**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 20106753 |
| | ) CDTFA Case ID 159-024 |
| **MISS OLLIE'S LLC** | ) |
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## OPINION

Representing the Parties:

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| For Appellant: | Sarah Kirnon, Member |
| For Respondent: | Jason Parker, Chief of Headquarters Operations |
| For Office of Tax Appeals: | Craig Okihara, Business Taxes Specialist III |

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Miss Ollie's LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a July 6, 2017 Notice of Determination (NOD) for $96,409.47 in tax, a negligence penalty of $9,640.95, and applicable interest, for the period January 1, 2013, through December 31, 2015 (liability period). In its Decision, CDTFA deleted the negligence penalty and denied the remainder of the petitioned amount.

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

[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 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.

## ISSUE

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

## FACTUAL FINDINGS

1. Appellant, a limited liability company, operates a full-service restaurant, with sales of alcohol, located in Oakland, California. Appellant's seller's permit has an effective date of December 14, 2012, and remains active.
2. During the liability period, appellant reported total and taxable sales of $844,063 on its sales and use tax returns. Appellant explained that it reported taxable sales based on its bank deposits after making an adjustment for nontaxable sales. Appellant did not provide bank statements to support the reported taxable sales.
3. Upon audit, appellant provided its federal income tax returns for 2013, 2014, and 2015; point-of-sale (POS) system sales data for the liability period; and income statements for the liability period. Appellant did not provide sales tax worksheets; bank statements; cash register z-tapes;[2] purchase journals; or source documentation, such as guest checks, cash register tapes, sales invoices, or merchandise purchase invoices, for the liability period.
4. CDTFA compared the total sales that appellant reported on its sales and use tax returns for 2013, 2014, and 2015 to the corresponding gross receipts reported on its federal income tax returns and found that gross receipts exceeded total sales by $1,240,531 for the three years combined. Appellant stated that the differences resulted from nontaxable sales but did not provide documentation to support the amounts that it reported on the federal income tax returns.[3]

[2] A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain time period (e.g., a day or a shift).

[3] CDTFA found differences of $421,431 in 2013, $430,412 in 2014, and $388,688 in 2015.

5. CDTFA compared reported total sales to the corresponding cost of goods sold (COGS) reported on the federal income tax returns and computed book markups[4] of 3 percent for 2013, -6 percent for 2014,[5] 28 percent for 2015, and 7 percent for the three years combined. Based on its experience in audits of similar businesses in appellant's area, CDTFA expected a markup of 200 percent or greater. Thus, it considered the book markups to be too low for appellant's business. CDTFA could not verify appellant's COGS because appellant did not provide purchase journals and merchandise purchase invoices.

6. CDTFA used appellant's income statements to compile recorded restaurant sales of $1,976,150 and recorded catering sales of $109,225. CDTFA compared the total recorded sales of $2,085,375 to sales of $775,549[6] and computed a difference of $1,309,826 for the liability period.[7] Appellant stated that the difference was due to nontaxable sales. Appellant did not provide documentation to support its assertion.

7. CDTFA used appellant's POS system sales data to compile recorded total sales of $2,088,726 and recorded sales tax reimbursement collected of $173,579 for the liability period. CDTFA compared appellant's recorded total sales to appellant's reported total sales of $844,063 and found a difference of $1,244,663. CDTFA found that appellant's

[4] "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 markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 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 profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (0.30 ÷ 1.00 = 0.30).

[5] A negative book markup means that the COGS is more than reported total sales. In other words, it indicates that the retailer is selling merchandise, in this case food products, for less than it paid for the goods.

[6] According to CDTFA's audit workpapers, this amount is intended to be total sales reported on appellant's sales and use tax returns for the liability period. However, we note that total sales reported on the sales and use tax returns for the liability period is $844,063. It appears that CDTFA inadvertently omitted amounts that appellant reported for 1Q15 ($68,514) from the measure of reported taxable sales when comparing reported taxable sales to taxable sales recorded in appellant's income statements. A comparison of the taxable sales that appellant recorded in its income statements of $2,085,375 to reported taxable sales of $844,063 reveals a difference of $1,241,312. As this amount is greater than the deficiency measure ($1,060,704) found in the audit, this error will not be discussed further.

[7] We note an error in CDTFA's computation. Total sales for the liability period reported on the sales and use tax returns were $844,063; thus, the difference is $1,241,312 ($2,085,375 - $844,063). However, this difference is still large and does not affect our analysis as to whether CDTFA met the initial burden of showing that the taxable measure is reasonable and rational.

recorded taxable sales included nontaxable sales of food, such as nontaxable catering sales and nontaxable sales of cold food to-go.

8. CDTFA compared appellant's recorded sales tax reimbursement collected to reported sales tax of $77,170 for the liability period and found a difference of $96,409. Appellant stated that the sales tax reimbursement recorded in the POS system was inaccurate and did not reflect the actual amount collected.[8] CDTFA requested cash register tapes to support the recorded total sales and sales tax reimbursement collected, but appellant stated it did not maintain them. CDTFA concluded that the difference between appellant's recorded sales tax reimbursement collected and appellant's reported sales tax was the most accurate method to establish unreported taxable sales. CDTFA divided unreported sales tax reimbursement for each quarterly reporting period by the applicable sales tax rate to compute unreported taxable sales of $1,060,704 for the liability period.

9. CDTFA also obtained reported Form 1099-K[9] data from the Internal Revenue Service and compiled credit card sales of $2,033,294 for the liability period. From the credit card sales, CDTFA removed estimated credit card tips and then divided the result by an estimated credit-card-sales-ratio of 78.49 percent to compute total sales of $2,269,972 for the liability period. CDTFA then removed sales tax reimbursement at the applicable tax rates to calculate taxable sales of $2,080,007 for the liability period. Upon comparison to appellant's total reported sales of $844,063, CDTFA computed a difference of $1,235,944. CDTFA noted that this result was similar to the differences computed from the federal income tax returns, income statements, and POS sales data. CDTFA considered that the audit's calculation of unreported taxable sales based on recorded sales tax reimbursement was reasonable and was in appellant's favor since it was the lowest of the differences computed.

[8] Although appellant disputed the accuracy of its POS records during an appeal with CDTFA, appellant has not raised this contention here. Thus, we assume the accuracy of the POS records is no longer in dispute. Even if appellant did raise this contention, appellant has not provided, and we do not find any evidence in the record, to support that the POS records are incorrect.

[9] Internal Revenue Service Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (credit cards, debit cards, PayPal, etc.).

10. Ultimately, CDTFA decided to use the audit method which yielded the lowest deficiency measure. CDTFA used the difference between recorded sales tax reimbursement collected and reported sales tax to establish a deficiency measure of $1,060,704.
11. CDTFA issued an NOD to appellant on July 6, 2017, based on the above-mentioned audit, with a tax liability of $96,409.47, a negligence penalty of $9,640.95, plus applicable interest.
12. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
13. CDTFA held an appeals conference with appellant, and subsequently issued a Decision on December 12, 2019, deleting the negligence penalty but otherwise denying the petition.
14. Appellant filed a timely request for reconsideration alleging it had new documentation to present to CDTFA. CDTFA allowed appellant additional time to submit new documentation, but appellant failed to do so. Thus, CDTFA issued a Supplemental Decision on August 4, 2020, that continued to recommend that the negligence penalty be deleted but otherwise denying the petition.
15. Appellant timely appealed to the Office of Tax Appeals (OTA).

## DISCUSSION

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (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 to support reported amounts 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, 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 a complete set of books or records for the audit. As a result, CDTFA calculated the deficiency measure based on differences in the amount of sales tax reimbursement that appellant's POS system sales data recorded as collected and the sales tax that appellant reported on its returns. The sales tax reimbursement recorded in appellant's POS system is evidence of appellant's taxable sales. Appellant failed to provide any evidence to substantiate its claims that the POS system sales data was inaccurate, and thus appellant's argument on this point is not persuasive.

Additionally, CDTFA's determination was supported by alternative audit methods, including: a comparison of gross receipts reported on appellant's federal income tax returns to the total and taxable sales that appellant reported on its sales and use tax returns; a comparison of taxable sales recorded by appellant to the taxable sales that appellant reported on its sales and use tax returns; and a projection of sales based on appellant's federal Forms 1099-K. We note that in each case, these alternate audit methods yielded a greater deficiency measure. As such, we find that CDTFA's use of the sales tax reimbursement that appellant recorded in its POS system sales data to establish its determination is reasonable and rational. Accordingly, the burden shifts to appellant to show errors in the audit.

Appellant asserts that during the audit, CDTFA represented that the deficiency measure and penalties would be reduced. While we do not have any specific information regarding this alleged conversation, we note that CDTFA deleted the negligence penalty imposed on appellant.[10] As to the deficiency measure itself, CDTFA's Audit Manual section 0401.05[11] states that a primary purpose of CDTFA's audit program is to provide reasonable assurance that

[10] Appellant has not provided any evidence with its appeal. Our review of the audit workpapers revealed that on April 13, 2017, CDTFA made a note in its form 414Z, *Assignment Activity History*, that the taxpayer met with an audit supervisor who would review the audit working papers and let them know about a possible adjustment. There are no further entries indicating that CDTFA found an adjustment to be warranted.

[11] CDTFA's Audit Manual summarizes CDTFA's audit policies and procedures. It is a useful resource that OTA may look to for guidance in interpreting the law; however, the Audit Manual is not binding legal authority, and should not be cited as such. As such, OTA will exercise its own independent judgement in determining the proper weight, if any, to afford CDTFA's construction of the law, as set forth in the Audit Manual. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.)

taxpayers pay neither more nor less than required by law. Therefore, CDTFA is required to correct its audit methodology during the course of the audit if it determines that more accurate information is available, or it finds that its previous conclusions are incorrect. (See, e.g., CDTFA Audit Manual § 0401.14.) CDTFA may have presented interim findings to appellant. However, these interim findings did not preclude CDTFA from coming to a different conclusion upon completion of the audit. As stated above, CDTFA has met its initial burden of showing that its determination was reasonable and rational. Therefore, appellant must show that there are errors in the audit.

Appellant asserts that the taxable measure does not consider times that the business was closed. However, appellant has not specified any alleged closure periods or provided evidence of a closure. Appellant's unsupported assertions are not sufficient to meet its burden of proof. (*Appeal of Talavera*, *supra*.) Even if appellant was closed for periods of time during the liability period, the deficiency measure would not be affected because it is based on the sales tax reimbursement that appellant recorded as collected. Appellant would not have collected sales tax reimbursement during periods of closure. Accordingly, we find no basis to reduce the taxable measure.

Finally, with respect to settlement, OTA has no authority to either settle or compromise a disputed tax liability, and our jurisdiction in this case is limited to determining the correct amount of an appellant's tax liability. (*Appeals of Dauberger*, *et al*. (82-SBE-082) 1982 WL 11759.)[12] As appellant bears the burden of proof in this case, we must conclude that no adjustments to unreported taxable sales are warranted.

[12] CDTFA has various programs that appellant may wish to explore. Appellant would need to contact CDTFA to discuss eligibility for or participation in any such program.

## HOLDING

Appellant has not shown that adjustments to the measure of tax are warranted.

## DISPOSITION

CDTFA's action in deleting the negligence penalty, but otherwise denying the petition, is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

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