OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19034515
	) CDTFA Account No. 101-252489
I. MULLICK	) CDTFA Case ID 690128
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	I. Mullick
For Respondent:	Mariflor Jimenez, Hearing Representative Kevin Smith, Tax Counsel III Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, I. Mullick (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA[1]) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) for $19,162.16 tax, plus applicable interest, for the period May 15, 2009, through December 31, 2011 (audit period).

Office of Tax Appeals Administrative Law Judges Andrea L.H. Long, Andrew J. Kwee, and Suzanne B. Brown held an oral hearing for this matter in Sacramento, California, on July 27, 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 (board). In 2017, functions of the board 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 January 1, 2018, "CDTFA" refers to the board; and when this opinion refers to acts or events that occurred on or after January 1, 2018, "CDTFA" refers to CDTFA.

[2] Due to the COVID-19 pandemic, the oral hearing was conducted electronically with the agreement of the parties.

ISSUE

Whether adjustments are warranted to the measure of unreported taxable sales for the audit period.

FACTUAL FINDINGS

1. Appellant operated a coffeehouse in San Francisco, California, as a sole proprietor from May 15, 2009, through December 31, 2011, selling coffee, tea, and pastries. As of January 1, 2012, appellant formed a limited liability company (LLC), with himself as the sole member, and thereafter the LLC operated the coffeehouse.
2. For the audit period, appellant reported total sales of $533,110, all of which appellant claimed as exempt sales of food products. Appellant reported no taxable sales.
3. In May 2012, CDTFA initiated an audit of the coffeehouse. At the time of the audit, the coffeehouse provided seating for 42 people inside and 32 people outside.[3] According to CDTFA's Assignment Activity History (Form 414Z) for this audit, CDTFA visited the coffeehouse on June 6, 2012, and observed that there were "at least 24 customers consuming coffee or pastry on the premises," although the cash register tape showed only 21 taxable sales. On June 7, 2012, CDTFA conducted a full one-day observation test. For that day, CDTFA computed a percentage of taxable to total sales (taxable sales ratio) of 60.19 percent.
4. For audit, appellant provided federal income tax returns for 2009 and 2010, a profit and loss statement for 2011, cash register z-tapes,[4] and purchase invoices.
5. Based on its reconciliation of recorded and reported total sales and its analysis of appellant's achieved markups, CDTFA concluded that appellant's reported total sales were substantially accurate.[5]

[3] At one point during the audit period there was a bench outside the front of the business, but CDTFA did not include that bench in the count of available seats for the audit computations.

[4] 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).

[5] Reported total sales of $533,110 exceeded recorded total sales of $531,272 by $1,838. CDTFA computed achieved markups of 200, 176, and 197 percent for 2009, 2010, and 2011, respectively, which were within the range of markups CDTFA expected for this business.

6. During the audit and in his testimony at hearing, appellant stated that he did not collect sales tax reimbursement with respect to any of his sales during the audit period because he believed all of his sales were exempt. CDTFA informed appellant that the sale of food consumed on appellant's premises is subject to sales tax. CDTFA asked appellant to begin segregating taxable and nontaxable sales on the cash register and to provide cash register z-tapes for a two-week period.

7. Appellant reprogrammed his cash register to track taxable and nontaxable sales, and he provided cash register z-tapes for the period June 26, 2012, through July 9, 2012 (test period).[6] CDTFA used those records to compute a taxable sales ratio of 51.71 percent for the test period.

8. Appellant asserted that the taxable sales ratio was lower in earlier portions of the audit period because he did not add outdoor seating until 2010. Appellant also argued that his customers did not utilize the outdoor seating in inclement weather. In consideration of these claims, CDTFA agreed to adjust its calculations by using 51.71 percent as the audited taxable sales ratio only for the second quarter of 2010 (2Q10), 3Q10, 2Q11, and 3Q11.

9. To establish the taxable sales ratio for the remainder of the audit period, CDTFA computed that the indoor seating (42 seats) represented 56.76 percent of the total seating (74 seats). CDTFA multiplied 51.71 percent by 56.76 percent to compute a taxable sales ratio of 29.35 percent for the remaining quarters of the audit period (2Q09, 3Q09, 4Q09, 1Q10, 4Q10, 1Q11, and 4Q11).

10. As support for appellant's position that seating was added later in the audit period, CDTFA requested appellant's invoices for the purchases of furniture. CDTFA also stated that appellant could provide records of his purchases of paper cups during the audit period as support for his position that a larger percentage of sales were "to go." Appellant indicated he did not have any of those purchase records.

11. CDTFA applied the audited taxable sales ratios to reported total sales, by quarter, to compute audited taxable sales of $206,978.

[6] The test period is after the audit period, which ended December 31, 2011. Further, the test was conducted after appellant had reorganized the business as an LLC. There is no evidence or argument that the restaurant operations changed when the business was reorganized.

12. On November 2, 2012, CDTFA issued to appellant the NOD for tax of $19,162.16, plus interest. On November 20, 2012, appellant filed a timely petition for redetermination.
13. On August 22, 2014, CDTFA issued a Decision and Recommendation denying the petition.[7]
14. This timely appeal followed.

DISCUSSION

California imposes a sales tax on retailers, measured by the retailer's gross receipts from sales of tangible personal property in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) 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.* (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 for human consumption are exempt from tax. (R&TC, § 6359.) 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)). As explained in California Code of Regulations, title 18, section (Regulation) 1603(e), hot bakery goods and hot beverages such as coffee are hot prepared food products, but their sale for a separate price is exempt unless the sale is subject to tax as provided in subdivisions (b), (c), (d), or (f) of Regulation 1603. Regulation 1603(f) provides that tax applies

[7] The appeal was deferred for settlement negotiations from March 2015 until March 2019.

to sales of food sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer.

The sales tax is imposed upon retailers for the privilege of selling tangible personal property at retail in this state (R&TC, § 6051). The retailer may collect sales tax reimbursement from the purchaser if the contract of sale so provides (Civ. Code, § 1656.1(a)). Sales tax applies regardless of whether the retailer collects reimbursement from its customer. (R&TC, § 6051.) While a taxpayer may collect tax reimbursement from its customers, there is no requirement that it do so, and failure to collect reimbursement is generally not a basis for relief from the tax. (See *Pacific Coast Engineering Co. v. State of California* (1952) 111 Cal.App.2d 31, 34 (*Pacific Coast*).)

For this audit, CDTFA concluded that reported total sales were substantially accurate. However, since appellant was unaware that any of his sales were subject to tax, he had neither reported any of his sales as taxable sales nor segregated taxable sales and nontaxable sales in his records. Since appellant's records for the audit period did not provide data from which to establish the taxable sales ratio, it was reasonable for CDTFA to obtain additional information to calculate appellant's taxable sales. Specifically, CDTFA asked appellant to retain cash register tapes for two weeks, segregating taxable and nontaxable sales. CDTFA used those cash register tapes to establish a taxable sales ratio for the test period. CDTFA then made adjustments in response to appellant's assertions that there was less seating in the restaurant during the early years of the business's operation and that customers did not utilize the outdoor seating in inclement weather. Based on all of the evidence, we find that CDTFA has shown that its determination is reasonable and rational. Thus, appellant has the burden to establish that adjustments are warranted.

Appellant contends that during the earlier portion of the audit period, the percentage of customers eating and drinking at the coffeehouse (and thus, the taxable sales ratio) was significantly lower than the 51.71 percent ratio CDTFA applied to a portion of the audit period. While appellant agrees that the coffeehouse provided up to 74 seats (42 inside and 32 outside) when the observation test occurred in 2012, he argues that there were far fewer seats during the business's first two years of operation. Regarding inside seating, appellant states that there were no more than 20 indoor seats; as evidence, appellant points to several photos he indicates show the coffeehouse during its early years of operation. Appellant also states that outside seating was

not available at all during the business's first year of operation, and in the second year there were only two tables and eight to ten plastic chairs on the patio, although even then few people sat outside because outdoor seating in San Francisco is often unappealing due to poor weather, and also at that time staff did not encourage use of the patio. Using these lower numbers for seating, appellant computes taxable sales of $118,818 during the audit period. In addition, appellant states that compared to the audit period, dine-in sales were higher during the observation test in 2012 because the business had begun selling tea in teapots, which increased dine-in sales.

CDTFA has provided photos that customers posted to Yelp.com (Yelp) showing additional seating (not shown in appellant's photos) as early as June 2009. CDTFA notes that appellant has not provided more persuasive evidence, such as purchase invoices, to show the dates that appellant added seating.

As noted above, appellant asserts that the coffeehouse provided significantly fewer seats during the first two years of operation, covering the period May 15, 2009, through May 15, 2011. However, the comments in the audit workpapers document that during the audit, appellant told the auditor that a long bench was attached to the interior wall at the end of 2009, a small bench was added in early 2010, and outside seating was purchased in 2010. Moreover, the evidentiary record includes a photo posted to Yelp on June 19, 2009, which shows a long bench inside the coffeehouse; thus, we conclude that the bench was added at least by that date.

For several reasons, the photos appellant provided are not persuasive evidence in supporting further adjustment. First, the photos show various sections of the coffeehouse, and it is not possible to identify all the available seats. Second, appellant's photos are not dated. Further, CDTFA has provided photos from Yelp that show there were more seats than the number shown in appellant's photos. Accordingly, we find that appellant's evidence does not establish that during the audit period there were fewer seats than the number that CDTFA already accounted for in the audit calculations.

Moreover, CDTFA has made reasonable adjustments to incorporate appellant's assertions during the audit that he did not add the outdoor seating until 2010 and that customers did not use the outdoor seating when the weather was unpleasant. CDTFA has computed a percentage of indoor seating to total seating of 56.76 percent and has applied that percentage to the taxable sales ratio of 51.71 percent for the test period to establish a taxable ratio of 29.35 percent. In other words, CDTFA has computed that 29.35 percent is the taxable sales ratio applicable to

periods when there were only 42 seats (the available seating inside the coffeehouse at the time of the audit). CDTFA used that lower taxable sales ratio for 62.5 percent[8] of the audit period. We conclude that use of the lower ratio for the period May 15, 2009, through April 1, 2010, fully addresses appellant's position that he did not add outside seating until 2010. Since the audit computations are based on an assumption that the outside seating is not used in the first and fourth quarters, we find that CDTFA's adjustment also fully addresses appellant's assertion that customers do not use the outside seating during inclement weather.

Appellant also asserts that taxable sales ratio changed when more customers sat in the coffeehouse after it began to offer tea in teapots. While the availability of teapots could have some effect on a customer's decision to dine in the restaurant, we are not convinced that it would have a material impact, and in any event would be impossible to quantify. Thus, we find that appellant has not established that the addition of teapots to the menu warrants a reduction to the determined measure.

To substantiate his assertion that the taxable sales ratio should be reduced, appellant states that the sales and use tax returns filed by the coffeehouse (during the period it was operated by the LLC) subsequent to the audit period reflect a taxable sales ratio of 45 percent. Appellant does not state whether the periods for which those returns were filed have been audited by CDTFA and verified as substantially accurate. Absent such verification, the LLC's reported taxable sales ratio is of limited evidentiary value. Additionally, we note that for the audit at issue, the overall taxable sales ratio is 38.88 percent ($206,978 taxable / $533,110 total), which is lower than the LLC's 45 percent ratio. In light of all evidence, the LLC's reported taxable sales ratio does not support a reduction to the audited taxable sales ratio in the present case.

Based on its full one-day observation test on June 7, 2012, CDTFA computed a taxable sales ratio of 60.19 percent. CDTFA conducted the one-day test because, on a brief visit to the coffeehouse, the auditor noted that there were 24 customers eating at the tables, while the cash register tape showed only 21 taxable sales. In other words, CDTFA had evidence that the taxable and nontaxable sales segregation on the cash register tapes was not precisely accurate. Nevertheless, CDTFA did not utilize the 60.19 percent in its computation of the audited taxable

[8] The lower ratio was used for 20 months of the 32-month audit period (eight months of 2009, six months of 2010, and six months of 2011) 20 ÷ 32 = 62.5 percent.

sales ratio. Instead, it accepted the cash register tapes provided by appellant for the test period (June 26, 2012, through July 9, 2012), from which the auditor computed a materially lower taxable sales ratio of 51.71 percent. We find that the results of the one-day observation test offer additional evidence that the audited taxable sales ratios are reasonable.

In addition to his argument that the audited taxable sales ratios are excessive, appellant testified that the business did not collect sales tax reimbursement during the audit period. Appellant explains that his failure to collect sales tax reimbursement was the result of miscommunication, not maliciousness.[9] As stated above, sales tax is imposed on the retailer for the privilege of selling tangible personal property in California. (R&TC, § 6051.) The retailer may collect sales tax reimbursement from customers, but is not required to do so. Failure to collect reimbursement based on oral advice is not a basis for relief from the tax. (R&TC, § 6596; see *Pacific Coast, supra*, 111 Cal.App.2d at 34.) Accordingly, the fact that appellant did not collect sales tax reimbursement from customers does not constitute any basis for an adjustment to the deficiency measure.

[9] Appellant testified that when he first began operating the business, he asked CDTFA staff about whether he needed to collect sales tax, and they replied that his sales were nontaxable because coffee is food. Appellant did not request or obtain this advice in writing. There is no applicable legal provision that would allow for relief of taxes based on reliance on oral advice. (See R&TC, § 6596(b)(2); Cal. Code Regs., tit. 18, § 1705(a)(1).)

HOLDING

Appellant has not established that adjustments are warranted to the measure of unreported taxable sales for the audit period.

DISPOSITION

Sustain CDTFA's decision to deny the petition.

DocuSigned by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

We concur:

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

DocuSigned by:
Andrea LH Long
2Z2945EZB3Z2445...
Andrea L.H. Long
Administrative Law Judge

Date Issued: 10/8/2020