OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20096666
	) CDTFA Case IDs 580-852; 978-229
CULTURE SHOCK YOGURT, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Joanne "Bobbi" Giudicelli, President
For Respondent:	Nalan Samarawickrema, Hearing Rep. Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Craig Okihara, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Culture Shock Yogurt, Inc. (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) dated January 25, 2019. The NOD is for $17,517.00 in tax, a negligence penalty of $1,751.65, and applicable interest for the period January 1, 2015, through December 31, 2017 (liability period). Appellant also appeals a decision by CDTFA denying appellant's claim for refund of $18,000.00 for the liability period.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Amanda Vassigh held an oral hearing for this matter on August 18, 2021.[2] At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

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

[2] The parties agreed to hold the hearing electronically via Webex.

ISSUES

1. Whether adjustments are warranted to the measure of unreported taxable sales.
2. Whether the negligence penalty was properly imposed.

FACTUAL FINDINGS

1. Appellant, a corporation, began operating a frozen yogurt shop in Grass Valley, California on Mill Street (Mill location) on July 24, 2009. Next, appellant opened a second location in Grass Valley, California on Sutton Way (Sutton location). Appellant opened a third location in Auburn, California (Auburn location). Sometime after appellant opened the Auburn location, it obtained a seller's permit effective February 1, 2012. Appellant operated three locations during the liability period. The Mill location was closed effective September 8, 2017, prior to the audit start date.
2. On September 22, 2013, The Union, a local newspaper, published an article titled, "Culture Shock location's future in doubt over health regulation." The pertinent parts of the article are as follows:
    a. "Culture Shock owner Bobbi Guidicelli said she is frustrated by the requirement because 85 percent of her customers take their yogurt to go, and she is in a historic building in downtown Grass Valley that cannot provide a restroom for customers;" and
    b. "Though a majority of customers take their yogurt to go, those who may stop coming because they can't sit down will negatively affect the business, Guidicelli said."
3. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of $2,250,908. Appellant claimed a total of $2,228,228 in deductions for sales for resale, nontaxable sales of food products (cold food to-go), and nontaxable labor, resulting in reported taxable sales of $22,680. For the SUTRs, appellant reported on a calendar-year basis (i.e., January 1 to December 31).
4. On February 1, 2018, CDTFA sent an audit engagement letter to appellant. Upon audit, appellant provided CDTFA with its federal income tax returns (FITRs) for 2015 and 2016; profit and loss statements for the liability period; bank statements for 2016 and 2017; fixed asset purchase invoices for the liability period; and daily sales reports for

May 2018 and June 2018 (after the liability period). Appellant did not provide sales tax worksheets; cash register z-tapes;[3] or source documentation, such as cash register tapes, for the liability period.

5. CDTFA compared total sales reported on the SUTRs for 2015 and 2016 to the corresponding gross receipts reported on the FITRs, noting no differences. CDTFA compared gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs and computed an average (taxable and nontaxable sales) book markup of 228 percent for the two years combined,[4] which CDTFA considered reasonable. CDTFA concluded that additional testing was required to confirm the reported taxable sales because appellant provided no documentary support or basis for using the 2 percent estimate for its reported taxable sales. CDTFA decided to perform an observation test to establish whether appellant's 2 percent estimate was reasonably accurate.[5]

6. Since the Mill location closed prior to the audit field work, CDTFA performed site observations at the two remaining locations to determine the ratio of to-go sales (non-taxable sales) compared to dine-in sales (taxable sales). On Thursday, March 8, 2018, CDTFA observed sales transactions at the Auburn location for the full business day. CDTFA reported that seating for six customers inside and six customers outside was available. For the Auburn location, CDTFA computed a taxable sales ratio of 41.24 percent. On Tuesday, April 10, 2018, CDTFA observed sales transactions at the Sutton location for the full business day. CDTFA reported that appellant had 6 tables and seating for 13 customers. For the Sutton location, CDTFA computed a taxable sales ratio of 29.88 percent. Appellant denied CDTFA's request to observe additional days at both locations.

7. CDTFA requested that appellant maintain and provide the May 2018 and June 2018 daily sales reports for both locations. In total, CDTFA computed a taxable sales ratio of

[3] A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain time period (e.g., a day or a shift).

[4] "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. A claim "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

[5] The Audit Manual language regarding observation testing is in Chapter 8, entitled "Bars and Restaurants." <https://www.cdtfa.ca.gov/taxes-and-fees/manuals/am-08.pdf>

20.54 percent for the Auburn location and a taxable sales ratio of 16.72 percent for the Sutton location. CDTFA concluded that the Sutton and Mill locations were similar and applied the taxable sales ratio of 16.72 percent to both.

8. Using the profit and loss statements, CDTFA compiled total sales in the liability period and applied the taxable sales ratio of 20.54 percent to recorded total sales for the liability period at the Auburn location. CDTFA applied the taxable sales ratio of 16.72 percent to recorded total sales at the Sutton and Mill locations. In total, CDTFA calculated audited taxable sales of $247,501. Upon comparison to taxable sales of $22,680 reported on the SUTRs for the liability period, CDTFA computed unreported taxable sales of $224,821.
9. CDTFA examined appellant's purchases of fixed assets and consumable supplies and found purchases of warehouse crates from an out-of-state vendor. Appellant did not pay sales or use tax on the purchase. CDTFA established unreported purchases subject to use tax of $1,392. Appellant does not dispute this item; thus, we do not address it further.
10. CDTFA concluded that the $226,213 understatement was the result of negligence.
11. CDTFA issued an NOD to appellant based on the audit results, with a tax liability of $17,517.00, plus applicable interest, and a negligence penalty of $1,751.65.
12. On January 27, 2019, appellant executed a petition for redetermination.
13. On January 28, 2019, appellant executed a claim for refund.
14. CDTFA held an appeals conference with appellant, and subsequently issued a Decision on August 31, 2020, denying the petition and claim for refund. The Decision reports that appellant made a payment of $18,000 on May 11, 2018. The Decision also reports that appellant made a second payment of $2,924 on October 29, 2019, which paid the negligence penalty and interest in full.
15. Appellant timely appealed to OTA.

DISCUSSION

Issue 1: Whether adjustments are warranted to the measure of unreported taxable sales.

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.) "Gross

receipts" means the total amount of the sales price of the retailer's retail sales of tangible personal property. (R&TC, § 6012(a)(2).) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), and (d)(2).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA 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 retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (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 claimed that it estimated reported taxable sales, at 2 percent of its total sales, based on its experience operating the Mill location. During the liability period, appellant did not ask its customers whether they would be dining-in or taking their order to-go. Appellant acknowledged that it did not charge sales tax on its taxable sales and, therefore, did not keep a separate accounting of its taxable dine-in sales. Thus, CDTFA concluded that a direct audit method could not be used to verify taxable sales for the liability period. Because compiling audited taxable sales directly from appellant's records was not possible due to the lack of records documenting taxable sales, we find that CDTFA's use of an indirect audit method was warranted. CDTFA's use of an observation test as the basis for its determination is a recognized and standard accounting procedure. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613.) Although CDTFA's audit manual provides for a minimum of three full-day observation tests, appellant would not allow more than one day at each of the two active

locations.[6] Appellant described it as "disruptive" and uncomfortable for employees and customers to have a stranger sitting in neighborhood shops all day. CDTFA, therefore, agreed that appellant would maintain and provide records of dine-in and to-go sales for May 7, 2018, through May 23, 2018, and for June 1, 2018, through June 30, 2018 (the 2018 records). CDTFA used a combination of the observation tests and the 2018 records to compute taxable sales percentages of 20.54 for the Auburn location and 16.72 for the Sutton location. CDTFA determined that the closed Mill location was more like the Sutton location than the Auburn location. Therefore, CDTFA applied the 16.72 percent to the Mill location as well. Since appellant objected to continuing with the observation tests, we find that it was appropriate for CDTFA to adapt its indirect approach by combining the results of the observation tests with appellant's own records that were produced shortly after the liability period. We also note the Mill location was closed, and thus could not produce comparable 2018 records. Therefore, it was also reasonable for CDTFA to apply the lower percentage to the Mill location because it had fewer seats than the Auburn location. Accordingly, we find that CDTFA has met its initial burden and thus, the burden of proof shifts to appellant.

Appellant asserts that the percentage of food purchased to-go is much higher than the amount CDTFA calculated for the liability period. Appellant presents several arguments in support of its position. Appellant contends that it adopted a digital point-of-sale (POS) system beginning January 1, 2019, which allowed it to more accurately record dine-in or to-go sales. Appellant contends that the data derived from the new POS system should be used to calculate the percentage of taxable sales for the liability period. In support of its position, appellant provided reports from January 1, 2019, through October 27, 2019, which show that taxable sales ratios were 6.88 percent at the Sutton location and 7.31 percent at the Auburn location. Appellant also contends that CDTFA exaggerated the seating in the Sutton and Mill locations. Appellant contends that the Mill location was very different from the Sutton location. Furthermore, appellant asserts that all sales at the Mill location were nontaxable and, thus, should not have been included in CDTFA's calculation of audited taxable sales. Appellant states that the Mill location was "a place the customers would come in to grab a yogurt and continue walking around town to do their shopping or participate in the event going on in the streets."

[6] See CDTFA Audit Manual section 0810.30.

Lastly, appellant testified that "in 2013, we took out most of the original eight seats" due to a new requirement make a bathroom available to its customers unless adjustments were made.

CDTFA counters that the audit method provided the most accurate data from which to calculate audited taxable sales. CDTFA combined the percentage of taxable sales calculated from the 2018 records with the results of the observation tests, even though the percentage of recorded taxable sales was much lower than in the observation tests. CDTFA states that 41.24 percent of the observed sales were taxable at the Auburn location compared to 20.26 percent taxable sales calculated from the 2018 records. Also, 29.88 percent of the observed sales were taxable at the Sutton location compared to the 16.57 percent calculated from the 2018 records. CDTFA does not accept the 2019 POS records because appellant did not provide source documentation, CDTFA did not have an opportunity to review the POS system, the nontaxable sales ratio was significantly lower than in the observation tests, and the observation tests and recorded sales in 2018 were much closer to the liability period so they were more likely to be representative of the liability period.

We are not persuaded by appellant's arguments regarding its 2019 POS data because appellant did not provide source records. Since CDTFA was unable to review the POS system, it is unknown whether there was third-party software that might impact the POS data. Also, appellant has not adequately explained how switching to a digital register renders a more accurate result than the POS system in place during the 2018 records. Since the 2018 records were recorded closer to the liability period and were obtained pursuant to CDTFA's instruction, we find these records to be more persuasive. We also note that the 16.57 percent calculated for the Sutton location is substantially similar to the percentage referenced in the September 22, 2013 article, which we discuss below. We also note that it is undisputed that appellant did not keep the necessary records during the liability period. We, therefore, find that the combined 2018 observation tests with the 2018 recorded sales provide the most accurate measure of appellant's nontaxable sales ratio during the liability period.

With respect to appellant's contentions regarding seating capacity, CDTFA provided copies of appellant's webpage archived on February 26, 2015, and June 25, 2015, and a copy of a September 22, 2013 article from a local news outlet about the Mill location. CDTFA notes that the photos on the archived webpage show tables and stools at the Mill location. Appellant responds that the webpage photos were stock photos that had been taken prior to the liability

period. Appellant's president testified that it removed most of the tables and stools at the Mill location that were depicted in the pictures from appellant's archived webpages. Additional testimony established that the Mill location was a downtown location that was different from the other two locations, which were in strip malls. We find appellant's additional testimony with respect to the differences between the downtown location and the strip mall locations to be credible (i.e., that the downtown location was more conducive to customers stopping in for a yogurt and continuing to stroll and shop downtown, especially during local events). However, we note that the comments reported in the September 22, 2013 article expressed concern that if seats were removed, then appellant's business would be negatively impacted, which is evidence that appellant was aware that a percentage of the Mill location sales were dine-in. Also, we note that the 15 percent dine-in referenced in the September 22, 2013 article is similar to the 16.57 percent dine-in that CDTFA applied to the Mill location. There is also conflicting information regarding the number of seats during the liability period. According to testimony there were four seats during the liability period, whereas according to appellant's petition for redetermination there were six seats. Alternatively, there could have been eight seats according to the archived webpage. Whether the seats were four, six, or eight, we find it highly unlikely that the dine-in percentage was zero percent during the liability period.

In addition, to satisfy its burden of proof, appellant must prove not only that the tax assessment is incorrect but must also prove the proper amount of the tax. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744; *Appeal of AMG Care Collective*, 2020-OTA-173P.) Appellant has not provided any additional documentation or other verifiable evidence from which a more accurate determination could be made. Accordingly, we have no basis upon which to recommend any adjustments for this contention.

If we accept each of appellant's contentions with respect to seating at the Auburn and Sutton locations, it makes no difference. CDTFA is using data from what it observed, together with appellant's recorded total sales. In this regard, the number of available seats is of limited relevance. Additionally, appellant recorded its own sales in May and June of 2018, which would presumably be accurate regardless of the seating capacity.

In summary, we find that CDTFA computed audited taxable sales based on the best-available evidence. Appellant has not provided new documentation or other evidence in support

of its contentions from which a more accurate determination could be made. Thus, appellant has not met its burden to show that adjustments are warranted by clear and convincing evidence.

Issue 2: Whether the negligence penalty was properly imposed.

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. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal. App. 4th 434, 447.) Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318,321-324.)

A taxpayer shall maintain and make available for examination on request by CDTFA, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b).) All records required to be retained under this regulation must be preserved for a period of not less than four years. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties or other appropriate administrative action. (Cal. Code Regs., tit. 18, § 1698(k).)

Here, appellant's president testified that it did research prior to opening a frozen yogurt business. Appellant's president claims that during her research, she was going to yogurt shops all over California and that she was never once asked if her purchase was to dine-in or to-go. She stated, "I needed to learn about running a retail shop, about handling frozen products, about building a clean room, et cetera." Appellant claims that it checked with the City of Grass Valley or appellant's contractor and asserts that it was informed that if the establishment included fewer than ten seats, it was considered a "to-go" business. Appellant began operating the Mill location

on July 24, 2009. Subsequently, appellant opened the Sutton location and the Auburn location. According to the testimony of appellant's president, shortly after appellant opened the Auburn location sometime in 2011 or 2012, a woman from [CDTFA][7] visited the shop. Appellant's president testified as follows: "She gave me her card and told me that I needed to get a new seller's permit and that I needed to file a sales tax return. She did explain that I need to pay sales tax on all dine-in sales. I told her it wasn't that much and asked if I can estimate it, and she said yes as long as I file my taxes." Thereafter, appellant voluntarily obtained a seller's permit, effective February 1, 2012.[8] In February of 2018, CDTFA began the audit process for the liability period. It is undisputed that this is appellant's first audit.

Appellant claims that this is a case of ignorance, not negligence. Appellant asserts that it should not be subject to the negligence penalty because its failure to properly report and remit tax was the result of its reliance on verbal advice from an employee of CDTFA.[9] Appellant believed that dine-in sales were 2 percent of its total sales according to its experience operating the Mill location. Appellant further states that it paid the sales tax even though it did not collect sales tax reimbursement and that it otherwise kept meticulous records.

CDTFA argues that it properly imposed the negligence penalty based on its determination that appellant's books and records were incomplete and inaccurate for sales and use tax purposes. More specifically, CDTFA argues that appellant failed to provide documents to support its reported sales. CDTFA compared audited unreported taxable sales of $224,821 to reported taxable sales of $22,680, which results in an error rate of 991.27 percent. CDTFA also asserts that appellant knew that it was required to collect and pay sales tax on all of appellant's dine-in sales, and that appellant did not make reasonable efforts to accurately ascertain its taxable sales. Because appellant's error rate was "exceedingly high," CDTFA concluded that appellant could not have held a reasonable belief that its reporting practices were in substantial

[7] Appellant testified that the person who advised it was an employee of the Franchise Tax Board (FTB). FTB is a separate agency that does not administer sales and use taxes. During that time period, sales and use taxes were administered by the Board of Equalization (BOE). Therefore, we infer that appellant is referring to a visit from a BOE employee. See footnote 1 for more information.

[8] A copy of the seller's permit is not in the record, nor is there a copy of the application for seller's permit. However, it is undisputed that appellant obtained a seller's permit. According to CDTFA's August 31, 2020 Decision, the effective date of appellant's seller's permit is February 1, 2012.

[9] R&TC section 6596 provides relief from tax and any penalty or interest added thereto when a person's failure to pay the tax is the result of its reliance on *written* advice from CDTFA, under specified conditions. Here, there is no evidence or argument that appellant received written advice from CDTFA.

compliance with the requirements of the Sales and Use Tax Law or authorized regulations. In support of its position, CDTFA submitted a 2013 newspaper article that claims appellant's president stated that 85 percent of customers take their yogurt to-go.

Although this is appellant's first audit, we find that the negligence penalty was properly imposed, as discussed below. Based on testimony, we note that appellant was aware it needed to learn how to operate a retail shop prior to opening its business, and that it conducted research prior to opening its first location, the Mill location. Also, appellant's claimed understanding that a shop with fewer than 10 seats is considered a "to-go" business is based on information derived from appellant's contractor or the City of Grass Valley, neither of which are responsible for administering the Sales and Use Tax Law. Shortly after opening the third location, appellant was made aware that all dine-in sales were subject to tax when a CDTFA representative visited its shop, approximately three years prior to the liability period. Even if not a direct quote, the September 22, 2013 article supports the position that appellant was aware that a portion of its business was dine-in, and thus taxable. Regarding the 15 percent figure in the September 22, 2013 article, the testimony of appellant's president does not directly deny or refute the information in the article, but rather appellant's president testified "I don't believe that I said that. But if I did pull a figure out of the air, it was to make a point" regarding an unrelated permitting issue. Thus, the September 22, 2013 article also supports CDTFA's position that well before the liability period, appellant was aware that approximately 15 percent of its Mill location sales were taxable.

Prior to obtaining its seller's permit, appellant had been operating retail establishments for approximately two and a half years. After obtaining the seller's permit, appellant elected to estimate its taxable sales at 2 percent of its sales based on its experience operating the Mill location. The lack of records to substantiate the basis for the estimated percentage (e.g., a test period with source documents) is evidence of negligence. Prior to, and during, the liability period appellant knew that dine-in sales were taxable, yet appellant never performed a test to verify the accuracy of its estimate, which falls below the "reasonable and prudent person" standard. We also note that the Mill location had the least amount of seating. In contrast, the Sutton location and Auburn location, as discussed above, were more conducive to dine-in sales. Therefore, it was unreasonable for appellant to project the estimate to the other two locations since those locations would have had a higher percentage of taxable sales. Regarding the

estimate, we note that appellant elected to underestimate rather than overestimate its taxable sales even though there is evidence that appellant knew that its dine-in sales were approximately 15 percent at the Mill location. Also, appellant's election to underestimate produced a significant error rate of 991.27 percent. During the liability period, approximately three years after the effective date of appellant's seller's permit, appellant still did not maintain records to substantiate the amounts reported on its SUTRs (i.e., tracking dine-in and to-go sales), which is evidence of negligence. We also note that appellant did not comply with its own estimate since the reported taxable sales for the liability period are approximately 1 percent of total sales.[10]

In light of the above, we find that appellant did not have a good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law. We also find that appellant did not exercise the care that a reasonable and prudent person would exercise under similar circumstances. Accordingly, the negligence penalty was properly imposed.

HOLDINGS

1. Appellant has not shown that any reduction to the measure of unreported taxable sales is warranted.
2. The negligence penalty was properly imposed.

DISPOSITION

CDTFA's action in denying appellant's petition and claim for refund is sustained.

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

I concur:

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Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

[10] Reported taxable sales of $22,680 ÷ total sales of $2,250,908 = 1.01 percent.

T. STANLEY, concurring in part and dissenting in part:

I agree with the majority with respect to the finding that appellant did not prove that adjustments to the measure of unreported taxable sales are warranted. I dissent from the conclusion that the negligence penalty may not be deleted.

Revenue &Taxation Code 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. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal. App. 4th 434, 447.) A negligence penalty should not be added to a deficiency determination associated with the first audit of a taxpayer in the absence of evidence 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. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318,321-324.)

Appellant had not been previously audited. This business was appellant's first venture into operating a retail business. Appellant asserts that it should not be subject to the negligence penalty because its failure to properly report tax was the result of its reliance on verbal advice from an employee of the California Department of Tax and Fee Administration (CDTFA).[1]

According to appellant's president, the employee visited the Mill location and advised that appellant needed to obtain a seller's permit and to file sales and use tax returns. Appellant further asserts that the CDTFA employee informed it that sales tax applies to all dine-in sales, and that appellant could estimate the ratio of dine-in sales to to-go sales as long as it filed tax returns. Appellant believed dine-in sales to be approximately 2 percent of total sales, and after

[1] Appellant testified that the person who advised it was an employee of the Franchise Tax Board, which is a separate agency that does not handle sales and use taxes, which were handled by the State Board of Equalization (CDTFA after January 1, 2017) during the liability period. R&TC section 6596 provides relief from tax and any penalty or interest added thereto when a person's failure to pay the tax is the result of his or her reliance on *written* advice from CDTFA, under specified conditions. Here, there is no evidence that appellant received written advice from CDTFA.

obtaining a seller's permit in 2012, reported 2 percent of its gross sales as taxable sales. Appellant further states that it paid the sales tax even though it did not collect sales tax reimbursement.

CDTFA agrees that this was appellant's first audit. However, CDTFA asserts that appellant knew that it was required to collect and pay sales tax on all of appellant's dine-in sales, and that appellant did not make reasonable efforts to accurately ascertain its taxable sales. Because appellant's error rate was "exceedingly high," CDTFA concluded that appellant could not have held a reasonable belief that its reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. In support of its position, CDTFA submitted a 2013 newspaper article that claims appellant's owner stated that 85 percent of customers take their yogurt to-go. Furthermore, CDTFA asserts that appellant negligently failed to keep records showing the actual taxable sales.

Appellant checked with the City of Grass Valley and asserts that it was informed that if the establishment included fewer than ten seats, it was considered a "to-go" business. It continued to operate under that assumption until the CDTFA employee informed appellant that dine-in sales were taxable. At that time appellant obtained a sales and use tax permit and began to estimate its dine-in sales and to pay tax on those sales. During the audit, when appellant discovered that it was required to record actual dine-in and to-go sales and to report and pay taxes on the dine-in sales, appellant began asking each customer if their order was to go. Thereafter, appellant obtained a new point-of-sale system that enabled it to accurately record taxable sales. Appellant asserts that while it did not retain its z-tapes to produce for CDTFA during the audit, those documents would not have assisted with the audit since it was not recording dine-in or to-go sales. Furthermore, appellant testified that it recorded the data from the z-tapes, and more, on spreadsheets, and recorded data from the check register on a daily basis. Appellant provided those spreadsheets.

I find appellant's testimony credible that it kept all the records and summaries and "impeccable records." Additionally, I believe that appellant held a good faith belief that it could estimate its taxable sales based on what appellant considered to be official CDTFA advice. Although appellant was mistaken, I would find that it was not the result of negligence but rather because of an incorrect belief that its recordkeeping was adequate, and therefore the negligence penalty should be deleted.

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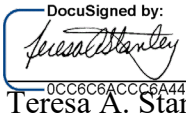
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Teresa A. Stanley
Administrative Law Judge

Date Issued: 11/18/2021