

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

<p>In the Matter of the Appeal of:</p> <p>LAS PLAYAS #10, INC.,</p> <p>dba DEL MAR</p> <hr/>	<p>) OTA Case No. 18073485</p> <p>) CDTFA Case ID 954466</p> <p>)</p> <p>)</p> <p>)</p> <p>)</p>
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OPINION

Representing the Parties:

For Appellant:	Linda T. Sung, Attorney & CPA
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For Respondent:	Nalan Samarawickrema, Hearings Representative Jason Parker, Chief of Headquarters Operations Christopher Brooks, Tax Counsel IV
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For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III
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J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Las Playas #10, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's petition for redetermination of the Notice of Determination (NOD) issued on May 3, 2016. The NOD is for \$54,778.26 of additional tax, plus applicable interest, for the period October 1, 2012, through September 30, 2015 (audit period).

Office of Tax Appeals (OTA) Administrative Law Judges Daniel K. Cho, Andrew Wong, and Josh Aldrich held an oral hearing for this matter on January 26, 2021.² At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

¹ Sales and use taxes were formerly administered by the State Board of Equalization (BOE). Effective July 1, 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, BOE.

² The hearing was noticed for Cerritos and conducted electronically by agreement of the parties due to COVID-19.

ISSUES

1. Whether appellant owned the business at issue during the audit period and is liable for the unreported taxable sales.
2. Whether a reduction to the amount of audited unreported taxable sales is warranted.

FACTUAL FINDINGS

1. California Secretary of State (SOS) records indicate that appellant was formed as a corporation on April 10, 2012, and remains active.
2. On December 17, 2014, ownership of the corporation was transferred for consideration of \$126,000. A Statement of Information filed with the SOS on December 23, 2014, shows a complete change of corporate directors and officers.
3. Appellant operates a restaurant serving Mexican-style food and alcoholic beverages in California. Appellant obtained a seller's permit, effective June 6, 2012. The seller's permit remained active through at least July 5, 2018.
4. Appellant provided the following documents regarding the change of ownership: a Notice to Creditors of Bulk Sale dated November 21, 2014, indicating an anticipated sale date of December 17, 2014; escrow documents showing a closing date of December 17, 2014; a Fictitious Business Name statement filed on December 4, 2014; a Notice of Intended Transfer of Retail Alcoholic Beverage License filed on January 23, 2015; a Department of Alcoholic Beverage Control Public Notice of Application for Ownership Change for Change in Stock Ownership, which posted on January 29, 2015; and an Application for Health Permit signed on April 3, 2015.
5. The document entitled "Escrow Instructions, Sale of Business" includes the statement: "Corporation: Buyer is taking over Seller's corporation and stock transfer will be handled outside of Escrow. Buyer is taking over daily operation of business and is assuming any and all debt owed by the corporation."
6. Upon audit, appellant provided its federal income tax returns for 2013 and 2014, sales tax worksheets for the period July 1, 2012, through June 30, 2015, bank statements, and food purchase journals. CDTFA computed an average book markup of 128.85 percent by comparing appellant's recorded sales with its recorded merchandise purchases for the same period. CDTFA determined that the book markup was lower than expected for the

- type of business and its location.³ CDTFA prepared a credit card sales ratio analysis to establish audited taxable sales.
7. Appellant provided CDTFA with 15 daily cash register Z-tapes for the period October 23, 2015, through November 6, 2015 (test period). CDTFA used the Z-tapes to calculate a ratio of credit card sales to total sales (credit card sales ratio) of 56.855 percent, excluding sales tax reimbursement of 8 percent. CDTFA also calculated a credit card sales ratio of 56.723 percent, excluding sales tax reimbursement of 7.75 percent to account for the tax rate of 7.75 percent during the fourth quarter of 2012 (4Q12). CDTFA divided audited credit card deposits of \$981,290, compiled from appellant's bank statements for the period January 1, 2013, through September 30, 2015, by the credit card sales ratio of 56.855 percent to calculate audited taxable sales of \$1,725,963 for that period. For 4Q12, CDTFA divided audited credit card deposits of \$75,747 by the credit card sales ratio of 56.723 percent to calculate audited taxable sales of \$133,538. In sum, CDTFA established audited taxable sales of \$1,859,501 (\$1,725,963 + \$133,538), which exceeded appellant's reported taxable sales by \$686,524.
 8. CDTFA compared audited taxable sales with appellant's recorded merchandise purchases and computed an average book markup of 223 percent. CDTFA had expected a book markup of at least 250 percent for a restaurant selling alcohol, but CDTFA concluded that the book markup of 223 percent was evidence that audited taxable sales were reasonable.
 9. On May 3, 2016, CDTFA issued the NOD to appellant based on unreported taxable sales of \$686,524. Appellant filed a petition for redetermination, protesting the calculation of the measure of tax and arguing that it was not responsible for tax liabilities arising on or after December 17, 2014, because its ownership changed on that date.
 10. CDTFA held an appeals conference with appellant on February 21, 2018.
 11. On July 5, 2018, CDTFA issued its decision denying the petition for redetermination in its entirety. This appeal to OTA followed.

³ "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 \$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 ($.30 \div .70 = 0.42857$). 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 ($.30 \div 1.00 = 0.3$).

DISCUSSION

Issue 1: Whether appellant owned the business at issue during the audit period, and whether appellant is liable for the unreported audited taxable sales.

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.) A "retailer" is defined, as relevant here, as a seller who makes any retail sale or sales of tangible personal property. (R&TC, § 6015(a)(1).) A "seller" includes every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of sales tax. (R&TC, § 6014.) As relevant here, "person" includes a corporation. (R&TC, § 6005.)

Every person desiring to conduct business as a seller within this state must file an application for a seller's permit for each place of business. (R&TC, § 6066.) A seller's permit can be held only by persons actively engaged in the business of selling tangible personal property within this state, and any person not so engaged must surrender his or her permit to CDTFA for cancellation. (R&TC, § 6072.)

Here, appellant argues that, due to a change of ownership on December 17, 2014, it can only be held liable for tax on unreported taxable sales for periods prior to December 17, 2014, or it can only be held liable for tax on unreported taxable sales on or after December 17, 2014, depending on whether the previous owners of the corporation or the new owners are making the argument.

Based on the record, it is evident that there was a change in corporate ownership and a change of corporate officers on December 17, 2014. Nonetheless, appellant remained the same person that operated the business during the audit period. (See R&TC, § 6005.) The SOS records indicate that the corporation remained active throughout the audit period. Appellant reported the restaurant's sales under the same seller's permit during the entire audit period. Appellant is the only entity that has been identified as the retailer making those sales.

Appellant argues that its liability should be limited because the change in ownership in December 2014 should be treated as a purchase and sale of the business. In support, appellant references its 2015 tax return, wherein the goodwill and equipment were depreciated, as evidence that the purchasers of the stock intended to purchase the business. Appellant is

confusing the identity of the retailer (the corporation) with the identity of the owners of the retailer (the shareholders). The retailer is the entity operating the business and making sales. A change in shareholders of a corporation is immaterial for sales and use tax purposes. (Cal. Code Regs., tit. 18, § 1595(a)(6).) If appellant had sold the assets of the restaurant business to a different corporation or other entity, and the new corporation operated the business using appellant's seller's permit, then both entities could potentially be held liable for the tax. (Cal. Code Regs., tit. 18, § 1699(f)(2).) The documents in the record, however, establish that it was only the stock in the corporation that was sold on December 17, 2014, not the business. Furthermore, there is no evidence that any other entity operated the business during the audit period. The statements in the document entitled "Escrow Instructions, Sale of Business" support the conclusion that the stock, not the business, was sold. Likewise, the document entitled "Department of Alcoholic Beverage Control, Public Notice of Application for Ownership Change" includes the statement, "Applicant has filed for: Change in Stock Ownership." Even with a transfer of all of appellant's stock for consideration, appellant continued to be the "person" owning and operating the business. Appellant, therefore, continued to be the retailer liable for sales tax on the taxable sales made by the business after the December 17, 2014, sale of stock. Accordingly, we find that no reduction to the tax liability is warranted. We also find that appellant is liable for the tax on the audited taxable sales made by the business during the audit period.

Issue 2: Whether a reduction to the amount of unreported taxable sales is warranted.

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).)

If CDTFA is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

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, appellant did not provide complete source documents showing its sales, such as cash register tapes and guest checks, and did not provide sales journals, general ledgers, or financial statements. We find that the books and records provided for examination were not sufficient to verify the accuracy of appellant's reported sales using a direct audit approach. Under these circumstances, it was appropriate for CDTFA to utilize the credit card sales ratio method, an indirect audit method. We have examined CDTFA's analysis and have found no errors in the procedures or in the computations. Thus, we find CDTFA has shown that its determination is reasonable and rational. Therefore, appellant has the burden to establish that adjustments are warranted.

Appellant argues primarily that the change in ownership of appellant warrants a reduction to the audited taxable measure. We examined the test period, which we note occurred after the change in stock ownership. To determine whether the test period was representative of appellant's sales prior to December 17, 2014, we reviewed appellant's reported taxable sales for the first nine quarters in the audit period, from 4Q12 to 4Q14. From 4Q12 to 4Q14, the average daily taxable sales were \$1,062, which is slightly lower than average daily taxable sales of \$1,158 reported during the last three quarters in the audit period when appellant's new owners operated the restaurant. We, however, have found no evidence indicating that there was any change in the percentage of customers paying with credit cards during the audit period. Therefore, we conclude that the credit card sales ratio calculated from the test period was representative of appellant's credit card sales ratio throughout the audit period.

Appellant argues that an adjustment for claimed exempt food sales is warranted based on the sale of *raspados*.⁴ CDTFA notes that appellant did not provide any cash register Z-tapes to support exempt *raspado* sales for the test period. CDTFA also notes that during the auditor's observation, appellant did not sell any *raspados* on a to-go or take-out basis. CDTFA argues that

⁴ A *raspado* is commonly known as a fruit flavored shaved ice. However, appellant indicated that the sales of *agua frescas* constituted its *raspado* sales. This distinction does not impact our Opinion.

appellant added sales tax reimbursement to the selling price of all items. Appellant did not provide documentation to support the claimed exempt sales. Based on the foregoing, we find appellant has failed to meet its burden.

Appellant’s new owners claim that the burden of the audit liability will require them to sell the business, stripping them of their only source of income to raise a family. While we are sympathetic to appellant’s difficult circumstances, financial hardship is not part of the legal analysis before us.

In the absence of any documentation or other evidence from which a more accurate determination may be made, we conclude that no reduction to the amount of unreported taxable sales is warranted.

HOLDINGS

1. Appellant was the only retailer operating the business for the entire audit period, and thus, is liable for the tax on the unreported taxable sales made by the business during the audit period.
2. No reduction to the amount of audited unreported taxable sales is warranted.

DISPOSITION

CDTFA’s action in denying the petition for redetermination is sustained.

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 Josh Aldrich
 Administrative Law Judge

We concur:

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 Daniel K. Cho
 Administrative Law Judge

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 Andrew Wong
 Administrative Law Judge

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