

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

In the Matter of the Appeal of: ) OTA Case No. 19034417  
**AMMM CORP.,** ) CDTFA Case ID 941663  
**dba Fresco 2 On The Marina** )  
 \_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

For Respondent: Jason Parker, Chief  
Headquarters Operations BureauFor Office of Tax Appeals: Craig Okihara,  
Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, AMMM Corp., dba Fresco 2 On The Marina (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) dated February 24, 2016. The NOD is for tax of \$291,648.19, plus applicable interest, for the period May 1, 2012, through December 31, 2014 (audit period).

CDTFA's decision dated December 6, 2017, reduced the determined measure of tax by \$309,202 from \$3,668,616 to \$3,359,414.<sup>2</sup> Subsequently, CDTFA further reduced the understated measure of tax from \$3,359,414 to \$2,633,951 based on additional information it obtained regarding appellant's credit card sales as reported on form 1099-K.<sup>3</sup>

<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 this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

<sup>2</sup> CDTFA completed the first reaudit to make the conceded adjustments on or about February 26, 2018.

<sup>3</sup> Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (credit cards, debit cards, PayPal, etc.). It is authorized by the Internal Revenue Service for tax administration purposes.

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

### ISSUE

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

### FACTUAL FINDINGS

1. Appellant operated a restaurant with a full bar located in Oxnard, California, with a start date of May 1, 2012. The restaurant included a banquet room which could be rented for large gatherings. Appellant also provided catering services, serving food and drinks on the premises of the customer or on premises supplied by the customer.
2. For the audit period, appellant reported taxable sales of \$980,422.<sup>4</sup>
3. Upon audit, appellant provided federal income tax returns (FITRs) for 2012 and 2013; and point-of-sale (POS) sales summaries for March 2013. Appellant did not provide any other of its books and records, such as POS cash register tapes for the audit period, merchandise purchase invoices, or purchase journals for the audit period.
4. CDTFA compared total sales reported on the sales and use tax returns (SUTRs) to the corresponding gross receipts reported on the FITRs and noted that gross receipts exceeded total sales by \$764,126 in 2012 and \$869,638 in 2013. Appellant asserted that the differences represented consulting fees and cover charges, but did not provide supporting documentation. CDTFA compared gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs and computed book markups of 134.41 percent for 2012 and 133.27 for 2013. Based on its experience in audits of similar businesses in appellant's area, CDTFA expected a markup of at least 300 percent.<sup>5</sup> Due to the low book markups, lack of source documentation, gross receipts, and COGS, CDTFA concluded an alternate method was needed to verify reported taxable sales.

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<sup>4</sup> Total reported sales of \$988,372 less reported nontaxable sales of \$8,050.

<sup>5</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  $\text{markup amount} \div \text{cost}$ . 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  $\text{profit amount} \div \text{sales price}$ . In the above example, the gross profit margin is 30 percent ( $0.30 \div 1.00 = 0.30$ ).

5. CDTFA decided to use the credit-card-sales-ratio method.<sup>6</sup> Using the POS sales summaries for March 2013 that appellant provided, CDTFA compiled credit card sales, including sales tax reimbursement and tips, of \$63,723; credit card tips of \$7,972 and cash sales, including sales tax reimbursement, of \$17,865. CDTFA computed a credit card tip ratio of 12.51 percent.<sup>7</sup> Applying that ratio, CDTFA computed the following: credit card sales, excluding sales tax reimbursement and tips, of \$51,621; cash sales, excluding sales tax reimbursement, of \$16,542; and total sales, excluding sales tax reimbursement and tips, of \$68,163.<sup>8</sup> Accordingly, CDTFA computed a credit-card-sales-ratio of 75.73 percent.
6. CDTFA performed a site observation test on Tuesday, September 1, 2015, for the full business day. From that observation, CDTFA compiled credit card sales, including sales tax reimbursement and tips, of \$2,696, credit card tips of \$375, and cash sales, including sales tax reimbursement, of \$739. CDTFA computed a credit card tip ratio of 13.91 percent. Applying that ratio, CDTFA computed credit card sales, excluding sales tax reimbursement and tips, of \$2,149, cash sales, excluding sales tax reimbursement, of \$684 and total sales, excluding sales tax reimbursement and tips, of \$2,833.<sup>9</sup> CDTFA computed a credit-card-sales-ratio of 75.85 percent. CDTFA found that the one-day observation test supported the credit-card-sales-ratio of 75.73 percent and the credit card tip ratio of 12.51 percent that it determined using the POS sales summaries for March 2013. Based on its experience in audits of similar businesses in appellant's area, CDTFA concluded that the credit-card-sales-ratio of 75.73 percent and credit card tip ratio of 12.51 percent were reasonable and representative of the audit period.
7. CDTFA obtained appellant's credit card sales reported on form 1099-K for May 1, 2012, through December 31, 2013 (1099-K period). Using that data, CDTFA compiled credit

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<sup>6</sup> The credit-card-sales-ratio method is a standard audit procedure that is effective in establishing taxable sales because it relied on readily verifiable information: the amount of credit card receipts. This audit method is described in further detail in CDTFA's Audit Manual section 0810.12.

<sup>7</sup>  $(\$7,972 \div \$63,723) = 12.51$  percent.

<sup>8</sup>  $(\$63,723 - \$7,972) \div (1 + 8 \text{ percent sales tax rate}) = \$51,621$ ;  $(\$17,865 \div (1 + 8 \text{ percent sales tax rate})) = \$16,542$ ; and  $(\$51,621 + \$16,542) = \$68,163$ .

<sup>9</sup>  $(\$2,696 - \$375) \div (1 + 8 \text{ percent sales tax rate}) = \$2,149$ ;  $(\$739 \div (1 + 8 \text{ percent sales tax rate})) = \$684$ ; and  $(\$2,149 + \$684) = \$2,833$ .

card sales, including sales tax reimbursement and tips, of \$2,441,281 for the 1099-K period. CDTFA multiplied credit card sales, including sales tax reimbursement and tips, by the credit card tip ratio of 12.51 percent and computed credit card tips of \$305,404 and credit card sales, including sales tax reimbursement and excluding tips, of \$2,135,877. For each quarterly period, CDTFA divided credit card sales by one plus the applicable sales tax rate to compute credit card sales, excluding sales tax reimbursement and tips, of \$1,979,303 for the 1099-K period. CDTFA divided credit card sales, excluding sales tax reimbursement and tips, by the credit-card-sales-ratio of 75.73 percent to compute taxable sales of \$2,613,539 (rounded) for the 1099-K period. Upon comparison to taxable sales of \$551,163 reported on the SUTRs for the 1099-K period, CDTFA computed unreported taxable sales of \$2,062,376 for that period and an error ratio of 374.19 percent.<sup>10</sup>

8. CDTFA applied the error ratio to taxable sales of \$429,259 reported on the SUTRs for 2014, thereby computing unreported taxable sales of \$1,606,228 (rounded) for 2014. In total, CDTFA calculated unreported taxable sales of \$3,668,616 (rounded) for the audit period.
9. CDTFA issued the NOD to appellant on February 24, 2016, based on the above-mentioned audit, with a tax liability of \$291,648.19 plus applicable interest.
10. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.
11. For its appeals conference with CDTFA, appellant provided a sales report for 2016 as well as sales invoices and guest checks for 2016. Appellant argued that adjustments should be made for nontaxable sales for room rentals, equipment rental, consulting fees, cover charges, and sales of gift cards. CDTFA examined the new documentation and concluded that adjustments were warranted. Based on the new information, CDTFA compiled total sales of \$1,467,597 (including sales tax reimbursement), taxable sales of \$1,270,505, nontaxable sales of \$197,092, and computed a taxable sales ratio of 86.57 percent using the sales report for 2016, sales invoices, and guest checks for 2016.
12. CDTFA multiplied credit card sales, including sales tax reimbursement and tips, of \$2,441,281 for the 1099-K period, by the credit card tip ratio of 12.57 percent to compute credit card tips of \$306,869 and computed credit card sales, including sales tax

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<sup>10</sup> The “error ratio” is the percentage of unreported taxable sales to reported taxable sales.

- reimbursement and excluding tips, of \$2,134,412. CDTFA divided credit card sales, including sales tax reimbursement and tips, by the credit-card-sales-ratio of 75.74 percent to compute total sales of \$2,818,201 (rounded) for the 1099-K period. CDTFA multiplied total sales by the taxable sales ratio of 86.57 percent to compute taxable sales of \$2,439,729 (rounded) for the 1099-K period. CDTFA computed unreported taxable sales of \$1,888,566 for that period and an error ratio of 342.65 percent by comparing reported taxable sales for the 1099-K period with the computed taxable sales.
13. CDTFA applied the error ratio to taxable sales of \$429,259 reported on the SUTRs for 2014, thereby computing unreported taxable sales of \$1,470,860 for 2014. In the reaudit, CDTFA calculated unreported taxable sales of \$3,359,419 (\$1,888,566 + \$1,470,860) (rounded) for the audit period. In its decision dated December 6, 2017, CDTFA recommended reducing the determined measure of tax by \$309,202 from \$3,668,616 to \$3,359,414 as conceded by CDTFA.
  14. Appellant timely appealed to OTA.
  15. Appellant contended that credit card sales are overstated because CDTFA included form 1099-K data for a related company. CDTFA reviewed the form 1099-K data and found that it had inadvertently included credit card sales from appellant's related company. CDTFA also obtained appellant's form 1099-K data for 2014. Based on the new information, CDTFA prepared a second reaudit. CDTFA compiled credit card sales of \$3,616,679 for the audit period. CDTFA multiplied credit card sales, including sales tax reimbursement and tips, of \$3,616,679 for the audit period by the credit card tip ratio of 12.57 percent and computed credit card tips of \$454,617 and credit card sales, including sales tax reimbursement and excluding tips, of \$3,162,062. CDTFA divided credit card sales, including sales tax reimbursement and tips, by the credit-card-sales-ratio of 75.74 percent to compute total sales of \$4,175,074 (rounded) for the audit period. CDTFA multiplied total sales by the taxable sales ratio of 86.57 percent to compute taxable sales of \$3,614,381 (rounded) for the audit period. Upon comparison to taxable sales of \$980,422 reported on the SUTRs for the audit period, CDTFA computed unreported taxable sales of \$2,633,951 (rounded) for the audit period. CDTFA recommends that the determined measure of tax be reduced by \$1,034,665 from \$3,668,616 to \$2,633,951.

## DISCUSSION

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, § 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 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 accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.) It is the retailer's responsibility to maintain and make available for examination complete and accurate records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents supporting the entries in the books of account (i.e., books and records). (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer challenges an NOD, CDTFA has a minimal, initial burden of showing that its determination is 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.*) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*) To satisfy its burden of proof, a taxpayer must prove both (1) that the tax assessment is incorrect and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Here, appellant provided limited books and records (i.e., 2012 FITR, 2013 FITR, and POS summaries for March of 2013). Appellant did not provide source documents such as POS cash register tapes or merchandise purchase invoices. We find that the books and records provided for examination were not sufficient to verify the accuracy of appellant's reported sales using a direct audit approach. Under these circumstances, it was appropriate for CDTFA to utilize an indirect audit method. CDTFA used an observation test and the credit-card-sales-ratio method, which are standard and accepted audit procedures, as the basis for its determination.

Considering all of the evidence, 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 contended that CDTFA erroneously included form 1099-K data for a related company. However, the evidence shows that CDTFA addressed appellant's contention with the second reaudit. CDTFA's second reaudit reduced the determined measure of tax by \$1,034,665 after CDTFA reexamined the form 1099-K data for May 1, 2012, through December 31, 2013, and examined the form 1099-K data for 2014. Appellant has not identified any errors in CDTFA's computation of audited taxable sales in the second reaudit or provided any additional documentation or other evidence from which a more accurate determination could be made. We, therefore, find that appellant has not met its burden to prove that further reductions 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 of tax to \$2,633,951 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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*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

Date Issued: 10/8/2021