

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

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| In the Matter of the Appeal of: |) | OTA Case No. 20086516 |
| WS LOUNGE, INC. |) | CDTFA Case No. 272-014 |
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OPINION

Representing the Parties:

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| For Appellant: | Ibrahim R. Gad, Representative |
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| For Respondent: | Jason Parker, Chief of Headquarters Ops. |
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| For Office of Tax Appeals: | Lisa Burke, Business Taxes Specialist III |
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M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, appellant WS Lounge, Inc. appeals a decision issued by respondent California Department of Tax and Fee Administration denying appellant’s petition for redetermination of a Notice of Determination (NOD) issued on June 19, 2017.¹ The NOD is for \$46,826.38 in tax, plus applicable interest, for the period February 1, 2013, through December 31, 2015 (liability period), and is based on an audited deficiency measure totaling \$520,292. Of that amount, appellant disputes only one audit item: unreported taxable sales of

¹ Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (BOE). In 2017, the California Legislature transferred functions of BOE relevant to this case to respondent. The effective date of the transfer of all but adjudicatory functions was July 1, 2017. (Adjudicatory functions were transferred to the Office of Tax Appeals effective January 1, 2018.) Thus, when this Opinion refers to events that occurred before July 1, 2017, “respondent” shall refer to BOE.

\$403,944² for the period February 1, 2013, through March 31, 2015, which respondent determined using a credit card sales ratio analysis.³

We decide this matter on the basis of the written record because appellant waived its right to an oral hearing.

ISSUE

Is appellant entitled to a reduction to the \$403,944 measure of unreported taxable sales, which is based on a credit card sales ratio analysis?

FACTUAL FINDINGS

1. Appellant operated a restaurant with a full bar and hookah lounge in Winnetka, California. The business was open from 11:00 a.m. to 2:00 a.m. seven days a week.
2. For the liability period, appellant reported total sales of \$2,154,875, claimed deductions of \$153,042 for sales tax included in reported total sales, and, for 2013 only, claimed deductions of \$110,468 for gratuities included in reported total sales, which resulted in reported taxable sales of \$1,891,365 for the liability period.
3. For audit, appellant provided its federal income tax returns for 2013 and 2014; bank statements for the liability period; monthly sales summaries for 2013 and 2014; and incomplete data from its point-of-sale (POS) system for the first quarter of 2015 (1Q15) through 1Q16.⁴
4. Although appellant stated that it used its monthly sales summaries for reporting purposes, respondent found that the amounts recorded in the summaries did not reconcile with reported amounts. Based on respondent's finding that the invoice numbers in the available POS data appeared to be consistent and complete, and given the internal

² Based on a roughly 9 percent tax rate, we compute that this audit item represents disputed tax of approximately \$36,355.04.

³ As used here, "credit card" refers to sales involving electronic payment using some type of payment card. According to respondent's Audit Manual section 0810.12, because the proceeds from credit card transactions are deposited directly into the retailer's bank account by the merchant services provider, these amounts are verifiable. Typically, the auditor schedules credit card sales and total sales for a representative test period to compute a credit card sales ratio, which, after adjusting for tax and optional gratuities included and merchant service provider withholdings (if applicable), can be used to determine total sales for the period under examination.

⁴ Appellant explained that it started using a new POS system during 1Q15 after its old POS system crashed. Because appellant provided POS data from the current system only, the POS data provided for 1Q15 was incomplete.

controls reported to be in place at the business, respondent accepted the accuracy of the POS data. Respondent compared recorded taxable sales of \$654,656 shown in the POS data for 2Q15 through 4Q15 with appellant's reported taxable sales of \$567,973 for the same period and established the difference of \$86,683 as unreported taxable sales for the period 2Q15 through 4Q15.

5. Respondent also determined from its review of the data that appellant collected \$29,665 from its customers as mandatory gratuities during 3Q15 and 4Q15. Those mandatory gratuities should have been included in the measure of reported taxable sales pursuant to California Code of Regulations, title 18, section 1603(h). When appellant did not report them, respondent established an additional deficiency measure of \$29,665 for unreported taxable gratuities.
6. Lacking sufficient data or sales records to determine taxable sales for the period February 1, 2013, through March 31, 2015, on an actual basis, respondent used an indirect audit method based on the ratio of appellant's sales involving electronic payments to its total sales (credit card sales ratio analysis) to establish audited taxable sales for that period.
7. Respondent obtained appellant's 1099-K forms for 2013 and 2014 from the Franchise Tax Board.⁵ Based on credit card sales data shown on the 1099-K forms, and on appellant's bank statements for 1Q15, respondent computed appellant's total receipts from credit card sales of \$1,458,138 for the period February 1, 2013, through March 31, 2015.
8. Based on its examination of the POS data for the period 1Q15 through 1Q16, respondent computed that gratuities included in credit card sales represented 14.59 percent of the credit card sales. Respondent compared credit card sales of \$661,166, excluding gratuities, for that period with total sales of \$999,506, excluding gratuities, to determine that appellant's credit card sales represented 66.15 percent of its total sales.
9. Respondent reduced credit card sales of \$1,458,138 for the period February 1, 2013, through March 31, 2015, by the determined gratuity percentage of 14.59 percent to compute credit card sales of \$1,245,456, excluding gratuities, for that period.

⁵ Form 1099-K is an Internal Revenue Service form titled "Payment Card and Third-Party Network Transactions," which shows the monthly and annual amount paid to the merchant in a calendar year by customers using electronic payments.

- Adjustments to exclude sales tax reimbursement resulted in credit card sales of \$1,142,620. Respondent divided credit card sales of \$1,142,620 by the audited credit card sales ratio of 66.15 percent to establish audited taxable sales of \$1,727,336 (rounded) for the period February 1, 2013, through March 31, 2015, which exceeded appellant's reported taxable sales for the same period by \$403,944.
10. On June 19, 2017, respondent issued to appellant an NOD based on a \$520,292 deficiency measure. That measure consists of: (1) \$86,683 for unreported taxable sales for the period April 1, 2015, through December 31, 2015, based on the difference between recorded and reported taxable sales; (2) \$29,665 for additional unreported taxable sales attributable to mandatory gratuities for the period July 1, 2015, through December 31, 2015; and (3) \$403,944 for unreported taxable sales for the period February 1, 2013, through March 31, 2015, based on the credit card sales ratio analysis.
 11. Appellant filed a timely petition for redetermination disputing the NOD in its entirety, but appellant later conceded the \$86,683 deficiency measure based on the difference between recorded and reported taxable sales and the \$29,665 deficiency measure for unreported taxable sales attributable to mandatory gratuities. The only amount remaining in dispute is the \$403,944 measure for unreported taxable sales, which is based on the credit card sales ratio analysis described above.
 12. In a Decision issued on January 22, 2019, respondent denied the petition for redetermination. This timely appeal followed.

DISCUSSION

California imposes 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 prepared food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (2) & (7).)

When respondent is not satisfied with the amount of tax reported by the taxpayer, respondent 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.) 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met that burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide POS data or other sales records to support the accuracy of its reported taxable sales for the period February 1, 2013, through March 31, 2015. Given that appellant did not provide records sufficient to support a direct audit approach, we find that respondent's use of the indirect credit card sales ratio audit method was rational. We further find that respondent used that audit method correctly to calculate a reasonable estimate of appellant's unreported taxable sales for the period February 1, 2013, through March 31, 2015. We have reviewed the audit working papers and have found no material inaccuracies in the calculations. Therefore, the burden of proof shifts to appellant to establish by documentation or other evidence that a reduction to the amount of unreported taxable sales is warranted.

Appellant contends that respondent denied appellant's petition without addressing the main issues in its appeal. Appellant objects to a mischaracterization of his business as a "Mexican restaurant," and it expresses concern that it may be the victim of discrimination. Appellant argues that respondent did not properly respond to a Freedom of Information Act (FOIA) request by providing all documents appellant needs to confirm that the audit was performed according to standard audit guidelines. Appellant's submissions also suggest that it might even agree with respondent's findings if it could be confident that all requested records have been provided to appellant and reviewed.

Appellant's arguments either find no support in the record or they are irrelevant. It appears from the record that respondent's Decision addressed the correct issue, which we review here. (Cal. Code Regs., tit.18, § 30103(b).) If, as appellant argues, the issue is something other than what respondent addressed in its Decision and we address here, we cannot imagine what that would be, and appellant has provided no guidance. Furthermore, this is not the venue for

resolving a dispute regarding an FOIA request. (Cal. Code Regs., tit.18, §§ 30103(b) & 30104.) Regardless, the data upon which the audit is based is apparent from and contained in the audit work papers, or is otherwise available to appellant, and we are not aware of any effort by appellant, through discovery or otherwise, to obtain records or other potential evidence in this proceeding. We see no evidence that the mischaracterization of appellant’s business as a “Mexican restaurant” had any bearing on respondent’s Decision, and it has no bearing here. Finally, appellant has the burden to prove any error(s) in the audit by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219.) It has not done that. We find that appellant has not met its burden to show an error in the audit procedures or findings, and to provide documentation or other evidence from which a more accurate determination may be made. On that basis, we conclude that no adjustment is warranted.

HOLDING

Appellant is not entitled to a reduction to the \$403,944 measure of unreported taxable sales, which is based on a credit card sales ratio analysis.

DISPOSITION

We sustain respondent’s decision to deny the petition.

DocuSigned by:
Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
Nguyen Dang
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Nguyen Dang
Administrative Law Judge

DocuSigned by:
Alberto T. Rosas
B969EE4BD4914D5...
Alberto T. Rosas
Administrative Law Judge

Date Issued: 6/9/2021