OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeals of:	) OTA Case No. 18063358
	) CDTFA Case IDs. 786239, 786241
ARMANDO ALVAREZ and	) CDTFA Account Nos. SR Y EH 101-236248,
AAREMMAGEN, INC., dba	) SR EH 102-447146
	)
Veros Mexican and Seafood	) Date Issued: December 3, 2019
	)

OPINION

Representing the Parties:

For Appellants: Rasheed Ali

For Respondent: Scott A. Lambert, Business Taxes Specialist III

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

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 Armando Alvarez and Aaremmagen, Inc. (collectively, appellants) appeal from Notices of Determination (NODs) issued by respondent the California Department of Tax and Fee Administration (Department) for tax and accrued interest allegedly due in connection with their operation, at different times, of the restaurant Vero's Mexican and Seafood (the restaurant). The NOD issued to Armando Alvarez determined $38,890.85 in tax, plus accrued interest, which the Department later reduced to $25,681.44 in tax, plus accrued interest, for the period October 1, 2009, through June 30, 2012. The NOD issued to Aaremmagen, Inc. (Aaremmagen) determined $13,501.36 in tax, plus accrued interest, which the Department later reduced to $8,539.31 in tax, plus accrued interest, for the period July 1, 2012, through December 31, 2012.

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

ISSUE

Whether adjustments are warranted to the audited understatements of reported taxable sales.

FACTUAL FINDINGS

1. In May 2009, Armando Alvarez began operating a fast-food restaurant specializing in Mexican-style cuisine, in Temecula, California. On July 1, 2012, Armando Alvarez incorporated the business as Aaremmagen, and the corporation opened another location in Lake Elsinore, California. Armando Alvarez is a corporate officer of Aaremmagen.
2. The Department audited appellants' business and, on November 18, 2013, issued a timely NOD to Armando Alvarez for the period October 1, 2009, through December 31, 2012 (audit period). When the Department became aware that the business had been incorporated effective July 1, 2012, it removed the last two quarters from the NOD issued to Armando Alvarez and issued a timely NOD on November 26, 2013, to Aaremmagen for the period July 1, 2012, through December 31, 2012.
3. For audit, appellants provided federal income tax returns (FITR's) for 2009, 2010 and 2011; daily cash register Z-tapes for 16 days during the 18-day period from December 18, 2012, through January 5, 2013, inclusive;[1] and weekly sales summary reports.
4. The Department found differences between gross receipts reported on the FITR's and total sales reported on the sales and use tax returns (SUTR's). It also found that the computed markups were substantially lower than what the Department expected for a business of this type and at a comparable location. In addition, it appeared from the records that many of appellants' transactions were in cash, including payments to vendors and others. On these bases, the Department concluded that further investigation was warranted.
5. The Department used the cash register Z-tapes appellants provided (for 16 days during the period December 18, 2012, through January 5, 2013) to compute that 34.54 percent of

[1] Cash register Z-tapes, which are point-of-sale terminal (register) summaries of cash and credit card activity, were not provided for Thursday, December 20, Monday, December 24, Thursday, December 27, or Wednesday, January 2, and two Z-tapes were provided for Saturday, December 29. It is not clear from the record why cash register Z-tapes were not provided for each day during the test period. The auditor also noted that appellants sometimes ran Z-tapes more than once per day and that appellants ran some of the provided Z-tapes before 5:00 p.m.

appellants' total sales were credit card sales.[2] Appellants disagreed, arguing the percentage was too low.

6. The Department agreed to raise the percentage of credit card sales (to total sales) to 37.87 percent, purportedly based on its comparison of total credit card receipts with tax included to total sales for the 16 days net of tax.[3] Appellants continued to argue that the percentage was too low.

7. Later, with appellants' agreement, the Department conducted one partial-day observation test on Friday, February 21, 2014.[4] For that partial day, the Department computed a credit card sales percentage of 47.12 percent, which the Department used to compute understatements of reported taxable sales of $307,801 for Alvarez and $110,191 for Aaremmagen.[5]

8. On December 10, 2013, appellants filed timely petitions for redetermination, contending that the audited credit card sales percentage is too low.

9. On May 14, 2018, the Department issued its Decision, in which it found that the liabilities should be redetermined in accordance with the most recent reaudits, which established understatements of reported taxable sales of $307,801 for Armando Alvarez and $110,191 for Aaremmagen. This timely appeal followed.

DISCUSSION

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

[2] The Department refers to this as the credit card to total sales ratio. We will continue to refer to it as a percentage of total sales.

[3] We cannot understand the purpose of this comparison, unless it was simply to increase the credit card ratio, because it appears to be without a rational basis.

[4] The restaurant was open from 8 a.m. to 9 p.m., but the Department conducted the test from 11:00 a.m. to 7:00 p.m.

[5] The Department noted that the sales recorded on appellants' weekly sales reports (erroneously referred to in the Department's Decision as sales and use tax return worksheets) exceeded reported taxable sales. Therefore, for each audit period, the Department established a difference between recorded and reported taxable sales ($14,684 for Alvarez and $17,601 for Aaremmagen). The Department then established differences between audited and *recorded* taxable sales ($293,117 for Alvarez and $92,590 for Aaremmagen). For ease of discussion, we will refer to the entire amount of understatement for each audit period as the understatement of reported taxable sales, without that segregation.

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.)

When the Department 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, subd. (b)(1).)

When a taxpayer challenges an NOD, the Department has a minimal, initial burden of showing that its determination is reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawai'i 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.) If the Department carries that burden, the burden of proof shifts to the taxpayer to establish that a result differing from the Department's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) The applicable burden of proof is by a preponderance of the evidence. (*Appeal of Estate of Gillespie* (2018-OTA-052P) 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.) 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.) To satisfy the burden of proof, a taxpayer must prove that (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.)

Although gross receipts derived from the sale of "food products" are generally exempt from the sales tax, sales of food served in a restaurant and sales of hot prepared food are subject to tax. (R&TC, § 6359, subds. (a), (d)(2), (d)(7).) When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359, subd. (d)(6).) When a retailer's

sales fit within this provision, known as the "80/80 rule," the retailer may avoid its application by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. (R&TC, § 6359, subd. (f); Cal. Code Regs., tit. 18, § 1603, subd. (c)(1)(A).)

The Department determined that the 80/80 rule applied to appellants' sales during the audit period. Appellants do not argue otherwise. Consequently, we find that the 80/80 rule applies to appellants' business (i.e., both restaurants). Appellants have not alleged that they kept a separate accounting of sales of cold food to-go at either restaurant and appellants have provided no such separate accountings for the Department's (or our) consideration. Accordingly, we find that the Department correctly concluded that all of appellants' sales are taxable.

The question is not whether appellants failed to report all taxable sales. Appellants' own records demonstrate that they reported only a fraction of their cash sales. The question is the amount of the understatement. In this regard, appellants do not disagree with the Department's use of a credit card ratio to calculate the bulk of the understatement. Regardless, the Department's choice of that methodology appears to have been reasonable given the evidence of an understatement and the dearth of records to support a direct audit.[6] The sole dispute is about the correct credit card sales percentage.

The Department first used records provided by appellants to calculate that 34.54 percent of appellants' sales for 16 days, most of them during the audit period, were credit card sales. That calculation appears to have had a reasonable basis. When appellants did not agree, the Department offered to use a higher percentage (37.87 percent), which it calculated by comparing tax-included credit card receipts and total sales net of tax. That calculation appears to have no rational basis, but it favored appellants. When appellants refused to accept the 37.87 percent, the Department and appellants agreed to a partial-day observation test, which resulted in a finding that 47.12 percent of sales were credit card sales. Appellants also did not accept that percentage. We find that the Department has used sufficient testing and has made concessions that are more than reasonable and that the Department's decision to calculate the understatement of reported taxable sales using that 47.12 percent was both reasonable and rational.

[6] Credit card receipts, unlike cash receipts, must be deposited in a bank in order to be processed and are, therefore, readily verifiable.

Appellants provided cash register Z-tapes for 36 days during the 72-day period July 7, 2011, through September 17, 2012. All appear to be for the Temecula location. None had been previously provided to the Department or to the Office of Tax Appeals. For those days, chosen by appellants, the credit card ratios (rounded) range from 31 percent to 98 percent, with 3 percentages in the 30's, 5 in the 40's, 18 in the 50's, 7 in the 60's, 2 in the 70's, and the one, showing 98 percent. There is no discernable pattern to the days chosen (i.e., certain weekdays for each week during the period). Moreover, we note there is a broad discrepancy in the credit card ratios between the days chosen by appellants for our consideration and those previously provided by appellants for the 16 days during the period December 18, 2012, through January 5, 2013. For those 16 days, the credit card ratios range from 17 percent to 50 percent, with 3 in the teens, 4 in the 20's, 3 in the 30's, 5 in the 40's and one 50 percent. However, in the days chosen by appellants, there are no percentages in the teens or 20's, but there are 18 in the 50's, 7 in the 60's, and 3 above the 60's. Thus, when appellants provided 16 sets of Z-tapes for an 18-day period, the credit card sales percentage was 34.54 percent; but when they provided 36 sets of z-tapes for a 72-day period, the credit card percentages are substantially higher. These differences indicate the z-tapes provided for the 72-day period may not be fairly representative, so we decline to give that sample much weight. We also note that if we first disregard the 98 percent credit card sales percentage on the basis that it is so unusually high that it is certainly an aberration, and then use the data for 16 days used in the audit, the data from the observation day, and the data for the remaining 35 days submitted by appellants with their opening brief, we compute a ratio of 47.8 percent.[7] We find this result to be strong evidence that the 47.12 percent used in the audit was reasonable and fairly representative of appellants' sales.

Moreover, in its Decision, to evaluate the reasonableness of the audit findings, the Department has used audited taxable sales and the cost of goods sold claimed on the FITR's to compute markups of 309 percent for 2010 and 289 percent for 2011. As noted previously, the Department stated it would expect a markup of about 300 percent for a restaurant of this type, and we concur. In addition, the Department conducted a short shelf test during the audit, comparing the selling prices of certain items with their costs. In that short shelf test, the Department computed markups of 319 percent for taco rolls, 323 percent for Acate steak,

[7] For the 16 days in the audit period, the day of observation, and the 35 days included in the submission with the opening brief, respectively, we compute credit card sales of $19,677 ($4,152 + $539 + $14,986) and total sales of $41,130 ($12,020 + $1,235 + $27,875). We then compute a ratio of 47.8 percent ($19,677 ÷ $41,130).

303 percent for beer, and 371 percent for fountain drinks. Thus, we find that the markups computed using audited sales and claimed costs of goods sold are reasonable and offer additional and persuasive support for the audit findings.

In summary, we find that there is ample evidence to support the audit results. Accordingly, we conclude that no further adjustments are warranted to the audited understatements of reported taxable sales.

HOLDING

No further adjustments are warranted to the audited understatements of reported taxable sales of $307,801 for Armando Alvarez and $110,191 for Aaremmagen.

DISPOSITION

We sustain the Department's actions in reducing the understatements of reported taxable sales to $307,801 for Armando Alvarez and $110,191 for Aaremmagen, in accordance with the most recent reaudits, and otherwise denying the petitions for redetermination.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

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Neil Robinson
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Neil Robinson
Administrative Law Judge

DocuSigned by:
John O. Johnson
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John O. Johnson
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