OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18032420
	) CDTFA Account No. 99-563626
Z. ALAWDI	) CDTFA Case ID 856070
DBA LAFRANCHI'S LIQUOR	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Hassen Mohsen, Representative
For Respondent:	Mariflor Jimenez, Hearing Representative Jason Parker, Hearing Representative Christopher Brooks, Tax Counsel IV
For Office of Tax Appeals:	Deborah Cumins, Business Tax Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Z. Alawdi dba LaFranchi's Liquor (appellant) appeals a decision issued by the respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) for $37,904.07 of additional tax, a negligence penalty of $3,790.43, and applicable interest, for the period October 1, 2010, through September 30, 2013 (audit period).

Office of Tax Appeals Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Andrew J. Kwee, held an oral hearing for this matter in Fresno, California, on February 27, 2020. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUES

1. Has appellant shown that adjustments are warranted to the audited understatement of reported taxable sales?
2. Was the understatement due to negligence?

FACTUAL FINDINGS

1. Appellant has operated a liquor store, dba LaFranchi's Liquors, in Oakland, California, since September 1, 1994.
2. During the audit period, appellant reported total sales of $2,102,615, claimed deductions of $345,410 for sales of exempt food products, and reported taxable sales of $1,757,205.
3. For audit, appellant provided federal income tax returns (FITRs) for 2011 and 2012, sales and use tax returns (SUTRs) and related worksheets for the audit period, a profit and loss statement (P&L) for 2013, and purchase invoices for the audit period. Appellant did not provide summary records of sales (other than the FITRs and P&Ls); source documents for sales, such as cash register z-tapes; or summary records of purchases, such as a purchase journal. Moreover, while appellant used a Point of Sale (POS) system to record sales, he did not provide any POS records for audit.
4. In its preliminary review, CDTFA found that the total sales reported on SUTRs exceeded the gross receipts reported on FITRs by $47,826 in 2011 and $49,359 in 2012, the two years for which appellant provided FITRs.
5. According to appellant, reported taxable sales represented purchases of tobacco products, plus a markup of 21 percent, and purchases of other taxable merchandise, plus a markup of 41 percent.
6. CDTFA traced the amounts of merchandise purchases recorded on the SUTR worksheets to purchase invoices and found both unrecorded merchandise purchases and missing purchase invoices. Therefore, CDTFA concluded that the purchase amounts recorded on appellant's SUTR worksheets, and used to compute reported taxable sales, were not reliable, and decided to establish audited sales on a markup basis.
7. CDTFA asked appellant's known vendors to provide information regarding their sales to appellant. The vendors identified merchandise purchases of $497,171 for 2011, $703,152 for 2012, and $612,960 for the first three quarters of 2013. This exceeded the costs of goods sold that appellant reported on FITRs for 2011 of $455,437, and 2012 of $483,358. CDTFA used the amounts identified by the vendors as audited purchases.
8. CDTFA used the purchase invoices for May and June 2012 to conduct a purchase segregation test. It found that 82.42 percent of appellant's purchases represented taxable

merchandise.[1] CDTFA also segregated the taxable merchandise into various merchandise categories.[2]

9. CDTFA applied 82.42 percent to the audited merchandise purchases to compute audited purchases of taxable merchandise of $409,768 for 2011, $579,538 for 2012, and $505,202 for the partial year 2013.[3]

10. CDTFA reduced the audited purchases of taxable merchandise by estimated amounts of self-consumption[4] and pilferage, each computed at 1 percent, to compute audited costs of taxable goods sold of $401,614 for 2011, $568,005 for 2012, and $495,148 for the partial year 2013.

11. CDTFA then conducted a shelf test, comparing costs obtained from purchase invoices for the month of May 2014 and selling prices posted on the store shelves or provided by appellant's son on August 11, 2014, to establish audited markups for the various categories of merchandise identified in the segregation test.[5]

12. CDTFA used the percentages of merchandise in the various categories and the audited markups for each category to compute a weighted average markup of 35.40 percent.

13. CDTFA used the audited costs of taxable goods sold and the markup of 35.40 percent to compute audited taxable sales of $543,785 for 2011, $769,079 for 2012, and $670,431 for the partial year 2013. Audited taxable sales exceeded reported taxable sales by $24,331 for 2011, $221,522 for 2012, and $127,523 for the partial year 2013, which represented error rates of 4.68 percent for 2011, 40.46 percent for 2012, 23.49 percent for the partial year 2013, and 23.19 percent overall. CDTFA applied those percentages to reported

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[1] CDTFA found that 17.22 percent of appellant's purchases represented exempt food products, 0.24 percent represented miscellaneous nontaxable merchandise, and 0.12 percent represented supplies.

[2] CDTFA found that the taxable merchandise represented: 43.38 percent liquor; 25.81 percent beer and wine; 5.01 percent carbonated beverages; 23.90 percent tobacco products; and 1.90 percent sundry items.

[3] $497,171 x 82.42% = $409,768; $703,152 x 82.42% = $579,538; $612,960 x 82.42% = $505,202

[4] CDTFA computed an audited cost of self-consumed taxable merchandise of $16,303 for the audit period, which was established as a second amount of unreported taxable measure. Appellant has not disputed the audited cost of self-consumed taxable merchandise, and the adjustment for self-consumption effectively reduces the overall understatement because there is no markup added to that cost. Accordingly, the audited cost of self-consumed taxable merchandise will not be addressed further.

[5] CDTFA computed markups of 45.15 percent for liquor; 30.74 percent for beer and wine; 44.30 percent for soda; 18.16 percent for tobacco products; and 69.34 percent for taxable sundry products.

taxable sales (using 23.19 percent for the fourth quarter 2010) to establish an understatement of reported taxable sales of $407,535, the amount in dispute.

14. In a prior audit completed just prior to the current audit period, CDTFA used the markup basis and determined gross receipts were understated by $128,644.

15. On December 11, 2014, CDTFA issued an NOD for tax of $37,904.07, a negligence penalty of $3,790.43, and applicable interest.

16. Appellant filed a petition for redetermination, which CDTFA denied.

17. Subsequently, appellant submitted this appeal.[6]

DISCUSSION

Issue 1: Has appellant shown that adjustments are warranted to the audited understatement of reported taxable sales?

The California sales tax is imposed 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.) 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.) 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.)

[6] Appellant was invited to file an opening brief but did not do so. Appellant was invited to file a reply brief responding to CDTFA's brief but did not do so. Appellant was invited to attend a prehearing conference but did not call in or respond to calls from the Office of Tax Appeals. Appellant was invited to submit exhibits prior to the oral hearing but did not do so. Appellant requested the oral hearing, which was scheduled and held, but neither appellant nor his representative appeared. Thus, the only evidence in the record was submitted by CDTFA.

As noted above, appellant did not provide adequate records from which the amount of taxable sales could be established. Further, the available records were conflicting. Accordingly, we find it was appropriate for CDTFA to use an alternate audit method to establish audited taxable sales. We further find that the markup audit method was appropriate in this case and that CDTFA has shown that its determination is reasonable and rational. Thus, appellant has the burden of proving that adjustments are warranted.

Since appellant has not filed any brief or submitted any evidence, we rely on the information available to us regarding the appeal filed with CDTFA. The arguments in appellant's petition for redetermination, filed December 16, 2014, were: 1) the auditor used the wrong method to determine the understatement; 2) the audit results are not supported by the facts; and 3) further review has uncovered discrepancies that need to be sorted out. In an amended petition, dated February 26, 2015, appellant merely stated that he had been out of the country but had returned and would like to review the case. Since neither the original nor the amended petition provided arguments that were sufficiently specific to analyze effectively, we rely on the discussion in CDTFA's Decision to understand appellant's arguments in the appeal filed with that agency.

According to the Decision, appellant contended at the appeals conference that the purchase information obtained from the vendors was overstated. Appellant asserted that vendors often used appellant's seller's permit number when selling merchandise to other customers for resale. On that basis, appellant argued that the costs of goods sold reported on FITRs should be used in the audit computations. In addition, appellant asserted that he had identified errors in the selling prices used in the shelf test to compute audited markups. Although CDTFA's Appeals Bureau provided time for appellant to provide documentation to support these arguments, none was provided. Nor was any supporting documentation provided on appeal.

We reiterate that unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (See *Riley B's, Inc. v. State Bd. of Equalization*, *supra*; and *Appeal of Magidow*, *supra*.) We find that appellant has not met the burden of proving that there are errors in the audit results and establishing a different result. Therefore, no adjustment is warranted to the audited understatement of reported taxable sales.

Issue 2: Was the understatement due to negligence?

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Taxpayers are required to maintain and make available for examination on request by CDTFA, 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 returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

CDTFA found that appellant's failure to maintain and provide adequate records to support the amounts reported on its SUTRs represented negligence in record keeping. Although appellant used a POS system, no POS records were provided. A taxpayer's failure to introduce evidence that is within his or her control gives rise to the presumption that the evidence, if provided, would be unfavorable to his or her position. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.) Also, CDTFA found that the audited percentage of error of 23.19 percent was strong evidence of negligence, particularly since appellant had been audited previously. Moreover, CDTFA noted that the errors found in this audit were the same types of errors found in the previous audit, in which it had established additional taxable sales on a markup basis of $128,644 and disallowed claimed exempt sales of $4,932. When in a prior audit, a taxpayer is directed to certain errors it was making, it is relevant to the issue of the negligence penalty whether those same errors are repeated in a subsequent audit. (*Independent Iron Works Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323.)

Appellant disputed the negligence penalty on the basis that reported taxable sales were correct. As explained previously, appellant has provided no evidence to support adjustments to the audited understatement. Thus, this argument against the negligence penalty is unavailing.

Generally, we expect a taxpayer that is audited to correct its recordkeeping and reporting errors, such that similar errors are not found in a subsequent audit. In this case, however, the understatement established on a markup basis in the prior audit was $128,644, while the understatement in this audit was $407,535, more than three times as much as identified in the prior audit period. We find that appellant's failure to improve his record keeping and reporting accuracy is clear evidence of negligence. Thus, we find that the penalty was properly applied.

HOLDINGS

1. Appellant has not shown that adjustments to the audited understatement of reported taxable sales are warranted.
2. The understatement was the result of negligence, and the penalty was properly imposed.

DISPOSITION

We sustain CDTFA's decision to deny the petition for redetermination.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

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Andrew J. Kwee
Administrative Law Judge

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