

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

I. SINGH & T. SINGH
dba, PB Liquor & Food) OTA Case No. 19064904
) CDTFA Account No. 102-266907
) CDTFA Case ID's: 942653; 0-000-063-039
)
)**OPINION**

Representing the Parties:

For Appellant:

I. Singh, Partner

For Respondent:

Jason Parker
Chief, Headquarters Operations Bureau

For Office of Tax Appeals:

Deborah Cumins,
Business Tax Specialist III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, the partnership of I. Singh and T. Singh (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA), which denied appellant's timely petition for redetermination of a Notice of Determination (NOD) that assessed a tax liability of \$46,578.24 and applicable interest for the audit period of September 16, 2012, through June 30, 2015 (audit period).¹

Appellant waived its right to an oral hearing; therefore, we are deciding this matter based on the written record.

ISSUE

Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales established on a markup basis.

¹ The Board of Equalization (Board) formerly administered business taxes and fees. On July 1, 2017, CDTFA took over these duties. (Gov. Code, § 15570.22.) In this Opinion, when describing acts or events that occurred before July 1, 2017, our use of the term "CDTFA" shall refer to its predecessor, the Board.

FACTUAL FINDINGS

1. Appellant operated a liquor store in Fresno from September 16, 2012, through June 30, 2015.
2. During the audit period, appellant reported total sales of \$1,439,915, claimed deductions totaling \$472,567 for exempt sales of food products, and reported taxable sales of \$967,348.
3. For audit, appellant provided monthly cash register z-tapes for most of the audit period;² federal income tax returns (FITR's) for 2012, 2013, and 2014; and purchase invoices for October 2013, the second quarter of 2014, February 2015, and September 2015.
4. In its preliminary review of the records, CDTFA noted that total sales reported on appellant's sales and use tax returns (SUTR's) exceeded the amounts reported on the FITR's for 2012 and 2014. CDTFA found no difference in 2013.
5. CDTFA also found that appellant's recorded total sales of \$1,609,181 exceeded reported total sales of \$1,439,915 by \$169,266. In addition, its recorded taxable sales of \$1,053,476 exceeded reported taxable sales of \$967,348 by \$86,128.
6. Using the amounts of total sales reported on SUTR's and the amounts of purchases reported on FITR's for 2013 and 2014, combined, CDTFA computed an achieved markup of 19.1 percent, which was lower than CDTFA expected.³
7. Because of the conflicting records and an achieved markup that was lower than expected, CDTFA concluded that further investigation was warranted. Accordingly, CDTFA used markup audit techniques to analyze whether appellant's records effectively represented its sales.
8. CDTFA conducted a purchase segregation test using purchase invoices for the months of October 2013 and April 2014.⁴ CDTFA computed that 91.292 percent of appellant's purchases represented taxable merchandise.

² A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain period of time (i.e., a day or a shift).

³ According to the decision issued by CDTFA's Appeals Bureau, CDTFA would generally expect a markup of at least 25 percent (and perhaps as low as 20 percent in some instances), but probably not more than 45 percent.

⁴ In a purchase segregation test, CDTFA schedules merchandise purchases in various product categories (such as tobacco, beer, liquor, wine, carbonated beverages, sundries, periodicals, and food) in order to compute the percentage of taxable merchandise purchases, as well as the percentages of merchandise in each category.

9. Appellant conducted its own purchase segregation test using purchase invoices for the months of May 2014, June 2014, and February 2015. Appellant computed that 88.869 percent of its purchases represented taxable merchandise.
10. After reviewing appellant's test, CDTFA combined the two purchase segregation tests to compute that 89.923 percent of appellant's purchases represented taxable merchandise. It also used the combined purchase segregation test to compute the following (rounded) percentages of purchases in certain taxable merchandise categories: 29 percent cigarette and tobacco, 32 percent beer, 34 percent liquor and wine, 3 percent soda, and 1 percent miscellaneous taxable merchandise.
11. CDTFA applied 89.923 percent to the amounts of purchases reported on appellant's FITR's for 2013 and 2014, combined, to compute taxable purchases of \$781,134. That amount was greater than the taxable sales of \$709,357 reported by appellant for those two years. CDTFA regarded that discrepancy as evidence that recorded taxable sales were understated.
12. CDTFA conducted shelf tests in September 2015 using costs from purchase invoices dated in September 2015 and current selling prices.⁵ It computed markups of 14 percent for cigarettes and tobacco products, 26 percent for beer, 36 percent for liquor and wine, 51 percent for soda, and 53 percent for miscellaneous taxable merchandise (percentages rounded). It used those percentages and the percentages of purchases in those categories to compute a weighted average markup of 26.9 percent.
13. CDTFA requested transaction information from appellant's vendors. The information provided by beer vendors, showing purchases of \$403,540 for the audit period, was the most complete. CDTFA divided \$403,540 by 29.426 percent⁶ to compute audited total merchandise purchases of \$1,371,390.⁷
14. CDTFA used the beginning and ending inventories reported on appellant's FITR's for 2012, 2013, and 2014, along with audited total purchases for each year or partial year, to

⁵ A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

⁶ The percentage of beer purchases to total purchases computed from appellant's records.

⁷ We compute \$1,371,372. The \$18 difference is due to rounding when the audited purchases were computed for each year or partial year.

establish the cost of goods sold of \$1,295,642 for the audit period.⁸ CDTFA multiplied the costs of goods sold for each year or partial year by 89.923 percent, the percentage of taxable to total merchandise purchases established in the combined purchase segregation test, to establish the audited cost of taxable merchandise sold, which totaled \$1,165,080. CDTFA then reduced that figure by estimated losses due to pilferage, computed at 2 percent, to arrive at \$1,141,779.⁹

15. CDTFA added the markup of 26.9 percent to the audited cost of taxable goods sold of \$1,141,779 to compute audited taxable sales of \$1,448,915. It compared that figure to recorded taxable sales of \$1,053,477 to compute an understatement of \$395,438.¹⁰
16. On March 8, 2016, CDTFA issued the NOD for tax of \$46,578.24 and applicable interest.
17. On March 15, 2016, appellant filed a timely petition for redetermination, appealing the audited understatement established on a markup basis of \$395,438.
18. On May 23, 2019, CDTFA issued a decision denying the petition.
19. This timely appeal followed.

DISCUSSION

California imposes a sales tax on a retailer measured by the gross receipts from its retail sales 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, 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

⁸ In the absence of an FITR for 2015, CDTFA considered the inventories constant for the first two quarters of 2015. Also, since the inventories reported on the FITR's reflected an increase in inventory of \$75,748 over the audit period (\$125,748 ending - \$50,000 beginning = \$75,748), that amount of merchandise costs was excluded from the computation of audited taxable sales. However, there is no evidence in the record that appellant provided detailed inventory counts or any documentation to support the inventories, which CDTFA routinely requires.

⁹ CDTFA did not make an adjustment for self-consumption of taxable merchandise because appellant stated that any self-consumption was immaterial. At the CDTFA appeals conference, appellant confirmed that statement.

¹⁰ CDTFA's comparison of audited taxable sales to recorded taxable sales precluded duplicating a separate uncontested audit item for which CDTFA found an understatement of \$86,128 (difference between recorded and reported taxable sales).

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 this case, appellant provided incomplete records. It did not provide the sales summary worksheets used to prepare SUTR's, a purchase journal, or complete purchase invoices for the audit period. Further, the available records were not consistent and provided evidence of various understatements. Moreover, the audited purchases of taxable merchandise for 2013 and 2014 exceeded reported taxable sales for the same years. As a result of these discrepancies, we find it was appropriate for CDTFA to utilize alternate audit methods. The markup audit method is a well-established audit method that has been shown effective and reliable as long as there is sufficient information to establish an accurate cost of taxable merchandise sold and an accurate markup. (*Maganini v. Quinn* (1950) 99 Cal.App.2d 1.) We have reviewed the audit working papers, have found that there was sufficient information to utilize the markup audit approach, and have found no errors in the audit procedures or material inaccuracies in the calculations. Thus, we find that CDTFA has shown that its determination is reasonable and rational, and the burden of proof now shifts to appellant to establish that adjustments are warranted.

On appeal, appellant claims that “[w]e have invoices for nontaxable items that were missed in [the] original audit.” In other words, appellant argues that the audited percentage of taxable to total merchandise purchases should be reduced. However, appellant has not provided any invoices or other evidence.

As described above, CDTFA conducted a purchase segregation test using purchase invoices for two months. Appellant then conducted its own purchase segregation test using invoices for three other months. After reviewing appellant's test, CDTFA decided to combine the two purchase segregation tests into one. We note that the months tested are in three different years: 2013 (October); 2014 (April, May, and June); and 2015 (February). We find that a test of

five months is adequate. Also, the months tested are distributed throughout the audit period and include months in all four seasons. Thus, we find that the months tested are representative of appellant's operations. We also note that the percentages of taxable to total merchandise purchases computed by CDTFA and appellant are consistent (91 percent and 89 percent, respectively), which is another indicator that the test is reliable. Accordingly, in order to support a reduction to the audited percentage of taxable to total merchandise purchases, appellant must provide specific, clear, verifiable evidence.

Appellant asserts that there were purchases of nontaxable merchandise during the test periods that were overlooked in the purchase segregation tests. In order to document that argument, appellant would need to provide copies of purchase invoices, dated in one of the five months tested, that are not listed on purchase segregation tests. Appellant has not provided a single invoice that was missed.¹¹ In the absence of evidence (i.e., copies of purchase invoices for nontaxable merchandise during the months tested that are not listed on the purchase segregation tests), we find that no adjustment is warranted.


¹¹ At the appeals conference held by CDTFA's Appeals Bureau on July 25, 2018, appellant agreed to provide additional records. However, it had failed to provide any additional evidence by May 23, 2019, the date of the Appeals Bureau's decision. Since appellant's briefing to OTA did not include a single sample invoice that was "missed," we find it likely that no further evidence will be forthcoming.

HOLDING


Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales established on a markup basis.

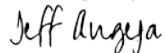
DISPOSITION

Sustain CDTFA’s decision to deny the petition.

DocuSigned by:

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:

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Josh Aldrich
Administrative Law Judge

DocuSigned by:

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Jeffrey G. Angeja
Administrative Law Judge

Date Issued: 4/28/2020