OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 21108861
	) CDTFA Case ID 1-826-103
CHINA STAR EXPRESS, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

        For Appellant: Lim E. Ung, Enrolled Agent

        For Respondent: Jason Parker, Chief of Headquarters Operations

For Office of Tax Appeals: Richard Zellmer, Business Taxes Specialist III

        J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, China Star Express, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated November 22, 2019.[2] The NOD is for tax of $51,775 and applicable interest, for the period April 1, 2015, through March 31, 2018 (audit period).

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

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[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE; and when referring to acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

[2] The NOD was timely issued because on June 17, 2019, appellant signed the latest in a series of waivers of the otherwise applicable three-year statute of limitations, which allowed CDTFA until January 31, 2020, to issue an NOD for the period of April 1, 2015, through September 30, 2016. (R&TC, §§ 6487(a), 6488.)

ISSUE

Whether appellant has shown that any reduction to the amount of unreported taxable sales is warranted.

FACTUAL FINDINGS

1.   Appellant operated a restaurant specializing in Chinese-style cuisine.

2.   CDTFA audited appellant for the period April 1, 2015, through March 31, 2018.

3.   For the audit period, appellant reported on its sales and use tax returns total sales and taxable sales of $1,691,272, claiming no deductions.[3] Upon audit, appellant provided federal income tax returns (FITRs) for 2015, 2016, and 2017; bank statements for the audit period; and sales data for the test period January 2, 2019, through January 15, 2019. Appellant did not provide sales journals, sales invoices, guest checks, purchase journals, purchase invoices, or point of sale (POS) data for any periods within the audit period. CDTFA obtained appellant's Form 1099-K information from the Franchise Tax Board for the period April 1, 2015, through December 31, 2017, which reported credit card payments received by appellant.[4]

4.   CDTFA found that the book markups were considered low for this type of business.[5] CDTFA also found that reported total sales exceeded bank deposits from sales by $472,724 for the audit period, and that appellant only deposited $4,731 of cash from sales proceeds into the bank account for the three-year audit period. CDTFA concluded that appellant did not deposit all the cash proceeds from sales into the business bank account,

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[3] It is undisputed that all of appellant's sales are taxable.

[4] Form 1099-K is an IRS form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third-party network, during a given time period. Form 1099-K includes payments made by any electronic means, including but not limited to credit cards, debit cards, PayPal, and Square.

[5] "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 markup amount ÷ cost. In this example, the markup percentage is 42.86 percent ($0.30 ÷ 0.70 = 0.42857$). 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 profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent ($0.30 ÷ 1.00 = 0.30$).

and thus, bank deposits could not be used to compute sales. Therefore, CDTFA computed appellant's taxable sales using a credit-card-sales-ratio method.[6]

5.   As requested by CDTFA, appellant saved its sales data for the test period January 2, 2019, through January 15, 2019. CDTFA notified appellant that a CDTFA auditor would be making unannounced visits to appellant's business during the test period to verify that all sales were being accurately recorded. A CDTFA auditor visited the business on January 8, 2019, and found that all sales were being properly recorded. A CDTFA auditor visited the business on January 11, 2019, and January 14, 2019, and noticed that not all sales were being rung up on the POS system. CDTFA also observed that appellant kept the cash register drawer open and would accept cash for payment of meals without ringing the sale on the register. Also, on January 14, 2019, CDTFA auditors purchased two meals at appellant's restaurant, paying with cash, and CDTFA noted that one of those meals was not recorded in the sales data provided by appellant. Therefore, CDTFA concluded that the sales data provided by appellant for the period January 11, 2019, through January 15, 2019, was unreliable, and CDTFA decided to exclude the sales data for that period from the test.

6.   Using the sales data from the period January 2, 2019, through January 10, 2019, CDTFA computed the ratio of sales paid for with credit cards to total sales (the credit-card-sales-ratio) at 51.56 percent. Using the Form 1099-K information, CDTFA computed credit card sales of $982,062, which included a reduction for tips and sales tax reimbursement. CDTFA applied the credit-card-sales ratio to that amount and computed unreported taxable sales of $496,995 for the period April 1, 2015, through December 31, 2017.

7.   CDTFA did not have Form 1099-K information for the first quarter of 2018 (1Q18). Therefore, CDTFA compared audited taxable sales to reported taxable sales for 2017 and computed an error ratio of 36.25 percent. CDTFA multiplied reported taxable sales for 1Q18 by the error ratio to compute unreported taxable sales of $49,765 for that period. In total, CDTFA computed unreported taxable sales of $546,760 for the audit period ($496,995 + $49,765). Unreported taxable sales were reduced to $546,739 because

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[6] Generally, the credit-card-sales ratio method involves establishing the ratio of sales paid for by credit card to total sales (the credit-card-sales-ratio), and then dividing credit card deposits from sales by the credit-card-sales-ratio to compute sales.

CDTFA calculated error ratios for each year or partial year in the audit and applied those error ratios to each quarterly period within each respective year or partial year.

8. CDTFA issued an NOD to appellant on November 22, 2019, based on the audit, for tax of $51,775, and applicable interest, for the period April 1, 2015, through March 31, 2018.

9. Appellant filed a timely petition for redetermination of the NOD. After an appeals conference with appellant, CDTFA issued a Decision denying appellant's petition.

10. This timely appeal followed.

<div align="center">DISCUSSION</div>

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 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, 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*.)

During the audit, appellant did not provide for audit sales journals, sales invoices, guest checks, purchase journals, purchase invoices, or POS data. Appellant's books and records were incomplete and could not be used to determine appellant's sales. Credit card deposits are required to be deposited directly into a retailer's bank account by third parties, and therefore the credit card deposits provide a verifiable source of information. The credit-card-sales-ratio method is a standard and accepted audit procedure. (*Appeal of Amaya*, 2021-OTA-328P.) Therefore, CDTFA was justified in using the credit-card-sales-ratio method to compute appellant's sales. It was reasonable for CDTFA to use appellant's sales data for the period

January 2, 2019, through January 10, 2019, to compute the credit-card-sales-ratio, and for CDTFA to exclude sales data from the period January 11, 2019, through January 15, 2019, from its test because CDTFA found that appellant was not recording all its sales during that period. CDTFA has met its initial burden to show that its determination was reasonable and rational and the burden of proof shifts to appellant to show errors in the audit.

Appellant contends that the 51.56 percent credit-card-sales-ratio is understated. Appellant argues that the one-day test used to compute the 51.56 percent credit-card-sales-ratio is not representative because appellant is located near California State University (CSU), Long Beach, which was on winter break during the test period and, as such, is not representative. Appellant contends that the true credit-card-sales-ratio is in the range of 67.70 percent to 70.63 percent as shown in appellant's Square Dashboard reports. Appellant provided copies of those reports which show credit-card-sales-ratios of 69.69 percent for 2017, 70.09 percent for 2018, 67.70 percent for 2019, and 70.63 percent for 2020.

The test used to compute the 51.56 percent credit-card-sales-ratio was a 9-day test using records supplied by appellant (January 2, 2019, through January 10, 2019), not a one-day test as alleged by appellant. In addition, appellant has not shown that having CSU Long Beach be on winter break during the test period caused the credit-card-sales-ratio to be lower than normal. Appellant has not otherwise shown that the 9-day test used to compute the credit-card-sales-ratio is not representative of the audit period. Thus, appellant has not shown that the audit test used to compute the 51.56 percent credit-card-sales-ratio is not representative.

Moreover, on January 11, 2019, and January 14, 2019, CDTFA visited appellant's restaurant and found that appellant was not recording all of its sales in the POS system. CDTFA observed that appellant kept the cash register drawer open and would accept cash for payment of meals without ringing the sale on the register. On January 14, 2019, CDTFA employees purchased two meals at appellant's restaurant and found that appellant did not record one of those meals in its sales data. Therefore, appellant did not record all of its cash sales, which suggests that the credit card ratios in appellant's Square Dashboard reports are likely overstated. Consequently, the Square Dashboard reports provided by appellant cannot be accepted as accurate without reliable supporting documentation. The Square Dashboard reports are not supported by complete source documents, such as sales receipts and guest checks. Thus, there is no way to know if all appellant's cash sales are recorded in the Square Dashboard reports.

Accordingly, the Square Dashboard reports provided by appellant are insufficient to support a larger credit-card-sales-ratio.

Appellant has not provided documentation or other evidence from which a more accurate determination could be made and has failed to meet its burden of establishing that a reduction to the measure of unreported taxable sales is warranted.

HOLDING

Appellant has not shown that reductions to the measure of tax are warranted.

DISPOSITION

CDTFA's action in denying the petition is sustained.

DocuSigned by:

Josh Lambert

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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:

Teresa Stanley

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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:

Daniel Cho

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Daniel K. Cho
Administrative Law Judge

Date Issued: 8/18/2022