OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19074993
	) CDTFA Account No. 100-262493
MBSC, INC.	) CDTFA Case ID 983104
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Shawn Zali, Representative
For Respondent:	Randy Suazo, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
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, MBSC, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated September 26, 2016. The NOD is for $47,701.44 in tax, and applicable interest, for the period January 1, 2011, through December 31, 2013 (liability period).

Office of Tax Appeals Administrative Law Judges Daniel K. Cho, Teresa A. Stanley, and Andrew J. Kwee held an oral hearing for this matter in Cerritos, California, on July 21, 2020.[2] At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall also refer to BOE.

[2] The oral hearing was noticed for Cerritos, California, but was conducted electronically by videoconference due to COVID-19.

ISSUE

Whether an adjustment is warranted to the determined measure of tax.

FACTUAL FINDINGS

1. During the liability period, appellant operated a restaurant in Mission Viejo, California, selling prepared food to be consumed on the business premises and to-go. Appellant also provided a delivery service and made catering sales.
2. For the liability period, appellant reported gross sales of $3,669,463, claimed deductions of $293,973, and reported taxable sales of $3,375,490 on its sales and use tax returns (SUTRs).
3. For audit, appellant provided federal income tax returns (FITRs) for 2011 and 2012; forms 1099-K[3] for 2011, 2012, and 2013; Point of Sale (POS) reports for the liability period and for September 2014; food purchases reported on credit card statements for May, June, and July 2014; monthly bank statements for the liability period and for September 2014; and SUTRs for the liability period.
4. In its preliminary review, CDTFA noted that the gross receipts reported on appellant's FITRs substantially reconciled with the amounts of total sales reported on its SUTRs. CDTFA used total sales reported on SUTRs (excluding sales tax) and the adjusted costs of goods sold[4] to compute achieved markups of about 108 percent for 2011, 111 percent for 2012, 121 percent for 2013, and 142 percent for 2014. These markups were much lower than the markup expected by CDTFA (150 to 200 percent). CDTFA also noted that appellant's catering and delivery sales were not recorded in the POS system.
5. Based on its review of the available records, CDTFA concluded that the restaurant sales recorded in the POS system were substantially accurate. However, because of the lower-than-expected achieved markups and the fact that the delivery sales and catering sales were not recorded in the POS system, CDTFA concluded that additional investigation was warranted.

[3] The form 1099-K is an Internal Revenue Service form which shows amounts paid to the merchant by customers using some type of payment card (i.e., credit card or debit card) or third-party network (e.g., PayPal).

[4] For 2011 and 2012, CDTFA used the costs of goods sold that appellant reported on its FITRs. For 2013 and 2014, CDTFA used the amounts of purchases recorded on income statements. CDTFA reduced the reported and recorded costs of goods sold for estimated amounts of pilferage and self-consumption, each computed at 2 percent.

6. CDTFA compiled bank deposits of $3,715,151, which excluded amounts verified as deposits unrelated to retail sales for the business. CDTFA reduced that amount for sales tax reimbursement included, using the sales tax rates applicable for various portions of the liability period,[5] to establish audited taxable sales of $3,440,026.[6] CDTFA compared that figure to reported taxable sales of $3,375,490 to establish an understatement of reported taxable sales of $64,536, which was audit item 1.
7. Because appellant did not record its catering and delivery sales in its POS system, CDTFA compared appellant's bank statements and POS records to determine that appellant's restaurant sales represented 65.97 percent of its total sales and that appellant's delivery and catering sales represented 34.03 percent of its total sales for September 2014.
8. CDTFA divided the restaurant sales as stated on the POS records of $2,619,466 by 0.6597 to compute total sales of $3,970,693, which included catering and delivery sales. CDTFA compared the total audited sales of $3,970,693 with reported taxable sales of $3,375,490 to compute an understatement of reported taxable sales of $595,203. CDTFA segregated this understatement into an understatement based on the analysis of bank deposits of $64,536 (audit item 1) and an understatement based on the ratio of restaurant sales to total sales of $530,666 (audit item 2).[7]
9. On September 26, 2016, CDTFA issued the NOD for an understatement of tax of $47,701.44.
10. Appellant filed a timely petition for redetermination.
11. On June 27, 2019, CDTFA issued a Decision in which it denied appellant's petition.
12. This timely appeal followed.

[5] The applicable sales tax rates utilized by CDTFA were 8.75 percent (January 1, 2011, through June 30, 2011); 7.75 percent (July 1, 2011, through December 31, 2012); and 8.00 percent for 2013.

[6] We note that CDTFA did not reduce the bank deposits for the amounts of nontaxable sales for resale claimed as deductions on returns, $24,103. Thus, CDTFA effectively disallowed appellant's claimed sales for resale. Although we find no audit comments related to sales for resale, CDTFA's Decision states (on page 3, lines 7 and 8) that appellant did not provide support for its claimed sales for resale. Since appellant has not disputed CDTFA's decision to disallow the claimed nontaxable sales for resale, this matter will not be addressed further.

[7] $64,536 + $530,666 = $595,202. The $1 difference is the result of rounding.

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.) Although gross receipts derived from the sale of food products are generally exempt from the sales tax, sales of food sold in a heated condition and food sold for consumption on or off the premises of the retailer are subject to tax. (R&TC, § 6359(a), (d)(1), & (d)(7).)[8]

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.)

Here, CDTFA compared appellant's bank statements for the liability period to appellant's reported taxable sales. This resulted in a deficiency measure for appellant's restaurant sales, which was audit item 1. In addition, CDTFA determined that appellant did not record its catering and delivery sales for the liability period on its POS records. As a result, CDTFA

[8] 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).)

In this case, CDTFA has not specifically expressed a conclusion that appellant's sales met the requirements of the 80/80 rule. However, CDTFA has regarded all of the audited sales as taxable, implying a conclusion that appellant's sales met the requirements of the 80/80 rule. Although appellant argued at the appeals conference with CDTFA that several of the large amounts deposited in the bank represented exempt sales of cold food to elder care facilities, it has not made this argument in the appeal before the Office of Tax Appeals. Accordingly, we do not address this further.

estimated appellant's catering and delivery sales for the liability period by comparing appellant's POS records for the month of September 2014 to appellant's bank statement for the corresponding month. Based on this comparison, CDTFA calculated a ratio of appellant's catering and delivery sales to its restaurant sales; CDTFA then projected that ratio to the total POS records for the liability period to estimate appellant's catering and delivery sales, which is audit item 2. Based on the foregoing, we find that CDTFA's determination is both reasonable and rational and that the burden of proof shifts to appellant to establish that a different result is warranted.

Appellant argues that CDTFA's use of appellant's sales records for September 2014 was erroneous because appellant made a number of catering sales to an adult health care center that were not representative of the catering and delivery sales made during the liability period. Appellant explains that it made catering sales to the adult health care center from September 2014 to April 2015, which was not during the liability period. As a result, appellant argues that CDTFA should reduce its estimate in the amount of the sales to the adult health care center because appellant did not make those sales during the liability period. In support of this argument, appellant provided a report from the adult health care center, showing all of appellant's sales to the adult health care center for the period January 2014 through July 2015.

Based on the report, we find that appellant made sales of $9,234 to the adult health care center in September 2014 and that appellant did not make sales to the adult health care center during the liability period. However, this evidence alone is not sufficient to demonstrate that CDTFA's estimate of appellant's catering and delivery sales is overstated. Appellant did not provide sufficient records to verify its catering and delivery sales for the liability period. As a result, CDTFA examined September 2014 as a sample period to estimate appellant's catering and delivery sales for the liability period. This sample period is not expected to be an exact replica of appellant's business for the entire liability period. Thus, the fact that appellant made catering and delivery sales to a certain customer during the sample period and not during the liability period does not establish that an adjustment is warranted. Therefore, we find that this evidence alone is not sufficient to warrant an adjustment to the determined measure of tax.

Throughout the appeal, appellant asserts that the markup for its business is lower than the markups for other types of restaurant food businesses. However, appellant has not provided sufficient evidence and corresponding calculations to establish the markup for its business.

Accordingly, we find this argument to be unsupported by the evidentiary record. Appellant further states that the auditor performed a markup test and that appellant performed a markup test on each individual dish. Appellant contends that the auditor accepted appellant's achieved markups. However, both the comments to the audit workpapers and CDTFA's decision concluded that the markups for 2011, 2012, and 2013 were too low and unacceptable. Therefore, we find that this assertion is incorrect.

Appellant also contends that it already provided all of the records necessary to support its position to CDTFA during the audit of the business. Although CDTFA responded that it did not receive all of the necessary supporting documentation, we note that this argument is immaterial to the outcome of this appeal. The Office of Tax Appeals is an independent agency from CDTFA, and appellant has not provided the alleged records to the Office of Tax Appeals. Without such records, appellant has failed to meet its burden to establish that CDTFA's estimate is erroneous or overstated. The only two exhibits that appellant provided in this appeal were the printout from the adult health care center and a credit card projection spreadsheet. As we found above, the printout from the adult health care center was insufficient to warrant any adjustments to the estimated catering and delivery sales. With respect to the credit card projection spreadsheet, this document is not supported by any original source documentation and is inconsistent with CDTFA's audit findings. For example, CDTFA's bank deposits analysis resulted in a deficiency measure of $64,536, while this credit card projection spreadsheet estimates that appellant overreported its taxable sales. Therefore, we find appellant's evidence to be insufficient to meet appellant's burden of proof.

HOLDING

No adjustments are warranted to the determined measure of tax.

DISPOSITION

Sustain CDTFA's decision to deny the petition for redetermination.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

DocuSigned by:
0CC6C6ACCC6A44D...
Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
3CADA62FB4864CB...
Andrew J. Kwee
Administrative Law Judge

Date Issued: 9/22/2020