OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No.: 18083613
	) CDTFA Case ID: 244-027
GLORIA'S RESTAURANT, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Warren Nemiroff, Attorney Luis Jimenez, CPA
For Respondent:	Ravinder Sharma, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 6561, Gloria's Restaurant, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] in response to appellant's timely petition for redetermination of a Notice of Determination (NOD) dated April 24, 2017. The NOD is for tax of $195,498.98, plus applicable interest, and a negligence penalty of $19,549.92, for the period January 1, 2014, through March 31, 2016 (audit period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Natasha Ralston, Andrew J. Kwee, and Josh Aldrich held an electronic hearing for this matter on January 25, 2022. At the conclusion of the hearing, the record was held open for additional briefing pursuant to appellant's request. On February 1, 2022, OTA issued Post-Hearing Orders which memorialize the scope of the additional briefing period and provide as follows: appellant could submit

[1] 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.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

[2] The penalty is slightly higher than 10 percent, by $.03, due to rounding.

exhibits together with evidence of timely filing of those exhibits until February 24, 2022; and upon receipt CDTFA would then have 30 days to respond. OTA did not receive a submission from appellant. On March 9, 2022, the record was closed.

ISSUE

1. Whether adjustments are warranted to the understatement of reported taxable sales.
2. Whether the understatement was the result of negligence.

FACTUAL FINDINGS

1. Appellant has operated a Mexican style restaurant with a full-service bar in Huntington Park, California since January 1, 2014.
2. This is appellant's first audit. A. Sanjuan is appellant's president.
3. Prior to incorporating, the restaurant was operated by J&J Limited Partnership (J&J) comprised of J. Sanjuan Jr., A. Sanjuan, and J. Blanco. According to the June 5, 2013 Report of Field Audit, J&J was audited for the period October 1, 2009, through September 30, 2012. J&J, doing business as Gloria's Restaurant, had a seller's permit with a start date of October 1, 2009, and a close out date of December 31, 2013.
4. A. Sanjuan appears on the seller's permit account information, according to CDTFA's Integrated Revenue Information System (IRIS),[3] for a separate restaurant, Gloria's Restaurant 2. The seller's permit for Gloria's Restaurant 2 has a start date of June 1, 1991, and a close out date of August 15, 2000. A. Sanjuan also appears on the seller's permit account information, according to IRIS, for Gloria's Restaurant. The start date for the seller's permit is March 1, 1985, and the close out date is December 31, 1991.
5. CDTFA audited appellant for the period January 1, 2014, through March 31, 2016. During the audit period, appellant reported $1,815,390 in taxable sales and claimed deductions totaling $135,536 for nontaxable sales of food products.
6. For audit, appellant provided the following: point-of-sale (POS) data for the period January 1, 2015, through February 6, 2017; sales receipts and daily sales summaries for the period January 4, 2017, through January 19, 2017; bank statements for most of the audit period (except January 2014, and February 2014); Form 1099-K (1099-K) credit

[3] IRIS is CDTFA's legacy account management software.

card reports for 2014 and 2015; merchant statements for January 2017; and purchase invoices for the period of January 1, 2014, through March 31, 2016.[4] Appellant did not provide federal income tax returns for the audit period.

7. CDTFA indicated that it obtained appellant's 2014 federal income tax return (FITR) through an interagency agreement. CDTFA noted that appellant's gross receipts, reported on its 2014 FITR, were $330,000 greater than total sales reported on its sales and use tax returns (SUTR's) for the same year. Based on the difference between reported gross receipts and total sales reported on its SUTR, CDTFA determined that additional investigation was warranted.

8. For the period January 1, 2015, through March 31, 2016, CDTFA compiled taxable sales from appellant's POS reports of $1,404,990, which exceeded reported taxable sales for that same period by $407,250. For the same period, CDTFA also concluded that there were 38,281 missing transactions in the POS reports based on an analysis prepared by its POS system specialist.[5] In addition, CDTFA made six cash purchases on varying dates between January 22, 2016, and March 25, 2016. This was done to verify the accuracy of appellant's POS and to ensure sales were being recorded. CDTFA compared its purchases to the POS data provided by the appellant in a statement of facts, executed on March 17, 2017, by auditor C. Jimenez (statement of C. Jimenez). Therein, CDTFA noted, in pertinent part, the following:

    a. The January 22, 2016 cash purchase was made at 3:59 p.m. in the amount of $14.16. The transaction is listed on the sales receipt as order number 68631; however, the transaction does not appear in the POS data. Also, the transactions listed before and after the date and time of the cash purchase are listed as order numbers 36079 and 36080.

[4] Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (e.g., credit card, debit card, and PayPal). It is filed by credit card processing companies to the IRS. CDTFA obtained the 1099-Ks from appellant's representative and from internal sources. 1099-K information was not available for the first quarter of 2016. For that period, CDTFA used credit card receipts of $9,345, the average of credit card receipts for the quarterly periods for which Form 1099-Ks were available.

[5] According to the audit workpapers, there were 6,756 missing transactions in first quarter 2015 (1Q15), 8,862 missing transactions in 2Q15, 7,380 missing transactions in 3Q15, 7,771 missing transactions in 4Q15, and 7,512 missing transactions in 1Q16.

b. The February 18, 2016 cash purchase was made at 2:04 p.m. in the amount of $8.18. The transaction is listed on the sales receipt as order number 73933; it does not appear in the POS data provided.

c. The March 4, 2016 cash purchase was made at 9:48 a.m. in the amount $7.62. The transaction is listed on the sales receipt as order number 76818; it does not appear in the POS data provided.

d. The March 9, 2016 cash purchase was made at 11:45 a.m. in the amount of $9.80. The transaction is listed on the sales receipt as order number 77868; it does not appear in the POS data.

e. The March 17, 2016 cash purchase was made at 3:38 p.m. in the amount of $8.71. The transaction is listed on the sales receipt as order number 79413; it does not appear in the POS data.

f. The March 25, 2016 cash purchase was made at 2:41 p.m. in the amount of $10.89. The transaction is listed on the sales receipt as order number 80964; it does not appear in the POS data.

Based on these analyses, CDTFA decided that the POS reports could not be used to compute appellant's taxable sales. Instead, CDTFA decided to compute appellant's taxable sales using the credit card sales ratio method.[6]

9. CDTFA asked appellant to maintain POS data for the 14-day period January 4, 2017, through January 17, 2017. The POS data included information regarding credit card sales, cash sales, and tips included in credit card payments. To verify that appellant was recording all of its sales with its POS system during the 14-day period, CDTFA observed appellant's sales for two days within that period, January 10, 2017, and January 11, 2017 (observation test). The POS reports show taxable sales of $74,042 or $5,289 per day. CDTFA used the POS data for 14 days to compute the ratio of credit card sales to taxable sales (credit card sales ratio) of 48.26 percent and to compute the ratio of tips to credit card sales (tips ratio) of 6.69 percent.

[6] The credit card sales ratio method is a standard audit procedure that is effective in establishing taxable sales because it relies 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. (See *Appeal of Amaya*, 2021-OTA-328P.)

10. CDTFA scheduled Form 1099-K information, which CDTFA used to compute credit card receipts of $2,237,929 for the audit period. CDTFA reduced this amount for tips at 6.69 percent and for sales tax reimbursement at 9 percent, to calculate credit card sales of $1,924,475. CDTFA divided credit card sales of $1,924,475 by the credit card sales ratio of 48.26 percent to compute audited taxable sales of $3,987,600 for the audit period. Audited taxable sales exceeded reported taxable sales, and CDTFA determined unreported taxable sales of $2,172,210.[7]
11. On April 24, 2017, CDTFA issued the NOD to appellant for tax of $195,498.98, plus applicable interest, and a negligence penalty of $19,549.92.
12. On May 8, 2017, appellant filed a timely petition for redetermination of the NOD.
13. On July 10, 2018, CDTFA issued its decision, denying appellant's petition for redetermination.
14. Appellant timely filed the instant appeal with OTA.

DISCUSSION

Issue 1 – Whether adjustments are warranted to the understatement of reported 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.) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot prepared 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 amount of tax reported by the taxpayer, 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).)

[7] ($3,987,600 - $1,815,390) = $2,172,210.

When a taxpayer challenges an NOD, CDTFA has a minimal, initial burden showing that its determination is reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) If CDTFA carries that 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); Evid. Code, § 115; *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 tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

As stated above, taxable sales recorded on appellant's POS reports for January 1, 2015, through March 31, 2016, exceeded reported taxable sales for that same period by $407,250, which supports CDTFA's analysis that additional investigation was warranted. In addition, CDTFA's records indicate that there were 38,281 missing transactions in appellant's POS data. The missing transactions were not used to develop the audited understatement, rather they were noted simply as evidence that appellant's records were not reliable, which was also noted in conjunction with other discrepancies.[8] We note that during the audit period CDTFA made six cash purchases between January 22, 2016, and March 25, 2016. According to the statement of C. Jimenez, none of the six purchases appeared in appellant's POS data. We also note that appellant did not provide any of its purchase records to support costs of goods sold as reported on its 2014 FITR. In addition, purchase invoices were only provided for January 2017, and no source documents for sales were provided for the audit period.

Based on the foregoing, we find that appellant provided incomplete records. Furthermore, we find that the records that were provided are inaccurate and unreliable. Therefore, it was rational and reasonable for CDTFA to use an indirect audit method (the credit card sales ratio method) to compute appellant's taxable sales. We have reviewed CDTFA's audit, we have found no errors in the computations or methodologies utilized therein to reach its determination. Therefore, the burden of proof shifts to appellant to provide evidence to refute the audit results.

Appellant argues that CDTFA essentially decided that appellant attempted "to avoid the payment of tax and constructed multiple computer systems and reporting systems, giving [it] a

[8] See Factual Findings 4 and 5.

mendacity and sophistication that is a physical impossibility." Appellant asserts that the audit findings disclose a deficiency that is greater than appellant's entire income and are, therefore, ludicrous. Also, Mr. Jimenez, appellant's CPA, testified during the hearing that there was potentially an understatement, but it was closer to $50,000 or $60,000 in tax at most. Mr. Jimenez also claims that the discrepancies in the POS data were due to his client changing POS systems but indicates that "I don't believe [appellant was] given the opportunity to provide that information."

Appellant has not shown any errors in the audit calculations, nor has appellant provided any documentary evidence to support reductions to the audit liability. We reject the notion that appellant did not have the opportunity to provide information. During the briefing period appellant failed to submit documents or other evidence to support its arguments. (See, Cal. Code Regs., tit. 18, §§ 30302(f) and 30303(a).) Based on the procedural history, appellant had multiple opportunities to submit documents or other evidence.[9] (See, Cal. Code Regs., tit. 18, §§ 30210(g) and 30420(a).) Despite these opportunities, appellant's argument remains unsupported. Thus, appellant has not met its burden of proof to provide evidence to refute the audit results.

In response to appellant's argument that the results are ludicrous, we emphasize that appellant's POS reports for the 14-day period January 4, 2017, through January 17, 2017, show taxable sales of $74,042, which represents an average of $5,289 per day. The audit results in audited taxable sales of $3,987,600, which represents an average of $4,863 per day for the audit period ($3,987,600 ÷ 820 days). Thus, the audit results in average daily taxable sales that are less than the average daily taxable sales recorded in appellant's own records for the 14-day period. This is evidence that the audit results are reasonable.

We conclude that no adjustment is warranted to the audited understatement of reported taxable sales.

[9] On June 14, 2019, OTA issued the first Request for Prehearing Conference (Request), which ordered the parties to exchange proposed exhibits by July 30, 2019. On August 2, 2019, appellant requested a postponement, which was granted. On December 7, 2020, OTA issued the second Request, which ordered the parties to exchange proposed exhibits by February 25, 2020. On February 14, 2020, appellant requested a postponement, which was granted. The appeal was then calendared for a prehearing conference on June 30, 2020. On June 30, 2020, OTA issued Prehearing Conference Minutes and Orders which ordered the parties to submit proposed exhibits by July 6, 2020. On July 10, 2020, OTA granted appellant's request for a postponement and waived a second prehearing conference. On December 17, 2021, OTA issued Prehearing Orders that ordered the parties to submit proposed exhibits no later than January 5, 2022.

Issue 2 – Whether the understatement was the result of negligence.

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 *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).) Such records include but are not limited to the following: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1)(A)-(C).) Failure to maintain and keep complete and accurate records is considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

First, CDTFA argues that although this is appellant's first audit, appellant's president previously operated the business under a partnership account, and that account was audited for the period October 1, 2009, through September 30, 2012. Next, CDTFA argues that appellant did not provide complete or accurate records. And lastly, CDTFA argues that the negligence penalty was properly imposed because the audited understatement is large in relation to the reported measure of tax (i.e., 120 percent).

Appellant contends it was not negligent because there is at most an understatement of $60,000 in tax.

Here, it is undisputed that appellant has not been previously audited. However, appellant, through its president, had extensive experience handling sales and use tax matters for this type of restaurant. The evidence shows that appellant's president was involved, as a partner, with an audit of Gloria's restaurant approximately three years prior to the audit at issue. Appellant's president has been consistently listed on accounts for seller's permits dating back to 1985 for restaurants named Gloria's or Gloria's 2. We also infer from the seller's permits that appellant's president has extensive experience operating this kind of business.

Despite the extensive experience of appellant's president, the records appellant provided for audit were incomplete and inaccurate. We find the incomplete and inaccurate records to be evidence of negligence.

The understatement of $2,172,210 represents an error ratio of 120 percent when compared to reported taxable sales of $1,815,390. In other words, appellant reported less than half of its taxable sales. We find that the large error ratio is evidence of negligence.

Taxable sales recorded on appellant's POS reports for January 1, 2015, through March 31, 2016, exceeded reported taxable sales for that same period by $407,250. At a minimum, appellant should have been able to report on its SUTRs the amount of taxable sales recorded in its own POS reports. We find that the failure to do so is evidence of negligence.

Based on the forgoing, we find that the understatement cannot be attributed to appellant's bona fide and reasonable belief that its bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (See *Independent Iron Works, Inc, supra*.) Therefore, we conclude that appellant was negligent, and the imposition of the negligence penalty is appropriate.

HOLDING

1. No adjustment is warranted to the audited understatement of reported taxable sales.
2. The understatement was the result of negligence.

DISPOSITION

Sustain CDTFA's decision to deny appellant's petition for redetermination.

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

Date Issued: 5/9/2022