OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20127043
	) CDTFA Case ID 677-566
DASH AND A HANDFUL, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Paul Raymond, Attorney
For Respondent:	Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Richard Zellmer, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Dash and a Handful, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] denying appellant's petition for redetermination of the Notice of Determination (NOD) for tax of $351,719.00, plus applicable interest, and a 40 percent penalty of $140,686.40 for failure to remit tax collected, for the period February 13, 2014, through September 30, 2017 (audit period).

Appellant waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides the matter based on the written record.

[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.

ISSUES[2]

1. Is a reduction to the amount of unreported taxable sales warranted?
2. Was the 40 percent penalty properly imposed, and if so, has appellant established a basis to relieve the penalty?

FACTUAL FINDINGS

1. Appellant has operated a Vietnamese-style restaurant (Pho 533) since April 3, 2015, and a catering and event planning business (Dash and a Handful) in Palm Springs since February 13, 2014.
2. CDTFA audited appellant for the period February 13, 2014, through September 30, 2017. For the audit period, appellant reported total sales and taxable sales of $2,206,334, claiming no deductions. Appellant provided its federal income tax returns (FITRs) for 2014, 2015, 2016; point-of-sale (POS) reports for January 1, 2016, through September 30, 2017; catering event reports for February 13, 2014, through March 31, 2017; catering invoices for the second quarter of 2016 (2Q16); profit and loss statements for the audit period; bank statements for May 2014, through September 2017; and restaurant sales worksheets for 2Q16. Appellant collected sales tax reimbursement on all sales.
3. Gross receipts reported on the FITRs for 2014, 2015, and 2016, exceeded total sales reported on the sales and use tax returns for the same years by a total of $2,449,719.
4. Total sales reported on the FITRs for 2014 and 2015 exceeded total sales recorded in the profit and loss statements for those two years by $10,791 and $3,082, respectively. The difference represented unreported taxable sales (audit item 1).
5. The restaurant and catering sales recorded in appellant's profit and loss statements exceeded reported taxable sales by $3,511,105 for the audit period. This difference represented unreported taxable sales (audit item 2).

[2] Appellant appealed the entire amount of $351,719 as stated in the NOD but did not provide evidence or argument with respect to audit items one through five, as delineated below. Thus, the Opinion addresses only audit item six and the 40 percent penalty set forth in R&TC section 6597.

6. The sales tax rate for Palm Springs was reduced from 9 percent to 8.75 percent starting on January 1, 2017.[3] Appellant continued to charge and collect sales tax at the rate of 9 percent on sales made in Palm Springs after January 1, 2017.[4] Appellant collected excess tax reimbursement on catering sales in the amount of $1,922, representing a measure of tax of $40,463, and excess tax reimbursement on restaurant sales of $2,479, representing a measure of tax of $52,190 (audit items 3 and 4, respectively).
7. Appellant made sales in Riverside county but failed to report district taxes that are applicable to Riverside county on sales totaling $335,981 (audit item 5).
8. Appellant's bank statements for the period June 1, 2014, through September 30, 2017, revealed deposits of $3,614,001. That amount was reduced by a rate of 9 percent to calculate bank deposits less tax of $3,315,599. This amount was further reduced by subtracting additional taxable catering sales already included in audit item 1, of $8,963, to calculate audited taxable sales based on bank deposits of $3,306,636. When compared to the taxable sales recorded in appellant's profit and loss statements of $2,998,646, appellant's bank statements reveal unreported taxable sales of $307,985 (audit item 6).[5]
9. CDTFA imposed the 40 percent penalty for failure to timely remit excess tax reimbursement appellant collected.

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[3] On January 1, 2017, the statewide sales and use tax rate was reduced from 7.5 to 7.25 percent. This rate consists of the California Sales and Use Tax (R&TC, §§ 6051 et seq., 6201 et seq.) and the Bradley-Burns Uniform Local Sales and Use Tax (R&TC, §§ 7200-7212). In 1969, the legislature enacted the Transactions and Use Tax Law. (R&TC, § 7251 et seq.) Pursuant to various enabling statutes, local jurisdictions are permitted to impose a "district tax" at rates ranging from 0.10 to 1 percent of the gross receipts from the retail sale of tangible personal property within the jurisdiction, or of the purchase price of property the use, storage, or consumption of which within the jurisdiction is otherwise subject to tax. (R&TC, §§ 7261(a), 7262(a).) A retailer engaged in business in a jurisdiction imposing the district tax is required to collect the tax. (R&TC, §§ 7261(a), 7262(a); see also Cal. Code Regs., tit. 18, § 1827(a).)

[4] When an amount represented by a person to a customer as constituting reimbursement for sales tax 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 person, the amount so paid is excess tax reimbursement. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).) Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when reimbursement is computed on an amount in excess of the amount subject to tax, when reimbursement is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the reimbursement on a billing. (*Ibid.*) When a retailer has collected excess tax reimbursement, the retailer may refund the excess tax collections to the customers from which they were collected. In the event of failure or refusal of the retailer to make such refunds, the retailer must pay the excess tax reimbursement to CDTFA. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(2).)

[5] CDTFA performed a similar analysis of restaurant deposits, finding no significant errors.

10. CDTFA issued an NOD to appellant on October 3, 2018, for the liability disclosed by the audit.
11. Appellant filed a timely petition for redetermination of the NOD.
12. On August 28, 2019, CDTFA issued a decision denying appellant's petition.
13. Appellant timely filed the instant appeal with OTA.

DISCUSSION

Issue 1: Is a reduction to the amount of unreported taxable sales warranted?

California imposes a sales tax on a retailer's 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, § 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" for human consumption are generally exempt from the sales tax, sales of hot food, sales of food served in a restaurant, and sales of food served by a caterer are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), (d)(7); Cal. Code Regs., tit. 18, § 1603(i)(3)(A).)

When 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.*)

In this case, gross receipts reported on the FITRs for 2014, 2015, and 2016, exceeded total sales reported on the sales and use tax returns for the same years by a total of $2,449,719. Also, restaurant and catering sales recorded in the profit and loss statements exceeded reported taxable sales by $3,511,105 for the audit period. These discrepancies are sufficient reasons for CDTFA to doubt the accuracy of recorded and reported sales. Using bank deposits to compute sales is a standard and accepted audit method. (See, *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613; see also *Appeal of Amaya*, 2021-OTA-328P.) Appellant does not dispute that all of the bank deposits in question represent monies received from

appellant's customers. It is reasonable, in the absence of evidence to the contrary, to assume that monies received from customers represent sales made by appellant. Therefore, 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 $307,985 measure of unreported tax that was established using bank deposits includes deposits for sales that were not made during the audit period and also includes amounts that were refunded to customers due to cancellations.

Appellant has not provided any specific catering contracts to show that deposits from those contracts were made during the audit period, but the actual catered event did not occur until after the audit period. Appellant has not provided any evidence of checks written to customers, or any other documentary evidence, to support that some of the deposits at issue were refunded to customers due to cancellations.

Because appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made, OTA concludes that appellant has failed to meet its burden of establishing that a reduction to the measure of unreported taxable sales established using bank deposits is warranted.

Issue 2: Was the 40 percent penalty properly imposed, and if so, has appellant established a basis to relieve the penalty?

Effective January 1, 2007, any person who knowingly collects sales tax reimbursement and fails to timely remit that tax or tax reimbursement to CDTFA is liable for a penalty of 40 percent of the amount not timely remitted. (R&TC, § 6597(a)(1).) The penalty does not apply if the person's liability for unremitted tax or tax reimbursement averages $1,000 or less per month or does not exceed 5 percent of the total amount of the tax liability for which the tax or tax reimbursement was collected for the period in which the tax was due, whichever is greater. (R&TC, § 6597(a)(2)(A).)

Based on a review of the available POS reports and event contracts, all of which included sales tax charged to customers, CDTFA concluded that appellant collected sales tax reimbursement on all its sales. Using appellant's records, CDTFA compiled taxable sales for each quarterly period in the audit, and then multiplied the taxable sales by the applicable tax rate to compute audited sales tax reimbursement collected of $543,534 for the audit period. Yet, appellant reported just $191,818 on the sales and use tax returns. Therefore, appellant failed to

remit sales tax reimbursement of $351,716 for the audit period. As noted above, the 40 percent penalty does not apply if the taxpayer's liability for unremitted tax reimbursement is less than $1,000. However, in this case appellant's average monthly unremitted tax reimbursement is approximately $8,000 per month, which greatly exceeds the minimum penalty threshold. Moreover, the unremitted sales tax reimbursement represented at least 16.88 percent of the total sales tax reimbursement for each quarterly period in the audit, which is far more than the 5 percent safe harbor to avoid application of the penalty. Thus, the 40 percent penalty of $140,686.40 was properly imposed.

The penalty shall be relieved if appellant's failure to timely remit sales tax reimbursement is due to reasonable cause or circumstances beyond appellant's control and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect. (R&TC, § 6597(a)(2)(B).) For these purposes, "reasonable cause or circumstances beyond the person's control" includes, but is not limited to, any of the following: (1) death or serious illness of the person or the person's next of kin that caused the person's failure to make a timely remittance; (2) an emergency (as defined by Government Code section 8558) that caused the person's failure to make a timely remittance; (3) a natural disaster or other catastrophe directly affecting the business operations of the person that caused the person's failure to make a timely remittance; (4) CDTFA's failure to send returns or other information to the correct address of record that caused the person's failure to make a timely remittance; (5) the failure to timely remit occurred only once over a three-year period or once during the period in which the person was engaged in business (whichever period is shorter); or (6) the person voluntarily corrected errors in remitting tax or tax reimbursement collected prior to being contacted by CDTFA regarding possible errors or discrepancies. (R&TC, § 6597(b)(1)(A-F).)

Appellant contends that the 40 percent penalty is a "fraud or intent to evade the tax" penalty, and thus, appellant argues that to impose the penalty there must be "clear and convincing evidence" of fraud. Appellant asserts that CDTFA has not shown clear and convincing evidence of fraud, and therefore, the 40 percent penalty cannot be imposed. Appellant notes that CDTFA initially regarded the 40 percent penalty as a fraud penalty, and later changed its position and concluded that the 40 percent penalty is not a fraud penalty. Appellant argues that CDTFA erred in changing its position.

OTA has previously held that the 40 percent penalty is not a fraud penalty, (*Appeal of Finnish Line Motorsports, Inc.*, 2019-OTA-138P), and thus does not require a showing of fraud or an intent to evade tax by clear and convincing evidence. Nothing in the plain language of section 6597 requires a finding of fraud or intent to evade the tax. Rather the threshold to impose the penalty is based on a failure to timely remit collected tax reimbursement of more than $1,000 per month on average or 5 percent of the total tax reimbursement collected. Moreover, R&TC section 6597(a)(2)(B) provides for circumstances where the penalty may be relieved if a taxpayer exercises reasonable care and not willful neglect. It may be inferred that if the penalty were intended to be a fraud penalty, then it could not be relieved due to the exercise of ordinary care. It is enough that the case under consideration meets the requirements of the statute, R&TC section 6597, which in this case it does for the reasons stated above. The fact that CDTFA initially treated the 40 percent penalty as a fraud penalty does not alter that conclusion.

Appellant also argues that the 40 percent penalty should not apply because CDTFA does not know how appellant prepared its sales and use tax returns. It is not necessary for CDTFA to know how appellant prepared its sales and use tax returns in order to impose the 40 percent penalty. Again, it is enough that the requirements of R&TC section 6597 are met, which they are. Thus, OTA rejects this argument.

Lastly, appellant argues that the penalty should be relieved based on the "totality of facts and circumstances." Appellant has not explained what facts and circumstances warrant relief of the penalty. Appellant has not provided any explanation as to why it failed to report substantial amounts of taxable sales and remit tax that was clearly recorded in its own records. Thus, appellant has not shown that the failure to remit collected taxes was due to reasonable cause or circumstances beyond appellant's control, and occurred notwithstanding appellant's exercise of ordinary care and in the absence of willful neglect. Thus, appellant has not established a basis to relieve the 40 percent penalty.

HOLDINGS

1. Appellant has not shown that reductions to the measure of tax are warranted.
2. The 40 percent penalty was properly applied, and appellant has not established a basis for relief of the penalty.

DISPOSITION

CDTFA's action in denying the petition is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Keith T. Long
Administrative Law Judge

DocuSigned by:
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Richard Tay
Administrative Law Judge

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