OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18073393
	) CDTFA Account No.: 97-958044
PRISCILLA'S GOURMET COFFEE, TEA, & GIFTS, INC.	) CDTFA Case ID No.: 985991
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Shannon Hartman, Owner Mark Hartman, Owner
For Respondent:	Sunny Paley, Attorney Monica Silva, Attorney Lisa Renati, Hearing Representative
For Office of Tax Appeals:	Deborah Cumins, Business Tax Specialist III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Priscilla's Gourmet Coffee, Tea, & Gifts, Inc., (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's timely petition for redetermination of an October 11, 2016 Notice of Determination (NOD). The NOD is for $25,765.35 in tax, plus accrued interest, for the period October 1, 2012, through September 30, 2015 (liability period). Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Michael Geary, and Richard Tay held an oral hearing for this matter in Los Angeles, California, on September 18, 2019. After the conclusion of the oral hearing, additional briefing was requested on the issue of interest relief. Following the close of additional briefing, OTA notified the parties by letter dated December 20, 2019, that the record was closed, and the matter was submitted for decision.

[1] Sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor; the board.

ISSUES

1. Whether appellant correctly reported its sales and use taxes during the liability period.
2. Whether appellant established a basis to relieve any portion of the liability.

FACTUAL FINDINGS

1. Appellant operates a coffee, tea, and gift shop with a single retail selling location in Burbank, California. Appellant sells food products such as coffee, tea, sandwiches, carbonated and non-carbonated beverages, cookies, and miscellaneous gift items including mugs, birthday cards, and books. Appellant began operating this business on July 1, 2001.[2]
2. On October 22, 2015, CDTFA sent an auditor to observe appellant's sales activities. The auditor noted that appellant's employees were not separately charging sales tax reimbursement on any of its sales, including soda or dine-in orders, and that appellant had a seating capacity for approximately 70 people. CDTFA notified appellant that it had been selected for audit and requested appellant's business records. Thereafter, on February 11, 2016, CDTFA met with Shannon Hartman, one of appellant's owners, at appellant's business location.
3. Appellant reported $2,461,402 in total sales and $92,910 in taxable sales during the liability period. Appellant's reported taxable sales are 3.77 percent of its reported total sales. Appellant did not charge or collect tax on any of its sales. Instead, appellant estimated that a percentage of its total sales (ranging from 3.5% to 4% during the liability period) was taxable and reported based on this estimated percentage.
4. During the audit, CDTFA informed appellant that its dine-in sales are taxable under California Code of Regulations, title 18, section (Regulation) 1602(f). Thereafter, at CDTFA's request, appellant revised its Point of Sale (POS) system to charge tax on dine-in orders, and submitted hardcopy daily POS reports for the period April 1, 2016, through May 20, 2016 (test period).[3] The POS reports indicate the total amount charged for dine-in sales, to-go sales, and the total amount of sales tax collected.

[2] Mark and Shannon Hartman operated the business prior to it being incorporated.

[3] The POS reports do not indicate on which items appellant collected tax. Thus, for example, it is unclear from the POS reports whether appellant collects sales tax on sales of carbonated beverages, which are taxable under R&TC section 6359(b)(3) regardless of whether sold "for here" or "to-go."

5. CDTFA accepted appellant's recorded total sales and recorded sales tax collected from the POS reports. Using those figures, CDTFA determined that appellant's total taxable sales ($23,087)[4] were 15.43 percent of its recorded total sales ($149,593) for the 50-day test period (the taxable sales ratio).

6. On Friday, May 20, 2016, CDTFA performed a half-day observation test of appellant's business from 10:00 AM to 2:09 PM, and determined that 28.87 percent of appellant's sales were taxable during this period. Based on the results of the observation test, CDTFA accepted the 15.43 percent taxable sales ratio as reasonable to project to the liability period.[5] Applying this ratio, CDTFA determined that appellant underreported taxable sales by $286,959.[6]

7. CDTFA completed the audit on August 26, 2016, when it issued a Report of Field Audit, summarizing the findings (discussed above).

8. On October 11, 2016, CDTFA issued the NOD for the liability disclosed by the audit.

9. On November 2, 2016, appellant timely petitioned the NOD, which CDTFA denied in a decision dated May 23, 2018. This timely appeal followed. During the appeal, appellants provided written declarations and oral testimony providing additional factual context, as summarized below, which we find credible.

10. On February 3, 2018, appellant submitted a statement signed under penalty of perjury, by both of its owners. The statement asserts that appellant's owners, Mark and Shannon Hartmann, met with Jerome Horton, a former chairperson of the board, and his representatives, on several occasions, with the first meeting occurring on February 14, 2011 (at which time the board was responsible for administering the Sales and Use Tax Law). Appellant's owners contend that Jerome Horton and his staff orally instructed appellant to adopt a reporting method allegedly used by Starbucks, whereby appellant reported an estimated percentage of its total sales as taxable, and that this is the

[4] CDTFA ascertained appellant's total taxable sales by dividing recorded sales tax collected by the applicable tax rate.

[5] In making this determination, CDTFA took into consideration the fact that while the average taxable sales percentage was 15.42 percent for the test period, the daily averages ranged from 7.47 to 28.33 percent.

[6] CDTFA calculated $286,959 as follows: (1) CDTFA multiplied the taxable sales ratio by reported total sales to compute audited taxable sales of $379,869; (2) CDTFA reduced this amount by appellant's $92,910 in reported taxable sales (i.e., $379,869 - $92,910 = $286,959).

method appellant used during the liability period.[7] Appellant concedes that the advice was not in writing. Appellant's owners reaffirmed these statements during testimony that they made under penalty of perjury at the oral hearing on September 18, 2019.

11. Appellant's owners further testified that appellant set the retail selling price of its products based on this taxable percentage (i.e., appellant included a 3.5-4 percent markup for sales tax in its selling price of items sold). Appellant did not advertise that it was charging sales tax or that tax reimbursement was included in its prices. If a customer inquired why sales tax was not being charged, appellant explained to the customer that tax was built-in to the selling price (as described above). Representatives from board member Horton's staff helped in deciding the estimated taxable percentage to use, and informed appellant that 5 percent would be too high, and 2 percent would be too low.

DISCUSSION

Issue 1: Whether appellant correctly reported its sales and use taxes during the liability period.

California imposes sales tax measured by a retailer's gross receipts from the retail sale of tangible personal property in this state 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 until the contrary is established. (R&TC, § 6091.) The law exempts from tax the sale of food products for human consumption. (R&TC, § 6359.) As relevant, this exemption does not apply to sales of carbonated beverages, sales of food for consumption at facilities provided by the retailer, and hot prepared food products sold for take-out. (R&TC, § 6359(b)(3), (c)(2), (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

[7] CDTFA concedes that, during the liability period, it entered into written agreements with certain (undisclosed) retailers to allow reporting in a manner similar to that which appellant used during the liability period.

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 only remitted sales tax to the state on 3.77 percent of its total sales for the liability period, which admittedly was an estimate. After CDTFA informed appellant that dine-in orders were taxable, appellant adjusted its POS system to collect sales tax reimbursement on dine-in transactions. Thereafter, appellant provided daily POS reports for a 50-day test period (April 1, 2016, through May 20, 2016). During the test period, according to appellant's own POS reports, appellant collected sales tax on 15.43 percent of its recorded total sales. Nevertheless, appellant only reported 3.77 percent of its reported total sales as taxable during the liability period. There is no evidence or contention that the sales made during the test period are not representative of the sales during the liability period. Therefore, we conclude that CDTFA established a reasonable and rational basis for concluding that the difference (i.e., 11.6585 percent of appellant's reported total sales) represents underreported taxable sales.

Appellant offered no evidence to establish that the percentage of taxable sales reflected in appellant's own daily POS reports was overstated or otherwise erroneous. Therefore, appellant failed to establish error in the NOD. As such, we conclude that appellant failed to correctly report its sales and use tax liabilities for the liability period, and that CDTFA's calculation of appellant's liability as determined in the audit was reasonable and rational.

Issue 2: Whether appellant established a basis to relieve any portion of the liability.

Appellant requests that all or a portion of the liability be deleted based on its reliance on and compliance with oral advice provided by Jerome Horton, former chairman of the board, and his staff.

1. Relief of taxes

As a preliminary matter, R&TC section 6596 provides for relief of taxes, interest, and penalties under certain circumstances where a taxpayer's failure to timely pay the tax is due to reasonable reliance on written advice provided by CDTFA (or, prior to July 1, 2017, the board). (R&TC, §§ 20, 6596(a).) Here, although appellant requests relief of the taxes, interest, and penalties, appellant further concedes that it did not receive any written advice. By its terms, R&TC section 6596 only authorizes such relief when there is reliance on written advice.

(R&TC, § 6596(b)(2); Cal. Code Regs., tit. 18, § 1705(a)(1).) Furthermore, there is no provision under the law that would otherwise allow for relief of taxes, interest, and penalties based on reliance on oral advice from the board. As such, OTA lacks statutory authority to grant the requested relief under R&TC section 6596.

2. Relief of interest

There is no statutory right to interest relief. The law allows OTA,[8] in its discretion, to grant relief of all or any part of the interest imposed on a person under the sales and use tax law where the failure to pay the tax is due in whole or in part to an unreasonable error or delay by an employee of the board (or, after July 1, 2017, CDTFA) acting in his or her official capacity. (R&TC, §§ 20, 6593.5(a)(1).) Such an error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c).) Regulation 1703 restates, without adding further clarification to, the requirements for interest relief within the meaning of R&TC section 6593.5. (See Cal. Code Regs., tit. 18, § 1703(b)(1)(E).)

At the oral hearing, during questioning by the Panel, CDTFA agreed that OTA had statutory authority under R&TC section 6593.5 to relieve interest due to erroneous oral advice. Subsequently, OTA requested further briefing on this matter, and in a post-hearing brief dated December 17, 2019, CDTFA contended that reliance on erroneous oral advice does not constitute unreasonable error or delay for purposes of interest relief. Aside from the statutory provisions described above, CDTFA has offered no additional authority for this proposition. On review we, too, are not aware of any California court cases, precedential decisions, or regulations which further interpret or implement the interest relief provisions of R&TC section 6593.5. As such, we must turn to other guidance, including legislative intent, to determine whether OTA has authority to grant discretionary relief of interest based on reliance on oral advice from the board or its successor, CDTFA.

The primary purpose in construing a statute is to ascertain and give effect to the Legislature's intent. (*Dyna-Med, Inc. v. Fair Employment & Housing Commission* (1987) 43

[8] R&TC section 6593.5 states "board," however, on and after January 1, 2018, the term "board," with respect to an appeal, means the Office of Tax Appeals (OTA). (R&TC, § 20(b).)

Cal.3d 1379, 1377-1387 [superseded for reasons unrelated to the rules of statutory construction].) In most cases, the plain language of the statute is the best gauge of that intent. (*Honey Springs v. Board of Supervisors* (1984) 157 Cal.App.3d 1122, 1137.) "If the language is clear and unambiguous there is no need for construction, nor is it necessary to resort to indicia of the intent of the Legislature." (*Delaney v. Superior Court* (1990) 50 Cal.3d 785, 798.) R&TC section 6593.5 grants OTA discretionary authority to relieve interest where there has been "an unreasonable error or delay by an employee of the board." There is no further definition of "unreasonable error," thus, based on the plain language, it would appear OTA has authority to conclude that erroneous *oral* advice constitutes an unreasonable error for purposes of interest relief. Nevertheless, we find it appropriate to turn to evidence of legislative intent to clarify any potential ambiguity caused by operation of R&TC section 6596, which requires *written* advice, to grant relief of taxes, penalties, plus applicable interest.

Evidence of the intent behind R&TC section 6593.5 is modest but compelling. First, as background, R&TC section 6596, specifying the circumstances for relief of taxes, interest, and penalties, was added by Assembly Bill 3338 (Stats. 1984, ch. 1728), which had an effective date of January 1, 1985. On the other hand, R&TC section 6593.5, specifying the circumstances for relief of interest (but not taxes or penalties), was added to the R&TC fourteen years after section 6596, effective January 1, 1999, pursuant to Assembly Bill 821 (Stats. 1992, ch. 612). The Legislative Counsel's Digest[9] for the Chaptered version of Assembly Bill 821 explains:

> This bill would *expand, modify, or supplement* [existing law] with respect to provisions relating to, among other things, relief of interest . . . .[10]

(Emphasis added.) The Office of Senate Floor Analyses for Assembly Bill 821 provides additional background and context for the purpose of adding section 6593.5 to the R&TC:

> In 1988 the Congress enacted a Taxpayers' Bill of Rights. A California version of that bill was enacted and became operative in 1989, for taxes administered by both the Franchise Tax Board and the [board]. In mid-1996, the Congress enacted "Taxpayers' Bill of Rights 2," [(TRB2)] to provide for increased protection of taxpayer rights. In 1997, Franchise Tax Board sponsored a bill patterned after many of the TBR2 provisions.

[9] The Office of Legislative Counsel prepares the Legislative Counsel's Digest, which is printed on the first page of each bill and contains a brief summary of the effect of the bill.

[10] See < leginfo.ca.gov/pub/97-98/bill/asm/ab_0801-0850/ab_821_bill_19980921_chaptered.html >.

> This bill, sponsored by the [board], would adopt several of the [TBR2] provisions for the sales tax. The provisions are patterned after the income and corporation tax provisions sponsored last year by the Franchise Tax Board, but, according to the [board], modified to more properly fit the sales tax. The provisions are:
>
> 1. Interest relief. Taxpayers would be provided relief from interest (1) where failure to pay is due to unreasonable error or delay by a [board] employee . . .[11]

The above legislative documents give valuable background to help understand the beneficial aim of R&TC section 6593.5. In summary, the purpose was to track, subject to some modifications, federal provisions applicable to abatement of interest and to which California conforms.

Assembly Bill 713 (Stats. 1997, Ch. 600), sponsored by FTB in 1997 and patterned after the federal provisions for, as relevant, interest abatement, amended R&TC section 19104.[12] The amendments to R&TC section 19104 authorized the Franchise Tax Board to abate interest under certain circumstances involving "any unreasonable error or delay by an officer or employee of the Franchise Tax Board (acting in his or her official capacity) in performing a ministerial or managerial act [¶] . . . [¶] if no significant aspect of that error or delay can be attributed to the taxpayer involved and after the Franchise Tax Board has contacted the taxpayer in writing with respect to that deficiency or payment." This language is patterned after Internal Revenue Code (IRC) section 6404(e), which allows for federal interest abatement under substantially similar circumstances.

With respect to sales taxes, in adding section 6593.5 to the R&TC, the Legislature included substantially identical language (as quoted above for income tax interest abatement) to allow for sales tax interest relief for an "unreasonable error or delay by an employee of the board acting in his or her official capacity" provided that "no significant aspect of the error or delay is attributable to an act of, or a failure to act by, the taxpayer." (R&TC, § 6593.5(a)(1), (b).) Notably absent is a requirement that the error or delay be in performance of a ministerial or managerial act, or that the error or delay occur after the taxpayer was first contacted in writing with respect to a deficiency or payment. (*Ibid*.) Omission of these elements must have been intentional, considering that the Senate Floor Analyses for Assembly Bill 821 explained that the bill "modified [section 6593.5 interest relief] to more properly fit the sales tax." In any event, we

[11] See <leginfo.ca.gov/pub/97-98/bill/asm/ab_0801-0850/ab_821_cfa_19980821_150946_sen_floor.html>.

[12] See <leginfo.ca.gov/pub/97-98/bill/asm/ab_0701-0750/ab_713_bill_19971003_chaptered.html>.

find it appropriate to turn to federal authority to interpret what is meant by an "unreasonable error or delay" because this requirement is universal to state sales and income taxes, and federal income taxes, for abating interest. (R&TC, §§ 6593.5(a)(1) [sales tax]; 19104(a)(1) [state income tax]; IRC, § 6404(e)(1)(A) [federal income tax].)

The United States Tax Court has concluded that erroneous oral advice constitutes an unreasonable error for purposes of federal interest abatement. (*Harbaugh v. Commissioner* (2003) T.C. Memo. 2003-316 [interest abated based on the Tax Court's factual finding that an IRS employee provided erroneous advice during a phone conversation which, but for the advice, would have resulted in the liability being paid sooner].) With respect to the period eligible for interest abatement, federal and state law imposes a requirement that no significant aspect of the delay may be attributable to the taxpayer. (R&TC, §§ 6593.5(b) [sales tax]; 19104(b)(1) [state income tax]; IRC, § 6404(e)(1)(B) [federal income tax].) Under this provision, interest abatement is not applicable for periods after the taxpayer is made aware of the error. (*Harbaugh v. Commissioner, supra,* T.C. Memo. 2003-316; *Braun v. Commissioner* (2005) T.C. Memo. 2005-221.) Consistent with the above authorities, and subject to the limitations described above, we find that OTA has discretionary authority to relieve interest on account of erroneous oral advice by a board member or his or her staff, acting in their official capacity, when we find that the erroneous oral advice constitutes an unreasonable error.

In the instant case, considering the specific details provided by appellant's owners in their written statement, and their testimony at the hearing, including the names of the persons that they met with, and nature of the advice provided, we find the testimony that appellant's owners met with board member Horton and his staff credible. CDTFA Audit Manual Section 0809.12 explains that CDTDFA may enter into written agreements to allow alternative reporting methods for "coffee houses" to report on a percentage basis under certain circumstances which were not met in this case including a prior audit, five or more selling locations, and a written request. Furthermore, CDTFA conceded at the oral hearing that, during the liability period, it did allow some retailers to report on an estimated percentage basis as described in CDTFA's Audit Manual. Considering the similarities between appellant's reporting method, and the provisions in the audit manual, we find it credible that a board employee erroneously advised appellant to apply such an alternative reporting method and report on a percentage basis. Therefore, we make a factual finding that appellant's owners met with board member Horton, and his staff, and

at that meeting, and in subsequent meetings, appellant's owners were erroneously advised to report appellant's taxable sales of food products on an estimated percentage basis.[13] We believe this erroneous advice, which resulted in an incorrect reporting of the liability, constitutes an unreasonable error by a board member and/or his staff, acting in their official capacity, and we find that it is appropriate to grant interest relief under the unique circumstances of this case.

Appellant was made aware that board member Horton's advice was erroneous no later than October 11, 2016, the date CDTFA issued a Notice of Determination to appellant for the additional tax liability caused by reporting on an estimated percentage basis. CDTFA's Audit Report, dated August 26, 2016, further documents that CDTFA's auditor discussed the liability disclosed by audit and errors in the reporting method with appellant. At the time of the NOD, $3,644.91 in interest accrued. As such, we exercise our discretion to grant interest relief in the amount of $3,644.91.

We find that any delay in payment of the tax liability after issuance of the NOD is attributable to appellant, and, as such, no further interest relief is applicable. Although appellant contends that it did not have the ability to pay the liability, because it did not collect the taxes at issue, the law does not allow interest relief on the basis of ability to pay. (R&TC, § 6593.5; see *Mitchell v. Commissioner* (2004) T.C. Memo. 2004-277.)

[13] CDTFA was unable to affirm or deny whether such a meeting occurred. In its post-hearing submission CDTFA did, however, provide an email dated February 14, 2011, from board member Horton's office to appellant, providing advice on the application tax to the sale of hot coffee, and the following additional advice for appellant "I have also attached a form regarding getting tax advice in writing rather than verbally." We find this evidence consistent with our making a factual finding that board member Horton's office met with appellants and provided them verbal advice during 2011, around the time of this email.

HOLDINGS

1. Appellant failed to correctly report its sales and use taxes during the liability period.
2. Appellant established a basis to relieve $3,644.91 in interest.

DISPOSITION

We grant interest relief in the amount of $3,644.91. CDTFA's decision denying appellant's petition is otherwise sustained.

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
1A9B52FF8AC4C7...
Michael F. Geary
Administrative Law Judge

DocuSigned by:
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Richard I. Tay
Administrative Law Judge

Date Issued: 1/28/2020