

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

H. ERAGA,
dba Ideal Market) OTA Case No.: 18124074
) CDTFA Account No.: 102-049717
) CDTFA Case ID: 940710
)
)**OPINION**

Representing the Parties:

For Appellant:

Hassen Mohsen, Representative

For Respondent:

Lisa Renati, Hearing Representative
Jason Parker, Chief, Hdqrs. Ops. Div.
Christopher Brooks, Tax Counsel IV

For Office of Tax Appeals:

Deborah Cumins,
Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, H. Eraga (appellant), doing business as Ideal Market, appeals the decision issued by the respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's timely petition for redetermination of the Notice of Determination (NOD), which assessed a tax liability of \$41,697.76 and applicable interest, for the period April 1, 2012, through December 31, 2014 (audit period).

Office of Tax Appeals Administrative Law Judges Andrew Wong, Sheriene Anne Ridenour, and Josh Aldrich held a telephonic hearing on April 21, 2020, for this matter, which was previously scheduled for Cerritos, California. At the conclusion of the hearing, the record was closed, and the matter was submitted for decision.

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.)

ISSUE

Whether appellant has shown that adjustments are warranted to the understatement of reported taxable sales.

FACTUAL FINDINGS

1. Appellant operated a convenience store known as “Ideal Market” in Oakland, California from April 1, 2011, until March 31, 2018.
2. During the audit period, appellant reported total sales of \$1,097,593, claimed deductions of \$333,154 for exempt sales of food and \$62,576 for sales tax included in reported total sales, and reported taxable sales of \$701,863.
3. For audit, appellant provided a federal income tax return (FITR) for 2012, profit and loss statements (P&Ls) for 2014, bank statements for third quarter 2013 (3Q13) and 4Q13, and merchandise purchase invoices for 1Q14.
4. In its preliminary review, CDTFA found that total sales reported on sales and use tax returns for 2012 reconciled with gross receipts reported on the 2012 FITR, and the reported taxable sales for 2014 reconciled with the amounts recorded on the P&Ls for that year. Using gross receipts and the cost of goods sold reported on the 2012 FITR, CDTFA computed a book markup² of 32.34 percent, which it considered reasonable for this business.
5. CDTFA compiled recorded merchandise purchases from appellant’s P&Ls for 2014 and found that recorded purchases of “other taxable merchandise,” which included purchases of tobacco products and sundry merchandise, totaled \$6,143 for the year. Also, CDTFA noted that no purchases for this category were recorded for the months of March, August, October, November, or December. CDTFA also observed a significant inventory of cigarettes and tobacco products when it visited the store. CDTFA, therefore, determined that further investigation was warranted.

² “Markup” is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer’s cost is \$.70 and it charges customers \$1.00, the markup is \$.30. The formula for determining the markup percentage is $\text{markup amount} \div \text{cost}$. In this example, the markup percentage is 42.86 percent ($.30 \div .70 = .42857$). A “book markup” (sometimes referred to as an “achieved markup”) is one that is calculated from the retailer’s records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is $\text{profit amount} \div \text{sales price}$. In the above example, the gross profit margin is 30 percent ($.30 \div 1.00 = .3$).

6. CDTFA requested purchase information from appellant's known cigarette and tobacco vendor, Pitco Wholesale. Pitco Wholesale provided CDTFA a sales report (Pitco report). From that information, along with recorded purchases for appellant's other vendors, CDTFA compiled total purchases of taxable merchandise of \$60,466 for 1Q14. CDTFA reduced that amount by an estimated amount of pilferage, computed at two percent, to establish the audited cost of taxable merchandise sold for 1Q14 of \$59,257.³
7. CDTFA decided to establish audited sales using the markup method.
8. Appellant declined CDTFA's request to perform a shelf test.⁴ In lieu of a markup established in a shelf test, CDTFA used the book markup of 32 percent, which it considered reasonable based on its experience with similar businesses in the local area, to compute audited taxable sales of \$78,182 (rounded) for 2014. CDTFA computed that audited taxable sales exceeded reported taxable sales of \$46,918 by 66.64 percent for 1Q14. It applied that percentage to reported taxable sales for the audit period to compute the understatement of \$467,689.
9. On March 8, 2016, CDTFA issued the NOD for tax of \$41,697.76 and applicable interest.
10. On March 12, 2016, appellant filed a timely petition for redetermination.
11. On November 28, 2018, CDTFA issued the decision denying the petition for redetermination.
12. 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).)

³ CDTFA did not make an adjustment for the cost of self-consumed merchandise because appellant stated that there was no self-consumption.

⁴ A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

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 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.)

In this case, appellant's reported total sales and reported taxable sales reconciled with the records provided by appellant. Also, the book markup was about 32 percent, which CDTFA found to be reasonable based on its experience with similar stores in the surrounding area. However, CDTFA noted recorded purchases of only \$6,143 in the "other taxable" category (which included cigarette and tobacco products (CTP) and sundry items) for the entire year of 2014. CDTFA also observed that, for five months of 2014, there were no recorded purchases of "other taxable" merchandise. For 2014, CDTFA computed recorded daily average purchases of "other taxable" of \$17, which would represent sales of \$22 per day ($\17×1.32). CDTFA had observed a significant inventory of CTP at the store. Thus, CDTFA determined it improbable that appellant's sales of CTP and sundry items would only average \$22 per day. CDTFA, therefore, requested purchase information from appellant's vendors.

We find that the discrepancy between the amount of recorded purchases of CTP and the readily observable inventory of CTP was a strong indication that the recorded purchases were incomplete. We, therefore, find it was appropriate for CDTFA to utilize an alternative audit method to establish audited sales. We further find that the markup method was appropriate. It was appropriate for CDTFA to utilize information provided by appellant's vendors to establish audited purchases. We also note that CDTFA has utilized appellant's markup of record of 32 percent. As such, we find that CDTFA has established that its audit is reasonable and rational. Thus, appellant has the burden to show that adjustments are warranted.

Appellant argues that the recorded amounts of purchases are correct. Appellant claims that she did not make the unrecorded purchases in the Pitco report. Appellant argues that the audited purchases included purchases made by individuals not associated with her business. She further asserts that anyone can make purchases from Pitco Wholesale without membership verification.

In support of her argument, appellant submitted a video, which is approximately four minutes long. It appears to be recorded in the interior of a Pitco Wholesale warehouse store. There is no indication of the warehouse location, the date, or the time of the video recording. In the video, a man states that he is from Ideal Market in Oakland and requests “the number” from an employee. The employee writes something down on a small piece of paper, which he then hands to the person who requested “the number.” Appellant contends that the employee provided Ideal Market’s account number to the man without confirming his identity. The video, however, does not offer evidence that the Pitco report included purchases by other individuals.

CDTFA argues that the records were incomplete because there were only four invoices for CTP in 1Q14, and those purchase invoices were insufficient to maintain appellant’s readily observable inventory. CDTFA argues that the taxable merchandise purchase percentages were inconsistent, which indicates that the records provided were incomplete.⁵

We find there is evidence that the recorded purchases for 1Q14 were understated. In that regard, we note that the recorded purchases of 29 cartons of cigarettes and 4 packages of tobacco for 1Q14 would not be adequate to maintain a large inventory of CTP for sale. We also note that appellant did not offer an explanation for the minimal purchases of CTP in relation to the large inventory of CTP. We find it more likely than not that recorded purchases for 1Q14 were incomplete.

Appellant’s video does not convince us otherwise. The only information that can be obtained from the appellant’s video is that Pitco employees do not always request identification before they provide information to the person requesting it. The video does not offer evidence to

⁵ According to CDTFA, the purchase invoices of taxable merchandise provided by appellant show that appellant’s purchases for 1Q14 were as follows: 87 percent for beer and wine; 8 percent for carbonated drinks; 4 percent for CTP; and less than 1 percent for sundry/other items. In contrast, the percentages of purchases in each taxable merchandise category, computed using the information in the Pitco report for 1Q14, along with recorded purchases from other vendors show the following: 52 percent for beer and wine; 6 percent for carbonated drinks; 41 percent for CTP; and less than 1 percent for sundry/other items.

show that individuals, who were not associated with appellant's business, made purchases or transactions in the Pitco report.

The Pitco report includes invoice numbers and lists the total purchases in each merchandise category for each invoice. Appellant has not identified a single invoice in the Pitco report that pertains to a purchase she did not make. Moreover, she has not offered evidence such as financial statements or other records that would support her assertions (e.g., credit card statements, cancelled checks, or bank statements).

Since appellant provided incomplete records for audit, CDTFA used the best available information to establish appellant's actual purchases. Appellant has not presented any evidence to the contrary. As such, appellant failed to meet her burden. Therefore, we find no adjustment is warranted to the audited understatement.

HOLDING

Appellant has not shown that an adjustment is warranted to the audited understatement of reported taxable sales.

DISPOSITION

We sustain CDTFA's decision to deny the petition.

DocuSigned by:

Josh Aldrich

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Josh Aldrich

Administrative Law Judge

We concur:

DocuSigned by:

Andrew Wong

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Andrew Wong

Administrative Law Judge

DocuSigned by:

Sheriene Anne Ridenour

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Sheriene Anne Ridenour

Administrative Law Judge

Date Issued: 6/18/2020