OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **RGD AND ASSOCIATES INC.**	) OTA Case No. 21027308) CDTFA Case ID 0-001-562-372))))

OPINION

Representing the Parties:

      For Appellant: Peter Guerrero, Representative

      For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Deborah Cumins,
                                                Business Taxes Specialist III

      A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, RGD and Associates Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's petition for redetermination of a Notice of Determination (NOD) dated July 12, 2019.[1] The NOD is for tax of $166,213, plus applicable interest, for the period of October 1, 2014, through September 30, 2017 (liability period).

      Appellant waived the right to an oral hearing, so we decide this matter based on the written record.

ISSUE

      Whether a reduction to the measure of unreported taxable sales is warranted.

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[1] On July 1, 2017, CDTFA took over the administration of the sales tax as well as other functions relevant to this case from the State Board of Equalization (BOE). (See 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; for acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

FACTUAL FINDINGS

1. Appellant is a California corporation that operates three restaurants at the following San Diego County locations: (1) Adams Avenue; (2) Kearny Villa; and (3) University. The Adams Avenue and Kearny Villa locations operated throughout the liability period while the University location opened in May 2017. All locations accepted credit cards and offered facilities to consume food on the premises. Over 80 percent of appellant's gross receipts were from the sale of food, and over 80 percent of its retail sales of food were subject to tax.

2. For the liability period, appellant claimed no deductions and reported total and taxable sales of $1,012,600 on its sales and use tax returns (SUTRs).

3. Appellant provided the following books and records during the audit: its profit and loss statements (P&Ls) for the liability period; its federal income tax returns (FITRs) for 2015 and 2016; Form 1099-K data for the Adams Avenue and University locations for the liability period;[2] two weeks of cash register z-tapes from all locations for February 2018 (post-liability period);[3] and some bank statements for the Kearny Villa location for the period of May 4, 2015, through December 30, 2016. Appellant did not provide any guest checks, cash register z-tapes, sales journals, or merchandise purchase invoices for the liability period.

4. CDTFA found that the amount of sales reported on appellant's SUTRs substantially reconciled with the amounts recorded on the P&Ls and reported on the FITRs, but the costs of goods sold (COGS) recorded on the P&Ls were lower than the amounts reported on the FITRs.

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[2] Form 1099-K (*Payment Card and Third Party Network Transactions*) is an IRS form showing amounts paid to a merchant by customers using a payment card (i.e., credit card or debit card) or a third-party payment network.

[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).

5.   Using the amounts of sales and COGS recorded on the P&Ls, CDTFA computed the following book markups:[4] 188 percent for the fourth quarter of 2014; 1,865 percent for 2015; 1,221 percent for 2016; and 739 percent for the first three quarters of 2017.

6.   Using the amounts of sales and COGS reported on the FITRs, CDTFA computed the following book markups: 382 percent for 2015; and 543 percent for 2016.

7.   CDTFA noted that the book markups fluctuated broadly from period to period and, for most of the periods, were much higher than expected for this type of business.

8.   CDTFA also noted that total credit card sales of $1,206,636 reported on the Form 1099-Ks exceeded total sales of $1,012,600 reported on SUTRs for the liability period.

9.   Because of appellant's fluctuating, unusually high book markups, as well as reporting discrepancies in appellant's books and records, CDTFA decided to investigate further.

10.   CDTFA found that the records provided by appellant for audit were incomplete and inadequate for examination using a direct audit approach, so CDTFA decided to use an indirect audit approach to establish audited taxable sales: the credit-card-sales-ratio method, which entails dividing total credit card sales by a credit card sales ratio (i.e., the percentage of total sales paid by credit card).

11.   To establish a credit card sales ratio for each of appellant's three locations, CDTFA and appellant agreed that appellant would retain two weeks' worth of cash register z-tapes from each location.

12.   CDTFA also observed sales at each location on various days during a two-week test period in February 2018. At appellant's request, CDTFA's observed sales at lunchtime.

13.   Based on its testing and observations, CDTFA concluded that appellant's cash register z-tapes accurately recorded sales at each location during the two-week test period.

14.   CDTFA used the cash register z-tapes from the two-week test period to compute the following credit card sales ratios: 52.31 percent for the Adams Avenue location; 60.64 percent for the Kearny Villa location; and 34.22 percent for the University location.

15.   To establish total credit card sales for the Adams Avenue and University locations, CDTFA looked to the Form 1099-K data, which commingled the credit card sales from

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[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 $.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 (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup) is one that is calculated from the retailer's records.

both locations for the period of May 2017 (when the University location opened) through September 30, 2017. To allocate these five months of commingled credit card sales, CDTFA analyzed the sales made at each location during the two-week observation test and estimated that the Adams Avenue location made 76 percent of these credit card sales, while the University location made 24 percent. For the liability period, CDTFA computed the following amounts of audited credit card sales, net of tax, made at these two locations: $1,067,922 at Adams Avenue; and $50,137 at University.[5]

16. For the Kearny Villa location, appellant could not obtain Form 1099-K data. Using bank deposits data from bank statements as a proxy for credit card sales, CDTFA computed audited credit card sales, net of tax and tip, of $558,805.

17. CDTFA used the audited credit card ratios and the audited credit card sales to establish audited taxable sales of $2,041,590 for the Adams Avenue location, $921,525 for the Kearny Villa location, and $146,516 for the University location. Total audited taxable sales of $3,109,631 exceeded reported taxable sales of $1,012,600 by $2,097,031.

18. CDTFA issued to appellant an NOD for tax of $166,213.

19. Appellant filed a petition for redetermination.

20. CDTFA issued a decision denying appellant's petition.

21. This timely appeal followed.

<div align="center">DISCUSSION</div>

California imposes upon all retailers a sales tax measured by the retailer's gross receipts from the sale of all tangible personal property sold at retail in this state, unless the sale is specifically exempted or excluded from taxation by statute. (R&TC, § 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent evasion of the sales tax, it is presumed that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) 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).)

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[5] CDTFA noted that, unlike the Kearny Villa location, the credit card receipts for the Adams Avenue and University locations did not have a line to add a gratuity/tip. Accordingly, CDTFA determined that there were no tips included in their credit card sales, so no reduction on that basis was warranted. CDTFA simply deducted the amount of sales tax included to compute the amount of credit card sales, net of tax, made at the Adams Avenue and University locations.

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may compute and determine the amount required to be paid upon the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) In the case of an appeal, CDTFA bears a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) If CDTFA carries 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 burden of proof is that of a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.) To satisfy its burden of proving that a result differing from CDTFA's determination is warranted, a taxpayer must prove both (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, *supra*.)

Generally, the gross receipts from the sale of food for human consumption are exempted from tax. (R&TC, § 6359.) However, the exemption does not apply to certain sales of food, rendering them subject to tax. Sales of food are subject to tax if the food is sold either for consumption at facilities provided by the retailer (R&TC, § 6359(d)(2); Cal. Code Regs., tit. 18, § 1603(f)) or as hot prepared food (R&TC, § 6359(d)(7); Cal. Code Regs., tit., § 1603(e)).

When more than 80 percent of a retailer's gross receipts are from the sale of food, and over 80 percent of its retail sales of food are sales subject to tax, then sales of cold food sold in a form suitable for consumption on the retailer's premises are subject to tax even if such food are sold "to go" or for "take-out." (R&TC, § 6359(d)(6); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).) When a retailer's sales fit within this provision, known as the "80-80 rule," the retailer may avoid its application by keeping a separate accounting of its sales of "to-go" or "take-out" orders of cold food in a form suitable for consumption on the retailer's premises. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)

It is undisputed that appellant's sales meet the requirements of the 80-80 rule, so all of appellant's sales are subject to tax.

Here, upon audit, appellant did not provide CDTFA with any guest checks, cash register z-tapes, sales journals, or merchandise purchase invoices for the liability period. There were also

significant discrepancies in the available records (e.g., widely disparate figures recorded as COGS on the P&Ls and reported on the FITRs, and credit card sales reported on Form 1099-K that exceeded sales reported on the SUTRs). When a restaurant that accepts credit cards does not provide CDTFA with books and records sufficient to verify the accuracy of reported sales using a direct audit approach, it is appropriate for CDTFA to utilize the credit-card-sales-ratio method, an indirect audit approach. (*Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) Accordingly, we find that CDTFA's use of the credit-card-sales-ratio method was appropriate here.

We have reviewed CDTFA's tests, which used appellant's own cash register z-tapes that encompassed two weeks of appellant's post-liability-period operations, and find that the tests were adequate to establish representative credit card sales ratios for each location. Moreover, we find that CDTFA had sufficient data from which to substantiate the audited amounts of credit card sales for each location (i.e., the Form 1099-K and bank deposits data). Thus, we find that CDTFA has shown that its determination is reasonable and rational, and appellant now has the burden to establish that adjustments are warranted.

On appeal, appellant contends that the $146,516 measure of unreported taxable sales for its University location is overstated and should be reduced for two reasons. First, appellant asserts that sales at the University location were much lower during the liability period (May 2017 through September 30, 2017) than during the test period (in February 2018) because that location had just opened in May 2017. Second, appellant asserts that the credit card sales ratio for the University location should be around 40 percent, not 34.22 percent, given the area where the business is located.

Here, appellant has not offered any documentation or other evidence to show that either of its assertions on appeal are more likely than not to be correct. Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (*Appeal of Talavera*, *supra.*) Thus, appellant has failed to prove that CDTFA's determination is incorrect or what the proper amount of the tax should be. Accordingly, we find that a reduction to the measure of unreported taxable sales for the University location is unwarranted.
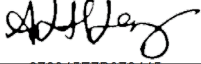
HOLDING

A reduction to the measure of unreported taxable sales is unwarranted.

DISPOSITION

We sustain CDTFA's decision to deny appellant's petition and to redetermine the liability without adjustment.

Andrew Wong
Administrative Law Judge

We concur:

Andrea L.H. Long
Administrative Law Judge

Daniel K. Cho
Administrative Law Judge

Date Issued: 11/23/2021