OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18032507) CDTFA Account No. 102-239685
CHARLIE'S PANTRY HOLDINGS, LLC	) CDTFA Case ID 914342)
	) Date Issued: October 18, 2019)

OPINION

Representing the Parties:

For Appellant:	Mikayel Israyelyan, former LLC Member Talin V. Yacoubian, Attorney
For Respondent:	Kevin C. Hanks, Chief, Headquarters Operations Bureau
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, Charlie's Pantry Holdings, LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petitions for redetermination of the Notice of Determination (NOD) issued on July 23, 2015. The NOD is for $172,617.51 in tax plus accrued interest, a penalty for failure to file returns of $2,031.04[2], and a penalty for negligence of $15,230.80 for the period June 1, 2012, through August 31, 2014 (audit period). On October 31, 2016, pursuant to R&TC section 6563, CDTFA timely notified appellant that it was asserting an increase, and the revised total was $205,870.69 in tax plus accrued interest, a failure-to-file penalty of $2,423.40, and a negligence penalty of $18,163.68 for the audit period.

[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.

[2] Appellant has not protested the imposition of the failure-to-file penalty, and therefore we decline to address it.

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

ISSUES

1. Whether any reduction to the measure of unreported taxable sales is warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant obtained a seller's permit with an effective start date of June 1, 2012, and closed out the seller's permit effective August 31, 2014. Appellant operated two restaurants offering casual dining and catering services, and another restaurant with counter sales of rotisserie chickens during the audit period.
2. Appellant did not provide any books and records for audit. Therefore, CDTFA obtained appellant's California state income tax return for 2013. A comparison of the gross receipts reported on the income tax return with appellant's reported taxable sales for 2013 showed an understatement of reported taxable sales. CDTFA computed a reporting error rate for 2013, and applied the error rate to appellant's reported taxable sales for the audit period to establish unreported taxable sales of $1,926,145.
3. On July 23, 2015, CDTFA issued the NOD for this liability. CDTFA added a 10-percent penalty for failure to file a return for the third quarter of 2014. Also, CDTFA added a 10-percent penalty for negligence to the liability established for the remaining quarters in the audit period.
4. CDTFA obtained 1099-K reports that showed appellant's deposits of proceeds from sales paid by credit card or debit card (credit card sales) totaling $3,235,044 for the audit period. Based on its estimate that 80 percent of appellant's sales were credit card sales and 20 percent were paid with cash, CDTFA computed total sales of $4,034,805, including sales tax reimbursement, in a reaudit. CDTFA then made adjustments to exclude sales tax reimbursement, and established audited taxable sales of $3,711,175, which exceeded appellant's reported taxable sales for the audit period by $2,296,344.
5. On October 31, 2016, pursuant to R&TC section 6563, CDTFA timely asserted an increase to the July 23, 2015 NOD and notified appellant of the increased liability by issuing a Statement of Liability Balances asserting tax of $205,870.69 plus accrued

interest, a failure-to-file penalty of $2,423.40, and a negligence penalty of $18,163.68 for the audit period.

6. Two of appellant's LLC members timely filed petitions for redetermination, each contending that they should not be held personally liable for appellant's liabilities.
7. CDTFA denied the petitions, and this timely appeal followed.
8. By letter dated February 4, 2019, CDTFA confirmed that it has not issued any Notice of Determination to any individual for appellant's unpaid tax liabilities.

DISCUSSION

Issue 1 - Whether any reduction to the amount of unreported taxable sales is warranted.

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 prepared food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359, subds. (a), (d)(1), (d)(2), and (d)(7).)

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.* (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.)

Here, appellant failed to provide any records to support the amounts of its reported sales. The gross receipts reported on appellant's California state income tax returns are evidence of its sales, and we find that it was reasonable for CDTFA to establish audited taxable sales based on

the reported gross receipts in the absence of any other records. However, we find that the third-party information provided in the 1099-K reports constitutes stronger evidence of appellant's sales, and thus, we find that it was reasonable for CDTFA to assert an increase using the 1099-K reports to perform a credit card sales ratio analysis. Therefore, the burden shifts to appellant to provide documentation or other evidence to demonstrate that a reduction to the amount of audited taxable sales is warranted.

Appellant has provided neither argument nor evidence to demonstrate that a reduction to the amount of audited taxable sales is warranted. Instead, two of appellant's members each argued that they should not be held personally liable for appellant's liabilities; however, CDTFA confirmed that it has not asserted personal liability against these individuals for appellant's unpaid tax liabilities, and therefore the individuals' contentions are moot. Appellant has taken no steps to meet its burden of establishing that a reduction to the amount of unreported taxable sales is warranted, and thus, we conclude that no adjustment is 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, is 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's failure to provide any books and records is alone compelling evidence of negligence. Further, a comparison of unreported taxable sales of $2,296,344 established in the reaudit with appellant's reported taxable sales of $1,414,831 shows a reporting error rate of 162 percent, which is substantial and constitutes additional strong evidence of negligence. In addition, while appellant's credit card receipts for the audit period totaled $2,968,941, excluding sales tax reimbursement, appellant only reported taxable sales of $1,441,831, a difference of $1,554,110. We find that appellant knew that it substantially understated the sales reported on its sales and use tax returns based on its own records (i.e., the credit card payment information) alone. Therefore, even though this was appellant's first audit, we find that appellant's failure to provide any books and records for audit and the magnitude of its reporting errors could not have been due to a bona fide and reasonable belief that its recordkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law. We conclude that appellant was negligent and the penalty was properly imposed.

HOLDINGS

1. No reduction to the measure of unreported taxable sales is warranted.
2. Appellant was negligent.

DISPOSITION

CDTFA's action in asserting tax of $205,870.69 plus accrued interest, a failure-to-file penalty of $2,423.40, and a negligence penalty of $18,163.68, and otherwise denying the petitions for redetermination, is sustained.

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

We concur:

DocuSigned by:
3CADA62FB4884CB...
Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
8B585BEAC08946D...
Linda C. Cheng
Administrative Law Judge