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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19105356) CDTFA Case ID 984568
D. SHARMA	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	D. Sharma
For Respondent:	Randy Suazo, Hearing Representative Jason Parker, Chief of Headquarters Ops. Kevin Smith, Tax Counsel III
For Office of Tax Appeals:	Richard A. Zellmer, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, D. Sharma, dba American Bar & Grill, (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] partially denying appellant's petition for redetermination of the Notice of Determination (NOD) issued on October 11, 2016. The NOD is for tax of $306,375.86, plus accrued interest, and a negligence penalty of $30,637.65 for the period January 1, 2013, through December 31, 2015 (audit period).

In its decision, CDTFA reduced the measure of tax based on unreported taxable sales from $3,224,952 to $2,576,764, added a new measure of tax for unreported self-consumed merchandise of $43,916, and deleted the negligence penalty.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Andrew Wong, and Nguyen Dang held an oral hearing for this matter in Cerritos, California, on

[1] Sales and use taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of the 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 the BOE; and when referring to acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

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July 21, 2020.[2] After the hearing, the record was reopened for additional briefing. The record was closed on November 10, 2020, and this matter was submitted for decision.

ISSUE

Has appellant shown that he is entitled to an additional reduction to the amount of unreported taxable sales based on employee theft or free giveaways?

FACTUAL FINDINGS

1. Appellant operated a restaurant and bar doing business as American Bar & Grill as a sole proprietor. The business is located inside of the Tradewinds Hotel in Inglewood, California.
2. For audit, appellant provided sales reports from a Point of Sale (POS) system for the audit period, a product sales summary for 2013, bank statements for January 2013 through December 2014, March 2015, July 2015, and September 2015. On reaudit appellant also provided 17 undated copies of coupons appellant claimed were redeemed by hotel guests for free drinks. Appellant did not provide any cash register tapes, sales receipts, merchandise purchase invoices, or federal income tax returns.
3. Sales tax reimbursement recorded on the POS reports exceeded sales tax reported on the sales and use tax returns (SUTRs) by $41,210 for the audit period. Taxable sales recorded on the POS reports also exceeded total sales reported on the SUTRs. CDTFA was unable to verify the sales recorded on the POS system; thus, CDTFA used an indirect audit method to compute appellant's sales.
4. Using the markup method, CDTFA computed unreported taxable sales of $3,224,952 for the audit period.[3] CDTFA concluded that the understatement was due to negligence.
5. CDTFA issued an NOD to appellant on October 11, 2016, based on the audit, in the amount of $306,375.86 tax, applicable interest, and a negligence penalty of $30,637.65, and applicable interest.
6. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.

[2] The oral hearing was noticed for Cerritos, California, but conducted electronically by video and audio conference due to COVID-19.

[3] The formula for determining the markup percentage is markup amount ÷ cost.

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7. Based on new information submitted by appellant, CDTFA decided that a reaudit was warranted.
8. Upon reaudit, CDTFA obtained information from appellant's alcohol vendors, which CDTFA used to compile alcohol purchases of $219,569 for the audit period. This amount was reduced by 20 percent to account for champagne purchases that were provided as complimentary drinks to hotel guests, and then further reduced by 2 percent for pilferage and 2 percent for other self-consumption, to compute the audited cost of alcohol sold of $168,699.
9. CDTFA was unable to perform a shelf test because appellant did not provide complete itemized records of its food or alcohol purchases. Based on its experience in auditing similar businesses and evidence of industry averages for this type of business, CDTFA estimated the markup for alcohol at 400 percent, which it applied to the audited cost of alcohol sold to compute audited alcohol sales of $843,495 for the audit period.
10. Based on information obtained from appellant's food vendors, CDTFA compiled food purchases of $758,914 for the audit period. This amount was reduced by 20 percent to account for complimentary breakfast, buffet dinners, and snacks provided to hotel guests, and further reduced by 2 percent for pilferage and 2 percent for other self-consumption, to compute the audited cost of food sold of $583,088.
11. CDTFA estimated the markup for food at 200 percent, which it applied to the audited cost of food sold to compute audited food sales of $1,749,265 for the audit period. The estimated markup was based on CDTFA's audits of similar businesses and industry averages for this type of business.
12. CDTFA added audited alcohol sales and audited food sales to compute audited taxable sales of $2,592,760. After subtracting reported taxable sales of $16,000, CDTFA computed unreported taxable sales of $2,576,764[4] for the audit period.
13. In the reaudit, CDTFA also established a separate measure of $43,916 for unreported use tax based on appellant's cost for complimentary champagne which he provided to hotel guests for the audit period, bringing the total measure of tax established in the reaudit to $2,620,680.

[4] We compute $2,576,760. The $4 difference is due to rounding.

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14. On October 11, 2016, CDTFA issued a decision reducing the total measure of tax to $2,620,680, as computed in the reaudit, and deleting the negligence penalty, but otherwise denying the appellant's petition.

15. Appellant filed a timely appeal.

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.) Although gross receipts from the sale of "food products" 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), (2) & (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 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. (*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*.) A taxpayer's failure to produce evidence that is within his or her control gives rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayer's case. (*Appeal of Morosky*, 2019-OTA-312P.)

Appellant reported taxable sales of only $16,000 for the audit period despite purchasing $978,483 of alcohol and food. Appellant reported taxable sales of exactly $1,000 for all eight quarterly reporting periods during the period January 1, 2014, through December 31, 2015. Also, sales tax reimbursement recorded on appellant's POS reports exceeded sales tax reported on the SUTRs, which established an underreporting of $428,873 due to differences between recorded and reported taxable sales. These facts plainly demonstrate that appellant's reported taxable sales were grossly understated. Further, appellant did not provide any source records of sales, such as cash register tapes or sales receipts. Thus, the amounts of sales recorded in the POS reports could not be verified. Because appellant did not submit sufficient evidence to

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perform a shelf test, CDTFA used estimates to mark up the total audited purchases for both food (200 percent markup) and alcohol (400 percent). These estimates were based on CDTFA's experience in auditing similar businesses as well as evidence of industry averages for this type of business. We find that CDTFA has met its initial burden to show that its determination was both reasonable and rational. Thus, the burden of proof shifts to appellant to show errors in the reaudit.

Appellant asserts that the unreported taxable sales computed in the reaudit are excessive. Appellant asserts most of the alcohol and food that he purchased was given away free to patrons of the hotel. Appellant further asserts that alcohol must have been stolen by employees. Appellant submitted no additional evidence on appeal to support any of his contentions, thus we rely only on what was submitted to CDTFA during the audit and appeals processes and entered into our record at the hearing and in additional briefing.

Appellant did not maintain a record of alcohol and food that was given away. CDTFA estimated the amount of alcohol and food given away at 20 percent of merchandise purchases in each category based on its review of social media accounts (i.e., Yelp) and its observations during various times the business gave away complimentary food and beverages, and the coupons provided by appellant. At the appeals conference with the CDTFA Appeals Bureau, appellant claimed that he could obtain a record of the complimentary food and drinks from the LLC that operates the hotel, but appellant did not provide any such information. Appellant has not established that the percentage of complimentary food and beverages is higher than estimated by CDTFA, nor that the estimated markups were higher than estimated by CDTFA.

With respect to claims of alcohol theft by employees, we note that CDTFA made a 2 percent allowance for pilferage, or theft, of both alcohol and food. Appellant has submitted no documentation, such as police reports or insurance claims, to show that a higher allowance for pilferage was warranted. Thus, we recommend no adjustment to the percentage allowed for pilferage.

Based on our finding that appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made, we conclude that appellant has failed to meet his burden of establishing that a reduction to the measure of unreported taxable sales is warranted.

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HOLDING

As conceded by CDTFA, the negligence penalty is deleted, and the total measure of tax is reduced from $3,224,952 to $2,620,680. Appellant did not establish that an additional reduction to the measure of unreported taxable sales is warranted.

DISPOSITION

CDTFA's action in deleting the negligence penalty and reducing the taxable measure to $2,620,680, but otherwise denying the petition, is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

DocuSigned by:
Nguyen Dang
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Nguyen Dang
Administrative Law Judge

Date Issued: 12/16/2020