

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

In the Matter of the Appeal of:  <b>B. ALZANDANI</b> <b>dba FUNKY TOWN APPAREL</b>	) OTA Case No. 19044593 ) CDTFA Case ID: 151-107 ) ) ) )
---	---

---

**OPINION**

Representing the Parties:

For Appellant:	B. Alzandani A. Asumari, Witness
----------------	-------------------------------------

For Respondent:	Nalan Samarawickrema, Hearing Representative Chad Bacchus, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
-----------------	--

For Office of Tax Appeals:	Craig Okihara, Business Tax Specialist III
----------------------------	--

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, B. Alzandani (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> partially granting appellant’s petition for redetermination of an August 8, 2017 Notice of Determination (NOD). CDTFA issued the NOD for tax of \$62,214.92, and applicable interest, for the period January 1, 2013, through December 31, 2015 (audit period).

CDTFA reviewed new information appellant provided relating to his appeal on August 13, 2018. As a result, CDTFA recommended reducing the determined measure of tax from \$815,933 to \$724,040 (as explained below) resulting in reductions to the determined tax.

Office of Tax Appeals (OTA) Administrative Law Judges Natasha Ralston, Suzanne B. Brown, and Andrea L.H. Long held an oral hearing for this matter in Sacramento,

---

<sup>1</sup> Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of the 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.

California, on February 23, 2021.<sup>2</sup> At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

### ISSUE

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

### FACTUAL FINDINGS

1. Appellant, dba Funky Town Apparel, has held a seller's permit to operate a men's clothing store in Modesto, California, since December 1, 2008.
2. CDTFA audited appellant for the audit period. Upon audit, appellant provided federal income tax returns (FITRs) for 2013, 2014, and 2015; income statements for 2014 and 2015; bank statements for partial 2013, 2014, and partial 2015; and various merchandise purchase invoices for December 2013, through December 2015. Appellant did not provide source documentation supporting sales, such as cash register tapes, for the audit period. CDTFA found the books and records provided were incomplete and inadequate for sales and use tax audit purposes. Appellant's method for reporting sales on his sales and use tax returns (SUTRs) is unknown.
3. CDTFA compared total sales reported on the SUTRs to the corresponding gross receipts reported on the FITRs and noted that gross receipts exceeded total sales by \$126,790, \$89,515, and \$22,162 for 2013, 2014, and 2015, respectively. CDTFA compared gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs and computed book markups of 66.97 percent, 54.98 percent, and 49.99 percent for 2013, 2014, and 2015, respectively. CDTFA considered the book markups on gross receipts reasonable for appellant's business.<sup>3</sup> However, CDTFA also compared total sales reported on the SUTRs to the corresponding COGS reported on the FITRs and computed

---

<sup>2</sup> The oral hearing was noticed for Sacramento, California, but was held electronically due to Covid-19.

<sup>3</sup> "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 ( $0.30 \div 0.70 = 0.42857$ ). 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 ( $0.30 \div 1.00 = 0.30$ ).

book markups of 2.9 percent, 18.65 percent, and 38.75 percent for 2013, 2014, and 2015, respectively. CDTFA considered the book markups on reported total sales unreasonable (too low) for appellant's business. Due to the incomplete books and records provided to CDTFA, the aforementioned differences between reported total sales and reported gross receipts, and the low book markups for reported total sales, CDTFA concluded that additional testing was needed to evaluate reported taxable sales.

4. To evaluate appellant's reported gross receipts, CDTFA conducted a bank deposit analysis.<sup>4</sup> Appellant maintained multiple business bank accounts during the audit period. CDTFA determined that the bank statements appellant provided for 2014 appeared to be the most complete. Thus, CDTFA compiled bank deposits from sales proceeds (excluding sales tax reimbursement) of \$422,134 for 2014. CDTFA noted that bank deposits from sales proceeds exceeded both taxable sales of \$292,302 reported on the 2014 SUTRs and gross receipts of \$381,817 reported on the 2014 FITR. CDTFA concluded that reported taxable sales were understated. However, CDTFA expected that appellant would use some cash sales proceeds to pay for merchandise purchases or operating expenses (cash payouts) and thus, CDTFA anticipated that some cash proceeds were not deposited into the business bank accounts. Because appellant did not provide documentation to determine cash payouts, CDTFA was unable to establish taxable sales using the bank-deposit-analysis method.
5. CDTFA next decided to compute taxable sales using the markup method and concluded that merchandise purchase invoices appellant provided for 2014 appeared the most complete. CDTFA also requested purchase data from appellant's known vendors for 2014. CDTFA compiled merchandise purchases of \$324,183 for 2014 using merchandise purchase invoices and purchase data from vendors. CDTFA noted that merchandise purchases for four months appeared incomplete in comparison with the remaining eight months. CDTFA compiled merchandise purchases of \$258,296 for those eight months and computed an average of \$32,287 per month. Thus, for the four incomplete months, CDTFA computed merchandise purchases of \$129,148 ( $\$32,287 \times 4$  months) and audited

---

<sup>4</sup> Bank deposits are not gross receipts. (R&TC, § 6012(a).) However, where, as here, a retailer is engaged in the business of making retail sales of tangible personal property, the retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of tangible personal property, which evidence CDTFA can use to determine audited taxable sales when sales cannot be accurately established using a direct approach because of a lack of adequate records.

- merchandise purchases of \$387,444 (\$258,296 + \$129,148) for 2014. CDTFA compared audited merchandise purchases with COGS of \$246,358 reported on the 2014 FITR, computed a difference of \$141,086, and calculated an understatement ratio of 57.27 percent. CDTFA concluded that COGS reported on the 2013 and 2015 FITRs were more complete than the purchase invoices for those two years, but also concluded that COGS reported on the 2013 and 2015 FITRs were understated. Therefore, CDTFA applied the understatement ratio of 57.27 percent to COGS reported on the 2013 and 2015 FITRs and computed audited merchandise purchases of \$311,246 for 2013 and \$309,934 for 2015.
6. CDTFA was unable to perform a shelf test because appellant did not provide cash register tapes.<sup>5</sup> Thus, CDTFA added the book markups of 66.97 percent, 54.98 percent, and 49.99 percent for 2013, 2014, and 2015, respectively, to audited merchandise purchases for those same respective years, and computed audited taxable sales of \$519,687 for 2013, \$600,461 for 2014, \$464,870 for 2015, and \$1,585,018 for the audit period. Upon comparison to reported taxable sales of \$769,086 for the audit period, CDTFA calculated unreported taxable sales of \$815,932.
  7. CDTFA obtained appellant's credit card transaction data reported on form 1099-K<sup>6</sup> for the audit period. Using the form 1099-K data, CDTFA compiled credit card sales, excluding sales tax reimbursement, of \$837,282 for the audit period. CDTFA noted that credit card sales alone significantly exceeded reported taxable sales of \$769,086 for the audit period. CDTFA compared credit card sales to audited taxable sales of \$1,585,018 and computed a credit-card-sales ratio of 52.8 percent, which CDTFA considered reasonable for appellant's business. Thus, CDTFA concluded audited taxable sales were reasonable.
  8. CDTFA issued an NOD to appellant on August 8, 2017, based on the above-mentioned audit, with a tax liability of \$62,214.92 and applicable interest.
  9. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
  10. For his appeal with CDTFA, appellant contended that the audited markups were too high. Appellant argued that CDTFA did not consider specials and discounted sales in the

---

<sup>5</sup> A shelf test is a comparison of known costs and associated selling prices used to compute markups.

<sup>6</sup> Internal Revenue Service form 1099-K is used to report a taxpayer's income received from electronic or online payment services (e.g., credit cards, debit cards, PayPal, etc.).

audited markup. Appellant provided merchandise purchase invoices from two vendors for July 2018 but did not provide any cash register receipts to support the sales amounts and compute a markup. Appellant stated that merchandise from these vendors was discounted 20 percent to 25 percent from the suggested retail selling price in order to establish appellant's selling prices. CDTFA reported that appellant stated to CDTFA that gross receipts on FITRs were inflated to show to the United States Embassy that his income was sufficient enough to sponsor his family to immigrate into the country. In addition, CDTFA estimated that 15 percent of merchandise was sold at cost (in other words at a zero percent markup) based on a visual comparison of the merchandise sales racks and overall layout of the store. Thus, CDTFA performed a shelf test using this information and calculated an audited markup of 48.04 percent. CDTFA applied the audited markup to audited merchandise purchases and computed audited taxable sales of \$1,493,126 for the audit period. Upon comparison to reported taxable sales of \$769,086 for the audit period, CDTFA calculated unreported taxable sales of \$724,040.

11. CDTFA issued a decision recommending that the determined measure be reduced by \$91,893, from \$815,933 to \$724,040, but otherwise denied the petition.
12. Appellant timely appealed to OTA.

#### DISCUSSION

California imposes a sales tax on a retailer's retail sales of tangible personal property sold 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.) 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).)

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 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 not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

In the case at hand, appellant's books and records provided for audit were incomplete; thus, CDTFA was unable to use a direct audit method to verify sales reported on his SUTRs for the audit period. CDTFA's preliminary analysis found large differences between reported total sales and reported gross receipts, and also found unacceptably low book markups on reported total sales, which were indications that reported sales may have been understated. We find that CDTFA was justified to question reported sales and use an indirect audit method to compute appellant's sales. CDTFA used the markup method as the basis for its determination, and the markup method is a recognized and standard accounting procedure. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613.) Thus, we find that CDTFA has met its initial burden to show that its determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

Appellant alleges that CDTFA refused to conduct a shelf test. However, we find no evidence that CDTFA refused to conduct a shelf test as appellant has alleged. The evidence shows that CDTFA conducted a shelf test in August 2018, following receipt of appellant's explanation of his pricing policy and merchandise purchase invoices from July 2018 from two of his vendors. CDTFA used the results of that test in computing the audited markup. Appellant has not provided any new documentation to establish a more accurate calculation of audited taxable sales. Hence, appellant failed to establish an adjustment is warranted on this basis.

Appellant states he disagrees with "the method that the auditors used in determining my markup percentage." At the hearing, appellant identified Schedule R2-12A, which was provided as part of CDTFA's Exhibit A and contains a breakdown of appellant's credit card sales, based on the credit card receipts reported on Form 1099-K for each quarter at issue. Appellant asserts that CDTFA erroneously applied an additional markup to appellant's credit card sales reported on Schedule R2-12A. Appellant further contends that credit card sales were overstated because 10 percent of the credit card sales amounts shown on his form 1099-K data were refunded back to the customers. He also contends that the reported amounts contained credit card fees of 4 percent that were paid to the processor.

We find that appellant's description of CDTFA's audit methodology is inaccurate. CDTFA applied the audit markup of 48.04 percent to audited merchandise purchases and computed audited taxable sales of \$1,493,126 for the audit period. CDTFA compared appellant's reported taxable sales of \$769,086 for the audit period to the audited taxable sales and calculated unreported taxable sales of \$724,040. CDTFA did use the credit card amounts shown on Schedule R2-12A to allocate taxable sales to each quarter, but this did not affect the amount of the markup.

The markup method is one of CDTFA's generally accepted methods for determining sales. To compute the audited markup, CDTFA used the best available information for the shelf test it performed in response to the documentation appellant provided for his appeal with CDTFA, merchandise purchase invoices from two of appellant's vendors, and appellant's assertions of the amount he discounted off the suggested retail selling prices. Appellant has not identified any errors in CDTFA's computation of the audited markup or provided any new documentation to establish a more accurate calculation of audited taxable sales. Thus, no adjustment to the audited markup of 48.04 percent is warranted. Regarding appellant's arguments that credit card sales were overstated, appellant has not provided any evidence to support these contentions.

As stated earlier, unsupported assertions are not sufficient to satisfy appellant's burden of proof. (See *Appeal of Talavera, supra.*) Therefore, we find that appellant has failed to meet his burden of establishing that a further reduction to the measure of unreported taxable sales is warranted.

HOLDING

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

DISPOSITION

CDTFA’s action in reducing the measure for unreported taxable sales from \$815,933 to \$724,040 but otherwise denying the petition is sustained.

DocuSigned by:  
*Natasha Ralston*  
DE5600E566FB40F  
Natasha Ralston  
Administrative Law Judge

We concur:

DocuSigned by:  
*Suzanne B. Brown*  
47F45ABE69E34B0  
Suzanne B. Brown  
Administrative Law Judge

DocuSigned by:  
*Andrea L.H. Long*  
272945E7B372445  
Andrea L.H. Long  
Administrative Law Judge

Date Issued: 5/18/2021