OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19085140) CDTFA Case ID 997820
POLANI FINANCIALS & INVESTMENTS CORP. dba SHALIMAR RESTAURANT SUNNYVALE	))))

OPINION

Representing the Parties:

For Appellant:	Mo Polani, President
For Respondent:	Jarrett Noble, Tax Counsel III Monica Silva, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Richard A. Zellmer, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Polani Financial & Investment, Corp. (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 January 18, 2017. The NOD is for $55,311.75 in tax, plus accrued interest, and a negligence penalty of $5,531.27 for the period August 1, 2013, through March 31, 2016 (audit period).

On November 7, 2017, CDTFA issued an adjusted Billing and Refund Notice to appellant, which asserted an increase to the determined measure of tax from $518,494 to $784,419 based on a reaudit.[2] Prior to the hearing, CDTFA conducted a second reaudit that

[1] 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.

[2] CDTFA may increase the amount of an NOD only if CDTFA asserts an increase at or before a hearing before OTA. (R&TC, § 6563(a).) Also, as relevant here, the increase must be asserted within three years after the first NOD was issued, or within three years after the time tax records requested by CDTFA are made available, whichever is later. (R&TC, § 6563(a)(1).)

reduced the measure from $784,419 to $605,909, which will result in a reduction to the tax and penalty; and denied the remainder of the petitioned amount.

Office of Tax Appeals (OTA) Administrative Law Judges Andrea L.H. Long, Teresa A. Stanley, and Josh Aldrich held an oral hearing for this matter on January 26, 2021.[3] During the hearing, appellant requested an opportunity to submit evidence regarding its sales to Levi's Stadium, which was granted.[4] Appellant submitted additional briefing on January 29, 2021. CDTFA submitted its response to the additional briefing on February 5, 2021. Appellant then submitted additional briefing on February 9, 2021. CDTFA objected to appellant's February 9, 2021 submission on the basis that it was outside the scope of the Post-Hearing Order and that it was untimely. We sustain CDTFA's objection because appellant's submission was untimely, outside the scope of the Post-Hearing Order, and of limited relevance.[5] The record closed on February 9, 2021, pursuant to our Post-Hearing Order.

ISSUES

1. Whether any reduction to the amount of unreported taxable sales computed in the second reaudit is warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated a restaurant in Sunnyvale, California, until October of 2018, when appellant sold the business.
2. CDTFA audited appellant for the audit period. For audit, appellant provided limited records. Namely, appellant provided reportable credit card merchant statements known as Internal Revenue Service Forms 1099-K "Payment Card and Third Party Network Transactions" (1099-K forms).

[3] The hearing was noticed for Fresno and conducted electronically due to COVID-19.

[4] On January 28, 2021, we issued a Post-Hearing Order. As noted therein, appellant could submit additional documents until the close of business on February 2, 2021, but the scope of the submission was limited to Levi's Stadium sales that occurred during the audit period. CDTFA had the opportunity to respond until the close of business on February 9, 2021.

[5] Appellant submitted a response to CDTFA's objection, which included additional documents. Since we sustain CDTFA's objection, however, we consider it no further.

3. CDTFA compiled credit card sales from 1099-K forms of $995,227 for the period August 1, 2013, through December 31, 2014. To compute audited sales of $1,060,339 for this period, CDTFA added $48,112 for Groupon sales and $17,000 for estimated cash payouts to the credit card sales.[6] CDTFA removed sales tax reimbursement from this amount to compute audited taxable sales of $970,562 for the same period. CDTFA computed an understatement of $253,047 for the period August 1, 2013, through December 31, 2014, which represents an error ratio of 35.27 percent. CDTFA applied the error ratio of 35.27 percent to reported taxable sales for the audit period to compute unreported taxable sales of $518,494 for the audit period. Based on the error ratio, the record keeping, and the amount of the unreported taxable sales, CDTFA determined that appellant was negligent.
4. CDTFA issued the NOD to appellant on January 18, 2017.
5. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
6. Appellant then provided its point of sale (POS) reports for the period October 1, 2015, through March 31, 2017. CDTFA decided to prepare a reaudit, using appellant's POS reports. Based on these reports, CDTFA compiled recorded sales of $878,027 for the period October 1, 2015, through March 31, 2017. CDTFA concluded that all the sales during this period were taxable because there was insufficient documentation to show that any of the sales were nontaxable or exempt. Recorded sales of $878,027 for the period were compared to reported taxable sales of $578,033 for the same period. CDTFA computed unreported taxable sales of $299,994, which represents an error ratio of 51.9 percent.[7] CDTFA applied the error ratio of 51.9 percent to reported taxable sales for the audit period to compute unreported taxable sales of $784,419 for the audit period.
7. In the adjusted Billing and Refund Notice dated November 7, 2017, CDTFA asserted a timely increase to the NOD.
8. Appellant filed a timely petition for redetermination of the asserted increase.
9. CDTFA held an appeals conference with appellant on November 27, 2018.
10. On July 15, 2019, CDTFA issued its decision denying the petitions.

[6] $995,227 + $48,112 + $17,000 = $1,060,339. A cash payout is cash from the cash register that is used to pay employees, vendors, or used for some other purpose.

[7] ($878,027 - $578,033 = 299,994) and ($299,994 ÷ $578,033 = 51.9%).

11. Appellant timely appealed to OTA.

12. CDTFA conducted a second reaudit in preparation for the oral hearing. CDTFA noted that appellant's reported taxable sales for the second quarter of 2016 (2Q16), 3Q16, and 1Q17 were materially lower than the sales during the audit period. Since CDTFA determined that those quarters were not representative, they were excluded. The second reaudit utilized POS data for 4Q15 and 1Q16 (test period) only, which reduced the error rate to 40.09 percent. Based on the error rate, CDTFA reduced the unreported taxable measure from $784,419 to $605,909.

DISCUSSION

Issue 1: Whether any reduction to the measure of unreported taxable sales computed in the second reaudit is warranted.

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, §§ 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 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 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 provided incomplete records for audit. Complete POS reports for periods prior to October 1, 2015, were not made available to CDTFA. Based on the available POS

reports, CDTFA used appellant's POS records to calculate the error ratio between reported and recorded taxable sales for the test period. CDTFA excluded 2Q16, 3Q16, 4Q16, and 1Q17 because the sales were unrepresentative of the audit period. CDTFA applied the error rate for the test period to the audit period to establish audited taxable sales.[8] We, therefore, find that the determination based on CDTFA's second reaudit is reasonable and rational. Thus, the burden of proof shifts to appellant to show errors in the second reaudit.

Appellant asserts that the sales recorded in its POS system include nontaxable sales of event tickets for Bollywood events that were purportedly held at other locations.[9] Appellant asserts that the event tickets totaled $26,900 in 2015, and $6,200 in 2016. To support this assertion, appellant provides two event fliers, concert promotional advertisements, and a listing of food festival ticket prices. Appellant has not provided ticket sales receipts or a sales journal recording these ticket sales.

The event fliers and concert promotional advertisements do not indicate that persons attending those events purchased tickets from appellant. Instead, the documentation indicates that appellant sponsored events that were held at other locations. Since the events were held at other locations, there is uncertainty as to whether appellant would have recorded such sales in its POS system. Appellant has not provided any documentation to show that it recorded these sales in its POS system. Thus, we reject appellant's contention regarding the Bollywood events.

Appellant also contends that an adjustment should be made for free food and free drinks. Appellant has not provided any documentation to show that it gave away free food and drinks at Bollywood events or otherwise. Appellant has also not shown that the sales recorded in its POS system included free food and drinks. We, therefore, reject this argument.

[8] See CDTFA's Audit Manual section 0405.20 for more information on CDTFA's use of test basis. 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 Michelle Laboratories, Inc.*, 2020-OTA-290P.)

[9] At various points in the record, appellant appears to have asserted that some of the events were hosted at the restaurant. Appellant, however, testified that the events occurred off-location.

Appellant contends that it made sales through third-party service providers, such as Groupon[10] and Grubhub,[11] and that it improperly recorded these sales in its POS system at the full price, and charged sales tax reimbursement on the full price, even though appellant did not receive full consideration for the sales due to the use of Groupon coupons by its customers or discounts offered to customers for using Grubhub.

Whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. (Cal. Code Regs., tit. 18, § 1700(a)(1).) It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if: (1) the agreement of sale expressly provides for such addition of sales tax reimbursement; (2) sales tax reimbursement is shown on the sales check or other proof of sale; or (3) the retailer posts in its premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable. (Civ. Code, § 1656.1(a); Cal. Code Regs., tit. 18, § 1700(a)(2)(C).)

Excess tax reimbursement is charged when tax reimbursement is computed on a transaction that is not subject to tax, when tax reimbursement is computed on an amount in excess of the amount subject to tax, when tax reimbursement is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the tax reimbursement on a billing. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).) A retailer that allows discounts on sales prices, but charges customers sales tax reimbursement computed on the prices before the discount is deducted, is collecting excess tax reimbursement. (Cal. Code Regs., tit. 18, § 1700(b)(5)(A)(1).) When CDTFA ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax collections to the customers from whom they were collected. In the event of failure or

[10] CDTFA reports that Groupon is a third-party vendor that allows a customer to purchase discounts from participating retailers, which the customer then redeems at the participating retailer for a reduced price on whatever item the customer purchased through Groupon.

[11] CDTFA reports that Grubhub is a third-party online order and delivery service from which customers order food from various restaurants, after which Grubhub employees pick up the prepared food from the restaurants and deliver the food to the customers.

refusal of the retailer to make such refunds, the retailer must pay the excess tax reimbursement to CDTFA. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).)

Under certain circumstances cash discounts, coupons, rebates, and other incentives may reduce the selling price. (Cal. Code Regs., tit. 18, § 1671.1) Here, appellant asserts, however, that it had calculated and charged sales tax reimbursement on the full amount of the sale before the Groupon discount was taken, then we would also find that appellant has computed and collected excess tax reimbursement because the correct method is to calculate sales tax after taking the discount. Appellant has not provided any evidence that it has refunded the excess tax reimbursement to its customers. Appellant also has not provided documentation sufficient to show that it allowed Groupon discounts to its customers on certain sales but erroneously recorded those sales in its POS system at the full price. As such, we find no basis for any adjustment concerning Groupon discounts. Likewise, we find no basis for adjustment for sales made through Grubhub.

Appellant also argues that it is entitled to a credit for tax-paid purchases of items that appellant resold to Levi's Stadium, a football stadium in Santa Clara, California. A retailer that resells tangible personal property before making any use thereof may take a deduction of the purchase price of the property if, with respect to its purchase, it has reimbursed its vendor for the sales tax or has paid the use tax. (R&TC, § 6012 (a)(1); Cal. Code Regs., tit. 18, § 1701(a).) We note that appellant's post-hearing submission included approximately nine (9) pages regarding Levi's Stadium sales. These documents, however, are outside the scope of the audit period, and outside the scope of the test period utilized in the second reaudit. As such, appellant has not provided any documentary evidence, such as contracts between Levi's Stadium and appellant or purchase invoices, to show that it paid sales tax to its vendors on tangible personal property that appellant resold during the audit period. Accordingly, we reject this argument.

Based on our finding that appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made, we conclude that appellant has failed to meet its burden of establishing that a reduction to the measure of unreported taxable sales computed in the reaudit is warranted.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules

and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (Cal. Code Regs., tit. 18, § 1698(b)(1), (d), (k).).)[12]

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence. (Cal. Code Regs., tit. 18, § 1698(k).)

California Code of Regulations, title 18, section 1703(c)(3)(A) provides that a negligence penalty should not be added to a deficiency determination associated with the first audit of a taxpayer unless evidence exists establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the sales and use tax law or authorized regulations. (See also *Independent Iron Works, Inc. v. BOE* (1959) 167 Cal.App.2d 318, 323-324.) Here, there is no dispute that appellant has not been previously audited. Even so, CDTFA notes that appellant's corporate president is familiar with the audit process because he owns or owned other businesses with seller's permits that have been previously audited.

CDTFA argues that the imposition of the negligence penalty is proper because appellant failed to maintain adequate books and records, the books and records provided for audit were incomplete, and appellant substantially underreported its taxable sales as evidenced by the large unreported measure and the 40.09 percent error rate. Appellant opposes the penalty on the basis that it believes that it does not owe any additional tax.

[12] See also CDTFA Audit Manual section 0506.10, which states in pertinent part that "[w]ith respect to business tax matters, negligence may be further defined as a substantial breach by the taxpayer of some duty imposed by the law or authorized rules and regulations."

For audit, appellant only provided the 1099-K forms for the period July 1, 2013, through February 28, 2014, Restaurant Depot vendor purchase survey information, copies of its POS sales information for October 1, 2015, through March 31, 2017, and de minimis cash register z-tapes. Appellant did not provide sales journals, purchase journals, purchase invoices, or a general ledger for any portion of the audit period. We find that appellant's books and records were incomplete. We also find that the incomplete books and records are evidence of negligence.

The second reaudit results in an underreporting error rate of 40.09 percent. The audited unreported taxable measure of $605,909 is substantial, when compared to appellant's recorded total sales of $878,027, and reported taxable sales of $578,033. We find that the error rate and the corresponding audited unreported taxable measure are strong evidence of negligence.

Appellant's own POS reports show that it charged sales tax of $31,354 for the period October 1, 2015, through March 31, 2016. Appellant reported sales tax of $23,166 for that same period. Yet, appellant failed to report 35.3 percent of the sales tax that was recorded in appellant's own POS system for the same period.[13] Appellant must have known that the amounts of sales tax reported during the period October 1, 2015, through March 31, 2016, were understated because those amounts were significantly less than the amounts of sales tax recorded in appellant's own POS system. Based on the foregoing, we find that the audited understatement cannot be attributed to appellant's good faith and reasonable belief that its bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. We, therefore, conclude that appellant was negligent.

[13] (($31,354 - $23,166) ÷ $23,166) * 100 = 35.3%.

HOLDINGS

1. No reduction to the measure of unreported taxable sales as computed in the second reaudit is warranted.
2. Appellant was negligent.

DISPOSITION

CDTFA's action in adjusting the taxable measure to $605,909 and otherwise denying the petition is sustained.

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

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Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
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Date Issued: 4/14/2021