**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeals of:<br>**EAST COAST FOODS, INC.,**<br>**dba Roscoe's House of Chicken'n Waffles** | OTA Case Nos. 18011899, 18011953<br>CDTFA Case IDs: 613237, 613238 |

## OPINION

Representing the Parties:

For Appellant: John L. Sadd, Jr., CPA

For Respondent: Pamela Bergin, Assistant Chief Counsel
Jason Parker, Chief of Headquarters Ops.

For the Office of Tax Appeals: Corin Saxton, Tax Counsel IV

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, East Coast Foods Inc. (appellant) appeals to the Office of Tax Appeals (OTA) a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) on December 31, 2014, which partly granted and partly denied each of the following two appeals: (1) appellant's administrative protest of a Notice of Determination (NOD) dated April 30, 2012; and (2) appellant's timely petition for redetermination of another NOD dated May 29, 2012.[1]

The April 30, 2012 NOD is for tax of $617,354.77, plus applicable interest, and a negligence penalty of $61,735.49 for the period of January 1, 2009, through September 30, 2009. Because appellant did not pay or petition this determination by the time it became final (i.e., due and payable) on May 30, 2012, a finality penalty of $61,735.48 was added pursuant to R&TC section 6565.

The May 29, 2012 NOD is for tax of $1,423,885.19, plus applicable interest, and a negligence penalty of $142,388.54 for the period of October 1, 2009, through

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

September 30, 2011. On November 15, 2013, CDTFA timely increased the tax liability and the negligence penalty to $1,676,116.12 and $167,611.60, respectively, pursuant to R&TC section 6563.[2]

CDTFA based these two NODs (plus the subsequent liability and penalty increases) on its determination that appellant had aggregate unreported taxable sales of $24,121,200 for the consecutive liability periods of January 1, 2009, through September 30, 2009, and October 1, 2009, through September 30, 2011 (the combined liability period). Following CDTFA's internal appeals process, CDTFA partially granted appellant's appeals, reducing the aggregate amount of unreported taxable sales from $24,121,200 to $20,881,067, which is the current amount at issue. CDTFA otherwise denied appellant's appeals.

Appellant waived the right to an oral hearing, so OTA decides these matters based on the written record.

## ISSUES

1. Whether an automatic bankruptcy stay applies to these business tax appeals before OTA.
2. Whether the United States (U.S.) bankruptcy court has exclusive jurisdiction over these business tax appeals.
3. If the automatic stay does not apply to these business tax appeals, and the U.S. bankruptcy court does not have exclusive jurisdiction over them, whether a further reduction to the aggregate amount of unreported taxable sales is warranted.

## FACTUAL FINDINGS

1. During the combined liability period, appellant, doing business as Roscoe's House of Chicken'n Waffles, operated four restaurants specializing in chicken and waffles in southern California: three in Los Angeles and one in Pasadena.
2. For the combined liability period, appellant reported total sales of $25,248,782, claimed deductions of $801,296, and reported taxable sales of $24,447,486.
3. For the audit at issue, appellant did not provide any books or records to CDTFA despite CDTFA's numerous requests.

[2] Pursuant to R&TC section 6563, CDTFA may increase or decrease the amount of a determination before it becomes final, but CDTFA may increase the amount only if it asserts a claim for increase at or before a hearing.

4. Lacking appellant's books and records, CDTFA decided to compute audited taxable sales using the markup method and information acquired in a prior audit of appellant for the period of July 1, 2001, through June 30, 2005, and from third parties. Specifically, CDTFA acquired information about appellant's chicken purchases during the combined liability period directly from appellant's chicken vendor, and subpoenaed appellant's bank for appellant's account statements.

5. For appellant's four locations, CDTFA calculated total audited taxable sales of both chicken and non-chicken items (including beer, wine, and soda) in the following manner:

   a. Chicken

      i. CDTFA first obtained from appellant's vendor the amount of appellant's chicken purchases for each location during the combined liability period.

      ii. CDTFA then reduced this amount by an aggregate 17 percent allowance, which CDTFA and appellant had established together in the prior audit, to calculate the audited cost of chicken sold during the combined liability period.[3]

      iii. CDTFA then increased the audited cost of chicken sold by a fresh-chicken markup of 804.32 percent, which CDTFA had calculated in the prior audit.[4]

      iv. For appellant's four locations, CDTFA calculated that appellant made audited taxable sales of chicken totaling $33,556,821 during the combined liability period.

   b. Non-Chicken Food and Beverage Items (Including Beer, Wine, and Soda)

      i. In the prior audit, CDTFA had established that audited taxable non-chicken sales constituted 35.08 percent of audited taxable chicken sales.

      ii. CDTFA applied the taxable non-chicken sales ratio of 35.08 percent to audited taxable chicken sales of $33,556,821 and calculated that, for all four locations,

[3] The aggregate 17 percent allowance consisted of the following 10 individual allowances: (1) 1.0 percent for theft; (2) 0.5 percent for contamination; (3) 1.5 percent for spoilage; (4) 0.5 percent for frying machine malfunction; (5) 1.5 percent for saturated oil; (6) 7.0 percent for employee self-consumption; (7) 1.0 percent for employee take-out meals; (8) 1.0 percent for charitable donations; (9) 2.0 percent for complimentary meals; and (10) 1.0 percent for marketing strategy.

[4] "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 $.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).

appellant made audited taxable non-chicken sales totaling $11,771,732 (rounded) during the combined liability period.

c. Total Audited Taxable Sales: CDTFA computed audited taxable sales totaling $45,328,553 ($33,556,821 + $11,771,732) during the combined liability period.

6. CDTFA compared audited taxable sales of $45,328,553 to reported taxable sales of $24,447,486, which resulted in unreported taxable sales of $20,881,067.

7. CDTFA then increased the amount of unreported taxable sales by 20 percent, from $20,881,067 to $24,121,200, to account for "contingencies" (i.e., increased menu prices, discounted purchases, and changes in menu items), as well as CDTFA's determination that the 804.32 percent fresh-chicken markup computed in the prior audit was too low.

8. On April 30, 2012, and May 29, 2012, CDTFA issued the NODs to appellant.

9. Appellant filed an untimely appeal of the April 30, 2012 NOD, and CDTFA accepted appellant's late-filed appeal as an administrative protest.

10. Appellant timely petitioned the May 29, 2012 NOD.

11. On April 8, 2014, as part of its internal appeals process, CDTFA held a consolidated appeals conference for both appeals.

12. On December 31, 2014, CDTFA issued its decision partly granting and partly denying appellant's administrative protest and appellant's petition for redetermination. Specifically, CDTFA deleted the 20 percent increase to the amount/measure of unreported taxable sales, which reverted to $20,881,067.

13. Regarding its audit staff's conclusion that the 804.32 percent fresh-chicken markup calculated in the prior audit was too low, CDTFA noted that appellant had also appealed the determination from the prior audit. CDTFA reviewed its prior appeal decision from its internal appeals process, found that its audit staff had established the fresh-chicken markup by comparing appellant's menu selling prices to costs for June 2002, June 2003, May 2004, and February 2005, and concluded that its audit staff had calculated the fresh-chicken markup in accordance with CDTFA's Audit Manual. CDTFA also noted that OTA's predecessor, the State Board of Equalization (BOE), had held a hearing for that prior appeal but ordered no adjustments. Accordingly, CDTFA concluded that the 804.32 percent fresh-chicken markup was not too low.

14. Subsequently, appellant appealed CDTFA's decision to partly deny its appeals to BOE, and requested an oral hearing.
15. On March 25, 2016, appellant filed for Chapter 11 bankruptcy protection with the U.S. bankruptcy court.
16. On May 6, 2016, CDTFA filed with the U.S. bankruptcy court a claim, which CDTFA amended on March 7, 2017.
17. On September 29, 2016, the U.S. bankruptcy court appointed a trustee to operate appellant's business.
18. After December 31, 2017, BOE's duties, powers, and responsibilities for conducting business tax appeals hearings transferred to OTA,[5] and these appeals followed.

## DISCUSSION

Issue 1: Whether an automatic bankruptcy stay applies to these business tax appeals before OTA.

On appeal, appellant argues that, pursuant to federal law, its bankruptcy filing effected an automatic stay of all legal proceedings pending against appellant, including these appeals, as of the bankruptcy filing date of March 25, 2015, and these appeals do not qualify for any exception to the automatic stay under federal law. Appellant also argues that allowing these appeals to proceed would frustrate the purpose of the automatic stay, which is to preserve appellant's assets while allowing appellant to focus on reorganizing. Accordingly, appellant requests that OTA stay these appeals indefinitely.

Generally, the filing of a bankruptcy petition automatically stays the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the bankruptcy case. (11 U.S.C. § 362(a)(1).) The automatic stay has two broad purposes: (1) to protect debtors from "hungry" creditors by giving them a "breathing spell" against all harassment, collection efforts, and foreclosure actions; and (2) to protect the debtor's creditors by preventing a race for the debtor's assets. (*Grant v. Clampitt* (1997) 56 Cal.App.4th 586, 590.)

[5] See Government Code sections 15672 and 15674.

However, the automatic stay is subject to a number of exceptions. (See 11 U.S.C. § 362(b).) As relevant here, the automatic stay does not stay the making of an assessment for any tax. (11 U.S.C. § 362(b)(9)(D).)

Here, OTA's initial task is to determine whether the automatic bankruptcy stay—or an exception—applies to OTA's review of CDTFA's decision to partly deny two types of business tax appeals: (1) appellant's administrative protest of an April 30, 2012 NOD; and (2) appellant's timely petition for redetermination of a May 29, 2012 NOD. OTA will consider each type of appeal in turn, beginning with appellant's timely petition for redetermination.

*Appellant's Timely Petition for Redetermination of CDTFA's May 29, 2012 NOD*

Although subject to bankruptcy court review, state courts have jurisdiction to determine whether an exception to the automatic stay applies. (See *In re Gruntz* (9th Cir. 2000) 202 F.3d 1074, 1087 [finding that a state court properly proceeded with criminal action against debtor because the automatic stay did not apply to enjoin such action].) Accordingly, OTA may rely on state court opinions relevant to whether the automatic bankruptcy stay applies here.

In *Cavanagh v. Cal. Unemp. Ins. Apps. Bd.* (2004) 118 Cal.App.4th 83, the Third District Court of Appeal considered whether the Employment Development Department (EDD) violated an automatic stay in bankruptcy by issuing assessments for unpaid unemployment insurance contributions. The court held that, unlike federal tax assessments that become final when issued and immediately give rise to a statutory lien, EDD's assessments only triggered the time for a taxpayer to either pay the disputed tax or begin protest proceedings. (*Id*. at p. 94.) If a taxpayer filed a petition for reassessment to challenge the assessment, it prevented the assessment from becoming final or giving rise to liens. (*Ibid*.) Accordingly, the court concluded that EDD's assessments were exempt from the automatic stay provisions of the U.S. Bankruptcy Code. (*Ibid*.)

In arriving at this conclusion, the Third District Court of Appeal relied in part upon the reasoning in *H & H Beverage Distrib. v. Dept. of Revenue of Pa.* (3rd Cir. 2004) 850 F.2d 165. There, the U.S. Court of Appeals for the Third Circuit concluded that Pennsylvania did not violate the automatic stay in a Chapter 11 bankruptcy proceeding by conducting a sales tax audit and issuing a notice of audit assessment to the debtor. (*Id*. at p. 169.) The court noted that this notice only commenced the process by which a taxpayer either paid the government's estimate of the tax due or appealed for redetermination, and the issuance of such notice was not tantamount

to the creation of a lien. (*Ibid*.) As relevant here, the court noted that no lien was created because the debtor was in the midst of an administrative appeal in the state court system, and Pennsylvania could not obtain a lien until the appeal was resolved. (*Ibid*.) Further, under Pennsylvania law, no lien was created until the state demanded the tax, interest, penalty, and cost, and the debtor/taxpayer neglected or refused to pay. (*Ibid*.) Thus, the court concluded that Pennsylvania did not violate the automatic stay by auditing a debtor (which the court equated to the state calculating its claim) and then issuing a notice of audit assessment. (*Ibid*.)

Like EDD and as with Pennsylvania's sales tax regime, CDTFA will not commence collection activities until a liability is final. (Cal. Code Regs., tit. 18, § 35007(f); see also former Cal. Code Regs., tit. 18, § 5211(d).[6]) The filing of a timely petition for redetermination prevents the liability of the NOD being petitioned from becoming final, and will prevent the commencement of collection activities regarding amounts contained in the NOD being petitioned, at least until the petition has been acted upon and the liability becomes final. (*Ibid*.)

After being served an NOD by CDTFA, a person may petition for redetermination within 30 days after service. (R&TC, § 6561.) If a person timely files a petition for redetermination, CDTFA will reconsider the determination. (R&TC, § 6562.) CDTFA's decision on a petition for redetermination will become final after 30 days have passed following service of the notice of the decision on the petitioner. (R&TC, § 6564.)

However, if CDTFA's decision is adverse to the person, in whole or in part, then that person may appeal the decision to OTA (or BOE through 2017) no later than 30 days from the date CDTFA issued its decision. (Cal. Code Regs., tit. 18, §§ 30103(b)(1), 30203(b)(1); see also former Cal. Code Regs., tit. 18, § 5266(b).) If a person timely appeals CDTFA's decision to OTA (or BOE), the ensuing opinion will become final 30 days from the date OTA (or BOE) issues its opinion unless a party to the appeal files a petition for rehearing within that 30-day period. (Cal. Code Regs., tit. 18, §§ 30505(a), 30602; see also former Cal. Code Regs., tit. 18, §§ 5345(a), 5460(a).) If OTA (or BOE) denies the petition for rehearing, then both the opinion on the appeal and the opinion on the petition for rehearing become final 30 days from the date OTA (or BOE) issued the latter opinion. (Cal. Code Regs., tit. 18, § 30606(e); see also former Cal. Code Regs., tit. 18, § 5465(b).)

[6] All citations to California Code of Regulations, title 18, section 5000 and following are to earlier versions in effect during the time BOE conducted business tax appeals hearings.

Here, appellant timely petitioned the May 29, 2012 NOD, which prevented both the associated determination from becoming final and the commencement of any collection activities by CDTFA with regards to amounts in that NOD. At the conclusion of CDTFA's internal appeals process, CDTFA's Appeals Bureau partly denied appellant's timely petition, and appellant appealed CDTFA's partial denial to BOE, OTA's predecessor. This continued to prevent CDTFA's determination from becoming final. Subsequently, BOE's duties, powers, and responsibilities for conducting business tax appeals hearings transferred to OTA.

Presently, appellant's case is an administrative appeal before OTA and the subject of this Opinion. As illustrated in Issue 3 below, in the business tax context, OTA's main purpose here is to review CDTFA's redetermination and determine whether any further adjustments to the liabilities therein are warranted. During OTA's review, CDTFA's redetermination is not yet final as a matter of law and no lien is created. Rather, OTA's review is part of the process of establishing and/or refining appellant's ultimate tax liability (i.e., the amount to be assessed, if any) as well as any related penalties and costs. Barring a petition for rehearing by one of the parties, 30 days must pass before this Opinion and CDTFA's redetermination (including any further warranted adjustments) can become final and CDTFA can commence any collection activities. Accordingly, OTA concludes that its review of CDTFA's partial denial of appellant's petition for redetermination is simply part of the process of making a tax assessment and, per U.S. Bankruptcy Code section 362(b)(9)(D), is excepted from the automatic stay.

OTA now turns to appellant's argument that allowing this appeal to proceed would frustrate the purpose of the automatic stay, which appellant alleges is to preserve appellant's assets while allowing appellant to focus on reorganizing. OTA first notes that appellant's formulation of the automatic stay's purpose differs somewhat from what the applicable California case law states are the stay's two purposes: (1) to protect debtors from creditors by providing a breathing spell against all collection efforts; and (2) to protect the debtor's creditors by preventing a race for the debtor's assets. (*Grant v. Clampitt*, *supra*, 56 Cal.App.4th at p. 590.) Neither of these purposes is frustrated by OTA's present review, which is part of the assessment-making process and does not constitute collection action by CDTFA or contribute towards a race for debtor's assets. Second, OTA notes that appellant itself initiated these appeals, which were first before BOE and are now before OTA. The automatic stay authorized by U.S. Bankruptcy Code section 362(a)(1) only applies to actions "against" the debtor, not to

state-level administrative reviews of tax appeals initiated *by* the debtor. For these two reasons, OTA finds that appellant's argument on appeal lacks merit.

Next, OTA turns to the issue of whether the automatic stay—or an exception—applies to OTA's review of CDTFA's partial denial of appellant's administrative protest.

*Appellant's Administrative Protest of CDTFA's April 30, 2012 NOD*

A determination that is the subject of an administrative protest differs from one that is the subject of a timely petition for redetermination in several important respects. If a petition for redetermination is not filed within the 30-day period after service of an NOD, the determination becomes final at the expiration of that period. (R&TC, § 6561.) If any person fails to pay any amount imposed under the Sales and Use Tax Law at the time that the amount becomes final (i.e., due and payable), the amount thereof, including penalties, interest, and any added costs, shall thereupon be a perfected and enforceable state tax lien. (R&TC, § 6757(a) & (b).) However, such a lien shall not arise during any period that section 362 of the U.S. Bankruptcy Code applies to the person against whom the lien would otherwise apply. (R&TC, § 6757(c).)

If an appeal is filed after the due date of a timely petition for redetermination, the appeal does not qualify as a valid petition for redetermination. (Cal. Code Regs., tit. 18, § 35019(a); see also former Cal. Code Regs., tit. 18, § 5520(a).) However, such an appeal may be accepted as an administrative protest if CDTFA determines that there is a reasonable basis to believe that there may be an error in the taxpayer's notice. (*Ibid*.) If an appeal is accepted as an administrative protest, CDTFA will review the administrative protest in the same manner as a petition for redetermination, except that a request for an appeals conference may be denied. (Cal. Code Regs., tit. 18, § 35019(b); see also former Cal. Code Regs., tit. 18, § 5520(b).) The acceptance of the appeal as an administrative protest does not stay CDTFA's efforts to collect any such final liability that remains unpaid; however, the Business Tax and Fee Division of CDTFA may, in its sole discretion, stay efforts to collect a final liability. (Cal. Code Regs., tit. 18, § 35021; see also former Cal. Code Regs., tit. 18, § 5220.6.)

If CDTFA's subsequent decision regarding the administrative protest is adverse to the person, in whole or in part, then, as with an adverse decision regarding a timely petition for redetermination, that person may appeal the decision to OTA (or BOE through 2017) no later than 30 days from the date CDTFA issued its decision. (Cal. Code Regs., tit. 18, §§ 30103(b)(1), 30203(b)(1); see also former Cal. Code Regs., tit. 18, § 5266(b).)

As noted earlier, appellant originally appealed CDTFA's decision regarding its administrative protest to BOE, and then BOE's duties, powers, and responsibilities for conducting business tax appeals hearings transferred to OTA. The scope of OTA's present inquiry is limited to whether OTA's own review of CDTFA's partial denial of appellant's appeals, including the administrative protest, is subject to the automatic stay. OTA is not examining whether the automatic stay or an exception thereto applies to CDTFA's collection activities, if any, or to any state tax lien that may or may not arise as a matter of law with respect to the determination that is the subject of appellant's administrative protest.

With that said, OTA's appellate role remains the same whether CDTFA denied a timely petition for redetermination or an administrative protest, in whole or in part: reviewing CDTFA's adverse decision to determine whether further adjustments are warranted. Although an administrative protest relates to a "final" determination, OTA will still review CDTFA's decision regarding it in the same manner as a timely petition for redetermination, which means the determination may still be reduced. OTA's appellate jurisdiction is (and BOE's was) derived from CDTFA's decisions that are adverse to taxpayers, not from the type of appeal being decided, whether a timely petition for redetermination, a claim for refund, or an administrative protest. (See Cal. Code Regs., tit. 18, § 30103(b)(1) [OTA has jurisdiction to hear and decide timely-submitted appeals to OTA if CDTFA's decision is wholly or partly adverse to the taxpayer]; see also former Cal. Code Regs., tit. 18, § 5266(b).) Accordingly, OTA may conclude that further adjustments to CDTFA's underlying determination may be warranted; thus, as with timely petitions for rehearing, OTA's review is a step in establishing or refining an appellant's tax liability. Therefore, OTA concludes that its review of CDTFA's partial denial of appellant's administrative protest is part of the process of making a tax assessment and, per U.S. Bankruptcy Code section 362(b)(9)(D), is excepted from the automatic stay.

Issue 2: Whether the U.S. bankruptcy court has exclusive jurisdiction over these appeals.

On appeal, appellant argues that the U.S. bankruptcy court has exclusive jurisdiction to resolve the merits of CDTFA's pending tax claim against appellant. Appellant acknowledges that the U.S. bankruptcy court may relinquish its exclusive jurisdiction upon a tax agency's motion, but contends that CDTFA has not made, and the U.S. bankruptcy court has not granted, any such motion; accordingly, appellant argues that the U.S. bankruptcy court still retains exclusive jurisdiction.

In response, CDTFA argues that the U.S. bankruptcy court's jurisdiction over technical tax disputes is permissive, not mandatory, and that the U.S. bankruptcy courts have recognized that state forums are more appropriate for, and efficient at, determining state tax liabilities.

Pursuant to U.S. Bankruptcy Code section 505(a), the U.S. bankruptcy court "may" determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction. (11 U.S.C. § 505(a)(1).) This section has two purposes: (1) to provide an alternative forum for the prompt determination of tax claims if the administration of the bankruptcy case would be delayed by allowing the determinations to be made in other proceedings and/or various jurisdictions; and (2) to provide an opportunity for the trustee to contest a tax claim in order to protect creditors from the dissipation of estate assets if the debtor had been unable or unwilling to challenge the claim prepetition. (*In re Stone* (Bankr. M.D.Fla. 2005) 329 B.R. 882, 885; *In re Cable & Wireless USA, Inc.* (Bankr. D.Del. 2005) 331 B.R. 568, 575.)

The fact that the U.S. bankruptcy court may serve as an alternative forum for these business tax appeals indicates that its jurisdiction over them is not exclusive, but concurrent. The U.S. bankruptcy court's jurisdiction over these appeals may also be merely permissive and secondary based on how they can be transferred from OTA to the U.S. bankruptcy court: at the behest of the debtor (i.e., appellant), not CDTFA, contrary to appellant's assertion on appeal. If a debtor decides to litigate a tax claim filed against it, and to do so in U.S. bankruptcy court, it starts the process by filing a written objection to that claim with the U.S. bankruptcy court. (11 U.S.C. § 502(a); Fed. R. Bankr. P. 3007.)

Here, nothing in the record before OTA indicates that appellant (or its trustee) has filed any objection to the claim CDTFA filed with the U.S. bankruptcy court on May 26, 2016, and amended on March 7, 2017. Neither has appellant (nor its trustee) withdrawn these appeals before OTA, which appellant initiated with OTA's predecessor, BOE. Despite its assertion that the U.S. bankruptcy court has exclusive jurisdiction over these appeals, appellant has apparently done nothing to initiate the process of litigating these matters before the U.S. bankruptcy court. Based on both the applicable bankruptcy law and the practical effect of appellant's inaction, OTA concludes that the U.S. bankruptcy court does not have exclusive jurisdiction over these appeals.

Issue 3: If the automatic stay does not apply to these business tax appeals, and the U.S. bankruptcy court does not have exclusive jurisdiction over them, whether a further reduction to the aggregate amount of unreported taxable sales is warranted.

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of all tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051; see also R&TC, § 6012(c).) All of a retailer's gross receipts are presumed subject to tax unless the retailer can prove otherwise. (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 any person, or if any person fails to make a return, CDTFA may determine the amount required to be paid based on any information within its possession or that 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 Amaya*, 2021-OTA-328P.) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

If CDTFA carries its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Appeal of AMG Care Collective*, *supra*.) Unsupported assertions are not sufficient to satisfy the burden of proof. (*Appeal of Amaya*, *supra*.) To satisfy its burden of proof, a taxpayer must prove two things: (1) the tax assessment is incorrect; and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, *supra*.)

Here, because appellant failed to provide any books and records for audit despite numerous requests, CDTFA decided to use the markup method to determine appellant's taxable sales. The markup method is a recognized and accepted accounting procedure. (*Appeal of Amaya*, *supra*.) Accordingly, OTA finds that CDTFA's use of the markup audit method was appropriate.

However, the markup method is only effective and reliable if CDTFA has sufficient information to establish the cost of taxable merchandise sold and a reasonable markup. (*Appeal of Amaya*, *supra*.) Here, CDTFA acquired cost information about appellant's chicken purchases during the combined liability period directly from appellant's chicken vendor, which OTA finds is a reasonable source of cost information.

As for the 804.32 percent fresh-chicken markup, CDTFA calculated it in a prior audit of appellant for the period of July 1, 2001, through June 30, 2005, by comparing appellant's menu selling prices to its costs for June 2002, June 2003, May 2004, and February 2005. Appellant appealed the result of that prior audit to OTA's predecessor, BOE, who reviewed CDTFA's audit method, and determined that no adjustment to either the fresh-chicken markup or the audit result was warranted. OTA finds that, in the absence of appellant's books and records for the current combined liability period, CDTFA's use of a fresh-chicken markup established in a prior audit of appellant and for which BOE determined that no adjustment was warranted is itself reasonable. Accordingly, OTA concludes that CDTFA's determination of audited taxable chicken sales based on the markup method is reasonable and rational.

OTA has also reviewed CDTFA's audit method and calculations for establishing audited taxable non-chicken sales. CDTFA took the ratio of audited taxable non-chicken sales to audited taxable chicken sales it established for appellant in the prior audit, and applied it to audited taxable chicken sales in the current audit at issue. OTA finds this audit method reasonable on the basis that it would be unlikely that such a ratio would vary significantly from audit to audit for a business operating restaurants specializing in chicken (and waffles). Thus, OTA finds that CDTFA's determination of audited taxable non-chicken sales is also reasonable and rational.

Because OTA concludes that CDTFA has carried its minimal, initial burden of showing that its determination of appellant's audited taxable sales of chicken and non-chicken items was reasonable and rational, the burden of proof now shifts to appellant to establish that a different result is warranted.

On appeal, appellant argues that CDTFA's use of a markup from a prior audit was an "improper shortcut" because CDTFA could have calculated a new markup for the present audit without appellant's books and records. After recounting the various steps CDTFA took to calculate the prior markup, appellant argues that CDTFA should have taken those same steps

again for this audit, including conducting a shelf test,[7] acquiring information about merchandise purchases from appellant's third-party vendors, and conducting observations at appellant's various restaurants. Appellant also argues that CDTFA should have acquired the cost of non-chicken items directly from appellant's vendors, pursuant to CDTFA's Audit Manual, rather than applying a ratio.

Appellant's critiques of CDTFA's audit method fail to carry its burden of proof. CDTFA may base its determination of the amount of tax required to be paid by appellant on any information within its possession or that may come into its possession. (R&TC, §§ 6481, 6511.) "Any information" includes markup percentages and ratios that CDTFA established in a prior audit after apparently expending considerable effort (as recounted by appellant in its argument above), and to which OTA's predecessor, BOE, determined no adjustments were warranted on appeal. To satisfy its burden of proof, appellant must not just aim generalized critiques at CDTFA's audit method, but prove by a preponderance of evidence that CDTFA's tax assessment is incorrect and what the proper amount of tax should be. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of AMG Care Collective*, *supra*.) Despite its critiques, appellant has done neither. Accordingly, OTA finds that a further reduction to the aggregate amount of unreported taxable sales is unwarranted.

[7] A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

## HOLDINGS

1. The automatic bankruptcy stay does not apply to these business tax appeals before OTA.
2. The U.S. bankruptcy court does not have exclusive jurisdiction over these business tax appeals.
3. A further reduction to the aggregate amount of unreported taxable sales is not warranted.

## DISPOSITION

CDTFA's action partly granting and partly denying appellant's administrative protest and petition for redetermination is sustained.

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Andrew Wong
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

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Administrative Law Judge

Date Issued: 4/20/2023