DocuSign Envelope ID: 8FF77DF2-87C7-4788-8235-925C25426438

2022 – OTA – 263
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	
BUDDY BRASS LP	)	OTA Case No. 18073395
dba Smoke City Market	)	CDTFA Case ID: 978550

OPINION

Representing the Parties:

For Appellant: M. Gans, Representative[1]

For Respondent: Randy Suazo, Hearing Representative
Jason Parker, Chief of Headquarters Ops.
Christopher Brooks, Tax Counsel IV

For Office of Tax Appeals: Corin Saxton, Tax Counsel IV

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Buddy Brass LP dba Smoke City Market (appellant) appeals a decision by respondent California Department of Tax and Fee Administration (CDTFA)[2] denying appellant's petition of a Notice of Determination (NOD) dated July 26, 2016. The NOD is for $145,301.86 in tax, plus applicable interest, and a $14,530.20 negligence penalty, for the period July 1, 2012, through December 31, 2015 (liability period).

Appellant waived the right to an oral hearing. Therefore, the matter is being decided based on the written record.

[1] M. Gans identified himself to CDTFA as the managing member of appellant. CDTFA's Decision identified Mr. Gans as a partner in appellant. It is undisputed that Mr. Gans is authorized to represent appellant.

[2] Sales and use taxes were formerly administered by the State 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 the board.

ISSUES

1. Whether appellant established a basis for adjustment to the liability as determined by CDTFA.
2. Whether appellant established that the negligence penalty is inapplicable.

FACTUAL FINDINGS

1. Appellant is a limited partnership. M. Gans represented to CDTFA that he was a managing member and partner of appellant during the liability period.[3] According to federal income tax records provided by appellant, during 2015 appellant had five limited partners: L. Fricchione, J. Cestaro, MG Liquid Management Corporation (MGLM), 2012 Altshuler Irrevocable Trust, and the partnership of R & E Gromfin.[4]
2. During the liability period, appellant operated an American-style restaurant in Sherman Oaks, California, selling barbeque meat, salads, sandwiches, and alcoholic beverages. Appellant held a liquor license issued by the California Department of Alcoholic Beverage Control.
3. On August 12, 2015, CDTFA notified appellant that its account was selected for an audit. This was appellant's first audit. CDTFA subsequently sent two auditors for an in-person appointment at appellant's business location. Appellant used the Auphan Point of Sale (POS) system at its restaurant. Appellant's POS data was maintained electronically by a third party. The third party stored the data on a cloud server. During the appointment, Mr. Gans informed CDTFA that he did not have the login code or password required to access appellant's POS data because it was maintained by the Auphan POS system, and appellant would provide the POS data to CDTFA later.
4. On September 9, 2015, appellant informed CDTFA that there may be delays in turning over records to CDTFA because Mr. Gans was in a lawsuit with the other partners.

---

[3] Mr. Gans signed a form BOE-82, authorizing electronic transmission of data with CDTFA, as appellant's "managing member." The account update information from the audit also identified Mr. Gans as a partner.

[4] There are some inconsistencies. For example, appellant reported to the IRS that all five of these partners were limited partners, and appellant did not report the identity of its general partner(s). Also, the fifth partner was identified both as "R. Gromfin," an individual, and as a partnership of R. and E. Gromfin, during 2015. The federal tax records also indicate that Mr. Gans represents MGLM, and MGLM was responsible for tax matters. According to records maintained by CDTFA, Mr. Gans was appellant's managing member, and appellant's partners were Mr. Gans, MGLM, and D. Altshuler. OTA makes no findings on any of these inconsistencies because they are not relevant to the holding or disposition of this Opinion.

5. On September 29, 2015, appellant's attorney, Joseph Broyles, contacted CDTFA to state that he had reviewed appellant's POS data and the data was not reliable because it did not reconcile with appellant's income tax returns, QuickBooks data, or bank statements. Mr. Broyles thereafter provided appellant's POS data to CDTFA.
6. According to appellant's sales and use tax returns, appellant reported taxable sales of $939,214 for the period July 1, 2012, through June 30, 2015. Appellant's Auphan POS system recorded $2,442,947 in taxable sales for the same period.[5] Appellant used the Auphan POS system to ring up sales transactions on a daily basis. Appellant was unable to explain the $1,503,733 discrepancy between its reported taxable sales and the taxable sales recorded by the Auphan POS system.
7. CDTFA performed a one-day observation test to verify the accuracy of the POS data. During the test, CDTFA observed a credit card sales ratio of 70.89 percent, which was consistent with the 72.41 percent ratio recorded in appellant's records. CDTFA accepted appellant's recorded taxable sales, and determined that appellant failed to report $1,503,733 in recorded taxable sales ($2,442,947 - $939,214) during the period July 1, 2012, through June 30, 2015.
8. Appellant thereafter did not respond to requests for complete POS data for the period July 1, 2015, through December 31, 2015 (the remainder of the liability period). Appellant reported taxable sales of $291,704 for this period, and terminated its business effective December 31, 2015. CDTFA extended the audit through closeout of the business, and determined audited taxable sales of $407,158 for the final two quarters. CDTFA estimated the underreporting for the quarters by averaging appellant's recorded taxable sales for the prior 12 quarters and comparing it to reported taxable sales for each of the final two quarters. Based on the difference, CDTFA determined that appellant failed to report an additional $115,454 in taxable sales.
9. For the liability period, CDTFA calculated underreported taxable sales of $1,619,187 ($1,503,733 + $115,454.)

[5] For every transaction, appellant's POS system recorded the following information: (1) an invoice number; (2) date and time of the transaction; (3) invoice subtotal (without sales tax); (4) sales tax collected from the customer; (5) invoice total (with sales tax); and (6) and payment type (cash or credit card).

10. On March 14, 2016, Mr. Gans informed CDTFA that appellant terminated its business operations effective December 31, 2015, and that it should contact appellant's attorney to discuss the audit.
11. On March 28, 2016, appellant's attorney stated that appellant did not agree with the audit findings, but that CDTFA should proceed with issuing the NOD.
12. On July 26, 2016, CDTFA issued an NOD for the liability disclosed by audit, which appellant petitioned. In a decision dated May 23, 2018, CDTFA denied the petition. This timely appeal followed.
13. On appeal, appellant contends that the POS data contains errors, and that appellant's employees recorded tips as taxable sales. In addition, appellant contends that he was audited for 2015 by the IRS, and the IRS information proves CDTFA's audit was overstated. In support, appellant provided IRS audit documents. For 2015, appellant reported $704,965 in gross receipts for income tax purposes to the IRS. Upon audit, the IRS determined for that year appellant had $885,854 in gross receipts for income tax purposes.[6] The explanation provided in the IRS audit file states the auditor reviewed deposited items and "after an examination . . . it was determined that the amount of $885,854 more accurately reflects the income that was earned during the tax year."

DISCUSSION

Issue 1: Whether appellant established a basis for adjustment to the liability as determined by CDTFA.

California imposes 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, §§ 6012, 6051.) Sales of food served in a restaurant, including sales of hot prepared food to go, are subject to tax. (R&TC, § 6359(d)(1), (d)(2), (d)(7).) 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

[6] For 2015, appellant reported $451,255 in gross receipts for sales tax purposes to CDTFA. Upon audit, CDTFA had calculated $862,863 as appellant's gross receipts for sales tax purposes, which is less than the amount determined by the IRS.

DocuSign Envelope ID: 8FF77DF2-87C7-4788-8235-925C25426438

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 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 which 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, CDTFA's initial burden is met because CDTFA established a $1,503,733 discrepancy between appellant's reported and recorded taxable sales for the period in which it provided data to CDTFA: July 1, 2012, through June 30, 2015. Additionally, appellant failed to maintain documentation to support reported taxable sales for the remaining portion of the liability period: July 1, 2015, through December 31, 2015. Appellant admits that its recorded and reported sales do not reconcile. It is unclear how appellant determined reported taxable sales because appellant failed to provide documentation to support reported taxable sales. Appellant's own POS data evidences a substantial underreporting. As such, we find that it was reasonable and rational for CDTFA to reject appellant's reported taxable sales, and to instead accept appellant's recorded taxable sales (i.e., the Auphan POS data), and to estimate sales for the final two quarters for which no data is available, based on the Auphan POS data for the first 12 quarters.

Appellant has the burden of establishing error with CDTFA's determination. On appeal, appellant raises several contentions. First, appellant contends that the POS data overstated taxable sales because it recorded tips as taxable sales. As a preliminary matter, the application of tax to tips depends on whether the tip was mandatory or optional. (See Cal. Code. Regs., tit. 18, § 1603(g), (h).) Here, the POS data used in the audit to determine recorded taxable sales was the Invoice Subtotal. The POS data recorded sales tax based on the Invoice Subtotal. The amount paid by the customer was the Invoice Total. Appellant provided no evidence to demonstrate that the Invoice Subtotal included any tips and, if so, whether any included amounts were optional (nontaxable) or mandatory (taxable) tips. In addition, appellant provided no evidence to

establish that it did not collect any mandatory tips, for example, with large parties. As such, there is no evidence from which we could conclude that tips included in the POS data, if any, were recorded incorrectly by the POS data. Here, the POS data recorded 88,439 transactions. Appellant bears the burden to establish error, and appellant failed to identify a single transaction that was recorded incorrectly. Furthermore, CDTFA performed a full day observation test (nine and a half hours) during the liability period and found no evidence to indicate the POS data was unreliable. To the contrary, CDTFA's auditor wrote the following note in the audit file: "All sales transactions were entered to the POS system, no errors were noted during the observation test." In the audit verification comments, the CDTFA's auditor further noted that no irregular transactions were noted, and all sales were captured in the POS data. As such, we find that appellant failed to establish error with its recorded taxable sales data.

Next, appellant contends that the findings of the IRS audit establish that CDTFA overstated its liability. Here, it appears appellant's basis for this argument is that the IRS only increased appellant's taxable income by $180,889, as opposed to the understated measure of $1,503,733 determined by CDTFA. There are several errors with this logic. First, the IRS audit was for a one-year period, whereas CDTFA's audit was for a three-and-a-half-year period. CDTFA determined an understatement of $115,454 for 2015, which is less than the understatement determined by the IRS for 2015. Second, the IRS determined audited gross receipts of $885,854, which exceeds the $862,862 in gross receipts for sales tax purposes determined by CDTFA. The audit findings of the IRS and CDTFA indicate, if anything, that CDTFA underestimated the liability.[7] In summary, we find that appellant failed to establish that the NOD is overstated.

<u>Issue 2: Whether appellant established that the negligence penalty is inapplicable</u>.

If all or any part of a deficiency for which a NOD is issued was due to negligence or intentional disregard of the law, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) There is no provision in the law which would authorize relief or waiver of a properly imposed negligence penalty. (*Ibid*.) Failure to maintain and keep complete and accurate records will be considered

[7] We note that "gross receipts" or "gross income" for federal income tax purposes is not necessarily the same as it is for sales and use tax purposes, so there may be a reasonable explanation for the difference. (See R&TC, §§ 6012 [sales tax], 17071 [income tax].)

evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).) Generally, a negligence penalty should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the law. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Here, we do not see how, absent negligence or intentional disregard of the law and appellant's own records, appellant could fail to report such a significant amount of sales, considering that substantially all of the unreported taxable sales were recorded in appellant's own books and records.[8] The underreporting errors occurred over fourteen reporting periods and appellant did not provide sales journals, a general ledger, or source documents to support reported taxable sales. To the contrary, appellant is not even able to establish how it arrived at the reported taxable sales it reported on its returns, and the reported amounts conflict with appellant's own POS data. The failure to maintain complete and accurate records is additional evidence of negligence. Furthermore, although this was appellant's first audit, the discrepancies between total sales reported on appellant's sales and use tax returns and the gross receipts reported on appellant's federal income tax returns, as well as the discrepancies between reported taxable sales and taxable sales recorded on appellant's POS data, are sufficient to establish, at a minimum, negligence or intentional disregard of the law.[9] We find the POS data reliable because it was verified during an observation test, and it was maintained by a third party service provider. Appellant was aware that it recorded its taxable sales on its POS system, and it knew the amount of gross receipts that it reported on its federal income tax returns. As such, appellant had knowledge that the total and taxable sales reported on its sales and use tax returns were grossly understated. Therefore, the negligence penalty is warranted.

[8] Unreported taxable sales of $1,619,187 constitute an error ratio of 131.54 percent when compared to reported taxable sales of $1,230,918 ($1,619,187 ÷ $1,230,918).

[9] The Sales and Use Tax Law imposes a 40 percent penalty for knowingly collecting and failing to remit sales tax reimbursement, and a 25 percent penalty for fraud or intent to evade the tax. (R&TC, §§ 6485, 6597.)

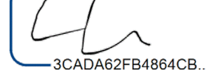
DocuSign Envelope ID: 8FF77DF2-87C7-4788-8235-925C25426438

HOLDINGS

1. Appellant failed to establish a basis for adjustment to the liability as determined by CDTFA.
2. Appellant failed to establish that the negligence penalty is inapplicable.

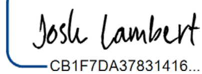
DISPOSITION

CDTFA's action is sustained.

DocuSigned by:

3CADA62FB4864CB...

Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:

CB1F7DA37831416...

Josh Lambert
Administrative Law Judge

DocuSigned by:

47F45ABE89E34D0...

Suzanne B. Brown
Administrative Law Judge

Date Issued: 6/9/2022