OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011944 CDTFA Case No. 794768 CDTFA Acct. No. 101-134942
ROBERTO HERNANDEZ	
dba Raliberto's Taco Shop	Date Issued: March 4, 2019

OPINION

Representing the Parties:

For Appellant: Peter P. Guerrero, Enrolled Agent

For Respondent: Kevin C. Hanks, Chief
Headquarters Operations Division

For Office of Tax Appeals: Richard Zellmer,
Business Tax Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 6561,[1] Roberto Hernandez, dba Raliberto's Taco Shop, (appellant) appeals a Notice of Determination (NOD) issued by respondent California Department of Tax and Fee Administration (CDTFA) assessing a tax deficiency of $28,230.73, plus applicable interest, and a negligence penalty of $2,823.09, for the period April 1, 2010, through March 31, 2013.

Appellant failed to respond to the Office of Tax Appeals' (OTA) letter dated April 19, 2018, in which appellant was asked to indicate if he wished to have an oral hearing. Therefore, the matter is being decided based on the written record.

ISSUE

Whether appellant established that reductions to the liability are warranted.

FACTUAL FINDINGS

1. Appellant operated a restaurant known as Raliberto's Taco Shop.

[1] Unless otherwise indicated, all statutory references are to sections of the California Revenue and Taxation Code.

2. CDTFA audited appellant for the period April 1, 2010, through March 31, 2013. Due to a lack of books and records, CDTFA decided to use the credit-card-sales-ratio method to compute appellant's sales. CDTFA performed a one-day observation test during which it observed sales made at appellant's business on Tuesday, June 25, 2013. CDTFA observed total sales, including sales tax reimbursement, of $757.66, taxable sales of $704.78, and sales paid for with credit cards including sales tax reimbursement (credit card sales) of $298.14. CDTFA divided credit card sales of $298.14 by total sales, including sales tax reimbursement, of $757.66 to compute a credit card sales ratio of 39.35 percent. CDTFA compiled credit card deposits from available bank statements of $204,841 for the periods April 1, 2010, through March 31, 2012, and May 1, 2012, through December 31, 2012. At the time of the audit, appellant did not provide bank statements for April 2012, or the first quarter of 2013 (1Q13). Therefore, CDTFA calculated that credit card deposits for the period May 1, 2012, through December 31, 2012, averaged $8,087 per month. CDTFA multiplied $8,087 by 4 to compute estimated credit card deposits of $32,348 for the period April 2012, and 1Q13, combined. CDTFA added the $32,348 amount to credit card deposits from the bank statements of $204,841 to compute audited credit card deposits of $237,189 for the audit period. CDTFA divided audited credit card deposits of $237,189 by the credit card sales ratio of 39.35 percent to compute audited taxable sales, including sales tax reimbursement, of $602,765 (rounded) for the audit period. CDTFA removed sales tax reimbursement from that amount to compute audited taxable sales of $560,113 for the audit period. CDTFA subtracted reported taxable sales of $190,144 from audited taxable sales of $560,113, to compute unreported taxable sales of $369,970.
3. On December 24, 2013, CDTFA issued an NOD to appellant based on the above-mentioned audit in the amount of $28,230.73 tax, plus applicable interest, and a negligence penalty of $2,823.09.
4. Appellant filed a timely petition for redetermination, contending that the audited taxable sales for the period April 1, 2010, through August 31, 2011, are too high. Appellant asserted that, after August 31, 2011, his daily sales increased significantly, and thus, he argues that the one-day observation test is not representative of his business prior to September 1, 2011. Appellant did not provide any evidence to support this contention.

5. In a Decision and Recommendation (D&R) issued August 12, 2015, CDTFA's Appeals Bureau noted that the one-day observation test did not meet the standards of the Business Tax and Fee Department Audit Manual (hereafter Audit Manual). The Appeals Bureau stated that section 0810.30 of the Audit Manual provides than an observation test should be conducted over several days, including a weekend day if the business is operated on the weekends (appellant's business operated daily). Thus, the D&R recommended a reaudit in order to conduct observation tests for two additional days. The D&R also concluded that appellant was negligent, and thus, the D&R upheld the negligence penalty.

6. CDTFA performed a reaudit, and performed two additional observation test days as recommended in the D&R. However, when the additional observation tests were performed, CDTFA found that appellant had stopped accepting credit cards as a method of payment. Thus, CDTFA decided to abandon the credit card sales ratio method and use the three-day observation test to compute an amount of average daily taxable sales, which would be projected throughout the audit period. In the reaudit, CDTFA computed that taxable sales from the three observation tests resulted in an average of $1,201 per day. CDTFA concluded that average daily taxable sales were less than $1,201 per day for periods prior to January 1, 2013. CDTFA computed ratios for each year or partial year, which were multiplied by the $1,201 amount to compute audited average daily sales of $752 for the period April 1, 2010, through December 31, 2010, $803 for 2011, and $1,055 for 2012. CDTFA used average daily sales of $1,201 for the period January 1, 2013, through March 31, 2013. For each year or partial year, CDTFA multiplied audited average daily taxable sales by the number of days the business was open in each respective period to compute audited taxable sales of $986,071 for the audit period. Reported taxable sales of $190,144 were subtracted from this amount to compute unreported taxable sales of $795,728 for the audit period. CDTFA noted that the $795,728 understatement computed in the reaudit was greater than the $369,970 understatement computed in the original audit.

7. Based on the reaudit results, on April 1, 2016, CDTFA timely asserted an increase in the determination in accordance with section 6563, resulting in a total tax deficiency of $60,835.92, a negligence penalty of $6,083.62, and applicable interest.[2]

8. Subsequently, the Appeals Bureau prepared a Supplemental D&R to address the reaudit and the increase in the determination. In the Supplemental D&R, the Appeals Bureau concluded that the amount of taxable sales computed in the reaudit was excessive. The Appeals Bureau stated that, had it known at the time that the D&R was issued, that appellant had stopped accepting credit cards, the D&R would not have recommended a reaudit to expand the observation test, but instead would have recommended no adjustment. The Appeals Bureau stated that taxable sales should be computed using the credit-card-sales-ratio method, as was done in the original audit. The Appeals Bureau concluded that the observation test could not be expanded because appellant had stopped accepting credit cards. Thus, the Appeals Bureau stated that the credit-card-sales-ratio of 39.35 percent should be used. The Appeals Bureau noted that, as part of the reaudit, information regarding appellant's credit card sales for April 2012 and 1Q13 had been obtained, and the Appeals Bureau concluded that the actual amounts of credit card sales should be used for those periods instead of the estimates that were used in the original audit. After making that adjustment, the Appeals Bureau computed unreported taxable sales of $365,854, which is less than unreported taxable sales of $369,970 computed in the original audit. Thus, the Supplemental D&R recommends that the determined measure of tax be reduced to $365,854. Also, the Appeals Bureau reconsidered the negligence penalty, and in the Supplemental D&R, concluded that appellant was not negligent and recommended deleting the penalty. In its brief, CDTFA stated that the Supplemental D&R represents its current position on this appeal.

9. Appellant filed the instant appeal with OTA. In its opening brief, appellant states that the gross sales calculated by CDTFA are too high. With its opening brief, appellant has provided copies of its bank statements for the period December 10, 2013, through

[2] CDTFA may decrease or increase the amount of the determination before it becomes final, but the amount may be increased only if a claim for the increase is asserted by CDTFA at or before an administrative hearing. (§ 6563(a).) As relevant here, the claim for the increase must be asserted within three years after the first deficiency determination, or within three years after the time tax records requested by CDTFA were made available, whichever is later. (§ 6563(a)(1).)

September 9, 2015, which is after the audit period (the audit period ends March 31, 2013).

10. By letter dated September 12, 2018, OTA asked appellant to explain the relevance of the bank statements he provided with his opening brief. Appellant did not respond to the letter.

DISCUSSION

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (§ 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (§ 6091.) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are subject to tax. (§ 6359, subds. (a), (d)(1), (d)(2), and (d)(7).)

When CDTFA is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (§ 6481.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (§§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer challenges a Notice of Determination, CDTFA has the burden to explain the basis for that deficiency. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610.) Generally, where a taxpayer challenges the additional tax, the government bears the initial burden of establishing a *prima facie* case that taxes are owed. (*Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950.) Based on *Riley B's, Inc.* and *Schuman Aviation Co. Ltd.*, we conclude that when a taxpayer challenges a Notice of Determination, CDTFA must establish a *prima facie* case that taxes are owed by proving the basis for that deficiency and providing evidence sufficient to establish that its determination is reasonable.

Where CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to explain why CDTFA's asserted deficiency is not valid. (*Riley B's, Inc., supra,* at pp. 615-616.) The applicable burden of proof is by a preponderance of the evidence. (Evid. Code, § 115;

Appeal of Estate of Gillespie, 2018-OTA-052P, June 13, 2018, at p. 4.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) To satisfy its burden of proof, a taxpayer must prove both (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

Here, the books and records appellant provided for audit were incomplete. Specifically, appellant did not provide cash register z-tapes, sales journals, purchase journals, or sales summaries. Further, appellant's bank deposits for the periods of April 1, 2010 through March 31, 2012, and May 1, 2012 through December 31, 2012, combined, exceed appellant's reported total sales for the audit period. Appellant has not explained the reason for the discrepancies. Accordingly, CDTFA found appellant's reported sales to be unreliable, and therefore used the credit-card-sales-ratio method and appellant's bank statements from the audit period to determine appellant's taxable sales. As noted above, the 39.35 percent credit-card-sales-ratio is based on a one-day observation test that does not comply with the Audit Manual's recommended three-day test; however, the test could not be expanded during the reaudit because appellant no longer accepted credit cards and any additional days would not have accurately represented the credit-card-sales-ratio during the audit period. Further, appellant provided no other evidence from which a more accurate determination could be made. In other words, the 39.35 percent ratio is based on the best-available evidence. Thus, CDTFA has established that its determination is reasonable and based on the best-available evidence, and thus the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

In the case at hand, appellant did not provide evidence to show that the measure of tax, as recommended in the Supplemental D&R, is excessive. We note that the bank statements appellant provided with its opening brief are all for periods after the audit period, and as such, they are not an accurate representation of the sales appellant made during the audit period. Thus, we find that the bank statements provided by appellant are not a valid basis for reducing the liability. Appellant provided no evidence, and therefore fails to carry his burden, to show that the gross sales calculated by CDTFA resulted in too high of a markup. Therefore, we conclude that no further adjustments to the audit liability are warranted.

HOLDING

Appellant failed to establish that reductions to the liability are warranted.

DISPOSITION

CDTFA's action in reducing the measure of tax to $365,854 and deleting the negligence penalty is sustained.

DocuSigned by:
Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:
Tommy Leung
0C90542BE88D4E7...
Tommy Leung
Administrative Law Judge

DocuSigned by:
Sara A. Hosey
6D3FE4A0CA514E7...
Sara A. Hosey
Administrative Law Judge