

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

In the Matter of the Appeal of:	)	OTA Case No. 20096724
<b>DON CUCO’S INC.</b>	)	CDTFA Case ID 232-196
<b>dba Don Cuco’s Mexican Restaurant</b>	)	
	)	
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**OPINION**

Representing the Parties:

For Appellant: Paul Azir, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Lisa Burke, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Don Cuco’s, Inc. dba Don Cuco’s Mexican Restaurant (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying, in part, appellant’s petition for redetermination of the Notice of Determination (NOD) issued on April 17, 2017. The NOD is for \$35,750.94 in tax, plus accrued interest, for the period January 1, 2013, through December 31, 2015 (audit period). CDTFA’s decision made an adjustment in the audit calculations that resulted in a reduction of \$1,772 to the determined tax liability, from \$35,751 (rounded) to \$33,979.

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

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<sup>1</sup> Sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to its predecessor, the board.

ISSUE<sup>2</sup>

Whether appellant established that an additional reduction to the amount of unreported taxable sales is warranted.

FACTUAL FINDINGS

1. Appellant has operated a restaurant with a full bar in California since July 1, 2007. The hours of operation were from 11:00 a.m. to 10:00 p.m. Sundays through Thursdays, and 11:00 a.m. to 11:00 p.m. Fridays and Saturdays. On Sundays, appellant sold brunch with champagne for a fixed price until 2:00 p.m.
2. During the audit period, appellant reported total sales of \$5,777,165 and claimed no deductions.<sup>3</sup>
3. For audit, appellant provided its federal income tax returns for 2013 and 2014; profit and loss statements and bank statements for the audit period; general ledger cost of sales for the third quarter of 2015 (3Q15); point of sales (POS) summary reports for 3Q15; July 2015 merchandise purchase invoices; and handwritten daily summary sheets with no totals. Appellant did not provide cash register receipts or detailed POS data for the audit period.
4. CDTFA decided to perform additional testing due to insufficient source documentation. CDTFA attempted to perform a credit-card-sales-ratio test, based on three full days of observation, to establish audited taxable sales. CDTFA noted, however, that it was unable to complete the observation test because after one full day of observation, appellant declined to allow the two remaining days of observations. CDTFA, therefore, determined it was appropriate to use a markup method to establish audited sales instead.
5. CDTFA used appellant's records for 3Q15 to compute that purchases of food represented 77 percent of appellant's merchandise purchases, purchases of alcohol represented 18.85 percent of the purchases, and purchases of mixers or other bar supplies represented 4.15 percent of the purchases.

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<sup>2</sup> CDTFA also determined a separate audit item for unreported ex-tax purchases of tangible personal property that was self-consumed of \$6,436, which is not in dispute in this appeal.

<sup>3</sup> There is an immaterial \$10.00 difference in the Form 414M reported amount.

6. CDTFA examined appellant's 3Q15 POS summary reports, which showed that recorded food sales comprised 73 percent of the total recorded sales for that quarter, and the remaining 27 percent represented sales of alcoholic beverages. CDTFA multiplied appellant's total reported sales (food and alcohol) of \$5,777,165 for the audit period by 73 percent to compute food sales totaling \$4,217,330. CDTFA multiplied appellant's total recorded merchandise purchases (food and alcohol) for the audit period by the food cost ratio of 77 percent to compute purchases of food (excluding champagne) totaling \$1,365,924. Since appellant sold champagne with food during Sunday brunch for one fixed price, CDTFA added champagne purchases of \$12,450 for the audit period to the food purchases to compute audited food purchases of \$1,378,373 (rounded). A comparison of total food sales of \$4,217,330 for the audit period with audited food purchases of \$1,378,373 showed a gross profit of \$2,838,957 and an average book markup for food of 205.96 percent.<sup>4</sup> CDTFA accepted the accuracy of appellant's reporting as it pertained to sales of food because the average book markup was reasonable.
7. CDTFA found that 27 percent of the recorded total sales for 3Q15 were sales of alcoholic beverages. CDTFA multiplied the recorded (and reported) total sales of \$5,777,165 for the audit period by 27 percent to compute recorded alcohol sales of \$1,559,835. CDTFA then compared recorded alcohol purchases of \$321,891 (excluding champagne purchases of \$12,450) with recorded alcohol sales of \$1,559,835 and computed an average book markup for alcohol of 384.59 percent. CDTFA determined that further analysis was warranted to verify the accuracy of the recorded alcohol sales.
8. On a *Bar Fact Sheet* dated June 24, 2016, appellant provided its drink prices, glass sizes, average amounts of liquor served in the various glass sizes, and other information necessary to compute its average markup for alcoholic beverages. Although CDTFA had not observed happy hour pricing during its one-day observation, CDTFA accepted that appellant sold approximately 25 percent of its alcoholic beverages at happy hour prices based on appellant's assertion in the *Bar Fact Sheet* that it reduced its drink prices from 4:00 p.m. to 7:00 p.m. every day. CDTFA also accepted that appellant poured 2.5 ounces

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<sup>4</sup> $\$2,838,957 \div \$1,378,373 = 2.0596$

- of tequila in its 16-ounce margaritas and 3.5 ounces of tequila in its 24-ounce margaritas, while the average pour size for other mixed drinks was 1.5 ounces.
9. CDTFA compared the regular drink prices and happy hour prices shown in the *Bar Fact Sheet*, excluding sales tax reimbursement, with the drink costs computed from the costs for bottles of alcohol shown in the purchase invoices for July 2015. CDTFA determined the following computed audited markups: 443.69 percent for bottled beer; 298.61 percent for draft beer; 558.94 percent for tequila; and 668.18 percent for other liquor and wine. Based on appellant's purchase invoices for July 2015, CDTFA computed that 6.53 percent of the purchases were of bottled beer, 16.39 percent were of draft beer, 62.21 percent were of tequila, and 14.88 percent were of other liquor and wine. By combining the purchase ratios with the average markups for each beverage category, CDTFA calculated an audited weighted average markup of 525.02 percent for sales of alcoholic beverages.
  10. CDTFA reduced audited purchases of alcohol, excluding champagne, by 2 percent to allow for self-consumption, and reduced appellant's purchases of bottled beer by 1 percent to allow for breakage. After reducing the adjusted alcohol purchases by 1 percent to allow for pilferage, CDTFA established audited costs of alcoholic beverages sold of \$312,095 for the audit period.
  11. CDTFA added the audited weighted average markup of 525.02 percent to the audited costs of alcoholic beverages sold to establish audited taxable sales of alcoholic beverages of \$1,950,641 for the audit period. CDTFA added the total food sales of \$4,217,330 and the audited sales of alcohol of \$1,950,641, to compute audited total (and taxable since there were no deductions claimed) sales of \$6,167,971. From this, CDTFA subtracted reported taxable sales of \$5,777,165, to compute unreported taxable sales of \$390,796 for the audit period.
  12. CDTFA used appellant's bank statements for the audit period to compute sales paid by credit card totaling \$4,890,034, excluding sales tax reimbursement and tips, to verify that the results of the markup analysis were reasonable. CDTFA then compared the sales paid by credit card with audited taxable sales of \$6,167,971 to compute a credit card sales ratio of 79.28 percent. CDTFA determined that the audit results were reasonable because the 79.28 percent credit card sales ratio was in line with the credit card sales ratio of

- 78.71 percent computed from its one-day observation of appellant's business.
13. The deficiency measure of \$397,231 on which the NOD is based consists of \$390,795 for unreported taxable sales and \$6,436 for unreported costs of self-consumed taxable merchandise.
  14. On March 4, 2020, CDTFA issued its decision which ordered a reaudit to increase the allowance for pilferage, from 1 percent to 2 percent, in computing the costs of alcohol sold, and otherwise denied the petition for redetermination. The reaudit resulted in a reduction of \$19,702 to the measure of unreported taxable sales.
  15. Appellant timely appealed to the Office of Tax Appeals.

### DISCUSSION

California imposes sales tax on a retailer measured by the gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempted or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) All of a retailer's gross receipts are presumed subject to tax unless the retailer can prove otherwise. (R&TC, § 6091.) 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).) 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 on the premises of the retailer are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).)

If 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 that 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 insufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant failed to provide complete source documents, such as cash register receipts, or detailed sales data from its POS system to support the accuracy of its reported sales. Given the inadequate records, CDTFA determined that an alternative audit method to establish audited taxable sales was warranted. Although CDTFA initially attempted to conduct a credit-

card-sales-ratio test, CDTFA used the markup method to establish audited taxable sales, which was based on appellant's records.<sup>5</sup> CDTFA's Audit Manual section 0407.10 states: In many types of businesses, particularly where the unit of sales is small, the volume of transactions relatively large and the mark-up does not fluctuate greatly, the sales may be estimated with a fair degree of accuracy by establishing the mark-up from a shelf test and applying the computed mark-up to the cost of sales.<sup>6</sup> We have reviewed the audit working papers, have found that the method used was reasonable and rational, and have found no material inaccuracies in the calculations. The burden of proof, therefore, shifts to appellant to establish by documentation or other evidence that a reduction to the amount of unreported taxable sales is warranted.

Appellant argues that it accurately recorded and reported its sales using its POS system. Appellant contends that the additional taxable sales established by the markup method cannot be accurate. Appellant argues that the test period of one month for the markup analysis was inadequate, and if CDTFA expanded its testing to include additional periods, CDTFA would have found that appellant's reported taxable sales for the audit period were accurate.

We note that CDTFA segregated appellant's purchases of alcohol shown in purchase invoices for one month, July 2015, and used the purchase ratios computed from that test in its computation of the audited weighted average markup for alcohol. Appellant has provided no evidence showing that it purchased more tequila or other liquor, which had higher average markups, or less beer in July 2015 than it usually purchased. In the absence of evidence showing otherwise, we find that the results of the purchase segregation test conducted for July 2015 adequately reflect appellant's average purchase ratios, and thus no expansion of the purchase segregation test is warranted.

CDTFA used the purchases shown in the purchase invoices for July 2015 to compute drink costs for the markup analysis. CDTFA compared the drink costs with the selling prices for drinks shown in the *Bar Fact Sheet* completed by appellant between April and June 2016 to compute an average markup for each beverage category. A more conservative approach would have been to compute drink costs from purchase invoices for the month prior to the month for

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<sup>5</sup> See Factual Finding 4.

<sup>6</sup> 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 Micelle Laboratories, Inc.*, 2020-OTA-290P.)

which drink selling prices were provided in the *Bar Fact Sheet* (e.g., March 2016). CDTFA notes that during the audit, appellant's purchase invoices for the period during which appellant completed the *Bar Fact Sheet* were not made available, and appellant has provided no additional purchase invoices since the audit was completed. We find that CDTFA relied on the best information available, and no additional testing to compute drink costs for the markup analysis is warranted. To compute the total cost of alcoholic beverages sold for the markup analysis, CDTFA used the cost of sales recorded in appellant's general ledger for 3Q15 and appellant's recorded total merchandise purchases for the audit period. For information regarding appellant's drink prices and the sizes of drinks served, CDTFA relied on the *Bar Fact Sheet* completed by appellant. Appellant has provided neither argument nor evidence showing errors in its recorded purchases or showing that information it provided on the *Bar Fact Sheet* was erroneous.

We find that appellant has failed to meet its burden. Therefore, we conclude that no additional adjustment is warranted.

#### HOLDING

No additional reduction to the amount of unreported taxable sales is warranted.

#### DISPOSITION

CDTFA's action in adjusting the taxable measure for unreported taxable sales from \$390,795 to \$371,093, and otherwise denying the petition, is sustained.

DocuSigned by:

*Josh Aldrich*

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Josh Aldrich

Administrative Law Judge

We concur:

DocuSigned by:

*Daniel Cho*

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Daniel K. Cho  
Administrative Law Judge

DocuSigned by:

*Andrea L.H. Long*

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Andrea L.H. Long  
Administrative Law Judge

Date Issued: 5/19/2021