

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

<p>In the Matter of the Consolidated Appeals of:</p> <p><b>NENA’S MEXICAN CUISINE, LLC AND</b></p> <p><b>NENA’S MEXICAN RESTAURANT, INC.</b></p> <hr/>	<p>) OTA Case Nos. 20096648, 20096649</p> <p>) CDTFA Case IDs 194-014, 154-137</p> <p>)</p> <p>)</p> <p>)</p>
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**OPINION**

Representing the Parties:

For Appellants:	Jason L. Perisho, Representative
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For Respondent:	Jason Parker, Chief of Headquarters Operations
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For Office of Tax Appeals:	Craig Okihara, Business Taxes Specialist III
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S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Nena’s Mexican Cuisine, LLC (the LLC) and Nena’s Mexican Restaurant, Inc. (the corporation) (collectively, appellants) each appeal a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> in response to each appellant’s timely petition for redetermination of a Notice of Determination (NOD). The NOD issued to the LLC is for \$61,996.18 in tax, plus applicable interest, for the period January 1, 2014, through December 31, 2016 (liability period) based on an August 25, 2017 audit report that determined unreported taxable sales measured by \$729,366. The NOD issued to the corporation is for \$241,199.76 in tax, plus applicable interest, for the same liability period, based on an August 25, 2017 audit report that determined unreported taxable sales measured by \$2,689,720.

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<sup>1</sup> Sales and use 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.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to its predecessor, the board.

Appellants waived their right to an oral hearing; therefore, we decide the matter based on the written record.<sup>2</sup>

### ISSUE

Whether adjustments are warranted to the measure of unreported taxable sales for each appellant for the liability period.

### FACTUAL FINDINGS

1. Each appellant holds a seller's permit to operate a restaurant with a bar. The LLC's restaurant is in Sacramento, California, with a permit effective January 1, 2014. The corporation's restaurant is in Stockton, California, with a permit effective March 1, 2011.
2. For the liability period, the corporation reported on its sales and use tax returns (SUTRs) total sales of \$6,765,244 and the LLC reported on its SUTRs total sales of \$1,984,587. Both appellants claimed no deductions, resulting in reported taxable sales of the same respective amounts as reported total sales. Each appellant indicated that it verbally informed an outside bookkeeper of its monthly sales, and the bookkeeper used that information to prepare the quarterly SUTRs. Appellants' sources for the monthly sales were unclear.
3. Upon audit, each appellant provided the following: federal income tax returns (FITRs) for 2014 and 2015; bank statements for the liability period; cash register z-tapes<sup>3</sup> and credit card sales summaries for March 1, 2017, through March 14, 2017 (after the liability period); IRS forms 1099-K<sup>4</sup> (forms 1099-K) for 2014 and 2015; and merchandise purchase invoices for July 2016. Appellants did not provide sales journals, sales tax worksheets, or source documentation, such as guest checks or cash register z-tapes, for the liability period. Although each appellant used a point-of-sale (POS) system,

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<sup>2</sup> Though appellants initially requested an oral hearing, subsequently they failed to respond to multiple communications from the Office of Tax Appeals (OTA) related to scheduling a hearing. As detailed in a written notice to appellants, OTA removed these appeals from the oral hearing calendar due to appellants' failure to respond, and appellants were deemed to have waived their right to an oral hearing pursuant to California Code of Regulations, title 18, section 30404(a).

<sup>3</sup> 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).

<sup>4</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 IRS for tax administration purposes.

comments in CDTFA’s audit working papers indicate that appellants stated they did not maintain the POS records for the liability period.

4. CDTFA compared each appellant’s total sales reported on the business’s SUTRs for 2014 and 2015 to the corresponding gross receipts reported on its FITRs and noted no differences. By comparing gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs, CDTFA computed book markups for the corporation of 117 percent for 2014, 171 percent for 2015, and 143 percent for the two years combined.<sup>5</sup> Similarly, upon comparison of gross receipts to the COGS reported on FITRs, CDTFA computed book markups for the LLC of 163 percent for 2014 and 252 percent for 2015, and 208 percent for the two years combined. Based on its experience in audits of similar businesses in the LLC’s area, CDTFA considered the book markups to be low for both businesses. CDTFA was unable to verify COGS because appellants did not provide purchase journals and complete merchandise purchase invoices. Due to the incomplete records for the liability period and the low book markups, CDTFA concluded additional testing would be required to verify reported taxable sales.
5. For the corporation, CDTFA used bank statements<sup>6</sup> to calculate credit card deposits of \$5,874,502 from sales, cash deposits of \$392,649 from sales, and total bank deposits of \$6,267,151 from sales (\$5,874,502 + \$392,649). CDTFA calculated that the corporation’s cash deposits from sales proceeds were approximately 6 percent ( $\$392,649 \div \$6,267,151$ ) of total bank deposits from sales proceeds during the liability period, and that many months had little or no cash deposits. Because the corporation did not provide documentation to determine cash payouts, CDTFA was unable to establish taxable sales using the bank deposit analysis method.

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<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 ( $0.30 \div 1.00 = 0.30$ ).

<sup>6</sup> Bank deposits are not gross receipts. (See R&TC, § 6012(a).) However, where, as here, a retailer is engaged in the business of making retail sales of tangible personal property, the retailer’s bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of tangible personal property, which evidence CDTFA can use to determine audited taxable sales when sales cannot be accurately established using a direct approach due to a lack of adequate records.

6. For the LLC, CDTFA used bank statements to calculate credit card deposits of \$1,592,754 from sales, cash deposits of \$637,194 from sales, and total bank deposits of \$2,229,948 from sales ( $\$1,592,754 + \$637,194$ ). CDTFA noted that the LLC's total bank deposits of \$2,229,948 from sales exceeded the taxable sales of \$1,984,587 reported on the LLC's SUTRs for the liability period. CDTFA also compared the LLC's credit card sales to its total sales and calculated a ratio of 71 percent ( $\$1,592,754 \div \$2,229,948$ ). Based on its experience in audits of similar businesses in the LLC's area, CDTFA believed that the credit card sales ratio of 71 percent was unusually high and an indication that not all of the LLC's cash sales proceeds had been deposited into its business bank account.
7. CDTFA offered to have its computer audit specialist download appellants' sales data from their POS systems, but appellants declined. CDTFA decided to compute each business's audited taxable sales using an indirect audit method, the credit card sales ratio method.
8. CDTFA requested appellants maintain cash register z-tapes and credit card sales summaries for March 1, 2017, through March 14, 2017, which appellants provided. Using the corporation's cash register z-tapes for that two-week period, CDTFA computed the following: cash sales, including sales tax reimbursement, of \$57,641; credit card sales, including sales tax reimbursement, of \$66,063; total sales, including sales tax reimbursement, of \$123,704 ( $\$57,641 + \$66,063$ ); and a credit card sales ratio of 53.4 percent ( $\$66,063 \div \$123,704$ ). Using the LLC's cash register z-tapes for the same period, CDTFA computed the following: cash sales, including sales tax reimbursement, of \$17,988; credit card sales, including sales tax reimbursement, of \$22,116; total sales, including sales tax reimbursement, of \$40,104 ( $\$17,988 + \$22,116$ ); and a credit card sales ratio of 55 percent ( $\$22,116 \div \$40,104$ ). Based on its experience conducting audits of similar businesses in each appellant's area, CDTFA concluded that the 53.4 percent and 55 percent credit card sales ratios were reasonable and representative of each appellant's business during the liability period.
9. Using the credit card sales summaries from the corporation for March 1 through March 14, 2017, CDTFA calculated the corporation's credit card sales for that period as follows: credit card tips of \$6,409; credit card sales, including sales tax reimbursement

- and tips, of \$100,781; and a credit card tip ratio of 6.36 percent ( $\$6,409 \div \$100,781$ ). Similarly, using the LLC's credit card sales summaries for March 1, 2017, through March 14, 2017, CDTFA calculated the LLC's credit card sales for that period as follows: credit card tips of \$3,436; credit card sales, including sales tax reimbursement, of \$31,093; credit card sales, including sales tax reimbursement and tips, of \$34,529 ( $\$3,436 + \$31,093$ ); and a credit card tip ratio of 10 percent ( $\$3,436 \div \$34,529$ ).
10. CDTFA found that the corporation's credit card sales, including sales tax reimbursement and tips, of \$100,781 (computed using credit card sales summaries for the two-week period), exceeded credit card sales, including sales tax reimbursement, of \$66,063 (computed using the cash register z-tapes for this same period), and concluded that this discrepancy indicated that the corporation's cash register z-tapes were incomplete. Similarly, CDTFA found that the LLC's credit card sales, including sales tax reimbursement and tips, of \$34,529 (computed using credit card sales summaries for the two-week period) exceeded credit card sales, including sales tax reimbursement, of \$22,116 computed using the cash register z-tapes, indicating that the LLC's cash register z-tapes were incomplete. However, CDTFA concluded that appellants' credit card sales ratios of 53.4 and 55 percent were reasonable, and appellants had not provided any additional cash register z-tapes to establish a more accurate result.
  11. Using the corporation's 2014 and 2015 form 1099-K data, CDTFA computed credit card sales of \$3,549,172 for the two years combined. CDTFA observed that the corporation's credit card deposits of \$3,631,302 from sales for 2014 and 2015 exceeded credit card sales from form 1099-K data. The corporation stated that the difference likely related to sales for a sandwich shop adjoining the restaurant that the corporation operated for a short period of time through October 2015. The corporation stated that sales proceeds from the sandwich shop were deposited into the corporation's bank account and reported on its SUTRs. CDTFA concluded that the form 1099-K data for the corporation was incomplete and the bank statements were the best available evidence of the corporation's credit card sales, including both the restaurant and sandwich shop. Thus, from the \$5,874,502 for credit card deposits from sales for the liability period, CDTFA removed tips at 6.36 percent and then removed sales tax reimbursement at the applicable tax rate to calculate \$5,048,950 as the amount of bank deposits from credit card sales (excluding

sales tax reimbursement and tips). CDTFA then divided bank deposits from credit card sales (excluding sales tax reimbursement and tips) by the credit card sales ratio of 53.4 percent and computed audited taxable sales of \$9,454,963 for the liability period. Upon comparison to taxable sales of \$6,765,244 reported on the SUTRs for the liability period, CDTFA computed that the corporation had unreported taxable sales of \$2,689,719 (rounded).

12. To test whether these findings were reasonable, CDTFA compared the corporation's audited taxable sales for 2014 and 2015 to the corresponding COGS reported on the corporation's FITRs, calculating audited markups of 193 percent for 2014, 284 percent for 2015, and 236 percent for the two years combined. CDTFA considered these audited markups for 2014 and 2015 to be somewhat low, but nevertheless reasonable. Because CDTFA was unable to verify the corporation's COGS, it was unable to establish that the audited markups were reliable. CDTFA noted that the audit of the LLC for the same liability period resulted in a similar credit card sales ratio, and concluded that this was evidence that the audited credit card sales ratio for the corporation was reasonable and therefore supported the results of the corporation's audited sales computed by the credit card sales ratio method.
13. For the LLC, using the data on the forms 1099-K the LLC provided, CDTFA calculated \$1,028,091 as the amount of the LLC's credit card sales, excluding sales tax reimbursement, for 2014 and 2015 combined. CDTFA also obtained the LLC's 2014 and 2015 form 1099-K data from the IRS, and concluded that the data on the forms 1099-K the LLC provided did not include credit card sales paid with American Express. The form 1099-K data for sales paid with American Express was only available for January 1, 2014, through September 30, 2015. CDTFA compiled the LLC's American Express credit card sales of \$64,800 for January 1, 2014, through September 30, 2015; for the remainder of the liability period (October 1, 2015, through December 31, 2016), CDTFA calculated a monthly average of \$3,168 ( $\$63,366$  for January 1, 2014, through August 31, 2015  $\div$  20 months).<sup>7</sup> Thus, in total, CDTFA computed \$112,325 ( $\$64,800 + (\$3,168 \times 15 \text{ months})$ ) (rounded) as the amount of the LLC's American Express credit

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<sup>7</sup> CDTFA believed the September 2015 American Express credit card sales were incomplete because the total was significantly lower than previous months. Therefore, CDTFA excluded September 2015 in its calculation of the average monthly credit card sales.

card sales for the liability period. CDTFA concluded that the LLC's form 1099-K data for 2014 and 2015 would be the most accurate total since the audit found that merchant processing fees were deducted from the amounts deposited into the LLC's bank account. Because it did not have 1099-K data for 2016, CDTFA concluded the LLC's bank statements were the best available evidence of credit card sales for that year. Thus, CDTFA computed credit card sales of \$1,803,409 (\$1,028,091 credit card sales for 2014 and 2015 + \$662,994 credit card deposits from sales proceeds for 2016 + \$112,325 American Express credit card sales for the liability period) (rounded) for the LLC for the liability period.

14. From the LLC's credit card sales of \$1,803,409, CDTFA removed credit card tips at 10 percent and then removed sales tax reimbursement at the applicable tax rate to calculate credit card sales (excluding sales tax reimbursement and tips) of \$1,496,746. CDTFA then divided the LLC's credit card sales (excluding sales tax reimbursement and tips) by the credit card sales ratio of 55 percent and computed audited taxable sales of \$2,713,955 for the LLC for the liability period. Upon comparison to the LLC's reported taxable sales of \$1,984,587, CDTFA computed unreported taxable sales of \$729,368 (rounded). To test the reasonableness of these findings, CDTFA compared audited taxable sales for 2014 and 2015 to the corresponding COGS reported on the LLC's FITRs and computed audited markups of 305 percent for 2014 and 391 percent for 2015. CDTFA considered these audited markups reasonable, although because it was unable to verify COGS, CDTFA was unable to establish that these audited markups were reliable. CDTFA noted that the audit of the corporation for the same liability period resulted in a similar credit card sales ratio, and concluded that this was evidence that the audited credit card sales ratio for the LLC was reasonable and accordingly supported the results of the LLC's audited sales computed by the credit card sales ratio method.
15. CDTFA issued an NOD to the corporation on October 11, 2017, for tax of \$241,199.76 plus applicable interest, and issued an NOD to the LLC on October 26, 2017, for tax of \$61,996.18 plus applicable interest.

16. Each appellant filed a timely petition for redetermination of its respective NOD. On August 4, 2020, CDTFA issued a Decision in each case, denying each appellant's petition for redetermination.
17. Appellants timely appealed to the Office of Tax Appeals (OTA).

### DISCUSSION

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state 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.) 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).) 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).)

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 that is in its possession or may come into its possession. (R&TC, § 6481.) 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 not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellants' books and records provided for audit were incomplete. Appellants did not provide sales journals, sales tax worksheets, or source documentation for the liability period. According to comments in CDTFA's audit working papers, appellants stated that they did not maintain POS sales records for the liability period. Consequently, CDTFA was unable to verify sales reported on appellants' SUTRs for the liability period using a direct audit method (that is, calculating audited sales directly from appellants' records). CDTFA's preliminary analysis found low book markups, which were indications that appellants' reported sales may have been understated.



Given these facts, we find that it was reasonable for CDTFA to question the accuracy of appellants' reported taxable sales and use an indirect audit method to compute appellants' audited taxable sales. CDTFA used the credit card sales ratio method, which is a recognized and standard accounting procedure. (See *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613; CDTFA Audit Manual § 0810.12.<sup>8</sup>) Credit card deposits into appellants' bank accounts are independently verifiable evidence from a third party showing appellants' sales paid by credit card. In light of all of the above, we find that CDTFA computed audited taxable sales using the best available evidence, and further conclude that CDTFA has established that its determinations are reasonable and rational. Accordingly, the burden shifts to appellants to show errors in the audits.

On appeal, appellants assert that the determinations are excessive and not based on proven factual information. Appellants contend that each determination was based on a seven-day sample and CDTFA has not established that these samples that the audits relied upon were representative of the liability period. Appellants argue that the audit methods did not provide accurate information regarding appellants' business transactions because sales and consumer behavior fluctuate over time, and a seven-day sample does not accurately reflect years of sales. Moreover, the August 4, 2020 Decisions from CDTFA reflect that appellants provided their own self-conducted analyses of tip percentages from five days of the corporation's sales in September 2015 and their self-conducted analyses of the LLC's credit card transactions during two seven-day periods (August 14-20, 2014, and December 16-22, 2016) and one four-day period (September 16-20, 2015). The Decisions indicate that appellants pointed to this information in support of their position that the tip percentages and credit card ratios were both higher than the ratios CDTFA calculated in the audits.<sup>9</sup>

Initially, we note that the audits' samples of cash register z-tapes and credit card sales summaries were for appellants' transactions for a total of 14 days, from March 1 through March 14, 2017. Appellants' cash register z-tapes and credit card sales summaries for the 14-day period in March 2017 are evidence of appellants' sales. It is well established that CDTFA

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<sup>8</sup> CDTFA's Audit Manual does not provide binding legal authority; however, OTA may look to it for guidance. (*Appeal of Amaya*, 2021-OTA-328P.)

<sup>9</sup> Appellants submitted these documents only in their appeal to CDTFA, and did not mention these documents in their briefing to OTA; we received them in this appeal because they were attached as exhibits to CDTFA's August 4, 2020 Decisions.

may use testing techniques in its audits. (See *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 444.) Moreover, CDTFA offered to have its computer audit specialist download appellants' sales data from their POS systems, but appellants declined. As discussed above, we have determined that it was reasonable for CDTFA to use an indirect audit method to compute appellants' sales; to the extent that appellants dispute CDTFA's use of the credit card sales ratio method for these audits, we find that argument unpersuasive.

Appellants have not identified any errors or otherwise established a more accurate calculation of audited taxable sales.<sup>10</sup> Regarding appellants' self-conducted analysis of tip percentages from five days of the corporation's sales in September 2015, this analysis lists only transactions where the customer added a tip, and omits any sales where the customer failed to include a gratuity; as a result, appellants' calculations do not accurately reflect the overall tip percentage for the corporation's sales transactions. Regarding appellants' self-conducted analysis of the LLC's credit card sales, for two of the three sampled periods the document lists sales totals only for sales at dinner, not sales for the full day's business hours; thus, appellants' analysis is not based on the LLC's total sales for the sampled periods and does not provide calculations more accurate than the audit results. Given that appellants have the burden of proof in this case, we find that no further adjustments are warranted.

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<sup>10</sup> For a portion of the audit period, the corporation operated a separate sandwich shop next door. As such, a portion of the unreported liability includes the sandwich shop's sales. The audit liability was determined, in part, using the 53.4 percent credit card sales ratio, and 6.36 optional tip ratio, obtained from the restaurant's March 2017 sales, an adjustment for sales tax, and no other adjustments, such as nontaxable cold food to-go sales. Appellant offers no evidence or argument that the restaurant's sales ratios are not representative of the sandwich shop's sales. As such, we have no basis to make any further adjustments.

HOLDING

Appellants have not shown that any adjustments to the measures of unreported taxable sales are warranted.

DISPOSITION

CDTFA’s actions in denying the petitions for redetermination are sustained.

DocuSigned by:

*Suzanne B. Brown*

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Suzanne B. Brown  
Administrative Law Judge

We concur:

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*Josh Aldrich*

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Josh Aldrich  
Administrative Law Judge

DocuSigned by:

*Andrea L.H. Long*

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Andrea L.H. Long  
Administrative Law Judge

Date Issued: 3/16/2022