

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 20036004
EMILIANO’S RESTAURANT INC.) CDTFA Case IDs 286316, 322975
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OPINION

Representing the Parties:

For Appellant:	Carlos Chait, Representative Jose Davila, Representative
For Respondent:	Nalan Samarawickrema, Hearing Rep. Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Deborah Cumins, Business Tax Specialist III

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Emiliano’s Restaurant Inc. (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying in part appellant’s petition for redetermination of a Notice of Determination (NOD) dated April 10, 2018.² The NOD is for tax of \$49,622.25, and applicable interest, for the period January 1, 2015, through June 30, 2017 (liability period).

Office of Tax Appeals Administrative Law Judges Keith T. Long, Richard Tay, and Daniel K. Cho held an electronic oral hearing for this matter on September 28, 2021. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, the term “respondent” shall refer to BOE.

² Appellant had also filed a claim for refund for payments applied to the NOD; however, at the appeals conference with respondent, appellant stated that it no longer wanted to pursue the claim for refund. As a result, the claim for refund is no longer at issue.

ISSUE

Whether any further adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Appellant operated a restaurant in Pomona, serving Mexican style cuisine with beer and wine. Appellant also offered live entertainment on the weekends during the liability period.
2. The restaurant is open every day, serving breakfast, lunch, and dinner. In addition, the restaurant has a seating capacity of approximately 80 to 100 customers.
3. For the liability period, appellant provided its federal income tax return for the 2015 tax year; a merchant summary for the 2015 and 2016 tax years; bank statements for the liability period (except for January and December 2016); and sales receipts for August 14, 2017, August 17, 2017, and August 27, 2017. In addition, respondent obtained Form 1099-K³ information for the 2015 and 2016 tax years.
4. In its preliminary review of appellant's records, respondent calculated a book markup⁴ of 147.73 percent, which was lower than the markup that respondent expected for this type of business.⁵
5. Due to the low book markup and the lack of complete records, respondent used a credit card sales ratio audit method to verify appellant's taxable sales.
6. Respondent conducted three full-day observation tests on Monday, August 14, 2017; Thursday, August 17, 2017; and Sunday, August 27, 2017. Based on the data for those three days, respondent calculated credit card sales to taxable sales ratios of 64.52 percent, 61.45 percent, and 39.90 percent, respectively. This resulted in an overall credit card sales ratio of 48.99 percent.

³ The Form 1099-K (*Payment Card and Third Party Network Transactions*) is an IRS form that shows amounts paid to the merchant by customers using some type of payment card (e.g., credit card or debit card) or third-party network (e.g., PayPal).

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 for tangible personal property is \$0.70, and the retailer charges its customers \$1.00 for the sale of that tangible personal property, 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 also referred to as an "achieved markup") is one that is calculated from the retailer's records.

⁵ Respondent expected a markup of approximately 200 to 250 percent for this type of business.

7. Using the overall credit card sales ratio and the Form 1099-K information for the 2015 and 2016 tax years, which had a total gross deposit amount of \$452,231, respondent calculated audited taxable sales of \$923,109 ($\$452,231 \div 0.4899$). Respondent compared the audited taxable sales of \$923,109 to appellant's reported taxable sales of \$489,448 and determined a deficiency measure of \$433,661 for the 2015 and 2016 tax years.
8. Because respondent did not have Form 1099-K information for the first two quarters of 2017 at the time the audit was conducted, respondent calculated an error rate based on reported taxable sales to audited taxable sales, and respondent applied the error rate to appellant's reported taxable sales for the first two quarters of 2017. This resulted in a deficiency measure of \$121,059.
9. For the liability period, respondent determined a total deficiency measure of \$554,720 ($\$433,661 + \$121,059$).
10. On April 10, 2018, respondent issued the NOD for tax of \$49,622.25.
11. On May 7, 2018, appellant filed a timely petition for redetermination.
12. Subsequently, respondent concluded that appellant's reporting had improved by the 2017 tax year. As a result, respondent determined that when computing the error ratio for the first two quarters of 2017, it was inappropriate to use the percentage of error for the 2015 and 2016 tax years. Instead, respondent calculated an average of the audited taxable sales for the third and fourth quarters of 2016, which was \$107,332 per quarter. Respondent then compared the estimated average to appellant's reported taxable sales for the first and second quarters of 2017, which were \$62,099 and \$74,533, respectively. Respondent determined a deficiency measure of \$78,032 for the first two quarters of 2017. This resulted in an overall reduction to the deficiency measure of \$43,027.
13. On February 6, 2020, respondent issued a Decision ordering the \$43,027 reduction to the deficiency measure but otherwise denying the petition for redetermination.
14. This timely appeal followed.

DISCUSSION

California imposes 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, §§ 6012, 6051.) For the purpose of the proper

administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes 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).)

When respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, 6511.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

In general, sales of food products are exempt from tax. (R&TC, § 6359.) However, sales of food products that are sold for consumption at facilities provided by a retailer are subject to tax. (R&TC, § 6359(d)(2).) In addition, sales of food products that are sold as a hot prepared food product are also subject to tax. (R&TC, § 6359(d)(7).)

Here, respondent determined that appellant's books and records were inadequate to conduct an accurate audit of appellant's business. Respondent also concluded that appellant's book markup was substantially lower than what respondent expected for this type of business. As a result, respondent used a credit card sales ratio audit method, which was based on respondent's observation of appellant's business on three separate days (one weekend day and two weekdays) and the Form 1099-K information that respondent had obtained. Respondent also estimated a portion of appellant's liability using appellant's reported taxable sales compared to an average of audited taxable sales. Based on the foregoing, respondent has demonstrated that its determination is reasonable and rational. Thus, appellant has the burden to establish that any additional adjustments are warranted.

Appellant argues that respondent's credit card sales ratio is too low. In support of this argument, appellant provided its 2017 federal income tax return for an S corporation, a profit and loss statement from January through June 2017, Form 1099-K information for the 2017 tax year, sales and use tax returns for 2017, and an article titled "Tracking Payment Fundamentals." With

respect to appellant's documents related to the 2017 tax year, respondent used an error ratio of appellant's reported taxable sales versus audited taxable sales for the third and fourth quarters of 2016. As a result, it is unclear how appellant's 2017 federal tax return or its 2017 sales and use tax returns demonstrate how respondent's audited taxable sales for the third and fourth quarters of 2016 are overstated or erroneous. To the extent that appellant is using this information to demonstrate that its reported figures are accurate, appellant has not provided any original source documentation to support the amounts reported on the 2017 federal income tax return or the 2017 sales and use tax returns. Similarly, appellant has not provided any original source documentation to support its profit and loss statement for the period January through June 2017. Thus, these documents are insufficient to warrant any additional adjustments to the determined measure of tax.

With respect to the "Tracking Payment Fundamentals" article, appellant relies on this article to support its contention that respondent's credit card sales ratio is too low. However, the article is merely a general statement based on the information obtained from the consumer surveys that the author or authors received. The article is not specifically related to appellant's restaurant, and this article does not possess greater evidentiary weight than respondent's audit, which was based on actual data from appellant's business (e.g., a three-day observation test and Form 1099-K information for the 2015 and 2016 tax years). Thus, this article is insufficient to demonstrate that the credit card sales ratio is too low. Furthermore, appellant has not provided any original source documentation such as z-tapes or other records to support its assertion that the audited credit card sales ratio is too low or that respondent's determination is erroneous. Therefore, appellant has not met its burden of proof.

HOLDING

Appellant has not demonstrated that any additional adjustments are warranted.

DISPOSITION

Respondent’s action to reduce the measure of taxable sales by \$43,027, from \$554,720 to \$511,693, and to otherwise deny the petition for redetermination is sustained.

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

DocuSigned by:
Keith T. Long
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

DocuSigned by:
Richard Tay
F8E81582726F448...
Richard Tay
Administrative Law Judge

Date Issued: 12/8/2021