OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19105395
	) CDTFA Account No. 101-053533
S. PRICE	) CDTFA Case ID 995356
dba Filter Coffee and Tea	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	S. Price
For Respondent:	Jason Parker, Chief, Headquarters Operations Bureau
For Office of Tax Appeals:	Deborah Cumins, Business Tax Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, S. Price (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] in response to appellant's timely petition for redetermination of a Notice of Determination (NOD) for a tax liability of $68,953.20, a negligence penalty of $6,895.33, and applicable interest, for the period October 1, 2013, through September 30, 2016 (audit period). CDTFA conducted a reaudit which reduced the taxable measure from $861,914 to $603,731. CDTFA then reduced the corresponding tax liability from $68,954 to $48,296, deleted the negligence penalty, and denied the remainder of the petition.

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

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

ISSUE

Whether appellant has shown that further adjustments are warranted to the audited understatement of reported taxable sales.[2]

FACTUAL FINDINGS

1. Appellant operated coffee shops at multiple locations in San Diego during the period April 10, 2008, through December 23, 2016. During the audit period, appellant operated only one location, which opened on June 23, 2010. Appellant sold various coffee beverages, pastries, granola cups, sandwiches, and salads. The coffee shop had seating for 40 to 50 customers, who purchased food and beverages either for consumption at the coffee shop or "to go."
2. During the audit period, appellant reported total sales of $532,493, claimed deductions totaling $273,817, and reported taxable sales of $258,676. Appellant's claimed deductions included the following: exempt sales of food products of $258,184; nontaxable labor of $4,706; returned merchandise of $1,282; cash discounts of $2,003; and "other" deductions of $7,643.
3. Appellant provided no records for audit. Also, since the coffee shop closed before the audit work began, CDTFA did not have an opportunity to conduct an observation test.
4. CDTFA obtained 1099-K forms, *Payment Card and Third Party Network Transactions*,[3] information for the period October 1, 2013, through December 31, 2015, which it used to compile credit card receipts of $816,825. CDTFA assumed that all of appellant's credit card receipts were associated with taxable sales. CDTFA reduced appellant's credit card sales by the sales tax rate to compute taxable credit card sales of $756,319, which exceeded appellant's total reported sales during that period by $322,488. CDTFA, therefore, concluded that appellant's reported total sales were substantially understated.
5. CDTFA estimated that 80 percent of appellant's receipts represented credit card sales based on similar local businesses. Therefore, it divided $756,319 by 0.80 to compute

[2] CDTFA established two audit items, one for the period October 1, 2013, through December 30, 2015, and another for the period January 1, 2016, through September 30, 2016. However, both audit items represent audited understatements of reported taxable sales, so we address them as one issue.

[3] Federal Form 1099-K, "*Payment Card and Third Party Network Transactions*," is a form used by credit card companies and third-party processors (payment settlement agencies) to report the gross amount of reportable payments made to the taxpayer by the payment settlement agency.

audited total sales of $945,399 for the period October 1, 2013, through December 31, 2015. Since appellant has not provided any records to show that any of his sales were not subject to tax, CDTFA considered the entire amount to be taxable sales, and it computed an understatement of reported taxable sales of $727,164 ($945,399 - $218,235 reported taxable sales).[4]

6. CDTFA computed a percentage of error of 333.20 percent ($727,164 ÷ $218,235), which it applied to reported taxable sales for the period January 1, 2016, through September 30, 2016, to compute an understatement of $134,750, rounded ($40,441 reported x 3.3320).
7. CDTFA computed an understatement of reported taxable sales for the audit period of $861,914 ($727,164 + $134,750).
8. On January 17, 2017, CDTFA issued the NOD for a liability of $68,953.20, a negligence penalty of $6,895.33, and applicable interest.
9. On January 26, 2017, appellant filed a timely petition for redetermination.
10. On April 11, 2017, CDTFA issued an audit report that deleted the negligence penalty and made no adjustment to the liability.
11. On April 11, 2019, CDTFA issued a decision ordering a reaudit to provide a reasonable allowance for appellant's exempt sales of food.
12. In its reaudit, CDTFA allowed the exempt sales of food that appellant claimed on his sales and use tax returns of $258,184.
13. 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).)

[4] CDTFA effectively disallowed all of appellant's claimed deductions, including the deduction for exempt sales of food.

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.)

When a right to an exemption from tax is involved, the taxpayer has the burden of proving his right to the exemption. (*H. J. Heinz Co. v. State Bd. of Equalization* (1962) 209 Cal.App.2d 1, 4.) Any taxpayer seeking exemption from the tax must establish that right by the evidence specified by the relevant regulation. A mere allegation that sales are exempt is insufficient. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442.)

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)).

Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sales for a separate price are generally exempt. As relevant here, however, those sales are subject to tax if the hot bakery goods and hot beverages are consumed on the retailer's premises. (Cal. Code Regs., tit. 18, § 1603(e).)

For this case, appellant has not provided any records. Thus, CDTFA had no option but to utilize an alternate audit method. CDTFA used 1099-K forms to compile appellant's credit card receipts and used an estimated credit card ratio of 80 percent to compute audited total sales. CDTFA allowed all of the exempt nontaxable sales of food that appellant claimed on his sales and use tax returns. We find that CDTFA has shown that its determination is rational and reasonable. Therefore, appellant has the burden to show that adjustments are warranted.

Appellant's primary argument is that many of his sales were sales of cold food to go. Appellant also asserts the audit measure is not representative of sales, as evidenced by the fact that the coffee shop went out of business in 2016.

Addressing the audited total sales first, we note that CDTFA compiled appellant's credit card receipts from 1099-K forms for nine of the 12 quarters of the audit period. CDTFA then used an estimated credit card ratio of 80 percent, which assumes that 80 percent of appellant's customers paid with a credit card. We find this assumption to be reasonable because CDTFA based the 80 percent estimate on comparable businesses in the area. We find that CDTFA used the best available information (1099-K forms) and a reasonable credit card ratio to compute appellant's audited total sales for the period October 1, 2013, through December 31, 2015. Appellant has provided no evidence to show that any reductions are warranted for that period. Accordingly, we find no adjustment is warranted to audited total sales for the period October 1, 2013, through December 31, 2015.

CDTFA computed a percentage of error of 333.20 percent, using the first nine quarters of the audit period, and applied that percentage to reported taxable sales for the period January 1, 2016, through September 30, 2016. We find that a test period of nine quarters is sufficient to establish a representative percentage of error. We have reviewed CDTFA's computations and have found no errors. Appellant has provided no evidence, or even a detailed argument, to show that reductions are warranted to the audited amount of total sales for the last three quarters of the audit period. Thus, we find no adjustment is warranted to the audited amount of total sales for the period January 1, 2016, through September 30, 2016.

Regarding the audited amount of exempt sales of food, CDTFA allowed all the sales that appellant claimed as exempt sales on his sales and use tax returns. CDTFA asserts that, in the absence of evidence, it regards the amounts claimed on returns as an adequate allowance.[5]

As noted above, all gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) Further, when a right to an exemption from tax is involved, the taxpayer has the burden of proving his right to the exemption. (*H. J. Heinz Co. v. State Bd.*

[5] CDTFA notes that the claimed exempt sales of $218,235 for the period October 1, 2013, through December 31, 2015, represent about 23 percent of audited total sales for that period of $945,399. Similarly, with respect to the period January 1, 2016, through September 30, 2016, CDTFA allowed the claimed exempt sales of $55,668, which represent about 32 percent of audited total sales for the period of $175,191. CDTFA comments further that, in its audit experience, it has found that similar businesses claim about 30 percent of their sales as exempt sales of food.

of Equalization, supra.) Also, any taxpayer seeking exemption from the tax must establish that right by the evidence specified by the relevant regulation. A mere allegation that sales are exempt is insufficient. (*Paine v. State Bd. of Equalization, supra*.)

CDTFA has allowed the entire amount claimed on appellant's own returns as exempt sales of food. Appellant has not provided any records or evidence to show that the amounts claimed were incorrect or to otherwise support an increase in the audited amount of exempt food sales. Accordingly, appellant has failed to meet his burden of proof. (See *Riley B's, Inc. v. State Bd. of Equalization, supra*; see also *Appeal of Magidow, supra.*)

Thus, we find that no increase in the audited amount of exempt sales of food is warranted.

HOLDING

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

DISPOSITION

Sustain CDTFA's decision to reduce the audited understatement of reported taxable sales from $861,914 to $603,730, to delete the penalty, and to otherwise deny the petition for redetermination.

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
DC88A60D8C3E442...

Keith T. Long
Administrative Law Judge

DocuSigned by:
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Andrew Wong
Administrative Law Judge

Date Issued: 6/10/2020