OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **CHOPRAS RESTAURANT, INC.**	OTA Case No. 19054741 CDTFA Case ID 970976 CDTFA Account No. 100-403231

OPINION

Representing the Parties:

For Appellant: Frank Chopra

For Respondent: Jason Parker, Chief, Headquarters Operations Bureau

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

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Chopras Restaurant, Inc. (appellant) appeals a decision issued by the respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of the Notice of Determination (NOD) which assessed a liability of $284,411.32, a negligence penalty of $28,441.14, and applicable interest, for the period January 1, 2012, through July 31, 2015 (audit period).

Appellant waived its right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales.

FACTUAL FINDINGS

1. During the audit period, appellant operated three restaurants, the Clay Oven in Sherman Oaks (January 1, 2005, through March 31, 2015); Karma Indian Cuisine (Karma) in

Valencia (December 12, 2006, through July 5, 2015); and Moksha Restaurant Bar & Lounge (Moksha) in Canoga Park (January 12, 2009, through October 16, 2013). Appellant also operated Venus Banquet Hall (Venus) in Winnetka (November 20, 2010, through March 31, 2015).

2. During the audit period, appellant reported total sales of $5,021,507, claimed deductions for sales tax included of ($356,233), nontaxable food sales of ($352,590), and "other" of ($316,467),[1] for reported total taxable sales of $3,996,217.

3. On audit, appellant provided its federal income tax returns (FITR's) for 2012, 2013, and 2014; bank statements for Clay Oven, Karma, and Venus for 2014; Forms 1099-K (1099-K);[2] point of sale (POS) records for Clay Oven (first quarter 2012 (1Q12) through 4Q14) and Karma (2Q12 through 4Q15); and quarterly sales summaries recorded in an Excel spreadsheet, for the period 1Q14 through 4Q14, for Clay Oven, Karma, and Venus.

4. In its preliminary examination, CDTFA found that gross receipts of $2,168,858 reported on appellant's FITR for 2012 exceeded total sales, net of sales tax reimbursement, reported on its sales and use tax returns (SUTR's) for that year of $1,372,023 by $796,835. CDTFA used the figures reported on the FITR to compute an achieved markup of 187.25 percent,[3] which it considered lower than expected for this business.[4] As such, CDTFA found that additional investigation was warranted.

5. CDTFA established audited sales for Clay Oven, Karma, and Moksha using the credit-card-sale-ratio method.

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[1] The deductions for nontaxable food sales and "other" deductions were claimed only during the period January 1, 2014, through July 31, 2015.

[2] 1099-K, filed with the Internal Revenue Service by credit card processing companies, is used to report a taxpayer's income received from electronic or online payment services (e.g., credit cards, debit cards, etc.).

[3] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is $.70 and it charges customers $1.00, the markup is $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (.30 ÷ 1.00 = 0.3).

[4] CDTFA notes that the auditor should have used total sales reported on SUTR's in this computation and that the markup thus computed would have been 81.71 percent for 2012 and 86.72 for 2013, which is much lower than expected for this business.

6. CDTFA found that the amounts of credit card sales recorded in the available POS reports differed from the amounts compiled from the available 1099-K's. In addition, CDTFA found deposits in appellant's bank account from a merchant account for which appellant had not provided a 1099-K. In order to establish audited credit card receipts, CDTFA reviewed both the 1099-K and the available POS reports and scheduled the larger amount, on a quarterly basis. Using both sources of information, CDTFA was able to establish audited credit card receipts for each quarter of the audit period, and there was no need to compute a percentage of error to apply to any portion of the audit period.

7. For Clay Oven, CDTFA found total credit card receipts of $2,339,466. However, when it computed the credit card receipts, net of tips, it inadvertently used $2,309,379, the amount recorded on 1099-K's.[5] It reduced that figure by tips,[6] to compute credit card receipts, net of tips, of $2,082,773 ($2,309,379 ÷ 1.1088). CDTFA divided $2,082,773 by the ratio of credit card receipts to total sales (credit card ratio) of 84.50 percent, which it had computed for the prior audit period,[7] to compute audited total sales, including tax, of $2,464,821. It reduced that amount by sales tax, computed on a quarterly basis at the tax rate applicable for each quarter, to compute audited taxable sales of $2,262,903.

8. For Karma, CDTFA found total credit card receipts of $2,611,186, which it reduced by tips,[8] to compute credit card receipts, net of tips, of $2,365,633 ($2,611,186 ÷ 1.1038). It divided $2,365,633 by 88.06 percent, the credit card ratio, to compute audited total sales, including tax, of $2,686,389. It reduced that amount by sales tax, computed on a quarterly basis at the tax rate applicable for each quarter, to compute audited taxable sales of $2,466,325.

9. For Moksha, appellant provided no records of credit card receipts other than 1099-K's. CDTFA compiled credit card receipts, including tax and tip, of $660,098. It also found

[5] This error benefits appellant.

[6] Tips were computed at 10.88 percent, which is the weighted average of the 11.13 percent computed using appellant's POS report for 1Q12 and 8.16 percent computed in the prior audit.

[7] For each of the restaurants, CDTFA used the credit card ratio computed for the prior audit period because the records appellant originally provided were not sufficiently complete to compute a credit card ratio, and an observation test could not be conducted because the business had closed.

[8] The credit card ratio was computed at 10.38 percent from the prior audit.

that appellant had made credit card sales to Groupon of $20,195, which did not include tips. CDTFA reduced the $660,098 by tips,[9] to compute credit card receipts, net of tips, of $612,734 ($660,098 ÷ 1.0773). CDTFA divided $612,734 by a credit card ratio of 68.81 percent, to compute audited total sales, including tax, of $890,520.[10] CDTFA added the Groupon sales of $20,195 to compute audited total sales, including tax, of $910,715. It reduced that amount by sales tax, computed on a quarterly basis at the tax rate applicable for each quarter, to compute audited taxable sales of $836,766.

10. For Venus, CDTFA reviewed sales contracts for the year 2014, but concluded that the records were not sufficient because appellant did not provide any supporting documentation for verification.[11] Accordingly, CDTFA used the information from the prior audit period to establish audited sales for Venus. First, CDTFA found that appellant had made sales of $113,864 to 4,948 customers in 1Q11. It used those figures to compute an average price per guest of $23. It then divided 4,948 by 12 weeks to compute an average of 412 customers per week. It multiplied 412 by $23 to compute weekly sales of $9,489, annual sales of $493,410 ($9,489 x 52), and quarterly sales of $123,353 ($493,410 ÷ 4). CDTFA multiplied $123,353 by 13 to compute audited taxable sales for Venus for the period 1Q12 through 1Q15 of $1,603,583.

11. CDTFA added the audited taxable sales for each location to compute audited taxable sales of $7,169,578 ($2,262,903 + $2,466,325 + $836,766 + $1,603,583), which exceeded reported taxable sales of $3,996,217 by $3,173,361. For 2Q15 and 3Q15, CDTFA found that reported taxable sales exceeded audited taxable sales by $18,010. CDTFA concluded that appellant's sales were not less than reported, and that it was not appropriate to include the credits of $18,010 for those quarters in the computation of the audited understatement. Accordingly, CDTFA increased the audited understatement of reported taxable sales to $3,191,371 ($3,173,361 + $18,010).

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[9] The credit card ratio was computed at 7.73 percent from the prioraudit.

[10] Any minor computation differences, here and elsewhere in the text, are due to rounding in the audit computations.

[11] Appellant claims that he is unable to obtain supporting documents for the contracts in the audit period because of a dispute with the former landlord. In the prior audit, appellant provided banquet contracts with supporting documents for the period of January 2011 through March 2011.

12. CDTFA noted that the understatement of $3,191,371 represented an error rate of 79.86 percent ($3,191,371 ÷ $3,996,217 reported taxable sales). Since the error rate was substantial, and appellant had been audited previously, CDTFA concluded that the understatement was the result of negligence.
13. On July 7, 2016, CDTFA issued the NOD for a liability of $284,411.32, a negligence penalty of $28,441.14, and applicable interest.
14. On July 19, 2016, appellant filed a petition for redetermination.
15. On April 17, 2019, CDTFA issued a Decision, denying the petition.
16. 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 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)(1).)

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 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.)

In general, sales of food are exempt from tax. (R&TC, § 6359.) However, certain sales of food are excluded from the exemption (and are thus subject to tax). As relevant here, sales of food are subject to tax if the food is sold for consumption at facilities provided by the retailer

(R&TC, § 6359(d)(2)) or if the food is sold as hot prepared food products (R&TC, § 6359(d)(7)).[12]

Here, appellant provided incomplete records for audit, and its gross receipts reported on its FITR's exceeded the total sales reported on its SUTR's. In addition, the sales reported on SUTR's for 2012 achieved a markup on cost of about 82 percent, which was much lower than CDTFA expected for this business. Under these circumstances, we find it was appropriate for CDTFA to utilize an indirect audit method. We further find that it was appropriate to use the credit-card-sales ratio method to establish audited sales for the restaurants and to use information from the prior period to establish audited sales for Venus. Thus, we find CDTFA has shown that its determination is reasonable and rational. Therefore, appellant has the burden to establish that adjustments are warranted.

Appellant argues that some of the 1099-K reports are combined with other restaurants. Appellant appears to argue that CDTFA incorrectly allocated credit card receipts to the individual restaurants. In response, CDTFA has presented the audited amounts of credit card receipts for each restaurant. It has also presented the 1099-K payments by business address. CDTFA has not reconciled the differing figures presented. However, CDTFA identified credit card receipts of $4,938,409, which is $50,490 more than the total credit card receipts of $4,887,919 used in the audit calculations.

With respect to the allocation of credit card receipts to each of the three locations, we acknowledge that the allocation may not be precise, as evidenced by the differing figures. Appellant, however, has not established a more accurate allocation or shown how revisions in the allocation would reduce the audited understatement. We also note that, for Clay Oven and Karma, the audited percentages of tips included in credit card receipts and the audited credit card

[12] 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).)

ratios are quite similar.[13] As a result, any incorrect allocations of credit card receipts between those restaurants would not materially impact the audited understatement.

For Moksha, the audited percentage of tips and the audited credit card ratio (7.73 percent and 68.81 percent, respectively) are much lower than those established for the other two restaurants. Accordingly, any credit card receipts allocated to Moksha would result in higher audited sales than if they were allocated to the other restaurants.[14] Of note, the audited credit card receipts for Moksha total $660,098, while the credit card receipts listed by business address show a total of $967,303 ($443,812 + $523,491) at the address for Moksha.[15] Thus, there is no evidence that a reduction of the understatement is warranted because of purported errors in allocation of the credit card receipts to the various restaurant locations.

Appellant argues that the percentage of tips included in credit card receipts was 18 percent and that its cash sales were not more than 6 to 7 percent. The audited percentages of tips and the credit card ratios from the prior audit were used in the audit computations here.[16] Those percentages were used because appellant initially did not provide sufficiently detailed records from which CDTFA could compute percentages for this audit period. Appellant has not provided evidence to support higher percentages of tips included in credit card receipts or higher credit card ratios. As noted above, unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *Riley B's, Inc. v. State Bd. of Equalization, supra*; see also *Appeal of Magidow, supra*.) In the absence of supporting evidence, we find no adjustment is warranted to the audited percentages of tips or the audited credit card ratios.

Appellant further argues that he "was advised by [a CDTFA auditor] to pay sales tax on the food only." Appellant is asserting that its failure to properly report tax was the result of its reliance on advice from an employee of CDTFA. However, there is no evidence, or even

[13] For Clay Oven and Karma, the audited tip percentages are 10.88 percent and 10.38 percent, respectively, and the audited credit card ratios are 84.5 percent and 88.06 percent, respectively.

[14] A hypothetical computation illustrates: $10,000 ÷ 1.0773 = $9,282. $9,282 ÷ .6881 = $13,489. In contrast, $10,000 ÷ 1.1088 = $9,019. $9,019 ÷ .845 = $10,673.

[15] Moksha operated for two years of the audit period at 7140 DeSoto Avenue; it closed October 16, 2013.

[16] The one exception is that, for Clay Oven, the percentage of tips computed using the POS records for 1Q12 (11.13 percent) was averaged with the 8.16 percent computed in the prior audit to establish the 10.88 percent used in this audit.

argument, that appellant received advice in writing. Thus, there is no statutory basis for relief from the tax on the basis that appellant was relying on incorrect advice.[17]

CDTFA explains that the audited amount of average quarterly banquet sales was established using a transcription of banquet contracts for the 1Q11 (from the prior audit). CDTFA states that the prices on the banquet contracts provided in the prior audit were either a lump sum price or a total based on a set price per person. We infer that there was no separate charge for lease of the banquet hall premises, and appellant has provided no banquet contracts for this audit period as evidence of separately stated charges for lease of the premises.

During the prior audit, appellant had provided receipts to assist in the breakdown of the amounts charged, and CDTFA properly excluded fees for valets and cleaning from the audited taxable sales. The audited taxable sales for 1Q11 included only events for which appellant provided food and beverages in its facility. Thus, the entire lump sum contract price or the entire price per person was subject to tax. (See Cal. Code Regs., tit. 18, § 1603(i).)

Since appellant did not provide records for this audit period from which banquet sales by Venus could be established, we find that CDTFA used the best available information. We further find that appellant has not shown that the audited taxable banquet sales for 1Q11 were overstated.[18]

[17] R&TC section 6596 provides relief from tax when a person's failure to pay the tax is the result of his or her reliance on *written* advice from CDTFA, under specified conditions.

[18] CDTFA found that, in the prior audit period, appellant made sales through Venus of $113,864 to 4,948 customers in 1Q11. CDTFA then calculated a weekly number of customers and an average sale per customer to compute weekly sales of $9,489, which it multiplied by 52 and divided by 4 to compute quarterly sales of $123,353. However, in CDTFA's computation of the weekly number of customers, it divided 4,948 by 12 weeks. Since there are 13 weeks in each calendar quarter (13 x 4 = 52), the computed number of customers per week was overstated. However, any overpayment related to CDTFA's error would be more than offset by the error identified in CDTFA's reply brief. Specifically, CDTFA identified additional credit card receipts of $50,490 and understatements of reported taxable sales of approximately $390,000 based on appellant's POS records. (See R&TC, §§ 6563, 6483.)

HOLDING

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

DISPOSITION

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

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

DocuSigned by:
Jeff Angeja
0D390BC3CCB14A9...
Jeff Angeja
Administrative Law Judge

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