

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 18103860
)	Date Issued: March 29, 2019
)	
KAYED ENTERPRISES, INC.,)	
Dba Mediterranean Café & Lounge)	
_____)	

OPINION

Representing the Parties:

For Appellant:	Oladapo A. Olagbemi, CPA
For Respondent:	Leslie Ang, Tax Counsel III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 6561,¹ Kayed Enterprises, Inc., (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA), on a timely petition for redetermination of a Notice of Determination (NOD) assessing a tax deficiency of \$59,543.11, plus applicable interest, for the period April 1, 2011, through March 31, 2014.

Appellant waived its right to an oral hearing, and therefore the matter is being decided based on the written record.

ISSUE

Whether appellant has established that reductions are warranted to the measure of unreported taxable shisha sales.

FACTUAL FINDINGS

- Appellant operates a hookah lounge and café in San Diego, California. For the audit period, appellant reported total sales of \$795,249, and claimed deductions for nontaxable sales totaling \$696,706, resulting in reported taxable sales of \$98,543.

¹ Unless otherwise indicated, all statutory references are to “sections” or “§” of the Revenue and Taxation Code.

2. Upon audit, CDTFA reviewed appellant's credit card sales using appellant's Form 1099-K's from the audit period to establish audited credit card deposits of \$777,372. CDTFA determined that for this type of business, appellant's ratio of audited credit card deposits of \$777,372 to appellant's reported total sales of \$795,249 was too high, indicating that appellant's cash sales were understated. Thus, CDTFA concluded that appellant's tax returns were unreliable and that further investigation was warranted.
3. CDTFA requested that appellant retain its daily sales reports for 23 days, from November 11, 2014 through December 4, 2014. These reports show that appellant's food sales comprised 43.97 percent of appellant's total sales, appellant's shisha sales were 56.03 percent of the total, and appellant's credit card sales comprised 84.55 percent of appellant's total sales. Using these ratios, CDTFA determined that appellant underreported its taxable sales and issued an NOD based on an aggregate measure of tax of \$750,362, consisting of two audit items: 1) unreported taxable food sales of \$305,603; and 2) unreported taxable shisha² sales of \$444,759. Appellant concedes audit item 1.
4. Appellant does not dispute CDTFA's calculation of the measure of tax in audit item 2, but instead contends that most of this amount represents nontaxable hookah rentals. Appellant concedes that the sale of shisha to its customers is taxable, but that most of the transaction charges included in audit item 2 are nontaxable hookah rentals.³
5. There were no written rental agreements regarding the hookahs.
6. Appellant's menu from November 19, 2014, advertises a "\$10 SHEESHA SPECIAL ALL DAY, EVERY DAY TILL 6 PM" under which is a list of 33 "hookah flavors" from which appellant's customers could choose.
7. This timely appeal followed.

² "Shisha" (or Sheesha) is a product that is a mix of molasses and fruit flavors, which is mixed with tobacco and then smoked through a hookah. A hookah is a single or multi-stemmed instrument for vaporizing and smoking in which vapor is passed through a water basin before inhalation.

³ Generally, a lease of tangible personal property for consideration is subject to sales or use tax, measured by the rental receipts. (§§ 6006(g), 6010(e).) However, the term "lease" does not include certain restricted grants of a privilege to use property. To fall within the exclusion, the use of tangible personal property must be for a period of less than one continuous 24 hours, for a charge of less than \$20, and the use must be restricted to the premises or business location of the grantor of the privilege. (Cal. Code Regs., tit. 18, § 1660(e)(1).)

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.)

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 an NOD, 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 an NOD, 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. (Cal. Code Regs., tit. 18, § 30219(c).) 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 (*Paine*); *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

Here, CDTFA's analysis of appellant's credit card deposits indicates that appellant did not report all of its taxable sales on its sales and use tax returns. CDTFA based its deficiency determination on appellant's own daily sales reports arising from the 23-day test period, and appellant concedes the computation of the deficiency assessment. Accordingly, CDTFA has established that its determination is reasonable and based on the best-available evidence.

Appellant disputes the measure of tax in audit item 2, contending that an unspecified portion of each shisha transaction charge consists of nontaxable hookah rentals.⁴ Appellant contends that it provides its customers with a menu of shisha flavors, from which they order the flavor they want. Appellant then brings the shisha and a hookah to the table and charges the customer for the transaction, which it contends is primarily for the use of appellant's hookah by the customer. However, there is no evidence in the record of any written hookah rental contracts, and no evidence that appellant offered its customers any hookah rentals, such as by the hour, half-day, or otherwise. Appellant admits that it sold shisha to its customers, and the only documentary evidence in the record (i.e., appellant's menu advertising a \$10 "sheesha special" all-day happy hour price on 33 different flavors of shisha) does not mention that appellant charged for the use of its hookahs. Accordingly, we conclude that appellant has failed to establish that any reductions are warranted to the measure of unreported shisha sales in audit item 2.

HOLDING

Appellant has not established that reductions are warranted to the measure of unreported taxable shisha sales.

⁴From abundant caution, we note that even though tax does not apply to the gross receipts from the alleged hookah rentals, tax might apply to the cost of any alleged hookah rentals, if appellant purchased them without paying tax or tax reimbursement. (Cal. Code Regs., tit. 18, § 1660(e)(4).)

DISPOSITION

We sustain respondent's action in full.

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

We concur:

DocuSigned by:
Nguyen Dang
4D465973FB44469...
Nguyen Dang
Administrative Law Judge

DocuSigned by:
kenneth Gast
FD75A3136CB34C2...
Kenneth Gast
Administrative Law Judge