OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of:	) OTA Case Nos.: 19125594; 19125596) CDTFA Case IDs: 141-072; 238-021
V TROPICAL BAKESHOP III, INC. AND VALERIO'S TROPICAL BAKESHOP VI, INC.	)

OPINION

Representing the Parties:

For Appellant:	Graham Hoad, Representative
For Respondent:	Amanda Jacobs, Tax Counsel III Cary Huxsoll, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: These consolidated appeals are made pursuant to Revenue and Taxation Code (R&TC) section 6561. V Tropical Bakeshop III, Inc. (appellant V Tropical) 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 the Notice of Determination (NOD) for tax of $124,540.33, plus applicable interest, and a failure-to-file penalty of $10,820.05, for the period July 1, 2007, through December 31, 2014. CDTFA's decision called for a reaudit. Pursuant to its subsequent reaudit, CDTFA reduced the tax from $124,540.33 to $92,959 and the penalty from $10,820.05 to $8,096.35, and denied the remainder of the petitioned amount.

Valerio's Tropical Bakeshop VI, Inc. (appellant Valerio's) appeals a decision issued by CDTFA in response to appellant's timely petition for redetermination of the NOD for tax of

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

$44,564.34, plus applicable interest, and a failure-to-file penalty of $3,985.06, for the period January 1, 2010, through December 31, 2014. Pursuant to its subsequent reaudit, CDTFA reduced the tax from $44,564.34 to $36,971 and the penalty from $3,985.06 to $3,343.09, and denied the remainder of the petitioned amount.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Suzanne B. Brown, and Josh Aldrich held an electronic hearing for this matter on January 25, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES[2]

1. Whether appellants have shown that their sales of hot meat-filled foods are exempt from sales tax.
2. Whether CDTFA timely issued the NODs.

FACTUAL FINDINGS

1. Appellants are related entities under common ownership which operate bakeries. V Tropical, which incorporated in March 2007, operates two bakeries in Union City. Valerio's, which incorporated in July 2009, operates a bakery in Concord.
2. The bakeries sell Filipino-style bakery goods for take-out. Appellants do not offer facilities where customers can sit down to consume the food purchased. Appellants' food products include meat-filled foods that are sold cold (from the refrigerator), hot (from the warmer), or at room temperature (from display racks). The meat fillings include chicken, pork, tuna, corned beef, and others.
3. Initially, each appellant operated without a seller's permit.
4. In January 2014, CDTFA's Statewide Compliance Outreach Program (SCOP) visited one of the bakeries operated by V Tropical. The SCOP team found that V tropical was selling baked foods filled with meat (i.e., empanadas, siopao, and pandesal), and it concluded that those products were taxable when sold hot.
5. Following the SCOP visit, V Tropical obtained a seller's permit with a start date of March 20, 2014, and it filed quarterly sales and use tax returns (SUTRs) for the period

[2] Whether relief from the failure-to-file penalties is warranted is no longer in dispute. On January 14, 2022, appellants submitted Request for Relief from Penalty (Form CDTFA-735) to CDTFA. At the hearing, CDTFA indicated that it had relieved the failure-to-file penalties and that the penalty amounts have been "adjusted off" both V Tropical and Valerio's accounts.

January 1, 2014, through June 30, 2015, and annual SUTRs for the second half of 2015 and for the year 2016. On those SUTRs, V Tropical claimed all its sales as exempt sales of food.

6. CDTFA later changed the effective start date for the seller's permit for V Tropical to July 1, 2007, to approximate the date when business operations began.
7. Valerio's obtained a seller's permit with a start date of April 21, 2014, and it filed quarterly SUTRs for the period April 1, 2014, through December 31, 2014, claiming all its sales as exempt sales of food.
8. CDTFA later changed the effective start date for the seller's permit for Valerio's to January 1, 2010, to approximate the date when the business operations began.
9. CDTFA concluded, based on its review of the records, that the total sales reported on appellants' federal income tax returns (FITRs) were substantially accurate. To determine the percentages of taxable to total sales, CDTFA used a combination of observation tests and review of the records.[3] CDTFA computed percentages of meat-filled goods sold hot, cold, or at room temperature. In the revised audits, which were the bases of the above-referenced NODs, CDTFA considered sales of the meat-filled goods to be taxable if the products were sold hot or at room temperature. The audited percentages of taxable to total sales in the revised audits were 6.30 percent for V Tropical and 8.19 percent for Valerio's.
10. CDTFA's audits also included unreported purchases of fixed assets subject to use tax, measuring $266,685 for V Tropical and $175,145 for Valerio's.
11. On October 20, 2016, and November 21, 2016, CDTFA issued the above-referenced NODs to V Tropical and Valerio's, respectively. Appellants filed timely petitions for redetermination on November 10, 2016 (V Tropical) and November 28, 2016 (Valerio's).
12. On March 20, 2019, CDTFA issued a decision ordering a reaudit to delete meat-filled foods sold at room temperature from the taxable measure.
13. In the reaudits, CDTFA established audited taxable sales by applying the percentages of meat-filled foods sold hot (from the warmer) to the amounts of total sales reported on appellants' FITRs. As a result, the audited amounts of taxable sales were reduced from

[3] We exclude specific details regarding the computations because appellant has not specifically disputed the computed percentages of total sales that represent meat-filled pastries sold cold, at room temperature, or hot.

$1,070,901 to $786,095 for V Tropical and from $314,495 to $230,334 for Valerio's. Those amounts represent approximately 4.6 percent and 6 percent, respectively, of total sales for V Tropical and Valerio's.[4] In addition, in the reaudit of V Tropical, CDTFA reduced the measure of unreported purchases of fixed assets subject to use tax, by $50,613, because appellant provided evidence that it paid sales tax reimbursement to the retailer with respect to the $50,613 transaction.[5]

14. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants have shown that their sales of hot meat-filled foods are exempt from sales tax.

California imposes sales tax on a retailer's retail sales of tangible personal property (TPP) sold in this state measure by the retailer's gross receipts, unless the sales is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 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 are subject to sales tax. (R&TC, § 6359(a), (d)(7), (e); Cal. Code Regs., tit. 18, § 1603(a)(2)(A), (e)(1).)

Hot prepared food products are, "those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs." (Cal. Code Regs., tit. 18, § 1603(e)(1).) Although sales of hot prepared food products

[4] Following the reaudits, CDTFA sent each appellant an options letter dated October 25, 2019. We have used the information in the October 25, 2019 letters to appellants to compute unreported taxable sales of $786,095 established in the reaudit for V Tropical ($1,070,901 in the revised audit – reduction of $284,806) and $230,334 established in the reaudit for Valerio's ($314,495 in the revised audit – reduction of $84,161). Thus, the percentages of taxable to total sales in the reaudits were approximately 4.627 percent for V Tropical ($786,095 ÷ $16,987,603 total sales) and 5.996 percent for Valerio's ($230,334 ÷ $3,841,773 total sales).

[5] On appeal to OTA, appellants did not dispute the audited purchases of fixed assets subject to use tax. Thus, we will not further address that audit item.

are subject to tax, hot bakery goods and hot beverages, such as coffee, are exempt from tax when sold for a separate price. (R&TC, § 6359(e); Cal. Code Regs., tit. 18, § 1603(e)(1)).

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, 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, 6511.) 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*.)

In this case, CDTFA, through its SCOP program, became aware that, although neither appellant held a seller's permit, appellants were selling meat-filled food products in a heated condition. CDTFA concluded that appellants' sales of the meat-filled food products, when they were hot, represented taxable sales of hot prepared food products. In order to establish audited amounts of sales of those hot meat-filled foods, CDTFA conducted observation tests at appellants' locations and reviewed appellants' records. CDTFA computed percentages of sales of hot prepared food products to total sales and applied those percentages to the amounts of total sales reported on appellants' FITRs. We find that CDTFA's decision regarding the application of tax to the hot meat-filled food products was reasonable. Also, to establish audited taxable sales, CDTFA utilized appellants' own records to establish total sales and used undisputed percentages of sales of hot meat-filled food products to total sales. We find that CDTFA's audit approach was appropriate. Accordingly, we find that CDTFA has shown that its determination was reasonable and rational. Therefore, appellants have the burden of establishing that adjustments are warranted. Appellants argue that an adjustment is warranted because the products at issue qualify as exempt sales of food products.

Statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 765, 769.) The taxpayer bears the burden of showing that its sales qualify for the exemptions. (*Ibid.*; *Appeal of Snowflake Factory LLC*, 2020-OTA-270P.) Any doubt must be resolved against the right to an exemption. (*Associated Beverage Co. v. State Bd. of Equalization* (1990) 224 Cal.App.3d 192, 211.)

Here, appellants argue that the sales of hot meat-filled products (i.e., empanadas, pandesal, siopao, etc.) are not meals, and therefore are not subject to tax. In support, appellants point to R&TC section 6359 and *Treasure Island Catering Co., Inc. v. State Bd. of Equalization* (1941) 19 Cal.2d 181 (*Treasure Island*). Based on appellants' reading of the statutory framework and *Treasure Island*, appellants argue that under a three-part test, their hot meat-filled food products do not meet the definition of a meal because: (1) meals generally consist of a larger quantity of food; (2) meals consist of a diversified selection of foods, which would not be susceptible to consumption without some article of tableware; and (3) they could not be conveniently consumed while one is standing or walking about. Furthermore, appellants argue that their hot meat-filled products are bakery goods. Appellants argue that neither California Code of Regulation, title 18, section (Regulation) 1603, nor its corresponding statutory authority, R&TC section 6359, makes any distinction between hot bakery goods containing meat and non-meat products. Appellants assert that they are selling only bakery goods and argue that Regulation section 1603 carves out a specific exemption for hot bakery goods.

Appellants refer to CDTFA's Publication 22, which states, "…Examples of hot prepared food products include hot sandwiches…" and provides an exception: "[s]ales of hot bakery goods are not taxable when sold to go, unless they are sold as part of a combination package." According to appellants, none of the examples of hot prepared food products cited by Publication 22 "remotely" resembles a bakery good. Appellants state that the publication does not draw a distinction between a bakery good and a meat-filled baked good. Appellants argue, "Had the [CDTFA] intended for taxpayers to treat meat-filled hot bakery goods as taxable, they should have said so by adding, 'or they contain meat' to the language of Publication 22; however, they did not."

Appellants also cite CDTFA's Audit Manual section 811.30, which states, in part, that sales of hot beverages "to go" are not taxable if sold for a separate price, and continues, "Similarly, bakery items such as bread, croissants, pastries, muffins, cookies, bagels, and the like are also not taxable if sold on a 'to-go' basis."

Finally, appellants dispute CDTFA's comparison between appellants' products and meat pies (Cornish pasties), which are the subject of Sales and Use Tax annotation 550.1775 (11/14/95). That annotation states that a Cornish pasty is not a "bakery good" within the meaning of R&TC section 6359(e) because a Cornish pasty is an entire meal that when served

above room temperature is a "hot prepared food." Appellants argue that the meat-filled foods they sell are not an entire meal. According to appellants, each meat-filled food product they sell contains between 1.0 and 2.0 ounces of meat and is otherwise indistinguishable from the non-meat-filled goods.

CDTFA responds that a pastry (e.g., croissants) or bread product filled with meat or meat and vegetables is similar to a hot sandwich, and it cites Sales and Use Tax annotation 550.1712 (11/14/95), which states:

> A fruit or cream filled croissant is a "bakery good" within the meaning of Revenue and Taxation Code section 6359(e). However, a croissant filled with meat and cheese is not a "bakery good" within the meaning of Revenue and Taxation Code section 6359(e). It is more in the nature of a sandwich than a bakery good. Therefore sales of such items in a heated condition not in combination with any other item are taxable sales of hot prepared food products under Regulation 1603(e)(1).

Relying on that annotation, CDTFA argues that appellants' empanadas, siopao, and pandesal (i.e., pastries or bread products filled with meat and vegetables) that were sold in a heated condition are more in the nature of a hot sandwich than a bakery good. CDTFA argues that it has consistently held that sales of meat-filled pastries or meat-filled bread products served warm are not exempt sales of hot bakery goods, but rather they are taxable sales of hot prepared food products pursuant to R&TC 6359(d)(7) and (e), and Regulation section 1603(e)(1).

First, we note that, as confirmed at hearing and in the January 13, 2022 Minutes and Orders of Prehearing Conference, it is undisputed that appellants were not subject to the 80/80 rule.[6] It is also undisputed that there was no seating for customers at appellants' locations.

Regarding the three-part test that appellants propose, we decline to follow it because there was a change in the law that is directly on point. *Treasure Island* was decided in 1941. Thereafter, the Sales and Use Tax Law became effective on July 1, 1943. Thus, the Sales and Use Tax Law is the controlling statutory authority regarding the taxability of sales of hot prepared food and exempt bakery goods. Also noteworthy, "bakery goods" and "hot prepared food products" were added to R&TC section 6359 in 1971, approximately 30 years after

[6] When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359(d)(6).) 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 to-go 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).)

Treasure Island. The definition of hot prepared food products includes products, items, or components which have been prepared for sale in a heated condition. (Cal. Code Regs., tit. 18, § 1603(e)(1).) Thus, whether a food product is a meal is not dispositive of whether that food product is also a hot prepared food product. (*Ibid*.)

Annotations do not have the force or effect of law. (*Appeal of Praxair, Inc.*, 2019-OTA-301P.) However, "[a]nnotations have substantial precedential effect within [CDTFA]" and the "interpretation represented in [the] annotation is certainly entitled to some consideration by [OTA]." (*Appeal of Martinez Steel Corporation*, 2020-OTA-074P*,* citing *Yamaha Corp. v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 15 (*Yamaha*).) OTA must "independently judge the text of the statute, taking into account and respecting the agency's interpretation of its meaning … whether embodied in a formal rule or less formal representation." (*Yamaha*, at p. 7.) Annotations are "entitled to 'great weight' when, as here, [CDTFA] is construing a statute it is charged with administering and that statutory interpretation is long-standing." (*Appeal of Praxair, Inc.*, *supra*, citing *Yamaha* at p. 25.)

Here, CDTFA's annotation 550.1712 has remained unchanged since it was written. Also, we are not aware of another annotation that supersedes or conflicts with annotation 550.1712. Accordingly, we find that annotation 550.1712 clearly expresses CDTFA's long-standing position regarding hot prepared food products, such as a meat-filled croissants. As such, annotation 550.1712 is persuasive and entitled to great weight when interpreting whether a product is a hot prepared food product. The annotation describes a meat and cheese-filled croissant as a hot prepared food product, when sold in a heated condition, and concludes that sales of that item are subject to tax because the item is more in the nature of a sandwich. We note that appellants sell, amongst other meat-filled items, empanadas. While the empanada dough may be distinct from that of a croissant, empanadas and croissants are typically of the same approximate size and shape. Similarly, we find that the other meat-filled foods (e.g., pandesal, siopao) sold by appellants are similar to hot meat-filled croissants since they consist of hot baked dough filled with a small (i.e., 1-2 ounces) portion of meat. Therefore, it would be consistent with CDTFA's long-standing interpretation to also conclude that appellants' hot meat-filled products are hot prepared food products subject to tax. We also note that despite annotation 550.1712, appellants did not solicit clarification (e.g., written advice) regarding any doubts they may have had regarding sales of their food products. (R&TC, § 6596.) To the

extent that there is any remaining doubt as to whether appellants hot meat-filled foods are not exempt, we refer to *Associated Beverage Co. v. State Bd. of Equalization*, *supra*, which requires us to find against the right to an exemption.

Accordingly, we find that appellants have failed to meet their burden to prove that sales of their hot meat-filled products are exempt from tax within the meaning of R&TC section 6359 and Regulation section 1603. Therefore, we find that appellants' sales of hot meat-filled foods are sales of hot prepared food products subject to tax and that CDTFA has determined the amount of those sales using the best available information.

Whether appellants have shown that they are entitled to relief from tax.

In the event that OTA finds that appellant made taxable sales of hot prepared foods, appellants argue that they should be relieved from tax (regardless of whether that tax is due) because their failure to report tax was the result of their reliance on certain information disseminated by CDTFA. Appellants refer to Regulation section 1603; CDTFA's Publication 22;[7] CDTFA's Audit Manual section 811.30; and Sales and Use Tax annotation 550.1775. Regarding relief, appellants acknowledge that R&TC section 6596 is inapplicable to these appeals. (See *Appeal of Salam and Perveen*, 2019-OTA-092P; *Appeal of Dandridge*, 2019-OTA-458P.) Appellants have not identified any other legal authority that would allow us to grant relief of tax on this basis.

Since we have dispositively found that appellant made taxable sales of hot prepared foods, we examine appellants' reliance argument. We are not aware of any legal authority allowing relief based on the alleged reliance that appellants describe. Moreover, the law is clear. The authoritative sources of law are the statutes, regulations, and judicial decisions, not CDTFA's Publications or its Audit Manual. (See *Appeal of Dandridge*, *supra*.) And, no "interpretation by taxpayers of the language used in government pamphlets [can] act as an estoppel against the government, nor change the meaning of taxing statutes." (*Appeal of Dandridge*, citing *Adler v. Commissioner* (1964) 330 F.2d 91, 93.)

OTA is not a court. (Gov. Code, § 15672.) OTA is an administrative agency. Thus, we are precluded by the Constitution of the State of California from declaring a statute

[7] For informational purposes, CDTFA's Publications typically include a caveat that indicates that to the extent that a conflict between the publication and the law exists, the decision will be based on the law and not on the publication.

unenforceable or refusing to enforce the clear and unambiguous provisions of a statute, unless an appellate court has determined that the statute is unconstitutional. (Cal. Const., Art. III, § 3.5.) Also, OTA does not have jurisdiction to invalidate statutes or regulations. (See Cal. Code Regs., tit. 18, § 30104; *Appeal of Talavera*, *supra*.) Accordingly, we find appellants are not entitled to relief from tax based on their theory of reliance.

Issue 2: Whether CDTFA timely issued the NODs.

Generally, there is a three-year statute of limitations for CDTFA to issue an NOD. (R&TC, § 6487(a)(b).) When, however, a taxpayer fails to file a return, the statute of limitations is eight years. (*Ibid*.) The eight-year statute of limitations begins to run on the last day of the calendar month following the filing period, quarterly or annually, for which the amount is proposed to be determined. (*Ibid*.)

Here, appellants operated for several years before they obtained seller's permits. Since appellants had not filed SUTRs during those years, CDTFA concluded that the deadline for issuing NODs to appellants was eight years from the last day of the calendar month following the period for which the tax was being determined.

Appellants argue that the eight-year statute of limitations places an undue burden on them. Appellants argue that they did not obtain seller's permits because they believed that all their sales were exempt. They assert that it is unfair and burdensome to treat them differently from a bakery who did hold a permit.

R&TC section 6487 is clear. When a taxpayer was obligated to file a SUTR but did not do so, the statute of limitations is eight years. There is no legal authority to use a three-year period when a taxpayer argues that its failure to obtain a seller's permit and failure to file returns were due to a misunderstanding of the application of tax. Moreover, OTA does not generally have equity powers. Likewise, as discussed above, OTA does not have jurisdiction to invalidate or fail to enforce California statutes. (Cal. Code Regs., tit. 18, § 30104.) Therefore, we do not address appellants' argument that the three-year statute of limitations should be used in the interest of "fairness and uniformity." We find there is no legal basis to adjust the NODs by applying the three-year statute of limitations.

HOLDINGS

1. Appellants have not established that their sales of hot meat-filled foods are exempt from tax.
2. The NODs were timely issued.

DISPOSITION

Sustain CDTFA's decision to delete the failure-to-file penalties, reduce the tax to $92,959 for V Tropical, reduce the tax to $36,971 for Valerio's, and to otherwise deny the petitions for redetermination.

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Susana Seyller
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Josh Aldrich
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Date Issued: 4/28/2022