

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18011970
RUDE DOG BAR & GRILL, INC.) CDTFA Case ID 780873
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OPINION

Representing the Parties:

For Appellant: Tracy Fickett, CPA

For Respondent: Mariflor Jimenez, Hearing Representative
Christopher Brooks, Tax Counsel IV
Jason Parker, Chief of Headquarters
OperationsFor Office of Tax Appeals: Deborah Cumins,
Business Taxes Specialist III

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Rude Dog Bar & Grill, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ in response to appellant’s petition for redetermination of a Notice of Determination (NOD) for tax of \$152,046.43, a negligence penalty of \$15,204.69, and applicable interest, for the period January 1, 2009, through December 31, 2011 (audit period). The NOD is based on a taxable measure of \$1,611,977, which CDTFA subsequently reduced to \$1,124,896. In addition, CDTFA deleted the negligence penalty.

Office of Tax Appeals Administrative Law Judges Josh Lambert, Daniel K. Cho, and Andrew Wong held an oral hearing via videoconference for this matter on January 26, 2021. 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 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 BOE; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

ISSUE

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

FACTUAL FINDINGS

1. Appellant, a corporation that operates a bar and restaurant in California, was audited by CDTFA.
2. CDTFA found that appellant was unable to provide sufficient sales records, such as receipts, guest checks, and cash register z-tapes.² CDTFA calculated book markups for alcohol sales averaging 92 percent for 2009, 2010, and 2011, using reported taxable sales and costs of goods sold recorded on appellant's profit and loss statement.³ CDTFA concluded that further investigation was warranted because a markup of at least 180 percent was expected for this type of business.
3. Appellant's Chief Executive Officer (CEO) completed and signed a Bar Fact Sheet on February 5, 2012, which stated there was no theft for the audit period. The Bar Fact Sheet included other information, such as alcohol selling prices and pour sizes.
4. CDTFA used the markup method to establish an understatement of taxable sales of \$1,601,177. CDTFA's calculation included an examination of records requested from appellant's alcohol vendors, appellant's cash register z-tapes from outside the audit period, appellant's purchase invoices, appellant's profit and loss statements, and information on the Bar Fact Sheet. The calculation included a reduction to alcohol purchases of \$300 per month for self-consumption and 2 percent for pilferage. CDTFA established a separate audit item of \$10,800 (\$300 x 36 months) for the cost of beverages that were self-consumed.
5. On September 17, 2013, CDTFA issued an NOD for tax of \$152,046.43 and a negligence penalty of \$15,204.69, based on a total measure of tax of \$1,611,977 (\$1,601,177 + \$10,800). Appellant petitioned the NOD.

² Z-tapes are the part of the cash register tapes that summarize the sales by category for a given period of time.

³ "Markup" is the percentage by which the cost of merchandise is increased to set the retail price.

6. On October 25, 2016, CDTFA issued a Decision, which recommended reducing the total measure of tax from \$1,611,977 to \$1,125,406, and deleting the negligence penalty. This timely appeal followed.
7. On appeal, CDTFA concedes to further reduce the measure of tax from \$1,125,414 to \$1,124,896.⁴

DISCUSSION

California imposes a sales tax on a retailer's retail sales of tangible personal property in this state, 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.)

If 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 within its possession or that 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.*)

Here, CDTFA determined that appellant's book markups for alcohol sales were significantly lower than it expected for a business of this type. In addition, appellant did not provide sufficient records to verify its taxable sales. In this case, CDTFA utilized the markup method, which is a generally accepted audit procedure. (See *Maganini vs. Quinn* (1950) 99 Cal.App.2d 1 (*Maganini*)). Given the low book markups and absence of documentation to support the recorded sales amounts, we find that CDTFA's decision to use the markup method to compute appellant's taxable sales was appropriate.

In determining audited taxable sales, CDTFA had sufficient information in its possession to utilize in applying the markup method, such as extrinsic records requested from appellant's alcohol vendors, appellant's own records, which included purchase invoices, profit and loss statements, and cash register z-tapes, as well as information provided by appellant on the Bar

⁴ We note that CDTFA's Decision recommended the total determined measure of tax (including self-consumption) be reduced to \$1,125,406, whereas the re-audit conducted pursuant to CDTFA's Decision only reduced the measure to \$1,125,414. The difference appears to be related to rounding and is not material as CDTFA has agreed to further reduce the measure to \$1,124,896.

Fact Sheet. In addition, CDTFA granted appellant a standard 2 percent pilferage allowance, pursuant Chapter 8 of CDTFA's Audit Manual, Bars and Restaurants, section 0804.47. CDTFA's Audit Manual states that the allowance for pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, including employee theft.⁵

CDTFA granted a pilferage allowance even though appellant's records did not indicate pilferage, and none was reported. Such an allowance is generous, considering that R&TC section 6091 provides that "it shall be presumed that all gross receipts are subject to the tax until the contrary is established." Giving a beneficial allowance to appellant when no evidence was provided of pilferage, is more than reasonable. Therefore, we find that CDTFA has shown that its determination is reasonable and rational, and appellant has the burden to show that adjustments are warranted.

Appellant argues that the pilferage allowance should be increased from 2 percent to 10 percent due to theft of alcohol, which included drinks given away by bartenders without authorization and inventory taken without the owner's knowledge. Appellant asserts that, in a subsequent audit period, April 2012 to March 2015, where it was determined there was no understatement, the book markup averaged 167 percent. Appellant argues that the reason for the increase in book markups is that the CEO took steps to prevent theft, such as by securing inventory and installing security cameras.⁶

Appellant has not offered any evidence to show that theft occurred or that security measures were taken. Appellant provides no documentation, such as insurance claims, police reports, or evidence of security cameras.⁷ In addition, appellant's CEO stated there was no theft for the audit period in the Bar Fact Sheet dated February 5, 2012. Appellant points to a higher markup in a later period; however, appellant provides no evidence that connects the higher

⁵ CDTFA's Audit Manual "is an advisory publication providing direction to [CDTFA] staff administering the Sales and Use Tax Law and Regulations." OTA is not required to follow CDTFA's Audit Manual; however, OTA may look to it for guidance, such as when evaluating the reasonableness of CDTFA's determination. (*Appeal of Michelle Laboratories, Inc.*, 2020-OTA-290P.)

⁶ Appellant also contends that the security measures were implemented to prevent alcohol being consumed by staff. However, appellant already received a separate allowance for self-consumption, even though no self-consumption of ex-tax purchases was reported during the audit period.

⁷ CDTFA Audit Manual section 0804.47 states: "Any adjustment exceeding the 2% for pilferage must be clearly explained in the audit working papers and well documented by the taxpayer. Such documentation may include police reports, reports from regularly employed private security guards, private detective agencies, insurance claims, reports from inventory control companies or similar service firms."

markup in the later period to claims that theft occurred in the current audit period. As noted previously, unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Talavera, supra.*) Accordingly, appellant has not provided evidence to establish that a pilferage allowance higher than 2 percent is warranted.

HOLDING

Appellant has not shown that further adjustments are warranted to the audited understatement of taxable sales.

DISPOSITION

Reduce the measure of tax to \$1,124,896 as conceded by CDTFA on appeal; otherwise, sustain CDTFA’s decision to delete the negligence penalty and to deny the remainder of the petitioned amount.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

DocuSigned by:
Andrew Wong
8A4294817A67463...
Andrew Wong
Administrative Law Judge

Date Issued: 4/14/2021