OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No.: 18083527
	) CDTFA Case ID: 974554
GREGORIOS SHAKOLAS	) CDTFA Acct. No.: 101-283651
	)
	) Date Issued: October 11, 2019
	)

OPINION

Representing the Parties:

For Appellant:	Juan Guzman, Representative
For Respondent:	Scott A. Lambert, Hearing Representative Pamela Bergin, Acting Assistant Chief Counsel Lisa Renati, Supervising Tax Auditor III
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Gregorios Shakolas (appellant) appeals an action by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's timely petition for redetermination of a Notice of Determination (NOD), assessing additional tax of $60,033.37, plus applicable interest, for the period January 1, 2012, through December 31, 2014.

Office of Tax Appeals (OTA) Administrative Law Judges Daniel K. Cho, Nguyen Dang, and Kenneth Gast held an oral hearing for this matter in Los Angeles, California, on July 24, 2019. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether adjustments are warranted to the determined measure of tax.

[1] Prior to July 1, 2017, CDTFA's sales and use tax functions were administered by the State Board of Equalization (BOE). (See Gov. Code, § 15570.22.) Therefore, for ease of reference, when referring to acts or events that occurred prior to July 1, 2017, CDTFA shall refer to BOE.

FACTUAL FINDINGS

1. Appellant operated a fast food restaurant located in Garden Grove, California since September 1, 2009, selling hamburgers, sandwiches, related food items, and beverages. During the audit period, the business was open daily. Appellant provided sales information to an outside accountant who prepared his sales and use tax returns.
2. The Assignment Activity History of the audit report states that appellant provided the following records for audit: federal income tax returns (FITR) for 2012 and 2013, purchase invoice,[2] bank statements, merchant statements and 1099-K[3] statements. Appellant did not provide a purchase journal.
3. CDTFA found no differences between the gross receipts reported on FITR's for 2012 and 2013 and the total sales reported on appellant's sales and use tax returns for those years. Based on the available information, CDTFA computed markups of 115.25 percent for 2012, 160.36 percent for 2013, and an average of 136.85 percent for the two years combined.
4. CDTFA expected a markup in the range of 250 to 300 percent for this type of business. As a result, it decided that further investigation was warranted. CDTFA examined credit card deposits and total bank deposits for the audit period. For the three-year period, appellant had deposited $1,231,561, of which $1,229,785 represented credit card deposits and the remaining $1,776 represented cash deposits. CDTFA compiled credit card receipts of $1,235,398 from the 1099-K statements, noting that the amount reflected on the 1099-K statements exceeded amounts deposited in the bank by $5,613.[4] Based on appellant's records, CDTFA calculated appellant's credit card sales to be 65.95 percent of appellant's total reported taxable sales. CDTFA considered this credit card sales percentage higher than expected.
5. At the request of CDTFA, appellant provided sales summary reports, cash register z-tapes, and credit card statements for the period August 10, 2015, through August 24,

[2] It is unclear whether the use of a singular noun was purposeful or a typographical error.

[3] 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.

[4] There is no explanation in the record for this discrepancy.

2015, excluding August 18, 2015.[5] CDTFA computed that credit card sales represented 45.88 percent of total sales for those 14 days. The percentages of credit card sales to total sales were relatively consistent for the 14 days, ranging from 40.85 percent to 55.65 percent, with 10 of the 15 percentages in the range of 40-46 percent, rounded.

6. CDTFA decided to use the credit card sales ratio from the two-week test period to calculate appellant's audited taxable sales. Specifically, CDTFA established audited taxable sales of $2,495,102 by dividing the total credit card receipts for the audit period, net of tax, by 45.88 percent. It compared audited taxable sales of $2,495,102 to reported taxable sales of $1,735,804 to compute an understatement of $759,298, which is at issue here.

7. To evaluate whether its audit results were reasonable, CDTFA used the sales information for the period August 10, 2015, through August 24, 2015, to compute average daily sales for weekdays of $2,171 and average daily sales for weekends of $3,552. It then multiplied each of those figures by the number of weekdays and weekend days, respectively, in the three-year audit period and computed taxable sales of $2,801,287. Since that amount exceeded the audited amount of taxable sales of $2,495,102 by $306,185, CDTFA regarded the secondary test as evidence that its audit results were reasonable.

8. On July 26, 2016, CDTFA issued the NOD, showing tax of $60,033.37 and interest through July 31, 2016.

9. Appellant filed a timely petition for redetermination in which appellant contends that the audited understatement of reported taxable sales is excessive.

10. On June 19, 2018, CDTFA issued a Decision and Recommendation recommending no adjustments to the NOD.

11. This timely 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

[5] Appellant inadvertently neglected to provide sales data for August 18, 2015, and the test was extended through Monday, August 24, 2015.

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 sales tax, sales of food sold in a heated condition and food sold for consumption in a restaurant 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, 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 Michael E. Myers* (2001-SBE-001) 2019 WL 1187160.) 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 NOD is based on an audit of appellant's business. Specifically, CDTFA examined the limited records that appellant provided and determined that appellant's reported taxable sales were not accurate because appellant's overall markup percentages were lower than expected and reported credit card sales ratio was higher than expected for this type of business. As a result, CDTFA reviewed appellant's detailed sales records for 14 days (August 10, 2015, through August 24, 2015, excluding August 18, 2015) to determine appellant's audited credit card sales ratio, which it used, along with appellant's credit card receipts, as shown on its 1099-K statements, to compute audited sales. Based on this method, CDTFA concluded that appellant underreported his taxable sales by $759,298.

CDTFA tested the reasonableness of its determination by examining the results of the 14-day test period to compute average daily sales, for weekdays and for weekend days. It then projected those average daily sales to the total number of days in the audit period. Using that approach, CDTFA computed sales that were higher than the sales established by the credit card sales ratio by more than $300,000. Thus, CDTA's determination is both reasonable and rational because the calculation is based on the observation test and appellant's records, and CDTFA

performed a second audit method to ensure that its determination was reasonable. Therefore, the burden of proof shifts to appellant to establish that CDTFA's determined measure of tax is erroneous or overstated.

Although appellant argues that his reported taxable sales were accurate and should have been accepted, this argument does not explain why or how the determined measure of tax is erroneous other than appellant believes that he does not owe this liability. For example, whether CDTFA should have examined certain documentation does not establish that the credit card sales ratio employed by CDTFA is overstated or erroneous. Instead, appellant needed to provide the documentation (e.g., a purchase journal, purchase invoices, sales receipts, etc.) with an explanation as to how this evidence demonstrates that appellant owes a different amount of tax. Although appellant stated that he provided all of the necessary records at the time of the audit and provided pictures of those records as exhibit 10, there is no way for us to evaluate the veracity of this argument. Without the actual documents for our examination, we are unable to determine what information or evidence is actually contained in the picture of documents. Therefore, we find that this argument does not warrant any adjustments to the determined measure of tax.

Appellant also contends that CDTFA should have performed a markup analysis instead of using a credit card sales ratio. However, there is no requirement that CDTFA must use one audit method over another. It is up to CDTFA's discretion on what method it believes is the most accurate way to audit a taxpayer's business, and it is insufficient to criticize the audit method that CDTFA used without providing a valid reason as to why the audit method is erroneous or providing documentary evidence establishing appellant's taxable sales. Appellant's dissatisfaction with the ultimate result of CDTFA's audit does not explain why the audit method should not be accepted. Furthermore, appellant has not provided sufficient documentation to establish the accuracy of the cost of goods sold on his FITR's, and appellant's calculation of the markup percentage appears to be unreliable. For example, the calculations do not identify the amounts of each product (e.g., ounces of meat or cheese, amount of lettuce, etc.) included in the various menu items or the sources of the costs listed on the test. There is no weighting of the individual markups to reflect the menu items that are most frequently sold, which is particularly relevant here because the markups computed for individual items ranged from 132.5 percent for tacos to 266 percent for a pastrami burger. Thus, the shelf test provided by appellant does not

establish a reliable markup that could be effectively used to establish audited taxable sales. Without reliable information regarding the total cost of goods sold and an accurate weighted markup percentage, the markup audit approach is not viable. Thus, this argument is unpersuasive.

Lastly, appellant asserts that the audit is deficient because CDTFA did not use a second audit procedure to establish the reasonableness of the audit results and failed to determine the number of seats in the restaurant. Appellant also argues that appellant's net income supports his reported taxable sales. However, as stated above, CDTFA performed a second audit procedure wherein it used the results of the test period to calculate an average amount of daily sales. Accordingly, this argument is incorrect. With respect to appellant's remaining arguments, these arguments do not establish error with CDTFA's credit card sales ratio or establish a more correct amount of tax due.

Based on the foregoing, we find that appellant has not met his burden of establishing an error with the determined measure of tax.

HOLDING

No adjustments are warranted to the determined measure of tax.

DISPOSITION

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

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Nguyen Dang
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Nguyen Dang
Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge