

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 18011943  
 )  
**NOEL HERRERA LAUREL AND** ) Date Issued: May 15, 2019  
 )  
**LUZ MARIA IBARRA HERRERA** )  
 )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellant: Peter P. Guerrero

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

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

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Noel Herrera Laurel and Luz Maria Ibarra Herrera (appellants) appeal a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) assessing a tax deficiency of \$81,103.73,<sup>1</sup> plus applicable interest for the audit period April 1, 2011 through March 31, 2014 (audit period).

Appellants waived their right to an oral hearing; therefore, we decide the matter based on the written record.

**ISSUE**

Have appellants shown that adjustments should be made to the unreported taxable sales during the audit period?

---

<sup>1</sup> The Notice of Determination (NOD) that was issued following an audit of appellants’ business proposed additional tax of \$91,321.92. Based on the decision issued by the Appeals Bureau (Decision), CDTFA re-audited and determined that the tax due for the audit period is \$81,103.73.

## FACTUAL FINDINGS

1. During the audit period, appellants co-owned a business known as El Comal Antojitos Bar & Grill, in San Diego.<sup>2</sup> The business operated primarily as a Mexican-style restaurant with an associated bar. Appellants reported that the business had catering sales as well as in-restaurant food and beverage sales.
2. Appellants supplied CDTFA with federal income tax returns for 2011 and 2012; income statements for April 2011 through December 2013, and bank statements for all months in the audit period except for December 2013. Appellants did not provide source documents such as cash register Z-tapes and purchase invoices.
3. Appellants used a single-entry accounting system, and reported total sales to their bookkeeper at the end of each month. From those reports, appellants' bookkeeper prepared and filed appellants' sales and use tax returns (SUTR's).
4. The auditor determined that recorded sales shown on appellants' income statements exceeded the sales reported on the SUTR's for the last three quarters of 2011. Recorded and reported sales matched for 2012 and 2013.
5. The auditor compared sales with purchases recorded on the income statements and computed a markup believed to be lower than the markup that would be expected for this business.<sup>3</sup>
6. The auditor compared reported income on appellants' 2011 federal tax return (Schedule C) to reported receipts on the SUTR's for that year. CDTFA computed that appellants reported at least \$17,970 less on their SUTR's than they reported on their federal tax return. In addition, appellants reported \$347,109 of "other income" that had not been reported on the SUTR's. Appellants contended it was catering income; however, when given the opportunity to present evidence showing the origin of those receipts and whether they were paid using credit or cash transactions, appellants did not respond.

---

<sup>2</sup> Appellants incorporated the business in 2016; however, for the entire audit period appellants co-owned the restaurant and reported business income and deductions as sole proprietors. For sales and use tax purposes, appellants are considered to be operating as a partnership.

<sup>3</sup> CDTFA provided no supporting evidence showing the expected markup for similar restaurants in similar areas, during a same or similar period of time. The auditor used this as only one of the bases for his decision to perform further testing.

7. Based on the bank statements, credit card deposits (no cash included) totaled \$1,371,404 for the audit period. The credit card deposits exceeded reported total sales during the same timeframe by \$830,377 (\$1,371,407 - \$541,030).<sup>4</sup>
8. CDTFA used an alternate method to establish appellants' taxable sales. CDTFA used the credit-card-sales ratio method after conducting three, one-day observations; on Friday, June 27, 2014, on Monday, June 30, 2014, and on Sunday, July 6, 2014. CDTFA computed credit card sales ratios to be 63.22 percent, 63.30 percent, and 68.55 percent, respectively. The resulting credit-card-sales ratio for the three-day observation period was 66.30 percent.
9. CDTFA adjusted the credit card sales for nontaxable tips and tax-included amounts, divided the result by 66.30 percent credit-card-sales ratio, and computed that appellants had unreported gross receipts of \$1,148,045 for the audit period and owed additional tax of \$91,321.92. Because of a mathematical error, CDTFA re-audited and adjusted the unreported gross receipts to \$1,118,672, with an additional tax liability of \$81,103.73, plus applicable interest.
10. Appellants timely appealed CDTFA's use of the 66.30 percent credit-card-sales ratio to determine unreported sales, contending that "credit card sales are 90-95% of ... total gross sales." They also seek a "compromise agreement."

### DISCUSSION

California imposes a sales tax on retail sales of tangible personal property, measured by the retailer's gross receipts,<sup>5</sup> unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All gross receipts are presumed to be subject to sales tax, unless the retailer can prove otherwise. (R&TC, § 6091.) Although sales 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. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).) Alcoholic beverages are not considered to be "food products," and therefore sales of alcoholic beverages are subject to tax. (R&TC,

---

<sup>4</sup> Because appellants did not provide a bank statement for December 2013, the auditor used the average monthly credit card deposits for the other months in the audit period, and included the estimate in the total.

<sup>5</sup> The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (R&TC, § 6012(a).)

§ 6359(b)(3).) In addition, tax applies to the entire charge made by a caterer for serving meals, including labor for serving meals. (Cal. Code Regs. tit. 18, § 1603(i).)

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. (R&TC, § 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. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer challenges a 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, in circumstances where a taxpayer challenges the additional tax proposed, the government bears the initial burden of establishing a *prima facie* case that taxes are owed. (*Schuman Aviation Co. Ltd. v. U.S.* (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 NOD, CDTFA must establish a *prima facie* case that taxes are owed by proving the factual basis for any deficiency and providing evidence sufficient to establish that its determination is reasonable.

Where CDTFA has established its *prima facie* case, the burden of proof shifts to the appellants to explain the disparity between its own books and records and the results of CDTFA's audit. (*Riley B's, Inc., supra*, at p. 616.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) 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 that CDTFA's determination is incorrect, and must produce evidence of 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, CDTFA analyzed the evidence provided by appellants and determined that discrepancies existed between appellants' SUTR's and its income statements, bank statements, and tax returns. Neither the income statements, the bank statements, nor the tax returns matched the amount of gross receipts and sales tax reported by appellants. Moreover, the gross receipts

reported in the documents did not correspond to the other documents appellants provided. Appellants did not provide evidence supporting the amounts reported on their statements and income tax returns.

Because of discrepancies between appellants' records and reported sales, CDTFA found appellants' records unreliable and used an alternate method to establish appellants' taxable sales and the correct amount of tax. CDTFA used the credit-card-sales ratio method after conducting three, one-day observations on Friday, June 27, 2014, on Monday, June 30, 2014, and on Sunday, July 6, 2014. CDTFA computed credit card sales ratios to be 63.22 percent, 63.30 percent, and 68.55 percent, respectively. The resulting credit-card-sales ratio for the three-day observation period was 66.30 percent. CDTFA performed reasonableness tests to confirm that the audit findings appeared to be correct. For example, during the observation test, daily sales totaled \$1,529. The audit resulted in similar average daily sales of \$1,516. Also, credit card sales deposits into appellants' bank were more than double the amount reported by appellants, without including any cash sales. This shows that appellants substantially understated their gross receipts. Appellants failed to provide sufficient books and records to determine their sales tax liability, and therefore, CDTFA used a reasonable alternative method to obtain information with which to redetermine appellants' tax liability. The NOD has a rational basis, and the burden shifts to appellants to show that it is incorrect. (*Schuman Aviation Co. Ltd., supra*, at p. 950.)

On appeal, appellants assert that the credit-card-to-cash ratio is incorrect. They claim that credit card sales make up 90 to 95 percent of their sales. Appellants have failed to support that claim with any evidence. Accordingly, we conclude that appellants have failed to establish that CDTFA's determination for the audit period is incorrect.

Appellants also ask for a "compromise agreement." The Office of Tax Appeals has no authority to compromise a tax liability, and our jurisdiction is limited to determining the correct amount of an appellant's tax liability. (*Appeal of Dauberger, et al.*, 82-SBE-082, 1982 WL 11761.) CDTFA has various programs that appellants may wish to explore when this appeal is concluded.<sup>6</sup>

---

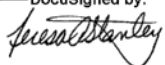
<sup>6</sup> Information on settlement programs may be found on CDTFA's website at: <<https://www.cdtfa.ca.gov/legal>>.

HOLDING

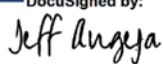
Appellants have not established that adjustments should be made to the unreported taxable sales during the audit period.

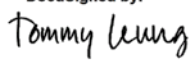
DISPOSITION

CDTFA's action is sustained.

DocuSigned by:  
  
0CC6C8ACCC8A44D  
Teresa A. Stanley  
Administrative Law Judge

We concur:

DocuSigned by:  
  
0D390BC3CCB14A9...  
Jeffrey G. Angeja  
Administrative Law Judge

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