

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

In the Matter of the Consolidated Appeals of:            ) OTA Case Nos. 19105329, 19105328  
   ) CDTFA Case IDs 056-049, 235-019  
**L. ROMAN, dba Sugars 1, AND**                                 )  
**SUGARS I, INC., dba Sugars 1 Inc.**<sup>1</sup>                         )  
   )

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**OPINION**

Representing the Parties:

For Appellants:   Faustino Rocha Reyes, Representative

For Respondent:   Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals:   Casey K. Green, Tax Counsel III

**M. GEARY**, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, L. Roman dba Sugars 1 (Roman), and Sugars I, Inc. dba Sugars 1 Inc. (collectively, “appellants”) appeal decisions issued by California Department of Tax and Fee Administration (respondent)<sup>2</sup> denying Roman’s petition for redetermination of a Notice of Determination (NOD) dated July 7, 2016, and Sugars I, Inc.’s petition for redetermination of an NOD dated July 7, 2016. The NOD issued to Roman was for tax of \$9,569.14, plus accrued interest, for the period July 1, 2013, through December 31, 2014 (liability period 1). The NOD issued to Sugars I, Inc. was for tax of \$8,973.06, plus accrued interest, and a failure-to-file penalty of \$77.84 for the period January 1, 2015, through January 22, 2016 (liability period 2).<sup>3</sup> The Office of Tax Appeals (OTA) consolidated these appeals, without objection from either

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<sup>1</sup> The record contains no evidence that Sugars I, Inc. did business under the fictitious name Sugars 1, Inc. It seems likely that the corporation continued to do business at Sugars 1. Nevertheless, this caption uses the information shown on the Notices of Determination issued by respondent.

<sup>2</sup> Prior to July 1, 2017, sales and use taxes (and other business taxes and fees) were administered by respondent’s predecessor, the State Board of Equalization (BOE). When this Opinion refers to events that occurred before July 1, 2017, “respondent” refers to BOE.

<sup>3</sup> Because nothing in the written record suggests that Sugars I, Inc. disputes the penalty, it will not be addressed further.

party, because they involve the same business, though under different ownership, consecutive liability periods, and substantially similar issues and facts.

These matters are being decided on the basis of the written record because appellants waived the right to an oral hearing.<sup>4</sup>

### ISSUE

Is either appellant entitled to a reduction of the measure of unreported taxable sales?

### FACTUAL FINDINGS

1. For an unknown period of time prior to March 7, 2013, Roman and her then-husband owned a cash-only bar in a strip mall in Anaheim. The bar, which had seating capacity for 31 customers and was open daily, served only bottled and canned beer. It did not serve food.
2. Pursuant to a property settlement agreement and judgment of dissolution issued to Roman and her ex-husband on March 7, 2013, Roman and her ex-husband were each awarded a one-half interest in the bar. The judgment stated that the ex-husband would continue to operate the business until it sold and escrow closed, and that the ex-husband would “continue to financially support” Roman, including paying Roman \$300 weekly, until Roman received her share of the proceeds from the sale of the business. In addition, the judgment stated that Roman would be allowed to continue to occupy the family home with the two minor children and that the ex-husband would pay the mortgage, insurance, property tax, maintenance, and repair expenses for that home.
3. Respondent first issued a seller’s permit for the bar to Roman only as a sole proprietor, effective July 1, 2013. Roman incorporated the business on December 31, 2014; and on January 1, 2015, Sugars I, Inc. took ownership of the business. Respondent closed Roman’s sole proprietorship account and opened a new account for Sugars I, Inc. with Roman as the sole officer.
4. There is no evidence in the written record concerning a sale of the business from the date

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<sup>4</sup> This matter had been scheduled for a prehearing conference on May 12, 2022, and for an oral hearing on June 14, 2022. Appellants failed to appear for the prehearing conference and failed to return the Response to Notice of Oral Hearing, the latter failure being a waiver of the right to an oral hearing. (Cal. Code Regs., tit. 18, § 30404(a).)

of the above-referenced judgement of dissolution until the end of the liability periods at issue here.

5. Roman's brother (her representative in this appeal), Mr. Faustino Rocha Reyes, managed the bar during at least some of the time that respondent was investigating and conducting the audit. The bar also employed a full-time bartender, two full-time servers, and a part-time DJ, who worked three nights a week, four hours per night.
6. Appellants used a single cash register to record all sales and used the Z-tapes from the register to prepare monthly sales summaries. Appellants used those summaries to prepare quarterly sales and use tax returns (SUTRs).<sup>5</sup>
7. For liability period 1, Roman reported \$101,039 in total sales and claimed a deduction of \$7,483 for sales tax included in reported total sales, resulting in reported taxable sales of \$93,556.
8. For liability period 2, Sugars I, Inc. reported \$86,529 in total sales and claimed a deduction of \$6,410 for sales tax included, resulting in reported taxable sales of \$80,119.
9. For audit, Roman initially provided only federal income tax returns (FITRs) for 2013 and 2014. These records were not adequate for sales and use tax purposes.
10. Respondent visited the bar during operating hours, observed a bartender and two servers working, and saw some indication that the bar was open daily from 6:00 p.m. to 2:00 a.m. A sign was posted to inform customers that sales tax was included in the price of beverages.
11. Sugars I, Inc. sold the business on or about January 22, 2016. Respondent closed out the corporation's seller's permit effective that date.<sup>6</sup>
12. Respondent was able to determine that for 2013 and 2014, total sales reported on SUTRs were similar to gross receipts reported on FITRs and that book markups calculated from reported cost of goods sold (COGS) averaged a little less than 378 percent for the two years combined, which was in line with what respondent expected. However, without

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<sup>5</sup> Z-tapes are printed point-of-sale terminal (register) summaries of sales activity. Depending on the equipment and software, they can include breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable.

<sup>6</sup> The written record suggests that respondent may have demanded that at least a portion of the purchase price be retained in escrow to protect respondent's interests, but those matters are beyond the scope of the issues in this appeal.

- adequate business records, respondent could not verify any of the reported amounts.
13. With so few business records available, respondent decided to estimate taxable sales for both liability periods using a break-even approach. This approach essentially estimates that the business income was at least sufficient to cover the basic business expenses and the personal expenses of the persons who relied upon the business income for support.
  14. On the basis of information contained in Roman's FITRs (i.e., that she was single, without dependents, and without other sources of income), respondent relied on statistical data contained in the Consumer Expenditure Survey for 2014, which was available from the United States Bureau of Labor Statistics, to estimate Roman's 2014 personal expenses at \$37,884.
  15. Respondent looked to Roman's 2014 FITR to estimate business expenses, which consisted of COGS of \$13,278 and other business expenses of \$51,468, including employee wages of \$16,092. However, respondent concluded that Roman's reported 2014 employee wages of \$16,902 were understated. Using California's minimum wage for three full-time employees, respondent estimated wages paid to the bartender and servers at \$24,960 for the period January 1, 2014, through June 30, 2014, and at \$28,080 for the period of July 1, 2014, through December 31, 2014, for a 2014 total of \$53,040.<sup>7</sup> Respondent thus estimated Roman's 2014 business expenses at \$101,694.<sup>8</sup>
  16. Respondent added audited estimated business expenses of \$101,694 to estimated personal expenses of \$37,884 to calculate Roman's break-even amount of \$139,578 for 2014. It then subtracted reported taxable sales for 2014 of \$61,258 from \$139,578 to estimate unreported taxable sales of \$78,320. Respondent used the \$78,320 amount to compute an error ratio of 127.85 percent ( $\$78,320 \div \$61,258 = 1.2785$ ). Finally, respondent multiplied Roman's reported taxable sales of \$93,556 by the error ratio to calculate total unreported taxable sales of \$119,614 for liability period 1.
  17. To calculate the corporation's unreported taxable sales for liability period 2, respondent

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<sup>7</sup> The difference is due to the increase in the minimum wage from \$8 per hour to \$9 per hour. We note that this estimate does not include wages paid to the DJ, who worked 624 hours per year, or Mr. Reyes, who must have received compensation for managing the bar.

<sup>8</sup> Wages for only three of the five employees of \$53,040 + COGS of \$13,278 + adjusted reported other business expenses of \$35,376 ( $\$51,468 - \$16,092$ ).

multiplied its reported taxable sales of \$80,119 by the same error ratio to estimate unreported taxable sales of \$102,434 for 2015. Because the corporation did not file an SUTR for the 22 days in January that it owned the business, respondent used the \$40,231.00 estimate of taxable sales for the fourth quarter of 2015 to compute average daily taxable sales of \$442.10 ( $\$40,231.00 \div 91 \text{ days} = \$442.10$ ) and estimated taxable sales of \$9,729.00 for the period January 1, 2016, through January 22, 2016. Respondent thus estimated \$112,163 in unreported taxable sales for liability period 2.

18. Appellants eventually provided additional business records, including bank statements, purchase invoices, and what Mr. Reyes represented to be cash register tapes.<sup>9</sup> Respondent found these records to be unreliable and declined to make any adjustments.
19. On July 7, 2016, respondent issued the aforementioned NODs to appellants.
20. Appellants filed petitions for redetermination to begin respondent's internal appeals process. The parties participated in an appeals conference, and on August 27, 2019, respondent issued Decisions denying both petitions. These timely appeals followed.
21. On appeal, appellants provided evidence indicating that at the times in question: Roman had two minor children, including a child with special needs, and may have received income from sources other than the business during both audit periods; and Roman's ex-husband had a 50-percent ownership interest in the business. OTA granted respondent's request to evaluate and respond to this evidence; however, respondent did not file a response or explain its failure to do so.

### DISCUSSION

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.)

If respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent may determine the amount required to be paid on the

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<sup>9</sup> These records are not in the written record.

basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer appeals a determination, respondent has a minimal, initial burden of showing that its determination was rational and reasonable. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met that burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera, supra.*)

Here, appellants provided only two FITRs (for tax year 2013 and 2014) for audit. Appellants did not provide the sales summaries from which they prepared their SUTRs. They did not provide the Z-tapes from which they prepared the sales summaries. They did not provide books of account or bills, receipts, invoices, or other documents of original entry that would normally be used to verify entries in the books of account. As a result, respondent was unable to compute reported taxable sales using any direct audit method and, in fact, respondent could not employ many of the usual indirect audit methods, most of which require some reliable evidence of purchases or sales. Under the circumstances, OTA finds that respondent's use of the break-even method to estimate taxable sales was a conservative and reasonable approach.

Looking next at how respondent used the break-even approach to estimate taxable sales, OTA finds that respondent reasonably relied on Roman's 2014 FITR to determine her marital status, dependents, and sources of income. There is nothing in the record to suggest that respondent had any reason to distrust the personal information Roman reported in her FITR, and the fact that appellants provided conflicting information during this appeal has no bearing on the reasonableness of respondent's earlier actions. OTA also finds that it was reasonable and rational for respondent to rely on the statistical data contained in the Consumer Expenditure

Survey for 2014, and OTA notes that appellants have not argued otherwise. Respondent correctly made the adjustment to the business's wage costs. Respondent's calculation of Roman's break-even point was also done correctly, based on the limited business records appellants provided for the audit, and it correctly calculated Roman's unreported taxable sales for 2014. Respondent's calculation and later use of the 127.85 percent error ratio to calculate unreported taxable sales for both liability periods was both reasonable and rational. It thus becomes appellants' burden to prove a more accurate measure of tax. (See *Appeal of Bachor (Rehearing)*, 2020-OTA-172P.)

Appellants argue that they gave respondent a complete set of original records, including cash register Z-tapes, a purchase journal, and bank statements for the liability periods, and that respondent did not return the records. They contend that the loss of the records, which appellants have been unable to obtain elsewhere, has significantly impaired their ability to carry their evidentiary burden. Appellants argue that they paid the taxes they owed and that respondent's estimate is wrong. They contend respondent overestimated business expenses because appellants did not pay three full-time employees, arguing that all servers helped around the bar for drinks and tips only. Appellants also argue that respondent erred regarding Roman's dependents, living expenses, and other sources of income, and that, in fact, she had two young children, one being a 10-year-old child with cerebral palsy and received income from multiple sources, including support from her ex-husband, social security benefits, and income from providing care for other children.

In support of these arguments, appellants provided copies of a March 7, 2013 Judgment of Dissolution with an attached property settlement and support agreement. These documents indicate that Roman's ex-husband, who was awarded a 50-percent interest in the bar, was to continue to operate the business until sale and close of escrow and that the ex-husband would continue to support Roman, paying her \$300 per week and all bills related to the residence that Roman would continue to occupy with the two minor children, then ages five and 10, until Roman received her share of the proceeds from the sale of the business. Appellants' evidence also includes documents showing that Roman's older daughter suffered from Cerebral Palsy with spasticity and quadriplegia, and that Roman received Supplemental Security Income of \$5,180.45 during 2013, \$7,983.24 during 2014, and \$8,058.24 during 2015, and \$400.00 per month for providing childcare services to Ms. N. Roman during 2014 and 2015.

The evidence does not show that appellants provided adequate records or that respondent failed to return records. The Assignment Activity Histories, which are in the written record, identify the records that appellants provided. Those are identified above. There is no evidence that respondent took exclusive possession of the records, and there is no indication in either of the decisions issued by respondent that appellants made this argument during respondent's internal appeal process. Also, if respondent had taken exclusive control of appellants' business records, it is likely that respondent would have issued a receipt for such records signed by the parties. (See Respondent's Audit Manual, § 0403.35.) The evidence does not show that respondent misplaced appellants' records.

Regarding appellants' arguments against respondent's break-even approach, the property settlement agreement indicates that Roman's ex-husband had been operating the bar and would continue to operate it until it was sold. The evidence indicates that Roman was not involved in the day-to-day operations at the bar because she was caring for her own children and at least one other child. Mr. Reyes told respondent that he operated the bar for Roman, but that is not consistent with the property settlement agreement. Neither party has explained these anomalies; but, regardless, it is undisputed that the seller's permit was in Roman's name for liability period 1 and in the name of Roman's corporation for liability period 2. As the permit holders, Roman and Sugars I, Inc. are liable for taxes, interest, and penalties incurred. (See Cal. Code Regs., tit. 18, § 1699(f)(2); *Appeal of Pasatiempo Investments, Ltd.*, 2020-OTA-069P.)

While it does appear that some of the underlying assumptions of the break-even approach were wrong, the evidence provided by appellants on these appeals does not prove that respondent's determination is wrong or establish a more accurate measure of tax. The evidence shows that the bar was also owned by Roman's ex-husband as of March 7, 2013, and the written record does not show that Roman and her children were the only persons who relied on the bar's income for support during the liability periods at issue. Further, there is no evidence regarding the ex-husband's other sources of income or the number of persons in his household. It thus appears that any revenue generated by the bar would have had to support not just Roman, but Roman and her ex-husband (and their respective households).

In addition, Roman's personal expenses were estimated on the assumption she had no dependents. In fact, appellant had two children, including a special needs child. Although appellant has not provided statistical data or other evidence to show how this different




circumstance would affect her financial needs, they would clearly be higher, and probably much higher. Both of these circumstances work significantly against appellants' argument. Although the evidence also indicates that in 2014, Roman received approximately \$665 in Social Security benefits and \$400 in childcare income monthly, and that she may also have been receiving free housing and \$300 per week from her ex-husband, this evidence is not sufficient to meet appellants' burden. Furthermore, it does not matter what other sources of income Roman had. Respondent calculated the break-even point at the lowest possible level: enough to keep the business going and support one person. Even if the calculation does not account for the personal expenses of Roman and her children, it cannot be assumed that Roman's ex-husband and his household no longer required support from the bar's revenue. Appellants have thus failed to prove by a preponderance of evidence that results differing from respondent's determinations are warranted.

#### HOLDINGS

Neither appellant is entitled to a reduction of the measure of unreported taxable sales.

#### DISPOSITION

Respondent's actions are sustained.

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Michael F. Geary  
Administrative Law Judge

We concur:

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Daniel K. Cho  
Administrative Law Judge

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Josh Aldrich  
Administrative Law Judge

Date Issued: 8/18/2022