OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **B. LIZARRAGA dba** **ALBERTO'S MEXICAN FOOD**	OTA Case No. 18032505 CDTFA Account No. 102-329696 CDTFA Case ID 957165

OPINION

Representing the Parties:

For Appellant:	Richard Carpenter, Attorney at Law
For Respondent:	Chief, Headquarters Operations Bureau
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, B. Lizarraga dba Alberto's Mexican Food (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) for $54,521.75 of additional tax and applicable interest, for the period January 2, 2013, through December 31, 2015 (audit period).

Appellant waived her right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

Has appellant shown that adjustments are warranted to the audited understatement of reported taxable sales?

FACTUAL FINDINGS

1. Appellant operated a fast-food restaurant, Alberto's Mexican Food, in Corona, California, and held a seller's permit, from January 2, 2013 through December 31, 2015.

2. During the audit period, appellant reported total taxable sales of $1,717,215, claiming no deductions.

3. For audit, appellant provided bank statements and sales tax worksheets for the audit period and federal income tax returns (FITRs) for 2013 and 2014. Appellant did not provide sales journals, purchase journals, cash register tapes, or purchase invoices.

4. The gross receipts reported on FITRs reconciled with the total sales reported on sales and use tax returns. Using gross receipts and costs of goods sold reported on FITRs, CDTFA calculated achieved markups of about 84 percent for 2013 and 88 percent for 2014, which were lower than expected for this type of business. CDTFA concluded that further investigation was warranted.

5. Because appellant sold the business prior to the start of the audit field work, CDTFA could not perform an observation test[1] to determine the ratio of sales paid by credit card to total sales (credit card ratio). Instead, CDTFA used the credit card sales ratios that had been established in audits of nine other Alberto's Mexican Food restaurants owned by others in Riverside county (where appellant's business was located).[2] The credit card ratios for these nine other Alberto's restaurants ranged from 39.24 percent to 62.68 percent, with an average credit card ratio of 50.14 percent.[3]

6. Using appellant's bank statements, CDTFA compiled appellant's credit card receipts of $1,202,737, which it divided by the credit card ratio of 50.14 percent to compute audited taxable sales of $2,398,737 (rounded) for the audit period. That amount exceeded reported taxable sales of $1,717,215 by $681,522, the amount in dispute here.

7. A comparison of audited taxable sales to the cost of goods sold claimed on FITRs resulted in audited markups of about 192 percent for 2013 and 141 percent for 2014, which was closer to the markup CDTFA expected for this type of business.

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[1] In the opening brief, appellant disputes statements made by CDTFA that she declined an observation test, stating that it was not within her purview to allow or decline a test of the business, which was then owned by someone else. CDTFA could not ask the new owner for authorization to conduct an observation test without disclosing confidential information regarding appellant (that her business was being audited). In any event, an observation test was not conducted.

[2] CDTFA could not provide the identities of the nine other Alberto's restaurants that were audited because that information is confidential. (R&TC, § 7056.)

[3] The credit card ratio per an analysis of appellant's bank deposits was 70.04 percent. CDTFA did not use this ratio because the evidence indicated that appellant did not deposit all the business cash into the bank account. CDTFA estimated that approximately $370,419 was not accounted for in the bank deposits.

8. On June 9, 2016, CDTFA issued an NOD for tax of $54,521.75 and applicable interest.

9. Appellant filed a petition for redetermination, which CDTFA denied. 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 presumed subject to tax unless the retailer can prove otherwise. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b).)

When CDTFA is not satisfied with the accuracy 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.)

Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are generally subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).) CDTFA concluded that appellant's sales met the requirements of the 80/80 rule and that all of appellant's sales were subject to tax. (See R&TC, § 6359(f); see also Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)[4]

[4] 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(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(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)

We find that the records provided for audit were incomplete and that CDTFA's use of an indirect audit method was warranted. We further find that the credit card ratio was appropriate in this audit. In addition, we find that, absent an observation test of the business at issue, CDTFA's method of establishing the credit card ratio using the weighted, average credit card ratios established in nine audits of other Alberto's restaurants in Riverside county is reasonable. We therefore find CDTFA has shown that its audit is reasonable and rational. Appellant thus has the burden to show that adjustments are warranted to the audited understatement.

Appellant asserts that she reported sales correctly and provided all the books and records related to her business. Regardless of whether appellant has provided all the records she maintained for the business, we have previously found that those records are inadequate to support reported sales. Moreover, bank statements alone are insufficient as the available evidence shows that appellant did not deposit all cash receipts in the bank. Specifically, appellant reported sales for the audit period of $1,717,215, while the bank deposits totaled $1,346,796. Further, with the exception of two quarters, all of the cash deposited with the bank were even amounts, which is an indicator that the amounts of cash deposited were incomplete.[5]

Appellant asserts that gross receipts were reported correctly and that the credit card ratio was 70 percent during the audit period. However, appellant did not support that number with underlying documents, such as cash register z-tapes and guest checks. For these reasons, we find appellant has not supported her assertion that her sales were reported correctly, and no adjustment is warranted on that basis.

Appellant then raises two related arguments: 1) use of an average credit card ratio for other Alberto's restaurants in the area is unreliable because those other restaurants are not representative of appellant's demographics, clientele, and credit card ratio; and 2) appellant's clientele primarily used credit cards to pay for sales.

As support, appellant has provided demographic information for the area where appellant operated the business.[6] Appellant notes that the household income levels shown thereon are similar for Corona (where the business is located) and Murrieta. Appellant further asserts that the Alberto's restaurant with the second highest audited credit card ratio CDTFA used in its

[5] For two quarters of the audit period, the amount of cash deposited was zero; for two quarters, the amount of cash deposited ended in 50; and for six quarters the amount of cash deposited were even 100's. We find it much more likely than not that the amounts deposited represented only a portion of the business's cash receipts.

[6] Appellant states that the documents submitted were taken from a United States Census Bureau website.

computations was located in Murrieta. Appellant draws the conclusion that credit card usage would be higher than average in Corona. It is not clear how appellant has determined that the business with the second highest audited credit card ratio used by CDTFA was located in Murrieta since CDTFA has not provided identifying information about the nine restaurants used in its computations. In any event, census data represent generalized averages. It is of no evidentiary value in determining whether adjustments are warranted to the audit findings for this particular business.

The final argument is that CDTFA should have used information from at least one of three other Alberto's restaurants in Corona (one of which was formerly owned by appellant) in its computation of the credit card ratio. There is no evidence in the record that a restaurant in Corona was or was not amongst the nine audited businesses. We find that using the credit card ratios from nine businesses that have been audited within the same county was likely to produce a reliable result, and appellant has not shown otherwise.

We find that CDTFA used the best available information to establish the credit card ratio, and it used that ratio along with appellant's recorded credit card receipts to establish audited total sales, which is a reasonable audit method. We further find that appellant has not established that adjustments are warranted to the audited understatement of reported taxable sales. Therefore, we conclude that no adjustment should be made to the audit liability.

HOLDING

Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.

DISPOSITION

CDTFA's decision to deny the petition for redetermination is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
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Jeffrey G. Angeja
Administrative Law Judge

Date Issued: 3/26/2020