

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
VIET RESTAURANT, INC.

) OTA Case No. 18113989
) CDTFA Case ID 933605
) CDTFA Account No. 101-546511
)
) Date Issued: July 23, 2019
)

OPINION

Representing the Parties:

For Appellant: Andy Yu, CPA

For Respondent: Scott A. Lambert, Hearing Representative

For Office of Tax Appeals: Deborah Cumins,
Business Tax Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Viet Restaurant, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant’s timely petition for redetermination of a Notice of Determination (NOD) for \$74,263.21 of additional tax, a negligence penalty of \$7,426.38, and applicable interest, for the period April 1, 2012, through March 31, 2015.

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

ISSUES

1. Whether appellant established that adjustments are warranted to the understatement of reported taxable sales.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated a restaurant in a food court in the Westfield Culver City shopping mall in Culver City, California, from March 18, 2010, through March 31, 2015, when it abandoned the business.¹
2. For the audit period, appellant reported total and taxable sales of \$576,636 (i.e., appellant claimed no deductions).
3. Appellant provided limited records for audit, including federal income tax returns (FITR's) for 2012, 2013, and 2014, 1099-K forms² showing credit card receipts for 2013, and bank statements from a Wells Fargo bank account for the period April 2012 through March 2015.
4. CDTFA found that gross receipts reported on the FITR's exceeded total sales reported on the sales and use tax returns (SUTR's) by \$103,520 for 2012, \$123,442 for 2013, and \$158,000 for 2014. Also, CDTFA concluded that appellant had additional bank accounts for which it had not provided deposit information because: a) there were no credit card deposits on the bank statements provided by appellant, and b) there were numerous transfers from other accounts into the bank account for which statements were provided. CDTFA found these records incomplete and unreliable.
5. CDTFA obtained the sales information provided by appellant to the Westfield Culver City mall management and found that appellant had reported to the mall sales of \$1,504,035 for the audit period. CDTFA considered those amounts tax-included, and it computed \$1,376,357 taxable sales, excluding tax, which exceeded reported amounts of \$576,636 by \$799,721. CDTFA concluded that the understatement was the result of negligence.
6. On January 15, 2016, CDTFA issued an NOD for additional tax due of \$74,263.21, a negligence penalty of \$7,426.38, and applicable interest.
7. On January 23, 2016, appellant filed a timely petition for redetermination.

¹ According to CDTFA's audit workpapers, on August 4, 2015, Andy Yu, CPA, reported to CDTFA that the owner was behind on his rent payments, had walked away from the business, and was in Vietnam.

² Federal Form 1099-K, "Payment Card and Third Party Network Transactions," is a form used by credit card companies and third-party processors (payment settlement agencies) to report the gross amount of reportable payments made to the taxpayer by the payment settlement agency.

8. On October 30, 2018, CDTFA issued a Decision, denying the petition for redetermination.
9. This timely appeal followed.

DISCUSSION

Issue 1. Whether appellant established that adjustments are warranted to the understatement of reported taxable sales.

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. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 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. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).)

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

When 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. (See *Schuman Aviation Co. Ltd. v. U.S.* (2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Michael E. Myers* (2001-SBE-001) 2001 WL 37126924.) 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. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *Ibid*; see also *Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.)

Here, the books and records appellant provided for audit were incomplete. Specifically, appellant provided no accounting records such as sales or purchase journals, a general ledger, or

financial statements, and it provided no source documents such as guest checks, cash register tapes, or purchase invoices. Further, appellant held other bank accounts for which it did not provide bank statements. In addition, the gross receipts reported on appellant's FITR's exceeded total sales reported on its sales and use tax returns by \$103,520 for 2012, \$123,442 for 2013, and \$158,000 for 2014. Each of these is a sufficient reason to question the reliability of appellant's reported taxable sales. (R&TC, § 6481.) Accordingly, we find that CDTFA was justified in questioning the reliability of appellant's reported taxable sales and computing appellant's taxable sales using an alternate method.

To establish audited sales, CDTFA relied on sales amounts that appellant reported to mall management.³ We find that sales information filed by appellant with a third party is a reliable source of data from which to establish audited sales. Thus, we conclude that CDTFA has established that its determination is reasonable and rational, and accordingly the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

On appeal, appellant asserts that it reported inflated sales amounts to mall management. Appellant's opening brief states that appellant does not know how the sales were reported to mall management, but it assumes the sales were inflated in order to retain the lease of the business premises. Appellant has not provided any evidence to support this assertion or to make a more accurate determination, such as business records, supported by source documents, along with worksheets showing the computation of the inflated figures reported to mall management. Instead, appellant simply argues that the audit should be based on the credit card sales ratio method.⁴

In this case, CDTFA based its determination on information that *appellant* reported to mall management. Appellant has not submitted any evidence to show that the sales it reported to mall management were incorrect or overstated, nor has appellant provided any evidence from

³ There is insufficient information to do a bank deposit analysis because appellant failed to provide all of its bank statements.

⁴ There is insufficient information for CDTFA to utilize the credit card sales ratio in this case. Appellant has not provided reliable records from which a credit card to total sales ratio could be computed. Further, since the business had been abandoned before the audit began, CDTFA did not have the option to conduct an observation test from which it could compute a credit card to total sales ratio. Also, appellant provided information regarding credit card receipts for only a portion of the audit period. Accordingly, it is not feasible to use the credit card sales ratio method in this case.

which a more accurate determination may be made. Accordingly, appellant has failed to establish that any reductions to the determined measure of tax are warranted.

Issue 2. Whether appellant was negligent.

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto.

As noted previously, taxpayers are required to maintain and make available to CDTFA for examination 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 sales and use tax returns. (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).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal Code Regs., tit. 18, § 1698(k).)

A negligence penalty should be upheld in a first audit if the understatement cannot be attributed to a bona fide and reasonable belief that the bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (See *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167 Cal App.2d 318, 321-324.)

Here, appellant failed to report taxable sales of \$799,721, which represented an error rate of 138.69 percent when compared to reported taxable sales of \$576,636. The significant level of understatement is strong evidence of negligence. Also, there is no question that appellant provided incomplete and inadequate records, which is also evidence of negligence. (See Cal. Code Regs., tit. 18, § 1698(k).) Further, the amount of gross receipts reported on appellant's FITR's exceeded amounts of total sales reported on SUTR's by more than \$100,000 for each of the years 2012, 2013, and 2014, with a total of \$384,962 for the three years. Appellant must have been aware those sales had been made since it reported them on FITR's, and appellant has

offered no viable explanation for its failure to report almost \$400,000 on its SUTR's. Moreover, the audited understatement is based on amounts that appellant, itself, reported to mall management, and it has not shown those figures to be incorrect.

We find all these facts to be strong evidence of negligence. Further, although this is the first audit of appellant, we find that its failure to report significant amounts of sales of which it must have been fully aware cannot be attributed to a bona fide and reasonable belief that its bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. Accordingly, we find that the negligence penalty was properly applied.

HOLDINGS

1. Appellant has failed to establish that adjustments are warranted to the audited understatement of reported taxable sales.
2. Appellant was negligent, and the penalty was properly applied.

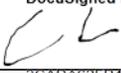
DISPOSITION

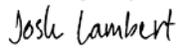
CDTFA's action in denying the petition for redetermination is sustained.

DocuSigned by:

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 Jeffrey G. Angeja
 Administrative Law Judge

We concur:

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 Andrew J. Kwee
 Administrative Law Judge

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 Josh Lambert
 Administrative Law Judge