**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 18113998 |
| | ) CDTFA Case ID 868452 |
| **A. KENNEY** | ) |
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**OPINION**

Representing the Parties:

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| For Appellant: | Richard Brickman, Attorney<br>Paul Beck, Attorney |
| For Respondent: | Randy Suazo, Hearing Representative<br>Christopher Brooks, Tax Counsel IV<br>Jason Parker, Chief of Headquarters Operations |
| For Office of Tax Appeals: | Deborah Cumins,<br>Business Taxes Specialist III |

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A. Kenney (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated March 26, 2015. The NOD is for $15,039.10 in tax, plus applicable interest, for the period October 1, 2010, through September 30, 2013 (liability period).

Office of Tax Appeals Administrative Law Judges Daniel K. Cho, Suzanne B. Brown, and Kenneth Gast held an oral hearing for this matter on September 22, 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 (BOE). In 2017, functions of BOE relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, respondent shall also refer to BOE.

[2] The oral hearing was originally scheduled for Cerritos, California, but was conducted electronically due to COVID-19.

## ISSUE[3]

Whether adjustments are warranted to the determined measure of tax.

## FACTUAL FINDINGS

1. Appellant has operated a flower store in Monterey Park since January 1, 2004 (Monterey Park location). The store in that location is very small and difficult to locate, and there are several competing flower stores within walking distance. It is located across the street from a cemetery and specializes in grave-site bouquets. On June 7, 2013, appellant opened a second flower store in Montebello, which she closed on March 1, 2014 (Montebello location). That store specialized in flower arrangements for special occasions, performed delivery service, and used the Teleflora networking services.
2. During the liability period, appellant reported total sales of $452,469; claimed deductions for nontaxable labor ($14,942) and sales tax reimbursement included in reported taxable sales ($24,159); and reported taxable sales of $413,368.
3. For audit, appellant initially provided sales and use tax returns (SUTRs); federal income tax returns (FITRs) for 2010, 2011, and 2012; sales summaries; sales invoices for the period November 25, 2013, through December 8, 2013; and paid bills. Appellant stated that she did not retain cash register z-tapes, and none were provided for audit.
4. In its preliminary review, respondent found that total sales reported on SUTRs substantially reconciled with gross receipts reported on FITRs. Also, respondent used the gross receipts and cost of goods sold reported on the FITRs to compute achieved markups of approximately 46 percent for 2010, 77 percent for 2011, and 75 percent for 2012, which respondent found to be within the range of markups expected for this business. In addition, respondent reviewed the sales transactions for the Montebello location that utilized Teleflora networking services and found that appellant had properly collected sales tax reimbursement on the sales that were subject to tax pursuant to California Code of Regulations, title 18, section 1571. Further, respondent found that appellant had

[3] Appellant originally requested relief of interest for the periods September 1, 2011, through October 10, 2013, and September 29, 2015, through March 14, 2018. Prior to the oral hearing, respondent conceded to interest relief for a portion of the requested periods. Specifically, respondent conceded to interest relief for the periods March 10, 2012, through October 10, 2013, and December 1, 2015, through August 1, 2016. At the hearing, appellant agreed to the concession and indicated that she no longer wished to continue pursuing additional relief of interest outside of the periods conceded by respondent.

correctly added sales tax reimbursement to delivery charges not connected to Teleflora sales for deliveries using her own vehicles. However, in its review of the available sales invoices, respondent determined that appellant had not added sales tax reimbursement to taxable cash sales.

5. Initially, respondent compared appellant's bank deposits to reported taxable sales and determined a difference of $42,739. However, during a review of this initial audit, respondent questioned the accuracy of the bank deposits because the percentage of cash to total deposits in the bank was about 48 percent, while 78 percent of the sales at the Monterey Park location (the location that was open throughout the liability period) were cash sales (based on a review of the available invoices). This caused some uncertainty regarding whether the bank deposits analysis produced an accurate result.

6. Based on the uncertainty about the bank deposits analysis, respondent decided to use appellant's sales invoices for November 25, 2013, through December 8, 2013, to estimate appellant's taxable sales for the liability period. Based on these sales invoices, respondent computed average daily sales of $559 for the Monterey Park location and $527 for the Montebello location. Respondent multiplied the average daily sales figures by the number of days in the liability period and computed audited taxable sales that exceeded reported amounts by $244,601, which resulted in an understatement of tax of $21,591.

7. Appellant disputed that understatement, arguing that the audited average daily sales for the Monterey Park location were unusually high, and therefore not representative, because the test period included the Thanksgiving holiday.

8. Respondent noted that the cash sales for the Monterey Park location were $1,079 for Thanksgiving (November 28) and $1,050 for the following Saturday (November 30). Respondent deducted those amounts from the total cash sales for the test period and divided the remainder by 12 to compute average daily cash sales of $328 for the remaining 12 days of the test period. Respondent substituted $328 for cash sales of $1,079 and $1,050 that had been scheduled for November 28 and 30. Respondent then computed average daily sales of $454 for the Monterey Park location. It used that figure and the $527 average daily sales for the Montebello location to compute audited taxable

sales that exceeded reported amounts by $171,572, and an understatement of tax of $15,145.

9. On June 23, 2014, an audit supervisor met with appellant and presented two separate audit reports, each dated June 3, 2014, which showed a different understatement of reported tax, $21,591 and $15,145. The second audit report incorporated respondent's adjustments based on the cash sales for November 28 and 30.

10. Appellant argued that there was no understatement, requested that the test be expanded, and provided sales invoices for the Monterey Park location for 26 of the 31 days of January 2014.[4] Respondent used those invoices, along with the totals for the original test period (after substituting the $328 average for cash sales for November 28 and 30) to compute an average per day of $481, rather than $454. Respondent used $481 to compute audited taxable sales for the Monterey Park location. For the Montebello location, respondent used the $527 average daily sales per day, but it excluded six days of June 2013 (before that location opened), which had not been previously excluded. For the two locations combined, respondent computed audited taxable sales of $579,558 for the liability period, which exceeded reported taxable sales by $166,190.

11. To test the reasonableness of the audit findings, respondent computed audited taxable sales using a credit card sales ratio method. Respondent used the available sales invoices to compute credit card to total sales ratios of 24.02 percent for the Monterey Park location and 70.39 percent for the Montebello location. Using those ratios and appellant's credit card receipts, respondent computed audited taxable sales that reflected average daily sales of $816. However, respondent noted that the Monterey Park location was a small store and concluded that $800 per day did not appear reasonable. Therefore, it did not utilize the credit card ratio method to establish audited sales. However, respondent found that the results of the credit card sales ratio method offered secondary support for the audit findings.

12. Respondent issued a timely NOD for tax of $15,039.10 plus applicable interest.

13. Appellant filed a timely petition for redetermination, and respondent issued a Decision denying the petition for redetermination.

14. This timely appeal followed.

[4] Appellant did not provide sales invoices for January 4, 7, 21, 22, and 29.

15. In preparation for the oral hearing, respondent obtained copies of appellant's credit card sales information that were reported on Form 1099-K[5] for the period January 1, 2011, through December 31, 2014.

## DISCUSSION

A sales tax is imposed on a retailer's retail sales of tangible personal property in California, 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 respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawai'i 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 respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent'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.)

Here, appellant did not have adequate books and records for respondent to verify appellant's reported taxable sales. As a result, respondent used a small sample of appellant's sales invoices to ultimately estimate appellant's total audited taxable sales for the liability period. These were the only sales invoices that appellant provided to respondent. In addition, respondent performed a secondary audit method to test the reasonableness of its estimated findings. Specifically, respondent used appellant's sales invoices to calculate a credit card to cash sales ratio and applied that ratio to appellant's bank information, which resulted in a higher deficiency determination. Because the secondary method resulted in a higher deficiency measure, respondent concluded that its initial audit method was reasonable.

[5] Form 1099-K is an Internal Revenue Service form which shows amounts paid to the merchant by customers using some type of payment card (i.e., credit card or debit card) or third-party network (e.g., PayPal).

On appeal, appellant's primary argument is that the audit was not conducted in a reasonable manner. Appellant asserts that the supervising tax auditor who met with her to discuss the audit arrived with two audit reports, which showed different tax liabilities ($15,145 and $21,591). Appellant alleges that she believed the purpose of providing two audit reports was to intimidate her and coerce her into accepting the lower of the two tax liabilities. Appellant also asserts that respondent has recognized her diligence, particularly in its decision to not apply a negligence penalty.

Although there is a dispute as to the intent of the presentation of the two audit methods,[6] we find that this intent is immaterial to the adjudication of this appeal. We are unaware of any provision in the Sales and Use Tax Law that would warrant an adjustment to a tax liability based on this situation.[7] Furthermore, these arguments only provide appellant's perception of what transpired during respondent's audit process. Appellant's arguments do not establish that respondent's ultimate determination was unreasonable or lacked any rational basis. For example, appellant does not dispute the sufficiency of the evidence respondent used to calculate appellant's total taxable sales nor the actual calculations of the liability.

Based on the foregoing, we find that respondent's determination was both reasonable and rational. Accordingly, the burden of proof shifts to appellant to establish an error in respondent's determination.

Appellant argues that her bank records are a more accurate representation of her business and tax liability. However, according to the Form 1099-K information, appellant received credit card sales from PayPal in an amount over $77,000, which she did not deposit into her bank account and were not included in respondent's bank deposits analysis. Furthermore, the Form 1099-K information shows that appellant received $153,000 of credit card sales for the 2011 taxable year, but appellant only reported taxable sales of $123,000 for this corresponding period. This evidence establishes that appellant not only failed to report at least $30,000 in credit card sales, but she also did not report any cash sales for the 2011 taxable year, which is contrary to her bank records that showed cash deposits during this corresponding period. Appellant has not explained these discrepancies. Therefore, we find this argument to be unpersuasive.

[6] Respondent explained that the purpose of the two separate audit reports was to inform appellant of the reasoning behind the decision to forgo the use of the bank deposits analysis.

[7] To the extent that appellant believed she was being treated unfairly, she had the option to contact the Taxpayers' Rights Advocate Office.

Appellant also argues that respondent's sample period was not representative of the liability period. Appellant states that the first test period included a holiday season, during which one can reasonably assume that sales of flowers would be higher than other periods of the year. Appellant further contends that respondent's use of January 2014 as part of the sample period was not representative of the liability period because January "remains part of the holiday season." However, respondent made adjustments to account for any days in which it appeared that the sales were unreasonably high. In addition, we note that appellant requested that the test period be expanded to include sales that occurred in January 2014, and it was then that appellant provided the additional invoices for respondent's examination. Given all of these circumstances, we find appellant's argument to be unpersuasive and does not warrant any adjustments to respondent's determination.

Based on the foregoing, we find that appellant has failed to meet her burden of proof.

## HOLDING

Adjustments are not warranted to the determined measure of tax.

## DISPOSITION

Relieve interest for the periods March 10, 2012, through October 10, 2013, and December 1, 2015, through August 1, 2016, as conceded by respondent. Otherwise, sustain respondent's decision to deny appellant's petition for redetermination.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

Date Issued: 12/16/2020