OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19043000
MOHAMMAD LAVAF	) Date Issued: May 7, 2019
dba The Hungry Pocket	)

OPINION

Representing the Parties:

For Appellant: Mohammad Lavaf

For Respondent: Scott Lambert, Business Tax Specialist III
Lisa Renati, Supervising Tax Auditor
Pamela Bergen, Tax Counsel III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Mohammad Lavaf (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] on a timely petition for redetermination of a Notice of Determination assessing a tax deficiency of $28,760.31, plus applicable interest, for the period July 1, 2012, through August 31, 2015.

Office of Tax Appeals (OTA) Administrative Law Judges Linda Cheng, Alberto Rosas, and Jeffrey G. Angeja, held an oral hearing for this matter in Los Angeles, California, on March 19, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Whether appellant has established that reductions are warranted to the measure of unreported taxable sales established in the audit.
2. Whether appellant should be relieved of the tax based on erroneous advice from CDTFA.

[1] Sales taxes were formerly administered by the State Board of Equalization. In 2017, functions of the board relevant to this case were transferred to the California Department of Tax and Fee Administration (CDTFA). (Gov. Code § 15570.22; 2017 Stats. 2017, ch. 16, § 5.) When referring to acts or events that occurred before January 1, 2018, "CDTFA" shall refer to the board; and when referring to acts or events that occurred on or after January 1, 2018, "CDTFA" shall refer to CDTFA.

FACTUAL FINDINGS

1. During the audit period, appellant operated a restaurant in Santa Monica known as The Hungry Pocket. Appellant's restaurant specialized in Middle Eastern style food. Appellant closed the restaurant effective August 31, 2015.
2. CDTFA sent a letter to appellant dated September 19, 2012, in which CDTFA questioned the validity of his claimed $22,961 deduction for exempt food sales on his second quarter 2012 sales and use tax return. That letter advised appellant to contact Mr. Michael J. Settles, a CDTFA employee, if appellant had any questions.
3. Appellant responded to CDTFA by letter dated September 26, 2012, in which appellant listed the types of food products that he considered to be cold food (such as orange juice, humus, various cold sandwiches and various salads). While appellant's letter mentions veggie plates, tuna plates, tabouli plates, and mushroom plates, appellant's letter does not explicitly state that these plates, or any other plates, contain both hot and cold food. Appellant's letter does not state whether he sold the foregoing items separately or as meals or combination plates.
4. Appellant has not provided any evidence that CDTFA stated in writing that appellant's sales of combination plates that include both hot and cold food are not subject to tax.
5. CDTFA audited appellant for the period July 1, 2012, through August 31, 2015. In the audit, CDTFA established two separate measures of tax: $298,783 for unreported taxable sales, and $5,000 for the unreported sale of fixed assets at close-out. Appellant concedes the $5,000 measure of tax for the unreported sale of fixed assets at close-out.
6. For the audit, the only records appellant provided were copies of his federal income tax returns for 2012 and 2013. Appellant did not provide cash register tapes, guest checks, sales journals, purchase journals, or purchase invoices for audit.
7. Gross receipts reported on appellant's 2012 and 2013 federal income tax returns exceeded appellant's reported total sales for those years by $22,000 and $18,000, respectively. Appellant provided no explanation for the discrepancies.
8. Due to the lack of books and records provided for audit, CDTFA decided to use the credit card sales ratio method to calculate appellant's sales. Appellant had closed the business prior to the audit field work, and thus CDTFA could not perform an observation test to determine the ratios of appellant's sales paid for with cash (cash sales) and sales paid for

with credit cards (credit card sales). Based on its experience with other similar businesses, CDTFA estimated that 30 percent of appellant's sales were cash sales, and 70 percent were credit card sales. At the time of the audit, CDTFA did not have information regarding appellant's credit card deposits. Thus, CDTFA concluded that the reported total sales of $397,180 represented appellant's credit card deposits. CDTFA multiplied the $397,180 amount by 1.3 (1 plus the 30 percent cash sales ratio) to compute audited total sales of $516,334 for the audit period. Based on its discussions with appellant and an examination of appellant's menu, CDTFA concluded that 20 percent of appellant's sales represented exempt sales of food products, and 80 percent represented taxable sales. Thus, CDTFA multiplied audited total sales by 80 percent to compute audited taxable sales of $413,067 for the audit period. CDTFA subtracted reported taxable sales of $114,284 from audited taxable sales of $413,067 to compute unreported taxable sales of $298,783 for the audit period.

9. On March 14, 2016, CDTFA issued a Notice of Determination to appellant based on the audit in the amount of $28,760.31 tax, plus applicable interest.

10. During the appeal process, CDTFA obtained appellant's 1099-K forms, which are Internal Revenue Service (IRS) forms that identify credit card deposits made by appellant, to compile credit card deposits (which include sales tax reimbursement and tips) of $382,415 for the period January 1, 2013, through September 30, 2015.[2] Using the 1099-K information, CDTFA computed unreported taxable sales of $325,086 for the audit period, which exceeded the measure of $298,783 determined in the audit. CDTFA did not increase the audit liability, even though the $325,086 understatement was based on more accurate information. Instead, CDTFA adhered to its original lower measure of $298,783.

11. CDTFA's Appeals Bureau issued a Decision on February 22, 2018, recommending that the petition for redetermination be denied. Appellant filed this timely appeal with OTA, contending that 5 percent of his sales were cash sales, and 95 percent of his sales were credit card sales. Appellant provided no records to support his assertion.

[2] CDTFA assumed that credit card deposits made after August 31, 2015 (the date the business closed), represented sales made prior to the closing of the business.

DISCUSSION

Issue 1 – Whether appellant has established that reductions are warranted to the measure of unreported taxable sales established in the audit.

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 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, 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 a taxpayer challenges a Notice of Determination, 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 a Notice of Determination, 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. (Evid. Code, § 115; *Appeal of Estate of Gillespie,* 2018-OTA-052P, June 13, 2018, at p. 4.) 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; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

Here, the books and records appellant provided for audit were incomplete. Specifically, appellant only provided federal income tax returns for 2012 and 2013, but did not provide a general ledger, sales journals, guest checks, purchase journals, cash register Z-tapes, or purchase invoices covering the audit period. Further, the gross receipts reported on the federal income tax returns exceeded appellant's reported total sales on his sales tax returns for those years. 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 a credit card sales ratio.

In computing appellant's taxable sales, CDTFA used its experience with audits of similar businesses to estimate a 70-percent ratio of credit card sales to total sales, and appellant submitted no evidence to refute the accuracy of CDTFA's estimated ratio. Accordingly, we conclude that the estimate was reasonable and based on the best-available evidence. Next, CDTFA treated appellant's reported total sales as the total credit card amounts, even though the 1099-K forms that CDTFA later acquired showed that the actual amount of credit card receipts exceeded the reported total sales. We find that CDTFA's determination is reasonable and conservative (and in appellant's favor). Thus, the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

On appeal, appellant argues that cash sales represented only 5 percent of his total sales, as compared to the 30 percent cash sales ratio used in the audit.[3] Appellant provided no

[3] Appellant also objected to several apparent factual errors in CDTFA's Appeals Bureau's Decision, such as statements that appellant sold beer and wine (he did not), or that appellant sold Greek and Mediterranean food (he sold Middle Eastern food). CDTFA incorporated the Appeals Bureau Decision as part of CDTFA's opening brief in this appeal, and as such it is not evidence but merely argument. Furthermore, the errors relate to background facts but do not relate to the method by which CDTFA determined the audit liability, and thus they do not affect our analysis of the merits of the appeal. Accordingly, we decline to further address them.

documentation in support of his contention.[4] Absent evidence from appellant from which a more accurate determination of tax can be made, we conclude that appellant has failed to meet his burden of establishing that reductions to the audit liability are warranted.

Issue 2 – Whether appellant should be relieved of the tax based on erroneous advice from CDTFA.

If a person's failure to make a timely return or payment was due to that person's reasonable reliance on written advice from CDTFA, the person may be relieved of any sales or use taxes imposed. (R&TC, § 6596, subd. (a).) A taxpayer is eligible for relief if, in reliance on the written advice, the taxpayer failed to charge or collect sales tax reimbursement. (R&TC, § 6596, subd. (b)(3).) A person seeking relief under R&TC section 6596 is required to file a statement signed under penalty of perjury setting forth the facts on which the claim for relief is based. (R&TC, § 6596, subd. (c)(2).)

On appeal, appellant contends that Mr. Settles, a CDTFA employee, confirmed by telephone that appellant had reported his sales correctly. Appellant also contends that Mr. Settles informed appellant in a telephone conversation that tax was not due on sales of combination plates that include both hot and cold food, and thus, appellant did not charge tax on those sales. Appellant requests relief from the tax based on the assertion that he received erroneous advice that he reported his sales correctly, and he received erroneous advice that tax is not due on sales of combination plates that include both hot and cold food.

Here, advice received orally (i.e., the alleged telephonic advice from Mr. Settles) is not eligible for relief under R&TC section 6596, and further, there is no evidence that CDTFA stated in writing that appellant's sales of combination plates that include both hot and cold food were not subject to tax. Accordingly, we conclude that appellant has failed to establish that he is entitled to relief of the tax under R&TC section 6596.

[4] Appellant provided copies of his menus as well as photos of his business premises; however, this evidence is not probative of appellant's ratio of credit card to cash sales.

HOLDINGS

1. Appellant failed to establish that reductions are warranted to the measure of unreported taxable sales established in the audit.
2. Appellant failed to establish that he is entitled to relief from the tax based on erroneous advice from CDTFA.

DISPOSITION

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

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

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Linda C. Cheng
Administrative Law Judge

DocuSigned by:
Alberto Rosas
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Alberto T. Rosas
Administrative Law Judge