2023 – OTA – 179
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:

YNL ENTERPRISES, INC.
dba Kung Pao Bistro

OTA Case No. 18053170
CDTFA Case IDs: 903013, 100718

OPINION

Representing the Parties:

For Appellant: Marc Brandeis, CPA

For Respondent: Nalan Samarawickrema, Hearing Rep.
Jason Parker, Chief of Headquarters Ops.
Christopher Brooks, Tax Counsel IV

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

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6901 and 6561, YNL Enterprises, Inc. (appellant) appeals a Decision and Recommendation (D&R) issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying, in part, appellant's petition of a Notice of Determination (NOD) dated July 2, 2015, and denying, in part, appellant's March 27, 2017 claim for refund. The NOD is for $39,608.94 in tax, plus $5,793.03 in accrued interest, for the period June 1, 2011, through July 15, 2014 (liability period).[2] On July 22, 2015, appellant made a $43,361.14 payment towards the NOD, representing the $39,608.94 in unpaid tax, and a partial payment of the accrued interest. The $43,361.14 payment is the subject of the refund claim.

CDTFA's July 27, 2017 D&R, which ordered a second reaudit adjustment, ultimately reduced the tax to $36,015.00, which reduced accrued interest, and resulted in a net overpayment

[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. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

[2] The $5,793.03 represents interest accrued through July 30, 2015.

of $2,710.47 (i.e., the payments now exceed the liability as determined). CDTFA otherwise denied the petition and balance of the refund claim.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Daniel K. Cho, and Keith T. Long held an oral hearing for this matter in Cerritos, California, on November 8, 2022. Thereafter, the record was closed, and this matter was submitted for an opinion on November 29, 2022.

ISSUES

1. Whether appellant established a basis for any adjustments to the measure of unreported taxable sales, excluding online sales, as determined by CDTFA.
2. Whether appellant established that it made nontaxable online sales for resale to GrubHub and Eat24.
3. If OTA finds that the online sales are taxable, whether appellant established a basis for adjustment to the measure of unreported online food sales.

FACTUAL FINDINGS

1. Appellant operated a restaurant doing business as Kung Pao Bistro from June 1, 2011, through July 15, 2014. Appellant made in-person sales at the restaurant, and online sales via Eat24 and GrubHub.
2. On November 21, 2011, appellant and GrubHub entered into a written agreement (Agreement) which, in pertinent part, includes the following terms:

> 4. GrubHub shall be an independent contractor of [appellant] during the term of this Agreement.
>
> 5. GrubHub shall provide certain services to [appellant] consistent with GrubHub's business practices . . . including advertising, sales and revenue collection (the "Services"). ......¶
>
> 10. GrubHub shall compute any sales...... tax due in connection with the sale of food or drink by [appellant] through GrubHub ("Sales Tax"). In addition, GrubHub shall collect Sales Tax on behalf of [appellant]........ ¶
>
> 11. [Appellant] warrants that it shall be solely responsible for every . . . liability, obligation . . . and expense ......arising in connection with [appellant's] sale of any food and drink, including alcohol, including, without limitation, computation of payment of Sales Tax to the appropriate taxing authority; compliance with any applicable laws, taxes

> or tariffs related to internet electronic commerce; delivery service and parking accessibility, if any; compliance with appropriate health codes with respect to preparation of food and beverages; and all matters concerning quality and condition of the food and beverages. ......¶
>
> 18. In addition to the Services, [appellant] authorizes GrubHub to secure a domain name for [appellant] to develop and/or improve and provide web page maintenance for [appellant] for advertising purposes.

3. GrubHub provided monthly deposit statements to appellant. The monthly statements included the following language:

> **Your sales tax**
> In this month's Statement outlined above, GrubHub collected $[dollar amount] in taxes as your agent and sent it directly to you. As part of your normal periodic tax return filing, it is your responsibility to pay $[dollar amount] to the proper taxing authority.

4. CDTFA audited appellant for the liability period. For the liability period, appellant filed sales and use tax returns (SUTRs) reporting $972,284 in total sales and $893,745 in taxable sales.[3]
5. Appellant informed CDTFA during the audit that it computed amounts reported on SUTRs based on data recorded in appellant's Point of Sale (POS) Sales report. Appellant's sales system maintained "POS Sales" and "POS Void" reports (collectively, POS reports). Appellant did not report data from its POS Void report to CDTFA.
6. CDTFA compared gross receipts reported on appellant's federal income tax returns for the liability period with total sales reported on the SUTRs and discovered discrepancies, which appellant was unable to explain.
7. CDTFA computed book markups using cost of goods sold as reported on the income tax returns, and total sales reported on the SUTRs, and CDTFA determined that, based on its experience, the markup was too low for this type of business.
8. CDTFA computed total credit card sales of $754,951 for the period June 1, 2011, through December 31, 2013. CDTFA calculated this based on CDTFA's examination of data on

[3] In addition, appellant reported the sale of fixed assets for $4,300 following the sale of the business.

Forms 1099-K provided by appellant's credit card processor,[4] and on CDTFA's review of bank statements reflecting deposits to appellant's bank account for those credit card sales. CDTFA then calculated taxable credit card sales, excluding amounts for sales tax and tips, of $619,205.

9. On October 13, 2013, and November 2, 2013, CDTFA made undercover cash purchases in-person at appellant's restaurant.
10. On May 30, 2014, CDTFA requested and obtained a copy of the POS reports from appellant.
11. CDTFA examined appellant's POS reports and discovered that the undercover cash purchases that CDTFA's agents made were not recorded or otherwise contained in appellant's POS Sales report. Instead, CDTFA located its undercover cash purchases in appellant's POS Void report, which consisted of the transactions which appellant did not report on its SUTRs. In addition, the number of voided transactions on the POS Void report exceeded the total number of recorded transactions on appellant's POS Sales report. CDTFA determined not to accept appellant's reported taxable sales, which appellant indicated were based on the POS Sales report.
12. On Thursday, June 19, 2014, CDTFA performed a one-day observation test of appellant's restaurant, from 11:00 a.m. to 10:00 p.m., representing a full business day for the restaurant. Based on the observation, CDTFA computed a credit card sales ratio of 60.06 percent. Next, CDTFA determined audited taxable sales of $1,030,978.00 for the period ending December 31, 2013, by dividing the taxable credit card sales by the credit card sales ratio of 60.06 percent ($619,205.00 ÷ .6006 = $1,030,978.00). For the remaining period of January 1, 2014, through July 15, 2014, CDTFA projected the unreported taxable sales using an error ratio of 36.32 percent, which was derived from the prior period. CDTFA subtracted audited taxable sales from reported taxable sales to calculate an underreporting of $324,604.00 for the liability period (audit item 1).
13. In addition, CDTFA computed unreported taxable sales for online delivery services of $56,443 for GrubHub (audit item 2) and $65,008 for Eat24 (audit item 3) based on sales

[4] Form 1099-K is an IRS form titled, "Payment Card and Third Party Network Transactions," which shows the gross 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, and PayPal.

DocuSign Envelope ID: 942A0602-4C45-4112-AB01-D8BA4130B7F9

reports provided by appellant.[5] Appellant treated these online transactions as nontaxable sales for resale.

14. Appellant sold the business on July 15, 2014, and closed out its seller's permit.
15. On August 1, 2014, CDTFA held an exit conference with appellant. Appellant did not agree with the findings of the audit.
16. On July 2, 2015, CDTFA issued an NOD to appellant for the liability disclosed by audit, which appellant timely petitioned.
17. On July 22, 2015, appellant made a $43,361.14 payment towards the NOD. Appellant filed a timely claim for refund of this payment on March 27, 2017.
18. On July 27, 2017, CDTFA issued a decision granting a first reaudit with respect to audit item 1. CDTFA made a reaudit adjustment to delete an erroneous transaction from the credit card sales ratio (first reaudit).
19. In a letter dated March 7, 2018, CDTFA notified appellant of the results of the first reaudit and informed appellant of its option to appeal those results to OTA. This timely appeal to OTA followed.
20. CDTFA made second reaudit adjustments (second reaudit) after it obtained data from an additional Form 1099-K for the period January 1, 2014, through closeout. From this information, CDTFA compiled credit card sales of $116,060.00 for the period during 2014. CDTFA previously computed $754,951.00 in credit card sales for the period ending December 31, 213. CDTFA removed tips and sales tax reimbursement from this amount to compute credit card sales, excluding tips and sales tax reimbursement, of $714,267.00 for the entire liability period. CDTFA divided this amount by the credit card sales ratio of 61.84 percent to compute audited taxable sales of $1,155,049.00 for the liability period.
21. These adjustments reduced the measure for audit item 1 to $261,304. In addition, while the additional unreported measure was unchanged ($56,443) for audit item 2 (GrubHub), it was reduced to $59,581 for audit item 3 (Eat24).
22. After the second reaudit was completed CDTFA notified appellant via letter dated September 21, 2022.

[5] CDTFA initially computed online sales of $125,123; however, CDTFA revised its audit prior to issuance of the NOD.

23. On October 24, 2022, shortly before the OTA oral hearing, CDTFA clarified that the measures being asserted by CDTFA are as follows: $261,304 for the first issue; $56,443 for the GrubHub transactions; and $59,581 for the Eat24 transactions. Appellant also raised issue 3, and it encompasses an unspecified portion of the disputed measure for issue 2 (the GrubHub and Eat24 transactions).

24. On the day of the hearing, appellant provided three new exhibits: an internal CDTFA memorandum; a POS Void report, and a POS Sales report. CDTFA reviewed the submissions following the hearing, and both parties agree that the POS reports are true and correct copies of the documents contained in CDTFA's records.

    1. The CDTFA memorandum. The internal memorandum is dated August 16, 2016, and addressed to the District Principal Auditor of the CDTFA office handling the audit of appellant, explaining that current guidelines call for three days of observation tests and noting that GrubHub may be responsible to collect the sales tax.
    2. The POS reports. The period covered by both POS reports is January 1, 2011, through May 29, 2014, which substantially, but not fully, overlaps with the liability period. The POS Void report indicates that appellant voided approximately 57,750 transactions during the period covered by the report. The POS Sales report indicates that appellant made approximately 50,177 sales during this same period.

25. During the oral hearing, appellant conceded that it erroneously voided some taxable transactions. Appellant continues to assert that some, but not all, of the voided transactions were properly voided.

DISCUSSION

Issue 1: Whether appellant established a basis for any adjustments to the measure of unreported taxable sales, excluding online sales, as determined by CDTFA.

California imposes sales tax on a retailer's retail sales of tangible personal property 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.) 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).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, 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, 6511.) 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*.)

CDTFA obtained credit card transaction data from Forms 1099-K for the period June 1, 2011, through December 31, 2013 (first reaudit), and for the period January 1, 2014, through the closeout (second reaudit). From this information, CDTFA computed audited taxable sales of $1,155,049.00 for the liability period. This amount was compared to reported taxable sales of $893,745.00 for that same period to compute an understatement of $261,304.00 for the liability period. In summary, CDTFA used appellant's data (i.e., from the Forms 1099-K), which was reported to the IRS, to compute audited taxable sales. There is no dispute as to the accuracy of the data reported to the IRS. OTA finds this approach reasonable and rational, as such, appellant bears the burden of establishing error with CDTFA's determination. (See *Appeal of Talavera*, *supra*.)

Appellant states that its federal income tax returns for the period 2011 through 2013 show a book markup of 185 percent, which appellant asserts is reasonable for its business. Appellant also states that its POS Sales report reflects a credit card sales ratio of 75 percent, which appellant asserts is also reasonable for appellant's business. Appellant believes that its reported taxable sales should be accepted as accurate with respect to the 185 percent book markup and the 75 percent recorded credit card sales ratio.

Here, CDTFA examined appellant's sales and use tax returns and federal income tax returns and discovered discrepancies, which appellant is unable to explain. In addition, CDTFA performed undercover cash purchases and, upon reviewing appellant's POS reports, discovered that appellant had voided all the cash purchases made by CDTFA's agents and failed to report all

of them. Furthermore, the total numbered of voided transactions exceeded the number of non-voided transactions in appellant's POS reports, which is highly unusual. Appellant offered no explanation, other than conceding that some of the cash transactions were improperly voided.

Based on the facts and circumstances of this appeal, OTA finds appellant's own records are unreliable, and as such OTA declines to apply any ratios or percentages requested by appellant, which are extrapolated from appellant's records. Furthermore, OTA finds that the data from the Forms 1099-K is the best available evidence from which to ascertain appellant's liability, because that data was reported to the IRS directly by appellant's credit card payment processor, and is also supported by bank deposits. Finally, for the same reasons, the scheduled transactions from the observation test are the best available evidence from which to ascertain the credit card ratio, because these transactions were physically observed and confirmed by CDTFA during the test.[6]

In summary, appellant failed to establish a basis for any adjustments to the measure of unreported taxable sales, excluding online sales.

Issue 2: Whether appellant established that it made nontaxable online sales for resale to GrubHub and Eat24.

The law creates a statutory presumption that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) The retailer has the burden of proving that a sale of tangible personal property is not a retail sale unless the retailer timely and in good faith obtains a resale certificate from the purchaser. (R&TC, § 6091; Cal. Code Regs., tit. 18, § 1668(a).) If the seller does not timely obtain a valid and complete resale certificate, the seller will be relieved of liability for the tax only where the seller shows that the property: (1) was in fact resold by the purchaser prior to an intervening use (resale in fact);[7] (2) is being held for purposes of resale by the purchaser and there has been no intervening use; or (3) was consumed by the purchaser and tax was reported by the purchaser directly to CDTFA on the purchaser's returns or in an audit of

[6] While CDTFA's policy, as noted in the memorandum provided by appellant, supports a three-day observation test, in this case appellant sold the business, so it is not possible to expand the observation test. Nevertheless, OTA finds nothing inherently erroneous in the full day observation test performed by CDTFA and, as discussed, this is the best available evidence in light of the facts of this appeal.

[7] This Opinion uses the term "intervening use" to mean a use for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business. (Cal. Code Regs., tit. 18, § 1668(e); Cal. Code Regs., tit. 18, § 1669(a).)

the purchaser. (Cal. Code Regs., tit. 18, § 1668(e).) One method CDTFA authorizes to assist a seller to show that the sale was for resale or the tax was paid is obtaining "XYZ" letters signed by its customers.[8] (Cal. Code Regs., tit. 18, § 1668(f).) CDTFA is not required to relieve a seller from liability for tax based on a customer's response to an XYZ letter. (Cal. Code Regs., tit. 18, § 1668(f)(3).) CDTFA may contact the purchaser or any other person to verify the responses in the XYZ letter. (Cal. Code Regs., tit. 18, § 1668(f)(3).)

The term retailer includes every seller who makes any retail sale or sales of tangible personal property. (R&TC, § 6015.) An agent is one who represents another, called a principal, in dealings with third persons. (Civ. Code, § 2295.) Specifically, an agent has the power to alter legal relations between the principal and third parties, and the principal has the power to control the agent with respect to matters entrusted to them. (*Lewis v. Superior Ct.* (1994) 30 Cal.App.4th 1850, 1868-1869.) Whether an agency relationship exists is determined by the relationship of the parties as they in fact exist under their agreement or acts. (*Appeal of Mark Pulvers* (SBE Memo.) 1994 WL 830388.) In determining the existence of an agency relationship, an examination of the agreement as a whole and the supporting facts and circumstances is necessary. (*Ibid*.)

As a preliminary matter, it is undisputed that appellant made sales using the online platforms GrubHub and Eat24, and the question here is whether appellant or the online platform was the retailer. To this end, appellant has not provided resale certificates from GrubHub or Eat24. Thus, it is presumed that the online sales are taxable.

Appellant argues that its sales to GrubHub and Eat24 are nontaxable sales for resale in fact. Appellant states that customers who order online understand that they are not ordering from appellant's website. Appellant also states that GrubHub and Eat24 collect the sales tax reimbursement from the customers. Appellant further argues that persons ordering food online have a contract with GrubHub or Eat24, as opposed to appellant.

The Agreement specifies that GrubHub is "an independent contractor of [appellant]." Although appellant contends that the customers are using GrubHub's website, the Agreement specifies that appellant "authorizes GrubHub to secure a domain name for [appellant] to develop and/or improve and provide web page maintenance for [appellant]." These contract provisions

---

[8] XYZ letters are letters in a form approved by CDTFA that are sent to some of or all the seller's purchasers inquiring as to the disposition of the property purchased from the seller.

indicate that GrubHub is performing these acts on behalf of appellant. This conclusion is supported by the language in GrubHub's monthly sales summary reports issued to appellant stating that GrubHub collected the sales tax "as your agent and sent it directly to you." Based on the above, OTA finds that GrubHub was acting as an agent of appellant, and that appellant was the retailer.

The Agreement further provides that appellant is solely responsible for any expense arising in connection with appellant's sale of food and drink including those related to sales tax liabilities. Based on all the above facts, OTA finds that GrubHub is an independent contract agent of appellant.

Appellant has not provided any agreement between itself and Eat24 to support that its sales to Eat24 were sales for resale. Furthermore, Eat24's sales summary reports that appellant provided CDTFA show the amount due to appellant for sales made through Eat24 is computed from the total of credit card sales, including sales tax reimbursement and tips, less credit card processing fees and commissions earned by Eat24. Thus, the facts indicate that Eat24 collected the sales tax reimbursement on behalf of appellant, and that the collected amounts were paid to appellant. This is consistent with finding that appellant is the retailer, and Eat24 is the agent of appellant. As such, OTA finds appellant failed to establish that any adjustments are warranted for the online sales.

<u>Issue 3: If OTA finds that the online sales are taxable, whether appellant established a basis for adjustment to the measure of unreported online food sales.</u>

As discussed above, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, supra.) Here, CDTFA calculated the liability on an actual basis, using the third-party online sales reports provided by GrubHub and Eat24. The sales reports were generated by third parties (Eat24 and GrubHub) and OTA finds that it was reasonable and rational for CDTFA to calculate the liability using these sales reports generated by appellant's online food delivery agents. As such, appellant has the burden of establishing error. (See *Appeal of Talavera*, *supra*.) Appellant contends that the liability is overstated, but appellant has identified no errors in the taxable sales picked up in the audit or in the sales reports generated by its agents. For the reasons discussed above under issue 1, OTA concluded that appellant's records are unreliable, and the best available evidence is documentation generated by a source other than appellant. In this case, that documentation was

DocuSign Envelope ID: 942A0602-4C45-4112-AB01-D8BA4130B7F9

the sales reports provided by appellant's agents. As such, OTA has no basis to recommend any adjustments based on sales, markups, or ratios recorded in or extrapolated from appellant's own records.

HOLDINGS

1. Appellant failed to establish a basis for any adjustments to the measure of unreported taxable sales, excluding online sales, as determined by CDTFA.
2. Appellant failed to establish that it made nontaxable online sales for resale to GrubHub and Eat24.
3. Appellant failed to establish a basis for adjustment to the measure of unreported online food sales.

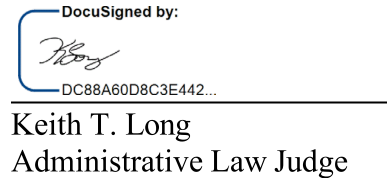
DISPOSITION

CDTFA's action is sustained.

Andrew J. Kwee
Administrative Law Judge

We concur:

Daniel K. Cho
Administrative Law Judge



Keith T. Long
Administrative Law Judge

Date Issued: 2/9/2023