imposed the negligence penalty for the following reasons: (1) the books and records provided were inadequate, (2) an indirect audit method was required due to the lack of adequate records, and (3) appellant was previously audited which provided appellant with knowledge of the records required for an audit. Appellant failed to provide purchase and sales journals, or proper documentation to support bad debts or repossessions. CDTFA received auction information provided by auction houses to determine if purchases on the FITRs were accurate and sales data provided by DMV were compared to the limited dealer jacket information to determine if reported taxable sales were accurate. Due to the limited records provided, CDTFA used a percentage of error to apply to quarters where sales data was not provided. Additionally, liability period-2 was appellant's second audit. Continuing errors from liability period-1 were present in liability period-2. (*Independent Iron Works, Inc. v. State Bd. of Equalization*, *supra*.) For these reasons and considering appellant's knowledge of the records required for an audit, OTA finds that CDTFA properly imposed the negligence penalty because, appellant was negligent in maintaining and making adequate records available.

HOLDINGS

1. Adjustments are not warranted to the unreported taxable sales of used vehicles.
2. CDTFA properly imposed the negligence penalty for liability period-2.

DISPOSITION

CDTFA's action is sustained.

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

We concur:

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

Signed by:
Josh Lambert
CB1E7DA37831416...
Josh Lambert
Administrative Law Judge

Date Issued: 1/5/2026