

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of:)	OTA Case Nos. 19034461, 19034462
FAIYAZ H. SABA-SYED, ET AL. AND)	CDTFA Case IDs 554539, 547742
STAFF FOOD CONNECTIONS, LLC)	
dba Mehran Restaurant)	

OPINION

Representing the Parties:

For Appellant:

Tayyab Alim, Representative
Faiyez H. Saba-Syed, Partner
Saryen Fiaz, Partner
Shahab M. Siddiqui, Partner
Quedsia Tayyab, Partner

For Respondent:

Ravinder Sharma, Hearing Representative
Jason Parker, Chief of Headquarters
Operations
Stephen Smith, Tax Counsel IV

For Office of Tax Appeals:

Corin Saxton, Tax Counsel IV

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 Faiyaz H. Saba-Syed, et al. dba Mehran Restaurant (the Partnership) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ denying a petition for redetermination of the Notice of Determination (NOD), for tax of \$120,320.75, applicable interest, and a negligence penalty of \$12,032.05, and applicable interest, for the period July 1, 2006, through December 31, 2007.

In a separate consolidated matter, pursuant to R&TC section 6561, Staff Food Connections, LLC (SFC) appeals a decision issued by respondent denying a petition for redetermination of the NOD for tax of \$25,433.80, applicable interest, and a negligence penalty of \$2,543.36, for the period January 1, 2008, through June 30, 2008.

¹ Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to the board.

Office of Tax Appeals Administrative Law Judges Josh Aldrich, Andrew J. Kwee and Natasha Ralston, held an oral hearing for this matter in Sacramento, California, on April 20, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUES

1. Whether adjustments are warranted to the measure of underreported taxable sales.
2. Whether adjustments are warranted for unreported taxable sales for special events and/or festivals.
3. Whether the negligence penalties were properly imposed.

FACTUAL FINDINGS

1. The Partnership operated a restaurant specializing in Indian and Pakistani cuisine in Newark, California. SFC took over operation of the business on January 1, 2008. Respondent closed SFC's seller's permit effective June 30, 2008, after the business was transferred to SFC Caters Corporation (corporation).
2. On September 14, 2009, respondent began an audit of the business for the periods July 1, 2006, through December 31, 2007 (the Partnership audit period); January 1, 2008, through June 30, 2008 (the SFC audit period); and July 1, 2008, through June 30, 2009 (corporate audit period).²
3. For their audit periods, the Partnership and SFC (appellants) reported exempt sales of food products of \$893,194 and \$290,672, respectively. Appellants did not provide adequate books or business records for the audit; thus, respondent disallowed the claimed deductions.³
4. Respondent performed a bank deposit analysis for the corporate audit period and determined that bank deposits for the third quarter 2008 (3Q08), 1Q09, and 2Q09 exceeded total sales reported during those quarters by \$316,017. Respondent therefore determined that the Partnership had underreported its total sales during the Partnership

² The corporate audit period is not at issue in these appeals.

³ Appellant only provided federal income tax returns for 2006 and 2007 and bank statements from July 2006 to December 2006. Appellant did not provide records, such as cash register z-tapes, sales summary reports, sales journals, purchase journals, journal ledgers or profit and loss statements for the audit periods.

audit period. Respondent further determined that these unreported total sales stem from off-site catering events that SFC Caters Corporation advertised on its website, and respondent estimated unreported sales based on the website information. Using events and attendance numbers stated on the website, respondent estimated unreported sales of \$490,700 for the Partnership audit period.⁴

5. Respondent also imposed negligence penalties on the Partnership and SFC of \$12,032.05 and \$2,543.36, respectively. These penalties were based on appellants' failure to maintain adequate books and records and the size of the deficiency measures as compared to the reported taxable sales.
6. Respondent issued a Decision on November 27, 2013, in which it recommended no adjustments. This timely appeal followed.

DISCUSSION

Issue 1: Whether adjustments are warranted to the Partnership's measure of underreported taxable sales.

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, §§ 6012, 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) 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).) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food to-go and sales of all (hot and cold) food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (2) & (7).)

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 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

⁴ Respondent determined that off-site catering events only occurred in the third and fourth quarters of each year. Therefore, respondent did not establish a deficiency measure for unreported sales for SFC, whose audit period consisted of only the first and second quarters of 2008.

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.*) 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.) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Ibid.*)

Charitable organizations are permitted an exemption from sales and use tax on tangible personal property, including food products, when purchased by a charitable organization for the purposes of donation by the organization provided that the following conditions are met: (1) the organization is formed and operated for charitable purposes and qualifies for the “welfare exemption” from property taxation provided by section 214 of the R&TC; (2) the organization is engaged in the relief of poverty and distress; (3) the organization’s sales or donations are made principally as a matter of assistance to purchasers or donees in distressed financial condition; and (4) the property sold or donated has been made, prepared, assembled or manufactured by the organization. (Cal. Code Regs., tit. 18, § 1570(c)(1).) Furthermore, neither the sales tax nor the use tax applies to tangible personal property purchased by a charitable organization for the purpose of donation by the organization provided all of the conditions of paragraph (a) above are met. Tax applies, however, to the sales to the organization of supplies, such as tools and office supplies, and other articles not otherwise exempt. Since appellants provided insufficient records respondent was unable to perform a direct audit. Instead, respondent performed an indirect audit based on the records that appellants did make available. Respondent’s use of a bank deposit analysis is a standard audit methodology that examines a taxpayer’s bank deposits to determine gross receipts for sales tax audit. (*People v. Schwartz*, 31 Cal.2d 59, 64, Respondent Audit Manual section 0405.25.) Furthermore, the bank deposit analysis performed for the corporate audit period indicates that total sales were underreported. Each of the foregoing is a sufficient reason to question the reliability of appellants’ reported taxable sales. (R&TC, § 6481.) Accordingly, we find that it was reasonable and rational for respondent to question the reliability of appellants’ reported taxable sales, and to compute taxable sales using an alternate method. Thus, the burden shifts to appellants to provide evidence from which a more accurate determination may be made.

As noted above appellants claimed exempt sales of food products for both the Partnership and SFC audit periods, which respondent disallowed due to the lack of substantiating books or records. Appellants asserted that the claimed exempt sales of food items constituted sales to charitable organizations or were for banquet hall rentals.

Appellants have not provided sufficient evidence to show that the claimed exempt sales were sales to charitable organizations that meet the requirements of California Code of Regulations, title 18, (Regulation) section 1570. While appellants did provide a letter from R. Merchant of the Islamic Center, the letter does not state that the food sales were made to an organization that is formed and operated for charitable purposes or that the organization meets the other requirements listed in Regulation section 1570. Instead, the letter indicates that appellants were one of the approved vendors to sell food at the Eid Festival in 2006 and 2007.

Appellants have also failed to provide any evidence to establish that any part of their claimed exempt sales were rentals of banquet rooms, furniture, equipment, and utensils. While it is possible that some of the claimed exempt sales were related to rentals, appellants have failed to submit evidence from which a more accurate determination may be made. Thus, we find that appellants have failed to establish that reductions to the deficiency measure for underreported taxable sales are warranted.

Issue 2: Whether adjustments are warranted for unreported taxable sales for special events and/or festivals.

Due to the lack of records provided by appellants, respondent calculated unreported catering sales using the information on the restaurant's current website, which we find to be a reasonable and rational method of calculating unreported sales. Thus, the burden shifts to appellants to provide evidence from which a more accurate determination may be made.

At the hearing, appellants' witnesses testified under oath that appellants did not create the website that respondent relied upon to calculate appellants' unreported taxable sales and the website was created by the new owners of the business in 2009, who greatly exaggerated the achievements listed for marketing purposes. Furthermore, appellants testified that while they did provide catering at several large events throughout the audit period, appellants were not the only food vendors at these events; and thus, would only serve a fraction of the attendees. Appellants also asserted that many of the events were held at appellants' location which could not accommodate the large numbers of attendees that respondent used to calculate appellants

underreported sales. Appellants also stated that they were sponsors of some of these events, meaning that they provided food to the performers and volunteers in exchange for being listed on a banner as a sponsor of the event.

Respondent's calculations are based on multiplying an estimated number of attendees by an estimated price per meal, to determine audited unreported catering sales. In its calculations, respondent assumed that appellant was the only food vendor, and that it was solely responsible for feeding all attendees, often thousands of people. For example, respondent estimated that appellant provided meals to all 7,000 estimated attendees at the annual South Bay Islamic Association festival in San Jose for each year in the audit period; all 8,000 attendees at the Pakistan Day festival in downtown San Francisco for each year in the audit period; all 5,000 attendees at the Prince Karum Agha Khan Community festival in Newark for each year in the audit period, in addition to catering several other events. In total, respondent projected that appellant earned \$490,700 from catering 12 events during the audit period.

At the hearing respondent argued that it was reasonable and rational to rely on the website information because appellants failed to provide any documentation to refute those amounts. Respondent also stated that it did not make any efforts to verify whether the information stated on the website was correct. For example, respondent did not verify whether the events had actually occurred, the number of attendees at the events, or whether other vendors were catering these events in addition to appellants.

While we find that it was reasonable and rational for respondent to rely on the website information because appellants failed to provide any supporting documentation, we find that respondent should have attempted to verify the information contained on the website, particularly in light of the fact that the website was created by a successor entity that appellants had no control over. We find appellant's testimony that they were a small business, without sufficient capacity to cater large events at their location, and that they were one of many vendors to be credible; therefore, we find that a reduction to respondent's assessment of unreported taxable catering sales is warranted. Here, aside from their testimony, appellants provided no specific documentation to support the number of sales from special events/festivals. Nevertheless, we find that it is not reasonable to assume that appellants were the sole caterers providing food for all the attendees, at the listed events. Absent specific documentation to support a higher reduction, we find a reduction of 20 percent to respondent's assessment of

unreported taxable catering sales is reasonable and rational, as there is a rational basis to find, based on the record, that appellants were not the sole caterers at the listed events and could not have provided food for all the thousands of attendees.

Issue 3: Whether the negligence penalty was properly imposed.

R&TC section 6484 provides that, if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Taxpayers are required to maintain and make available for examination on request by respondent, or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Furthermore, these records are required to be preserved for a period of not less than four years. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).) There is no question that the records provided by appellants were not adequate for a sales tax audit and appellants do not argue otherwise. Instead, appellants testified that the electronic records were lost or destroyed by their successor when it installed a new POS system and that any physical records must have been thrown out when the successor remodeled the location. Appellants further testified that they were unable to obtain the records from their accountant as he had passed away six to eight years ago.

We find that appellants did not act as the average prudent businessperson when they failed to maintain adequate books and records. We would expect the average prudent businessperson to keep copies of records when selling a business. Further, we note that the partnership transferred the business to the corporation, in June 2008. However, one of the partners in the partnership with appellants, Mr. Fiaz, continued with the business when it became

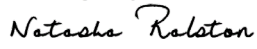
the successor corporation and thus would have had access to the records. We would expect an average prudent businessperson would have made efforts to keep copies of the electronic records before the new system was installed and would have made sure that the physical records were safe and secure during the remodeling of the premises. Furthermore, this audit was started in June 2010, therefore appellants should have been able to obtain copies of the documents from their accountant before he passed in either 2012 or 2014. Additionally, during the audit, respondent calculated an error rate for underreported taxable sales of approximately 300 percent for third quarter 2004 to fourth quarter 2007, and 278 percent for first quarter 2008 to second quarter 2008 which is substantial. While we recommend an adjustment to the measure of unreported taxable sales for special events/festivals, we find that the negligence penalty was properly imposed due to appellants' failure to provide adequate books and records for the audit.

HOLDINGS

1. No adjustments are warranted to the appellants’ measure of underreported taxable sales.
2. A twenty percent reduction to respondent’s assessment of unreported taxable sales for special events and/or festivals is warranted.
3. Respondent correctly imposed the negligence penalty.


DISPOSITION

Respondent’s assessment of unreported taxable sales for special events and/or festivals shall be reduced by 20 percent, otherwise, respondent’s action denying appellants’ petition for redetermination is sustained.


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 Natasha Ralston
 Administrative Law Judge

We concur:

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 Josh Aldrich
 Administrative Law Judge

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 Andrew J. Kwee
 Administrative Law Judge

Date Issued: 7/21/2022