

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
S. ALAMARI,) OTA Case No. 21037459
dba La Estrella) CDTFA Case ID 154-049
_____)

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative
For Respondent: Jason Parker,
Chief of Headquarters Operations
For Office of Tax Appeals: Craig Okihara, Business Tax Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, S. N. Alamari (appellant) appeals from a Decision issued by the California Department of Tax and Fee Administration (respondent)¹ partially denying appellant’s petition for redetermination of the Notice of Determination (NOD) dated June 29, 2016. The NOD is for tax of \$159,772.29 and applicable interest for the period July 1, 2012, through June 30, 2015 (liability period). The NOD was based on an audit, which determined a deficiency measured by unreported taxable sales of \$1,955,068.²

This matter is being decided on the basis of the written record because appellant waived a hearing.

ISSUE

Are further adjustments to the amount of unreported taxable sales warranted?

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 respondent. (Gov. Code, § 15570.22.) When this Opinion refers to events that occurred before July 1, 2017, “respondent” refers to BOE.

² As explained below, respondent later the reduced determined measure of tax from \$1,955,068 to \$1,709,930, which will result in a reduction to the tax.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, dba La Estrella, sold hot and cold food, soda, and miscellaneous taxable and nontaxable grocery items in Kerman, California, under a seller's permit that was effective from February 19, 2010, through June 4, 2017.³
2. On his sales and use tax returns (SUTRs) for the liability period, appellant reported total sales of \$1,950,518 and claimed deductions of \$1,408,701 for nontaxable sales of food products resulting in reported taxable sales of \$541,817. Appellant stated that his outside bookkeeper calculated taxable sales using the markup method⁴ prior to January 1, 2015, and cash register z-tapes⁵ after that date.
3. For audit, appellant provided federal income tax returns (FITRs) for 2012 and 2013; profit and loss statements for the liability period; cash register z-tapes for May 2014, January 2015, and May 2015; detailed cash register tapes for various days in September 2014; and merchandise purchase invoices for May 2013. Appellant did not provide sales tax worksheets, sales journals, purchase journals, or source documentation, such as transaction-level cash register receipts, for the liability period. Respondent found the provided books and records inadequate for sales and use tax purposes.
4. Respondent compared total sales appellant reported on the SUTRs for 2013 to the gross receipts reported on the corresponding FITR noting a minor difference. Appellant asserted that the difference related to non-store services income. Due to materiality, respondent did not pursue further verification of the difference.
5. Using the appellant's profit and loss statements for the liability period, respondent compiled recorded taxable sales of soda (\$28,177⁶), hot food (\$214,335), and miscellaneous taxable merchandise (\$299,302) totaling \$541,815, nontaxable sales of \$1,408,703, and total sales of \$1,950,517. Respondent compared recorded total and

³ Appellant did not sell alcoholic beverages or cigarettes.

⁴ The markup method, which uses cost of goods sold and markup percentages to compute taxable sales, is a generally accepted method for calculating sales.

⁵ A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain time period (e.g., a day or a shift).

⁶ All amounts appear to have been rounded by respondent.

- taxable sales to total and taxable sales reported on the SUTRs noting no differences.
6. Again, using the profit and loss statements, respondent compiled recorded purchases of taxable merchandise totaling \$359,842 (consisting of soda purchases of \$24,502, purchases of food used in hot food sales totaling \$122,283, and purchases of miscellaneous taxable merchandise of \$213,057), nontaxable merchandise totaling \$1,030,785, and total merchandise purchases of \$1,390,628.
 7. Respondent compared recorded taxable sales to the corresponding recorded taxable merchandise purchases to compute a 49.7 percent book markup for the period July 1, 2012, through December 31, 2012, a 38.9 percent book markup for 2013, a 45.3 percent book markup for 2014, and a 111.7 percent book markup for January 1, 2015, through June 30, 2015.⁷ Respondent also compared recorded nontaxable sales to the corresponding recorded nontaxable merchandise purchases to compute a nontaxable book markup of 33 percent for July 1, 2012, through December 31, 2012, a 33 percent book markup for both 2013 and 2014, and a 53 percent book markup for January 1, 2015, through June 30, 2015. Finally, respondent compared recorded total sales to the corresponding recorded total merchandise purchases to compute overall (taxable and nontaxable) book markups of 39 percent for July 1, 2012, through December 31, 2012, 35 percent for 2013, 36 percent for 2014, and 63 percent for January 1, 2015, through June 30, 2015.
 8. Based on its experience in audits of comparable businesses, respondent considered the overall book markups reasonable. However, it found the taxable book markups for July 1, 2012, through December 31, 2014 to be unexpectedly low, and it noted that the taxable book markup for the period after January 1, 2015, which was when appellant started reporting based on the cash register z-tapes, was more than double the markup for the earlier period when appellant was purportedly reporting sales using a markup calculation. On the basis of the information, respondent concluded that the markup used for reporting did not reflect actual markups achieved and thus, taxable sales were

⁷ In the context of an audit, “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 $\text{markup amount} \div \text{cost}$. In this example, the markup percentage is 42.86 percent ($0.30 \div 0.70 = 0.42857$). A “book markup” (sometimes referred to as an “achieved markup”) is one that is calculated from the retailer’s records.

understated. Due to this concern about the book markups and to the incomplete records provided for audit, respondent decided to perform additional testing to verify reported taxable sales.

9. Appellant claimed that taxable sales, which included taxable merchandise and hot food sales, were made through department 4.⁸ The September 2014 detailed cash register tapes confirmed that sales tax reimbursement was charged on sales recorded in department 4. However, those tapes also showed that sales tax reimbursement – or, at least, an amount consistent with sales tax reimbursement, was also charged on department 5 sales. In addition, respondent found that the sales prices shown on the September 2014 detailed cash register tapes for department 5 matched the sales prices of hot food items found on appellant’s menu. Based on this information, and using the cash register z-tapes appellant provided for May 2014, January 2015, and May 2015, respondent compiled sales by department and determined that taxable sales were recorded in departments 4 and 5.
10. For the three-month test period for which appellant provided z-tapes, respondent compiled taxable sales of \$31,195 for department 4, \$142,494 for department 5, and \$173,689 (\$31,195 + \$142,494) for both departments combined. Using the profit and loss statements for the same months (May 2014, January 2015, and May 2015), respondent compiled recorded taxable sales of \$37,690. Because recorded taxable sales on a quarterly basis agreed with taxable sales reported on the SUTRs, respondent concluded that the recorded monthly amounts reflected the amounts that were reported on the SUTRs. Thus, respondent compared taxable sales of \$173,689 recorded in the cash register z-tapes for May 2014, January 2015, and May 2015, to recorded taxable sales of \$37,690 from the corresponding profit and loss statements and computed an error ratio⁹ of 360.84 percent ($(\$173,689 - \$37,690) \div \$37,690$). Respondent applied the error ratio to taxable sales of \$541,817 reported on the SUTRs for the liability period and computed unreported taxable sales of \$1,955,068.

⁸ The cashier would identify transactions by using numbered “department” keys on the point-of-sale terminal or cash register.

⁹ In this context, the “error ratio” is the ratio of unreported taxable sales to reported taxable sales.

11. On the basis of its audit findings described above, respondent issued the NOD to appellant.
12. Appellant filed a timely petition for redetermination of the NOD in its entirety.
13. Appellant argued during respondent’s internal appeals process that department 5 sales were nontaxable taxable grocery sales and that the additional charges that appear on the z-tapes in connection with those sales were fees charged for the extension of credit and not sales tax reimbursement. Appellant also argued then that the audited taxable measure is more accurately calculated by starting with total “grocery sales” of \$1,709,928 (12 quarters at average quarterly grocery sales of \$142,494) and adding recorded taxable sales totaling \$541,815 to calculate a total audited taxable measure of \$2,251,743. Appellant proposed that respondent then deduct reported taxable sales, which were nearly identical to recorded taxable sales, to calculate “revised unreported taxable sales of \$1,709,926, which was \$245,142 less than audited unreported taxable sales. Respondent agreed. The August 3, 2020 Decision recommended a reaudit to recalculate sales as agreed but otherwise denied the petition.
14. Respondent prepared a reaudit computing unreported taxable sales of \$1,709,928.00 ($\$142,494.00 \times 12$ quarters) for the liability period. Respondent prepared a reaudit report dated August 21, 2020, reducing the determined measure of tax by \$245,140.00 from \$1,955,068.00 to \$1,709,928.00, which reduced the determined tax liability from \$159,772.29 to \$139,931.00.¹⁰ Appellant continues to contest the inclusion of department 5 sales in the taxable measure. This timely appeal followed

DISCUSSION

California imposes sales tax on a retailer’s retail sales of tangible personal property sold in this state measured by the retailer’s gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) 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.) Although gross receipts from the sale of “food products” are generally exempt from the

¹⁰ There are very minor differences (\$1 in a few quarters) between amounts calculated by appellant and those calculated by respondent. These are insignificant and this Opinion will attribute those to rounding.

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).) It is the retailer's responsibility to maintain 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).)

Pursuant to R&TC section 6901.5 and California Code of Regulations, title 18, section 1700(b)(1), when an amount represented by a retailer to a customer as constituting reimbursement for sales taxes due is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the retailer, the amount so paid is excess tax reimbursement. Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when tax reimbursement is computed on an amount in excess of the amount subject to tax, when tax reimbursement is computed using a rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the tax reimbursement on a billing. (Cal. Code Regs, tit. 18, § 1700(b)(1).) When respondent ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax to the customers from whom it collected the excess tax reimbursement. (Cal. Code Regs, tit. 18, § 1700(b)(2).) In the event of failure or refusal of the retailer to make such refunds, the retailer must pay the excess tax reimbursement to the state. (R&TC, § 6901.5; Cal. Code Regs, tit. 18, § 1700(b)(1).)

When 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 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

The books and records appellant provided for audit were incomplete and inadequate for sales and use tax purposes. Appellant failed to provide sales tax worksheets; sales journals, purchase journals, and source documentation such as cash register tapes, for the liability period. As a result, respondent was unable to verify sales appellant reported on his SUTRs for the

liability period using a direct audit method.¹¹ Respondent found in its preliminary analysis that book markups on recorded taxable sales increased significantly when appellant changed his reporting method from one that apparently required the tax preparer to apply a markup to purchase amounts to a method that determined taxable sales by reference to information contained on cash register z-tapes. This indicated that reported taxable sales were understated. Thus, respondent was justified to question reported sales and use an indirect audit method to compute appellant's sales.

Respondent used the limited records provided by appellant to create a block sample of sales. Appellant's records indicate that appellant collected sales tax reimbursement from the purchasers on sales identified as department 4 and department 5 sales. Although appellant objected to inclusion of department 5 sales because those amounts were not related to sales at all, but rather, related to purchases from vendors, appellant provided no credible evidence to support that argument.¹² Respondent rejected that argument as lacking evidence.

During the appeal to respondent, appellant appears to have abandoned the argument that the department 5 z-tape entries pertain to payments to vendors. Instead, appellant argued that those entries represented nontaxable grocery sales and that what appears to be sales tax reimbursement was actually a charge for extending credit to the purchasers. Appellant did not support that argument with evidence, and respondent rejected this argument, also.

Alternatively, appellant argued during respondent's internal appeal that, if the department 5 sales are found to have been taxable, the audited taxable measure is more accurately calculated by starting with total "grocery sales" of \$1,709,928 (12 quarters at average quarterly grocery sales of \$142,494) and adding recorded taxable sales totaling \$541,815 to calculate a total audited taxable measure of \$2,251,743. Appellant proposed that respondent then deduct reported taxable sales, which were nearly identical to recorded taxable sales, to calculate "revised unreported taxable sales of \$1,709,926, which was \$245,142 less than audited unreported taxable sales. Respondent agreed to use sales of \$142,494 for department 5 compiled from the cash register z-tapes for May 2014, January 2015, and May 2015, as the average

¹¹ By "direct audit method," this Opinion refers to one that enables respondent to calculate audited sales directly from a taxpayer's complete and accurate records.

¹² Appellant provided what appears to be an altered "Guest Check" containing the hand-written notation "Dept # 5 = Paid Invoice + -."

quarterly taxable sales understatement for the liability period, which is how it arrived at the current measure of tax.

Respondent's analysis has been well-reasoned. An indirect audit methodology was required because appellant failed to maintain and provide business records sufficient to support a direct calculation of taxable sales. It also appears that the block sample approach was correctly executed, that respondent's calculations are accurate, and that the results are reasonable. Therefore, the burden of proof shifts to appellant to establish a more accurate measure of tax.

In this appeal to the Office of Tax Appeals (OTA), appellant continues to argue that sales recorded under department 5 are exempt from sales tax. Appellant has not provided any additional evidence for OTA's consideration.

Respondent observed during the audit that the sales prices reflected on the detailed cash register tapes as department 5 sales matched the sales prices of hot food found on appellant's menu. This indicates that the transactions recorded as department 5 sales were taxable sales of hot food items. The detailed cash register tapes also show that appellant charged amounts consistent with sales tax reimbursement on sales recorded in departments 4 and 5. This is further evidence that the amounts collected were either sales tax reimbursement or excess tax reimbursement. Appellant has claimed that those charges were something other than sales tax reimbursement, and to the extent appellant makes those arguments here, they are unsupported by the record and are, therefore, unpersuasive. Appellant has not shown error in respondent's analysis and conclusion that department 5 sales were taxable. The measure has been established by agreement. Consequently, further adjustments to the amount of unreported taxable sales are not warranted.

HOLDING

Further adjustments to the amount of unreported taxable sales are not warranted.

DISPOSITION

Respondent’s action reducing the measure of tax by \$245,140.00 from \$1,955,068.00 to \$1,709,928.00, and thereby reducing the determined tax from \$159,772.29 to \$139,931.00, and otherwise denying the petition for redetermination is sustained.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

Date Issued: 9/21/2022