

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:	) OTA Case No. 20015767
<b>BUDDY’S BITES AND BREWS, INC.</b>	) CDTFA Case IDs 010-053; 010-055
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**OPINION**

Representing the Parties:

For Appellant:	Alan Yu, President
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For Respondent:	Jason Parker, Chief of Headquarters Operations
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For Office of Tax Appeals:	Craig Okihara, Business Taxes Specialist III
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S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 and California Code of Regulations, title 18, section 5220, Buddy’s Bites and Brews, Inc., dba Buddy’s Bites and Brews (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated January 29, 2016 (first NOD), issued for a tax liability of \$40,449.62, plus applicable interest, for the period April 1, 2012, through March 31, 2013, and also denying appellant’s administrative protest<sup>2</sup> of an NOD dated December 4, 2017 (second NOD), issued for a tax liability of \$30,828.83, plus applicable interest, for the period April 1, 2013, through March 31, 2015.

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<sup>1</sup> Sales 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 this Opinion refers to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to BOE; and when this Opinion refers to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

<sup>2</sup> Under regulations promulgated by CDTFA and applicable at the time the administrative protest was filed, if a taxpayer filed a petition for redetermination after the 30-day time period specified in R&TC section 6561, CDTFA may accept it as an administrative (late) protest. (Cal. Code Regs., tit. 18, § 5220 [superseded by Cal. Code Regs., tit. 18, § 35019].)

As explained below, CDTFA completed an audit and a revised audit. The revised audit reduced the deficiency measure for the first NOD from \$459,261<sup>3</sup> to \$119,437, which reduced that tax liability from \$40,449.62 to \$10,504.97.

Appellant waived its right to an oral hearing; therefore, the matter is being decided based on the written record.

### ISSUE

Whether any additional adjustments to the amount of unreported taxable sales are warranted.

### FACTUAL FINDINGS

1. Appellant operated a restaurant in Hayward, California, with a seller's permit effective January 1, 2012.
2. For the period April 1, 2012, through March 31, 2015 (audit period), appellant reported total sales of \$3,324,594 and claimed a deduction for nontaxable sales for resale of \$116, resulting in reported taxable sales of \$3,324,478 on its sales and use tax returns (SUTRs). Upon audit, appellant provided federal income tax returns (FITRs) for 2012, 2013, and 2014; point-of-sale (POS) reports for November 30, 2013, through May 30, 2015; and bank statements for the audit period. Appellant did not provide any other books and records, such as cash register tapes, merchandise purchase invoices, or purchase journals, for the audit period. Due to the lack of source documentation, CDTFA found the books and records provided were incomplete and inadequate for sales and use tax audit purposes.
3. Although appellant used a POS system to record sales, appellant stated that it used bank statements to prepare the SUTRs. CDTFA compared total sales reported on the SUTRs for 2012, 2013, and 2014 to the corresponding gross receipts reported on the FITRs noting gross receipts exceeded total sales by \$102,674, \$45,897, and \$85,891 for 2012, 2013, and 2014, respectively. Appellant could not explain to CDTFA the reason for the

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<sup>3</sup> CDTFA's decision dated November 14, 2019, indicates that the determined measure for the first NOD was \$493,480. However, the Request For Phone-Billing dated January 29, 2016, and CDTFA's audit schedule for the phone billing, both indicate that this measure was \$459,261. The audit schedule also states that the tax on \$459,261 is \$40,448. The source of the \$493,480 figure is unclear; thus, that figure appears to be erroneous.

differences. CDTFA compared total sales reported on the SUTRs for 2013 and 2014 to the corresponding cost of goods sold reported on the FITRs and computed book markups of 145.62 percent for 2013, 123.79 percent for 2014, and 133.62 percent for the two years combined.<sup>4</sup> CDTFA expected appellant's markup to be about 200 percent, and thus considered the book markups unreasonably low for appellant's business. Due to the incomplete books and records, the differences between reported total sales and reported gross receipts, and the low book markups, CDTFA concluded that additional testing was needed to verify reported taxable sales.

4. CDTFA issued the first NOD to appellant prior to completion of the audit because the statute of limitations for issuing an NOD for a portion of that period was set to expire. The first NOD is based on estimates, in which CDTFA established a deficiency measure of \$459,261 for unreported taxable sales for the period April 1, 2012, through March 31, 2013.
5. On January 29, 2016, CDTFA issued the first NOD for a tax liability of \$40,449.62, plus applicable interest. Appellant filed a timely petition for redetermination disputing the first NOD in its entirety.
6. CDTFA subsequently completed the audit and a revised audit.<sup>5</sup> CDTFA found appellant's POS reports to be substantially accurate. However, appellant did not provide POS reports for periods prior to November 30, 2013. Thus, CDTFA decided to use a combination of audit methods: a credit-card-sales-ratio method to establish audited sales for April 1, 2012, through December 31, 2013, and recorded sales from the POS reports to establish audited sales for January 1, 2014, through March 31, 2015.
7. To compute the credit card sales ratio for the period April 1, 2012, through December 31, 2013, CDTFA relied on available POS reports for November 30, 2013, through May 30, 2015, and compiled total sales (after discounts and including sales tax

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<sup>4</sup> "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 \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is  $\text{markup amount} \div \text{cost}$ . In this example, the markup percentage is 42.86 percent ( $0.30 \div 0.70 = 0.42857$ ). 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 ( $0.30 \div 1.00 = 0.30$ ).

<sup>5</sup> Because the revised audit was completed before the second NOD was issued, the second NOD reflected the findings of the revised audit, rather than the original audit.

reimbursement) of \$2,265,211, sales tax reimbursement of \$191,734, sales of gift certificates of \$10,266, complimentary meals of \$11,670, credit card sales of \$1,624,806, and credit card tips (voluntary and mandatory) of \$256,957. CDTFA reduced total sales by recorded sales tax reimbursement, gift certificates, and complimentary meals to compute audited taxable sales of \$2,051,206 ( $\$2,265,211 - \$191,734 - \$10,266 - \$11,670$ )<sup>6</sup> for November 30, 2013, through May 30, 2015. Next, CDTFA divided credit card sales for each quarterly reporting period by 1 plus the applicable sales tax rate to compute credit card sales, excluding sales tax reimbursement, of \$1,487,651 for November 30, 2013, through May 30, 2015. CDTFA divided credit card sales, excluding sales tax reimbursement, of \$1,487,651 by audited taxable sales of \$2,051,206 to compute a credit card sales ratio of 72.53 percent. CDTFA also divided credit card tips of \$256,957 by credit card sales of \$1,624,806 to compute a credit card tip ratio of 15.81 percent. Using the bank statements, CDTFA compiled credit card deposits of \$1,837,611 for the period April 1, 2012, through December 31, 2013. From this amount, CDTFA removed tips at 15.81 percent and then removed sales tax reimbursement at the applicable tax rate to calculate bank deposits from credit card sales proceeds (excluding sales tax reimbursement and tips) of \$1,457,066. CDTFA then divided bank deposits from credit card sales proceeds (excluding sales tax reimbursement and tips) of \$1,457,066 for April 1, 2012, through December 31, 2013, by the credit card sales ratio of 72.53 percent and computed audited taxable sales of \$2,009,034 (rounded). Upon comparison to reported taxable sales of \$1,814,503 for April 1, 2012, through December 31, 2013, CDTFA computed unreported taxable sales of \$194,531 for that period.

8. Using the amounts recorded in the POS reports, CDTFA compiled total sales (after discounts and including sales tax reimbursement) of \$1,860,097, sales tax reimbursement of \$156,164, complimentary meals of \$8,849, and computed audited taxable sales of \$1,695,085 ( $\$1,860,097 - \$156,164 - \$8,849$ ) (rounded) for January 1, 2014, through March 31, 2015. Upon comparison to reported taxable sales of \$1,509,975 for January 1, 2014, through March 31, 2015, CDTFA computed unreported taxable sales of \$185,110 for that period.

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<sup>6</sup> CDTFA noted an unknown difference of \$335 in its computations.

9. In total, CDTFA computed unreported taxable sales of \$379,641 (\$194,531 + \$185,110) for the audit period.
10. CDTFA also computed unreported taxable mandatory tips of \$77,898 (\$23,820 for the period April 1, 2012, through March 31, 2013 + \$54,078 for the period April 1, 2013, through March 31, 2015) for the audit period based on mandatory tips recorded in the POS reports. This item is not in dispute, and thus we do not address it further.
11. The revised audit reduced the deficiency measure for the first NOD by \$339,824 from \$459,261 to \$119,437 (\$95,617 unreported taxable sales + \$23,820 unreported taxable mandatory tips).<sup>7</sup>
12. On December 4, 2017, CDTFA issued the second NOD to appellant based on a deficiency measure of \$338,102 (unreported taxable sales of \$284,024 + unreported taxable mandatory tips of \$54,078) for the period April 1, 2013, through March 31, 2015, as determined in the revised audit.
13. Appellant did not timely pay the tax portion of the second NOD or file a petition for redetermination within 30 days from the date of the second NOD, and therefore the second NOD became final on January 4, 2018.<sup>8</sup> Appellant sent CDTFA a letter dated January 31, 2018, stating that it disputed only unreported taxable sales. Because appellant's letter was not filed within the 30-day period after the issuance of the second NOD, the letter was not timely as a petition for redetermination of the second NOD. However, CDTFA accepted appellant's letter as an administrative protest of the second NOD.
14. CDTFA's Appeals Bureau issued a decision dated November 14, 2019, denying the petition and administrative protest.<sup>9</sup> Appellant filed a timely appeal with OTA.

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<sup>7</sup> The revised audit also deleted a negligence penalty that had been recommended in the audit. As a result, the second NOD did not assert a negligence penalty, and thus it is not at issue before OTA.

<sup>8</sup> Because appellant did not timely pay the tax portion or timely file a petition for redetermination of the second NOD, a penalty of \$3,082.88 for failure to pay the NOD once it became due and payable (finality penalty) was imposed pursuant to R&TC section 6565. However, appellant did not dispute the finality penalty, and as a result we do not discuss it further.

<sup>9</sup> The decision also confirmed that the negligence penalty is not being asserted by CDTFA and the deficiency measure for the First Liability Period in the First NOD was reduced from \$493,480 to \$119,437.

## 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), (d)(2), and (d)(7).) 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, 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 (*Riley B's*)). Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, 2020-OTA-022P; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Here, appellant's books and records provided for audit were incomplete. CDTFA's initial analysis found unexplained differences between reported total sales and reported gross receipts, as well as low book markups, which were indications that reported sales may have been understated. We find that CDTFA was justified in questioning reported sales and using a combination of an indirect audit method (the credit-card-sales-ratio method) and direct audit method to compute appellant's sales. The credit-card-sales-ratio method is a recognized and standard accounting procedure. (See *Riley B's, supra*, 61 Cal.App.3d at pp. 612-613.) Based on all of the above, we find that CDTFA has met its initial burden to show that its determination

was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

Appellant argues that its POS system was unstable and the sales data from its POS system was not reliable. Appellant states that the credit card processing unit did not automatically sync to the data run through the order entry database and as a result, the amounts compiled from its own POS reports were not accurate. Despite this contention, appellant has not identified any erroneous amounts in its POS reports. CDTFA notes in its reply brief that it compared credit card sales deposits from appellant's bank statements to credit card sales recorded in appellant's POS reports for January 1, 2014, through March 31, 2015, and found a minor difference of \$3,353 or 0.22 percent. Sales made by credit card are required to be deposited directly into appellant's bank account; thus, the credit card sales deposits support that credit card sales recorded in appellant's POS report are substantially complete. Appellant has not identified any errors or provided any documentation to support its contention and establish a more accurate calculation of audited taxable sales. We find the POS reports are reliable and the best evidence of appellant's sales, and appellant has failed to establish adjustments are warranted on this basis.

Appellant contends that audited sales included deposits on account, gift card sales, employee meals, and complimentary meals and promotions which should be excluded in computing taxable sales. Using appellant's POS reports for January 1, 2014, through March 31, 2015, CDTFA computed audited taxable sales by compiling total sales which were then reduced for discounts, sales tax reimbursement, and complimentary meals. Appellant has not identified any errors in the nontaxable amounts allowed or provided any documentation to support its contention and establish a more accurate calculation of audited taxable sales. Appellant has not provided any documentation to establish if any adjustments are warranted for deposits on account. Regarding sales of gift cards, we note that CDTFA identified gift cards in the POS data and reduced sales accordingly, and those amounts were then used in the computation of the credit card sales ratio. Thus, the reduction for sales of gift cards was reflected in audited taxable sales for April 1, 2012, through December 31, 2013.

In contrast, CDTFA did not exclude \$8,105 in sales of gift cards for January 1, 2014, through March 31, 2015, in computing audited taxable sales from the POS data for that period; in a brief dated November 2, 2020, CDTFA acknowledges this omission and states that the audited

taxable sales should have been reduced by \$8,105. On that basis, a reduction to unreported taxable sales in the amount of \$8,105 would be warranted. However, CDTFA's audit schedule 1R-12A-5 also shows that appellant had an excess sales tax difference of \$376 for the 16-month period that appellant provided POS reports (November 30, 2013, through May 30, 2015), but CDTFA did not apply this difference to the calculation of appellant's audit liability. This difference computes to a quarterly average of \$71 ( $\$376 \div 5.33$  quarters), and projection for the entire audit period would result in a total sales tax difference of \$852 ( $\$71 \times 12$  quarters) and would result in an increase of \$9,451 to the deficiency measure. In its November 2, 2020 brief, CDTFA states that it did not perform a reaudit to reduce the measure by \$8,105 for the gift cards because the reaudit would also assess the excess sales tax difference, and thus would ultimately increase appellant's tax liability by \$103. Because this reaudit would increase appellant's tax liability, we do not order a reduction for sales of gift cards for January 1, 2014, through March 31, 2015.

Furthermore, appellant asserts that the 72.53 percent credit card sales ratio should be applied to the period 2013 through 2015. First, we note that the credit-card-sales-ratio method was used for the period April 1, 2012, through December 31, 2013; thus, taxable sales for 2013 were computed using the 72.53 percent credit card sales ratio. Second, for January 1, 2014, through March 31, 2015, CDTFA did not use the credit-card-sales-ratio method to compute audited taxable sales; accordingly, the 72.53 percent credit card sales ratio is not applicable to this period. Consequently, we reject appellant's argument for this issue.

Finally, appellant argues it disagrees with CDTFA that the taxable markups were 200 percent or higher during 2013 and 2014. However, the markup determined by the audit was less than 200 percent.<sup>10</sup> Furthermore, CDTFA did not use the markup method to establish audited taxable sales. CDTFA indicated during the audit that it would expect appellant's business to have a markup of at least 200 percent, and this expectation contributed to CDTFA's decision during the audit to conduct additional testing to verify reported taxable sales; however, that testing consisted of a credit-card-sales-ratio method and reliance on recorded sales from POS

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<sup>10</sup> CDTFA performed a post-audit markup calculation. The post-audit markup for these periods was 172.69 percent based on the original audit (representing 197.74 percent for 2013, and 152.19 percent for 2014). The \$125,864 reduction during the revised audit would further reduce the 172.69 percent markup (CDTFA did not calculate a post-revised audit markup).

reports, and did not include a markup method. Therefore, we find that appellant’s assertions regarding the markup percentage provide no basis for adjustment to the audit liability.

In summary, appellant has failed to provide sufficient evidence to support a more accurate determination could be made.

HOLDING

No further adjustments are warranted to the measure of unreported taxable sales.

DISPOSITION

CDTFA’s actions reducing the measure of the first NOD from \$459,261 to \$119,437, and making no changes to the second NOD, are sustained.

DocuSigned by:  
*Suzanne B. Brown*  
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Suzanne B. Brown  
Administrative Law Judge

We concur:

DocuSigned by:  
*Amanda Vassigh*  
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Amanda Vassigh  
Administrative Law Judge

DocuSigned by:  
*Andrew J. Kwee*  
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Andrew J. Kwee  
Administrative Law Judge

Date Issued: 2/9/2021