

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
SUN SUN ENTERPRISE, INC.

) OTA Case No. 19034415
) CDTFA Account No. 101-276827
) CDTFA Case ID 1048699
)
)
)

OPINION

Representing the Parties:

For Appellant: Chris Housh, Attorney
S. Sun, Chief Executive Officer
P. Chan, Secretary

For Respondent: Mariflor Jimenez, Hearing Representative
Christopher Brooks, Tax Counsel IV
Jason Parker, Chief of Headquarters Operations

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Sun Sun Enterprise, Inc. dba Aberdeen Café (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s petition for redetermination of the Notice of Determination (NOD) for a tax liability of \$49,221.94, plus applicable interest, for the period July 1, 2013, through June 30, 2016 (audit period).

Office of Tax Appeals Administrative Law Judges Josh Lambert, Andrea L.H. Long, and Josh Aldrich held an oral hearing for this matter on July 28, 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 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 referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to BOE; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

² The oral hearing was noticed for Sacramento and conducted electronically due to COVID-19.

ISSUE

Whether adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. CDTFA audited appellant, a full-service restaurant selling food, beer, and wine. Appellant provided its federal income tax returns for fiscal years 2013-2014 and 2014-2015, credit card payment information from its merchant services providers (Forms 1099-K), bank statements, monthly reports from its point-of-sale (POS) system for the audit period; and POS data for July 15, 2015, through January 17, 2017.
2. Appellant did not provide POS data for the periods prior to July 15, 2015. Appellant did not provide source documents, such as guest checks, to support the amounts recorded in its POS system.
3. CDTFA compared appellant's reported total sales, excluding sales tax reimbursement, with the costs of goods sold reported on its federal income tax returns. CDTFA determined that appellant's book markups were significantly lower than CDTFA would have expected for a business of this type.³
4. CDTFA accepted the accuracy of appellant's reported taxable sales for the second quarter of 2015 (2Q15) through 2Q16 because reported taxable sales were consistent with POS data and, in addition, CDTFA found the credit-card-to-total-sales ratio (credit-card-sales ratio) for that period to be consistent with appellant's type of business.
5. CDTFA did not accept the accuracy of appellant's recorded and reported taxable sales for the period 3Q13 through 1Q15 because appellant did not provide source documents or POS data for that period, and recorded sales paid with cash (cash sales) were substantially lower than during the later period.⁴

³ CDTFA stated at the hearing that the average markup for a restaurant in that area that sells beer and wine is around 200 percent. CDTFA also stated that the calculated markup was 117 percent for fiscal year 2013-2014, and 107 percent for fiscal year 2014-2015.

⁴ CDTFA examined appellant's monthly POS reports and noted that 34 percent of recorded sales were cash sales during the period 2Q15 through 2Q16, while 21 percent of the recorded sales were cash sales for the period 3Q13 through 1Q15. In addition, for the period 3Q13 through 1Q15, recorded quarterly cash sales averaged \$96,648 and recorded quarterly credit card sales averaged \$362,233. For the period 2Q15 through 2Q16, recorded quarterly cash sales averaged \$196,929 and recorded quarterly credit card sales averaged \$378,950.

6. Credit card sales and customer counts remained relatively consistent throughout the audit period. CDTFA decided to use a credit-card-sales ratio to establish audited taxable sales.
7. CDTFA computed a credit-card-sales ratio of 66.65 percent for 2Q15 through 4Q16 based on the recorded cash sales and credit card sales. CDTFA divided credit card sales for 3Q13 through 1Q15 by 66.65 percent and made adjustments to exclude tips and sales tax reimbursement, resulting in audited taxable sales of \$3,500,615. After comparing \$3,500,615 with reported taxable sales, CDTFA calculated underreported taxable sales of \$546,910 for 3Q13 through 1Q15.
8. On January 8, 2018, CDTFA issued the NOD to appellant based on underreported taxable sales of \$546,910. Appellant timely filed a petition for redetermination disputing the NOD, which CDTFA denied. This timely appeal followed.

DISCUSSION

California imposes a sales tax on a retailer's retail sales of tangible personal property in this state, 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 from the sale of "food products" (as defined in R&TC section 6359(b)(1)-(3)) are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), & (d)(7).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid on the basis of any information within its possession or that 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. (*Appeal of Talavera*, 2020-OTA-022P.) 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. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide any source documents or detailed POS data to support the sales amounts recorded in its monthly POS reports for the period 3Q13 through 1Q15. CDTFA found that a comparison of appellant's reported taxable sales with its costs of goods sold, reported on appellant's income tax returns for fiscal years 2013-2014 and 2014-2015, showed

book markups that were much lower than expected. Additionally, CDTFA found that appellant's average recorded cash sales of \$96,648 per quarter for the period 3Q13 through 1Q15 were much lower than its average recorded cash sales of \$196,929 per quarter for the period 2Q15 through 2Q16. Given the absence of documentation to support the recorded sales amounts for the period 3Q13 through 1Q15, the low book markups, and the differences between the average recorded cash sales for the earlier period and the later period, we find that it was reasonable for CDTFA to conclude that appellant's taxable sales were underreported for the period 3Q13 through 1Q15, and to determine audited taxable sales for that period based on a credit-card-sales ratio analysis using the information in CDTFA's possession. Therefore, the burden shifts to appellant to establish that a reduction to the audited taxable measure is warranted.

Appellant argues that CDTFA improperly applies *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616 (*Riley B's*) because appellant's records, including its bank records and tax returns, were not inconsistent and, after feeling only a "whim of uncertainty," CDTFA made a determination that is not based on the records. Appellant asserts that *Riley B's, supra*, involved circumstances where a "behind the books" determination of tax by CDTFA was allowed after the taxpayer's records were found to be inconsistent.⁵ Appellant asserts that it provided the documents necessary to demonstrate its reported taxable sales were consistent and accurate, including POS reports, bank statements, and tax returns. Appellant claims that the records it provided for examination were as complete as possible and that CDTFA failed to show that the records were inaccurate.

However, the court in *Riley B's* refuted the argument that "calculating theoretical sales is valid where the actual sales are unknown or unrecorded" and "improper where comprehensive business records are maintained." (*Riley B's, supra*, 61 Cal.App.3d at p. 615.) The court cited to *Maganini v. Quinn* (1950) 99 Cal.App.2d 1, 4 (*Maganini*), which stated that R&TC section 7054 grants CDTFA the "[a]uthority to verify the accuracy of any sales tax return... ." ⁶(*Riley B's, supra*, 61 Cal.App.3d at p. 615.) As noted by *Riley B's* at p. 615, the court in *Maganini* stated

⁵ During the hearing, appellant asserted that *Riley B's* states that "if the documents are not trustworthy, then the State can go and use whatever other methods to come up with a percentage to determine the accurate element."

⁶ Specifically, R&TC section 7054 states that "[CDTFA] or any person authorized in writing by it may examine the books, papers, records, and equipment of any person selling tangible personal property and any person liable for the use tax and may investigate the character of the business of the person in order to verify the accuracy of any return made, or, if no return is made by the person, to ascertain and determine the amount required to be paid."

that R&TC section 6481 authorizes CDTFA to compute and determine the amount of tax due “upon the basis of any information within its possession or that may come into its possession.”⁷ (*Maganini, supra*, 99 Cal.App.2d at p. 4 [original italics], citing R&TC, § 6481.) The court in *Maganini* stated that those code sections “clearly contemplate an examination ‘behind the books,’ so to speak, in which original records ... may be audited and analyzed” and that “[t]here is no requirement that such audit be restricted to pointing out falsifications, errors or omissions, if any, in the books of account themselves.”⁸ (*Maganini*, at p. 7.) Therefore, CDTFA is not required to find appellant’s records to be inconsistent or erroneous in order to conduct its examination and make a determination of tax due.

Appellant claims that it used the same reporting practices throughout the audit period and that cash sales increased during 2Q15 through 2Q16 for numerous reasons beyond its control. Appellant contends that a burglary occurred in 2015 that resulted in a breach of its credit card machine and POS system. Appellant argues that customers were less willing to use the credit card machine after the breach. Appellant also contends that, as a result of the breach, the credit card processing company stopped appellant from using the credit card system for a short period of time. Appellant asserts that it also could not use its credit card system because it often lost its internet connection due to rats biting through wires during a rat infestation. For the above reasons, appellant argues that cash sales increased for 2Q15 through 2Q16. Therefore, appellant argues that CDTFA should not question the accuracy of its reported taxable sales for 3Q13 through 1Q15.

One of appellant’s owners testified at the hearing that a police report was not filed with regard to the burglary, and that no insurance claim was filed for a door broken during the burglary. In addition, the owner testified that the credit card processing company provided notification of the breach by telephone, but that no documentation was provided. Appellant does

⁷ In addition, California Code of Regulations, title 18, section 1698(b)(1) states that “[a] taxpayer shall maintain and make available for examination on request by the Board or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return.”

⁸ The court in *Riley B’s* stated that, to hold otherwise would allow the avoidance of tax liability “simply by maintaining inaccurate but voluminous and consistent records.” (*Riley B’s, supra*, 61 Cal.App.3d, at p. 616.) As noted in *AMG Care Collective*, 2020-OTA-173P, R&TC section 6481 “establishes the broad power of respondent to determine a taxpayer’s liability,” and “the fact that appellant’s bank deposit information, [income tax returns], and cash register Z-tapes substantially reconciled with the amounts reported on [sales and use tax returns] does not establish that appellant correctly reported taxes due.”

not provide any documentation or otherwise sufficient evidence to support its contentions, such as that there was a burglary, a breach of its POS system or credit card machine, a rat infestation, or internet outages. Furthermore, appellant asserts that it does not have paper records or guest checks because such documentation was damaged and thrown out due to the rat infestation. Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) Accordingly, we find appellant has not provided sufficient evidence to substantiate its contentions, and it also has not provided evidence to establish that any adjustment is warranted. (*Ibid.*)

We also note that, while appellant contends that more customers paid with cash after the claimed robbery, appellant's credit card sales increased during the period in which it claims credit card sales should have declined.⁹ Therefore, appellant has not met its burden to show that a result differing from CDTFA's determination is warranted.

⁹ Credit card sales increased by 3.14 percent from 2014 to 2015, even though the total number of customer transactions decreased. Appellant's credit card sales totaled \$1,488,104 in 2014 and \$1,534,902 in 2015, representing an increase of \$46,798, or 3.14 percent of \$1,488,104. And average quarterly credit card sales of \$378,950 for the period 2Q15 through 2Q16 are higher than average quarterly credit card sales of \$362,233 for the earlier period.

HOLDING

Appellant has not established that any reduction to the amount of unreported taxable sales established by audit is warranted.

DISPOSITION

CDTFA’s action in denying appellant’s petition for redetermination is sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Andrea L.H. Long
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Andrea L.H. Long
Administrative Law Judge

DocuSigned by:
Josh Aldrich
48745BB806914B4...
Josh Aldrich
Administrative Law Judge

Date Issued: 10/7/2020