OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18012053
	) CDTFA Acct. No. SY DF 100-246113
GURDEEP SINGH BRAR AND	) CDTFA Case ID: 734225
GURMAKH SINGH SRAN	)
	) Date Issued: October 15, 2019
	)

OPINION

Representing the Parties:

For Appellant:	Amandeep Singh, CPA Gurdeep Singh Brar Gurmakh Singh Sran
For Respondent:	Scott Lambert, Hearing Representative Lisa Renati, Hearing Representative Chris Brooks, Tax Counsel IV
For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC), section 6561, the partnership of Gurdeep Singh Brar and Gurmakh Singh Sran (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying, in part, appellant's petition for redetermination of a Notice of Determination (NOD) issued on May 6, 2013. The NOD proposed to assess a tax liability of $29,421.96, plus accrued interest, and a negligence penalty of $2,942.24 for the period January 1, 2009, through December 31, 2011 (audit period).

Office of Tax Appeals (OTA) Administrative Law Judges, Andrew J. Kwee, Neil Robinson, and Jeffrey G. Angeja, held an oral hearing for this matter in Fresno, California, on August 29, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of the BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22) For ease of reference, when referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to the BOE; and when referring to acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

ISSUE

Whether any additional reduction to the measure of unreported taxable sales is warranted.

FACTUAL FINDINGS

1. Appellant operated five separate businesses in California during the audit period, including 1) a liquor store in Tulare (Lucky Liquors); 2) a gas station with a mini-mart in Lemoore (Lemoore); 3) a gas station with a mini-mart in Firebaugh (Firebaugh); 4) a market in Selma (Royal Market); and 5) a 98¢ store in Mendota (98¢ and Gifts).
2. For audit, appellant provided its federal income tax returns (FITR's) for 2009, 2010, and 2011, year-end sales summaries for 2009 and 2010, and profit and loss statements for 2011 for all five locations combined, merchandise purchase invoices, and sales and use tax return worksheets.
3. CDTFA used the markup method to compute audited taxable sales of $564,891 for Lucky Liquors. Because it found that the difference of $24,491 between audited taxable sales and appellant's reported taxable sales of $540,400 for Lucky Liquors was not material, CDTFA accepted the accuracy of appellant's reported taxable sales for that location.
4. For the Firebaugh and Lemoore gas stations, CDTFA accepted the accuracy of appellant's reported taxable sales of $13,078,700 (combined) after computing audited taxable sales of $12,975,026 using the mark-up method for the mini-marts and extending appellant's purchases of gasoline and diesel fuel to retail prices using average retail fuel selling prices obtained from the U. S. Department of Energy.
5. CDTFA obtained information from appellant's supplier, Phillip Morris, establishing that appellant received taxable cigarette rebates of $24,474 in connection with appellant's cigarette sales at the Lemoore location. Appellant did not report the cigarette rebates on its sales and use tax returns during the audit period. Accordingly, CDTFA assessed tax on the rebates on an actual basis, using the information provided by Phillip Morris, as well as appellant's income tax returns.
6. For Royal Market, CDTFA compared appellant's reported taxable sales with its recorded costs of taxable merchandise sold, and computed a book markup of 31.52 percent, which it found was reasonable for a market. However, because appellant's recorded beer purchases represented 91.60 percent of the total recorded taxable merchandise purchases,

and CDTFA's observation of the taxable merchandise on display in the market indicated that beer purchases represented approximately half of the taxable merchandise available for sale, CDTFA concluded that recorded taxable merchandise purchases were understated. Based on information it obtained from appellant's known beer suppliers, CDTFA established audited beer purchases of $141,580 for the audit period. CDTFA divided that amount by 50 percent to establish audited taxable merchandise purchases of $283,159, which it then reduced by 2 percent for pilferage to establish audited costs of taxable merchandise sold of $277,496 for the audit period. CDTFA compared costs for various taxable products shown in merchandise purchase invoices for August 2012 with their respective selling prices on September 4, 2012, and computed a weighted average markup of 40 percent for taxable merchandise. CDTFA then added the weighted average markup to audited costs of merchandise sold to establish audited taxable merchandise sales of $388,495 for the audit period.

7. To establish audited taxable sales of hot prepared food products for Royal Market, CDTFA began by examining the merchandise purchase invoices for October 2011, from which it computed that the tortillas and tortas purchased that month represented 1,537 hot food items. CDTFA reduced the number of tortillas and tortas purchased by a spoilage allowance of 5 percent to compute that appellant sold 1,460 hot food items during October 2011. Applying the selling prices provided orally by appellant to the number of hot food items sold, CDTFA established audited taxable sales of hot food products of $2,791 for the one-month period, and $33,493 for the year. A comparison of audited taxable sales of hot food products with appellant's reported taxable sales for 2011 showed a ratio of taxable sales of hot food to reported taxable sales of 43.84 percent. CDTFA applied that ratio to appellant's reported taxable sales for the audit period to establish audited taxable sales of hot prepared food products of $99,954.

8. CDTFA added audited taxable merchandise sales of $388,495 for Royal Market to audited taxable sales of hot prepared food products to establish audited taxable sales of $488,449, which exceeded appellant's reported taxable sales for Royal Market by $260,448.

9. For appellant's fifth location, 98¢ and Gifts, appellant estimated that 90 percent of its sales were taxable and 10 percent of its sales were exempt sales of food products. In the

absence of cash register tapes to support the reported taxable and claimed exempt sales, CDTFA examined the merchandise purchase invoices for 98¢ and Gifts for the period July 15, 2011, through December 22, 2011, and computed that 3.46 percent of the purchases were of nontaxable merchandise. CDTFA multiplied recorded total sales of $785,806 by 3.46 percent to establish audited exempt sales of $27,189, which it then subtracted from recorded total sales to establish audited taxable sales of $758,617. CDTFA found that audited taxable sales exceeded appellant's reported taxable sales for that location by $92,016.

10. On May 6, 2013, CDTFA issued an NOD to appellant based on unreported taxable sales of $352,464 ($260,448 for Royal Market plus $92,016 for 98¢ and Gifts), unreported taxable cigarette rebates of $24,474, and a credit of $3,549.00 for overpayments of prepaid sales tax to a fuel distributor established in the audit. Additionally, the NOD included a 10 percent penalty for negligence. Appellant timely filed a petition for redetermination, disputing only the amount of unreported taxable sales.

11. CDTFA increased the spoilage allowance for tortillas and tortas purchased by Royal Market from 5 percent to 10 percent of purchases, and further reduced audited purchases of tortillas and tortas to allow for self-consumption of two tacos and two burritos per day. Additionally, CDTFA reduced audited taxable sales of hot prepared food products by $2,762 to allow for a suspension of appellant's health permit, which it estimated to be for one month. For 98¢ and Gifts, CDTFA corrected a purchase segregation error, which increased the exempt sales ratio from 3.46 percent to 3.58 percent. Overall, CDTFA's adjustments resulted in a reduction of $8,969 to the amount of unreported taxable sales, from $352,464 to $343,495.

12. In a Decision and Recommendation issued on December 31, 2014, CDTFA reduced the measure of tax for unreported taxable sales by $8,969, from $352,464 to $343,495 (as described above), and also deleted the negligence penalty. This appeal followed.

DISCUSSION

California imposes 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 derived from the sale of "food products" are generally exempt from the sales tax, sales of food served at a restaurant and sales of hot food are subject to tax. (R&TC, § 6359, subds. (a), (d)(2), (d)(7).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, 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.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of 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 Magidow* (82-SBE-274) 1982 WL 11930.)

In this case, appellant operated five separate locations during the audit period. As noted above, CDTFA accepted appellant's reported taxable sales at three locations (Lucky Liquors, Firebaugh, and Lemoore), used a mark-up audit method to compute a deficiency at the fourth location (Royal Market), and accepted reported total sales but disallowed claimed nontaxable sales at the fifth location (98¢ and Gifts).

Royal Market

For Royal Market, appellant failed to provide sales records, such as cash register tapes and sales summaries, to support its reported amounts. Furthermore, appellant's recorded purchases for Royal Market were understated. Each of these is a sufficient reason for CDTFA 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 for Royal Market, and computing appellant's taxable sales using an alternate method. In computing the taxable sales for this location, CDTFA used audited purchases and a weighted mark-up using appellant's own records and information. Accordingly, we conclude that CDTFA's determination was reasonable, rational, and based on appellant's own records. Thus, the burden shifts to appellant to provide evidence to establish a more accurate determination.

On appeal, appellant contends that CDTFA did not conduct a "shelf test," as required by CDTFA's Audit Manual,[2] but instead established the weighted average markup of 40 percent based on a cursory visual observation. Additionally, appellant asserts that it routinely transferred some of the merchandise it purchased for Royal Market to other locations, and therefore, the costs of goods sold that CDTFA used in the markup analysis for Royal Market were overstated. Regarding its taxable sales of hot prepared food products, appellant contends that CDTFA failed to take the cyclical nature of its business into account. According to appellant, it made sales primarily to farm workers, such that its sales peaked during harvesting season and the summer months of May, June, July, and August, and were sluggish during the rest of the year. Therefore, appellant contends that the test period of one month (October 2011) was too short to accurately reflect its sales, and argues that the test period should have been extended to include at least four months. Additionally, appellant asserts that CDTFA failed to take into account the full length of time that it did not sell hot prepared food products after its health permit was suspended.

Here, we note that CDTFA conducted a shelf test to compute average markups for five merchandise categories, including beer, cigarettes, soda, soda fountain, and miscellaneous taxable merchandise. CDTFA then conducted a purchase segregation test, in which it computed ratios of purchases in each merchandise category to total purchases. Since beer purchases represented 73.51 percent of the total purchases in the test, it was clear that the purchase invoices available for the purchase segregation test were incomplete because appellant's recorded beer purchases represented 91.60 percent of the total recorded taxable merchandise purchases. However, CDTFA used the ratios from the purchase segregation test to compute a weighted average markup because the average markup for beer was lower than the markups for the other merchandise categories, such that using the ratios from the purchase segregation test resulted in a lower weighted average markup than might be expected and therefore benefitted appellant.

While CDTFA did not rely on visual observations to establish the audited weighted average markup, as appellant claims, CDTFA did rely on documented beer purchases and its visual observation that beer represented approximately half of the taxable merchandise available for sale to establish total merchandise purchases. Considering appellant's failure to provide evidence to support a different method, we find that CDTFA's method of estimating total

[2] A "shelf test" is a comparison of known product costs and corresponding selling prices, generally, for at least one complete purchasing cycle, used to compute markups.

merchandise purchases based on documented beer purchases and its visual observation was reasonable. While appellant claims that it routinely transferred merchandise from Royal Market's inventory to other locations, such that total merchandise purchases were overstated in the markup analysis, appellant has provided no documentation or other evidence to support its assertion. In the absence of reliable records of costs of goods sold, we find that audited taxable merchandise sales for Royal Market were established based on the best available evidence, and conclude that no reduction is warranted.

Regarding appellant's contention that CDTFA failed to take the seasonal nature of its business into account when it established audited taxable sales of hot prepared food products, we note that appellant failed to provide any documentary evidence, such as cash register tapes or sales summaries, to show that the test period of October 2011 did not accurately represent its sales because its business was seasonal. To support its contention that CDTFA failed to account for the full length of time that it was unable to sell hot prepared food products after its health permit was suspended, appellant provided a copy of a Fresno County food facility inspection report dated February 28, 2011, which ordered appellant to stop selling hot food products until it received written approval to resume its operations. However, hot food sales represented 44 percent of appellant's sales at the Royal Market location, which is a significant portion of appellant's sales at this location. Therefore, we would expect appellant to have remediated the suspension as quickly as possible. Without documentary evidence that the suspension lasted longer than one month, such as written approval from the Fresno County Health Department, we find that an allowance for a one-month suspension is reasonable. In the absence of documentation or other evidence to support a reduction to the amount of audited taxable sales of hot prepared food products, we conclude that no reduction is warranted.

98¢ and Gifts

For the 98¢ and Gifts location, appellant estimated claimed exempt sales of food products, and failed to provide cash register tapes or other sales records to verify the accuracy of its estimated amounts. In the absence of cash register tapes to support the reported taxable and claimed nontaxable sales, we find that CDTFA was justified in questioning appellant's reported sales for this location (R&TC, § 6481), and in using appellant's purchase invoices for this location to compute that 3.58 percent of the purchases were of nontaxable merchandise, rather than 10 percent as appellant estimated. Therefore, the burden of proof is on appellant to

establish by documentation or other evidence that a reduction to the amount of audited taxable sales is warranted.

On appeal, appellant contends that 10 percent of its sales were exempt sales of food products, and argues that CDTFA's methodology of applying a nontaxable purchase ratio to total sales would reflect nontaxable sales accurately only if the markups for nontaxable merchandise and taxable merchandise were the same. Appellant estimates that its average markups on nontaxable and taxable merchandise were 350 percent and 45 percent, respectively. Appellant applied those markups to its recorded nontaxable and taxable merchandise purchases for the period July 15, 2011, through December 22, 2011, to compute exempt sales, taxable sales, and total sales for that period. Appellant then divided the exempt sales amount thus computed by the total sales amount to show an exempt sales ratio of 10.33 percent. Because appellant claimed 10 percent of its total sales as exempt sales of food products, appellant asserts that its reported amounts for this location were accurate.

Here, appellant admitted that it estimated that 10 percent of its total sales at 98¢ and Gifts were exempt for reporting purposes, and appellant has provided no cash register tapes or other documentation to demonstrate that its claimed exempt sales were accurate. While appellant was able to calculate an exempt sales ratio of 10.33 percent based on estimated average markups of 350 percent for nontaxable merchandise and 45 percent for taxable merchandise, appellant has provided no documentation supporting those estimated average markups. In the absence of documentation or other evidence supporting a different result, we find that CDTFA's method of applying the nontaxable merchandise purchase ratio of 3.58 percent to reported total sales to compute audited exempt sales was based on the best available information, and we conclude that no reduction to the amount of unreported taxable sales for 98¢ and Gifts is warranted.

Lucky Liquors, Firebaugh, and Lemoore

Next, appellant contends that, instead of accepting the accuracy of its recorded and reported taxable sales of $540,400 for Lucky Liquors and $13,078,700 for the Firebaugh and Lemoore gas stations, combined, CDTFA should have relied on the audited taxable sales of $564,891 for Lucky Liquors and $12,975,026 for the Firebaugh and Lemoore gas stations, which would result in a reduction of $79,183 to the audited understatement of reported taxable sales. Essentially, appellant contends that the accuracy of its recorded and reported taxable sales should not be accepted, and instead, we should give it credit for an alleged net overreporting of its

taxable sales at two other locations. However, appellant used cash register tapes to record its sales for the Firebaugh and Lemoore gas stations in sales and use tax return worksheets, and then reported those same amounts on its sales and use tax returns. Based on appellant's method for recording and reporting its sales for those locations, we would expect appellant's sales to be at least as much as it recorded. Therefore, we find it highly unlikely that appellant overstated its reported taxable sales, and without evidence that appellant's reported sales are inaccurate, we reject appellant's contention that it should be given credit for an overstatement.

Cigarette Rebates

Finally, appellant contends that CDTFA's proposed assessment of tax on the cigarette rebates is erroneous because it is based on inaccurate estimates. Appellant does not dispute that tax applies to cigarette rebates (see Cal. Code Regs., tit. 18, § 1671.1, subd. (c)). Here, CDTFA based its assessment on information received from Phillip Morris, as well as appellant's federal income tax returns. Accordingly, we find that CDTFA's determination is reasonable and rational. Appellant has provided no evidence to warrant any adjustments to the proposed assessment of tax on the cigarette rebates, and has therefore failed to meet its burden of proof.

HOLDING

No additional reduction to the measure of unreported taxable sales is warranted.

DISPOSITION

CDTFA's action in reducing the measure of tax for unreported taxable sales to $343,495 (which reduces the total determined measure of tax to $367,969), deleting the negligence penalty but otherwise denying the petition, is sustained.

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Neil Robinson
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Neil Robinson
Administrative Law Judge