OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21129372 CDTFA Case ID: 1-984-688
MS FOODS, LLC **dba Hooters of Riverside**	

OPINION

Representing the Parties:

For Appellant: Mahmood A. Saifie, LLC Member

For Respondent: Randy Suazo, Hearing Representative
Cary Huxsoll, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, MS Foods, LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's petition for redetermination of a Notice of Determination (NOD) dated January 2, 2020. The NOD is for tax of $192,707, applicable interest, a negligence penalty of $4,034, and a 40 percent penalty of $60,945,[1] for the period April 12, 2018, through June 30, 2019 (liability period).

On appeal to the Office of Tax Appeals (OTA), CDTFA concedes to reducing the determined measure of tax from $2,202,356 to $2,140,696, which will reduce the tax and penalties.

OTA Administrative Law Judges Andrew J. Kwee, Andrew Wong, and Eddy Y.H. Lam held an oral hearing for this matter in Cerritos, California, on March 15, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

[1] The negligence penalty was imposed for the fourth quarter of 2018 (4Q18) and the 40 percent penalty was imposed pursuant to R&TC section 6597 for the reminder of the liability period.

ISSUES

1. Whether appellant established a basis for any adjustments to the measure of unreported taxable sales.
2. Whether the negligence penalty was properly imposed.
3. Whether CDTFA properly imposed a 40 percent penalty pursuant to R&TC section 6597 and, if so, whether appellant established a basis for relief from that penalty.

FACTUAL FINDINGS

1. Appellant, a limited liability company doing business as Hooters of Riverside, operated a Hooters-branded restaurant as a franchisee in Redlands, California. The restaurant included an eating area with 46 tables, including 15 twelve-person tables, and also operated a bar with seating for 14 people.
2. Appellant's seller's permit was opened with an effective start date of April 12, 2018. The restaurant was open 7 days a week.
3. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total and taxable sales of $91,511, claiming no deductions.
4. Appellant used a point-of-sale (POS) system to record sales and sales tax reimbursement collected. Appellant's franchisor, Hooters of America, LLC (HAL), also received and maintained appellant's POS data.
5. For audit, appellant provided a sales report (GL Commit Report) generated by its POS system on August 7, 2019, for the period April 12, 2018, through September 30, 2018,[2] and a copy of a Form 1099-K[3] issued to appellant for 2018, for sales that appellant made via Uber Eats.
6. According to the GL Commit Report, appellant recorded total sales of $935,977, discounts and coupons of $36,255, and recorded taxable sales of $899,722.

[2] The date range on the GL Commit Report lists April 12, 2018, through June 30, 2019. However, appellant's representative clarified that the correct range covered by the report is only the dates noted above.

[3] Form 1099-K is an Internal Revenue Service form titled "Payment Card and Third Party Network Transactions," which shows the 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.

7. Appellant recorded collecting sales tax reimbursement of $70,556.49 for the period April 12, 2018, through September 30, 2018. According to CDTFA's records, appellant reported sales tax of $4,452 to CDTFA for the same period.
8. Appellant reported to CDTFA that appellant had no sales data for 4Q18, and that it had not provided any sales data for 2019 to CDTFA. Based on appellant's statements, CDTFA concluded that further review of appellant's records was warranted to verify reported taxable sales for 4Q18 and 2019.
9. On August 26, 2019, CDTFA met with appellant at appellant's business location to obtain a copy of appellant's POS data. CDTFA observed that appellant used POSitouch software to record its sales data. During the meeting, Mr. Saifie, on behalf of appellant, accessed the POS system and provided the POS data to CDTFA for the period December 30, 2018, through July 26, 2019. Mr. Saifie did not provide appellant's 2018 POS data to CDTFA.
10. Mr. Saifie reported to CDTFA that appellant used the POS data to report sales to its franchisor, HAL, which was required in order to determine the amount of royalty payments appellant owed to HAL. Appellant did not use the POS data to report sales to CDTFA.
11. Appellant's reporting method for the SUTRs covering the liability period is unknown because appellant's recorded taxable sales (per the POS data) bear no relation to its reported taxable sales.
12. Appellant did not provide any other requested books and records such as purchase journals; bank statements; federal income tax returns; or source documentation, such as guest checks, cash register tapes, or merchandise purchase invoices.
13. According to appellant's POS data, appellant's POS system recorded taxable sales of $893,970 and recorded sales tax reimbursement collected of $77,648 for the period January 1, 2019, through June 30, 2019. According to CDTFA's records, appellant reported sales tax of $3,947 to CDTFA for this same period.
14. CDTFA requested appellant's sales information for appellant's franchise location from appellant's franchisor, HAL, for the period April 1, 2018, through September 30, 2018. HAL provided the requested sales reports, identified as "POS System Database File," to CDTFA. The sales reports included the amount of sales tax collected on every

transaction during the reporting period. According to HAL's sales reports, appellant recorded taxable sales of $933,265 for April 1, 2018, through September 30, 2018, which greatly exceeded reported taxable sales of $37,160 for the same period.

15. CDTFA concluded that the POS data and HAL's sales reports were the best evidence of taxable sales. CDTFA computed audited taxable sales of $1,827,235 for the periods April 1, 2018, through September 30, 2018 ($933,265), and January 1, 2019, through June 30, 2019 ($893,970). CDTFA also concluded that for 4Q18 (which was not included in either sales source) the average quarterly taxable sales of $466,632 from HAL's sales reports were reasonable. In total, CDTFA computed audited taxable sales of $2,293,867 ($1,827,235 + $466,632) for the liability period. Upon comparison to reported taxable sales of $91,511, CDTFA computed unreported taxable sales of $2,202,356.

16. On January 2, 2020, CDTFA issued the NOD to appellant for the liabilities disclosed by audit.

17. Appellant filed a timely petition for redetermination disputing the NOD in its entirety.

18. CDTFA issued its decision on December 6, 2021, denying the petition.

19. Appellant timely appealed to OTA.

20. HAL's sales reports included sales for the period April 1, 2018, through April 11, 2018. Based on a reaudit report dated February 3, 2022, CDTFA now concedes that during that period, appellant's Hooters location was operated by a different taxpayer who reported the sales under its own seller's permit. Using HAL's sales reports for only April 12, 2018, through September 30, 2018, CDTFA concedes to reducing the audited taxable sales from $933,265 to $879,702 for this period. This reflects sales tax collected of $76,974 for the period. According to CDTFA's records, appellant reported sales tax of $4,452 to CDTFA for the same period.

21. CDTFA also made a corresponding adjustment to audited taxable sales for 4Q18, which was computed based on appellant's average daily taxable sales of $5,039 (rounded), and the number of days in that reporting period (91 days).

22. In total, CDTFA computed audited taxable sales of $458,535 (rounded)[4] for 4Q18, and $2,232,207 for the liability period ($1,773,672 + $458,535). Upon comparison to

[4] $5,038.84 x 91 days = $458,534.52.

reported taxable sales of $91,511, CDTFA computed unreported taxable sales of $2,140,696.[5]

23. In summary, appellant's own records reflect collecting sales tax reimbursement of $70,556.49 for the period April 12, 2018, through September 30, 2018 (per appellant's GL Commit Report), and $77,648.00 for the period January 1, 2019, through June 30, 2019 (per appellant's POS data). In addition, appellant's franchisor recorded sales tax collected by appellant of $76,974.00 for the period April 12, 2018, through September 30, 2018. According to CDTFA's records, appellant reported sales tax of $4,452.00 to CDTFA for the period April 12, 2018, through September 30, 2018, and appellant reported sales tax of $3,947.00 for the period January 1, 2019, through June 30, 2019.

24. CDTFA's concession to delete sales for the period April 1, 2018, to April 11, 2018, and recompute average quarterly sales for 4Q18, reduces the measure of tax by $61,660 from $2,202,356 to $2,140,696.

25. Appellant also provided evidence of certain recurring business expenses. First, appellant submitted financial statements indicating that it leased the business premises and incurred the following monthly charges, payable to the landlord: rent, $18,150.00; property tax, $1,688.00; insurance, $308.00; utilities, $501.00; and common area surcharges, $1,365.00. Second, appellant provided one monthly utility statement indicating a charge of $2,409.87 for electricity, plus $224.94 for city services.

DISCUSSION

Issue 1. Whether appellant established a basis for any adjustments to the measure of unreported taxable sales.

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC,

[5] $1,687,712 for April 1, 2018, through September 30, 2018, and January 1, 2019, through June 30, 2019 + $452,984 for 4Q18.

§ 6091.) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When 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*.)

Here, appellant's books and records provided for audit were limited and incomplete. Appellant did not provide source documentation, such as guest checks or cash register tapes, supporting reported sales. It is the retailer'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).) CDTFA compiled recorded taxable sales of $893,970 using appellant's POS data for January 1, 2019, through June 30, 2019, which vastly exceeded reported taxable sales of $48,800 for that period. CDTFA also compiled taxable sales of $933,265 (later reduced to $879,702) using the franchise sales reports for April 1, 2018, through September 30, 2018, which vastly exceeded reported taxable sales of $37,160 for that period.

In light of the substantial discrepancies between appellant's own records, and its reported taxable sales, it was reasonable and rational for CDTFA to compute taxable sales based on a combination of appellant's POS sales data and sales reports provided by appellant's franchisor. In absence of any records, CDTFA's use of the average quarterly taxable sales (and average daily taxable sales in the reaudit) to calculate audited taxable sales for 4Q18 is a recognized and standard accounting procedure. (See *Appeal of Amaya*, 2021-OTA-328P; *Riley B's, Inc. v. State*

Bd. of Equalization (1976) 61 Cal.App.3d 610, 612-613.) Appellant's POS data is evidence of appellant's sales.

OTA further finds that the sales reports provided by the franchisor for its franchisee's location are a credible and reliable source of data from which to establish recorded taxable sales. OTA similarly finds that appellant's own POS data is a credible and reliable source to establish recorded taxable sales. Thus, OTA finds that CDTFA met its initial burden to show that its determination was reasonable and rational. Therefore, appellant has the burden of establishing adjustments are warranted.

During the oral hearing, appellant raised four contentions in support of adjustments. Appellant first contends that the recorded sales (both from HAL and its own POS data) are overstated because there were transactions where appellant obtained a preauthorization to charge the customer's credit card for the meal, but appellant ultimately did not receive payment from the credit card. In support, appellant submitted a screenshot of a system showing "problems" with 12 orders during the period January 25, 2023, through February 7, 2023, totaling $1,028.66.[6] As a general matter, a bad debt deduction is allowable to the extent the taxable measure is allocable to transactions found worthless and charged off for income tax purposes (bad debts). (Cal. Code Regs., tit. 18, § 1642.) Here, appellant did not provide any evidence that it charged off bad debts for income tax purposes during the liability period. As such, no deduction is allowable on this basis. It is also worth mentioning that the identified "problem" transactions all occurred after the liability period so, even if OTA were to find that an adjustment was warranted for any of the transactions identified, OTA would lack jurisdiction to grant an adjustment in this appeal because the later liability period is not before OTA.[7]

Appellant's second contention is that HAL's sales report included data from four other Hooters restaurant locations,[8] not just appellant's restaurant and, as such, HAL's records for the period April 12, 2018, through September 30, 2018, are overstated. In support, appellant

[6] Appellant submitted a screenshot of a system reporting "problems" with 12 orders, and a separate screen shot of 11 transactions listed in red as "! Sale." OTA infers that these are the problem transactions. Appellant submitted a third screenshot dated February 8, 2023, listing 24 "Problems" for an unspecified time period.

[7] The parties indicated that appellant was audited for a later audit period; however, appellant failed to timely appeal that matter and it is now a final liability.

[8] Appellant previously contended that HAL's records were overstated because it erroneously included appellant's sales for 2016 and 2017. For ease of analysis, this Opinion only addresses appellant's most recent contention in connection with HAL's records.

provided a copy of a "GL Commit Report," dated August 7, 2019. This document appears to be the same as the copy CDTFA obtained and included with CDTFA Audit Schedule 12B-1. CDTFA's audit work paper comments note that appellant stated that while the GL Commit Report should have included sales for the liability period, the sales totals included only 2Q18 and 3Q18. Appellant now argues that the GL Commit Report establishes recorded sales tax of $78,556, and this amount should be used to establish unreported taxable sales for the liability period. During audit, CDTFA concluded that the GL Commit Report was unreliable to establish audited taxable sales for the liability period since appellant previously reported it only covered 2Q18 and 3Q18. In addition, recorded taxable sales of $893,970 using appellant's own POS data for January 1, 2019, through June 30, 2019, alone was about as much as the taxable sales of $897,788 as listed in the GL Commit Report (which is consistent with appellant's original statement that it only covers 2 quarters). Finally, the assertion that the HAL data includes sales from five locations does not appear credible considering the fact that appellant's own records recorded taxable sales of $893,970 for the two reporting periods in 2019, and this amount is consistent with the $879,702 that appellant reported to its franchisor for the two quarters in 2018 (and considering that this later period is short of two quarters by 11 days). Thus, OTA finds no adjustment is warranted on this basis.

Appellant's third contention is that its employees embezzled from appellant, and appellant never recovered the money. In support, appellant provided a police report filed on January 8, 2021, for events occurring from January 1, 2019, through December 20, 2019. During the hearing, appellant acknowledged that the District Attorney did not pursue criminal charges in the matter; however, appellant contends that the money was never returned to appellant. As such, appellant contends that it does not have the funds to remit to CDTFA.

Appellant's fourth contention is also related to ability to pay; appellant contends that it was sued by former employees for over $250,000, and appellant is on the brink of filing for bankruptcy.[9] Appellant also provided some billing statements. During the oral hearing, OTA informed appellant that OTA lacks jurisdiction to consider settlement, bankruptcy, risks of litigation, or ability to pay in deciding this appeal. (See *Appeals of Dauberger*, *et al.* (82-SBE-082) 1982 WL 11759.) CDTFA indicated that it was unwilling to consider settlement because

[9] It is not clear from the record if the persons who allegedly embezzled funds from appellant are the same or different persons from the former employees currently suing appellant. Appellant did not provide any documentation about pending litigation.

two prior negotiations fell through, and that it cannot consider an Offer in Compromise (OIC) until the liability became final, which would be after OTA issues an Opinion and CDTFA issues a Notice of Redetermination incorporating CDTFA's concessions. (R&TC, § 6564.) As such, OTA is unable to make adjustments on this basis.

In summary, it was reasonable and rational for CDTFA to compute audited taxable sales based on appellant's records, and either average daily sales or the records provided by appellant's franchisor (for periods where appellant did not have records). CDTFA computed audited taxable sales based on the best available evidence. Appellant has not identified any errors in CDTFA's computation of audited taxable sales or provided documentation or other evidence to support that its franchise sales reports or POS sales data are inaccurate or are otherwise unreliable. Moreover, OTA has no authority to either settle or compromise a tax liability, and OTA's jurisdiction in this case is limited to determining the correct amount of an appellant's tax liability. As appellant bears the burden of proof in this case but failed to carry it, OTA must conclude that no adjustments to unreported taxable sales are warranted.

Issue 2. Whether the negligence penalty was properly imposed.

CDTFA imposed a 10 percent negligence penalty of $4,034 for 4Q18, the quarter for which records were not available.

If all or any part of a deficiency for which a NOD is issued was due to negligence or intentional disregard of the law, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) There is no provision in the law which would authorize relief or waiver of a properly imposed negligence penalty. (*Ibid*.) Failure to maintain and keep complete and accurate records will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).) Generally, a negligence penalty should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the law. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Here, appellant reported $5,551.00 in taxable sales (representing sales tax of $543.00) for its Hooters of Riverside business location during 4Q18. CDTFA estimated taxable sales of $458,535.00, based on appellant's recorded taxable sales for the two preceding and two

succeeding quarterly reporting periods. Appellant operated a restaurant that was open 7 days a week, with a bar with 14 stools, and a restaurant with 46 tables, including 15 twelve-person tables. Appellant's reported sales results in average restaurant sales of $61.00 per day ($5,551.00 ÷ 91 days) and $1,850.00 per month. Nevertheless, appellant submitted financial statements for the oral hearing reflecting the following recurring monthly charges related to its leased premises: rent of $18,150.00; property tax of $1,688.00; insurance of $308.00; utilities of $501.00; and common area surcharges of $1,365.00. Appellant also provided a utility statement indicating a charge of $2,409.87 for electricity, plus $224.94 for city services, for the month covered by the billing statement. In other words, appellant incurred fixed charges for monthly rent and utilities of approximately $25,000.00, not including employee wages, royalty payments to HAL, and costs for food and supplies. Appellant continues to operate to this day.

Appellant's reported monthly sales of $1,850 are implausible considering appellant's monthly expenses. Appellant's average daily sales of just $61 per day for a Hooters restaurant with a bar with seating for hundreds of people is also unrealistic and not believable. Furthermore, appellant reported only 1 percent of its audited taxable sales. This represents an error ratio of 8,260 percent. Nevertheless, it is evident that appellant knew how to access its POS data, given that appellant reported the data to its franchisor, HAL. Furthermore, CDTFA's auditor observed appellant's representative, Mr. Saifie, properly access the data to provide reports to CDTFA. Under these facts, there is no reasonable explanation, other than intentional disregard of the law, to explain appellant's failure to review its POS data and report the recorded taxable sales to CDTFA.

In summary, appellant knew that the amounts being reported on its SUTRs bore no relation to the amounts recorded in its own records, and appellant knew how to access and review the POS data. Nevertheless, appellant reported only 1 percent of its sales to CDTFA. This is sufficient to establish that imposing the negligence penalty was proper, even though this was appellant's first audit.

Issue 3. Whether CDTFA properly imposed a 40 percent penalty pursuant to R&TC section 6597 and, if so, whether appellant established a basis for relief from that penalty.

CDTFA imposed a 40 percent penalty for 2Q18, 3Q18, 1Q19, and 2Q19 (all quarters in the liability period except for 4Q18).

R&TC section 6597 provides, in pertinent part, that any person who knowingly collects sales tax reimbursement and who fails to timely remit it to the state shall be 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 sales 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 sales tax reimbursement was collected for the period in which the tax was due, whichever is greater. (R&TC, § 6597(a)(2)(A).) The law provides for relief of the 40 percent penalty for reasonable cause. (R&TC, § 6597(a)(2)(B).)

Here, appellant's liability for collected and unremitted sales tax is $147,675[10] for these four quarterly reporting periods (12 months). This corresponds to, on average, $12,306 in collected and unremitted sales tax reimbursement per month. The total amount of the tax liability for these four quarterly reporting periods is $155,196.[11] Appellant's liability for unremitted sales tax averages 95 percent of its total tax liability for sales on which tax reimbursement was collected from customers. This exceeds the $1,000 per month and 5 percent thresholds. Furthermore, Mr. Saifie demonstrated to CDTFA actual knowledge of how to access and review the POS reports which reflected sales tax collected. Mr. Saifie also reported to CDTFA that appellant used this POS data to report its sales to HAL, and to calculate the amount of royalty payments due to HAL. As such, appellant had actual knowledge of the collected sales tax reimbursement. Therefore, the elements required to impose the 40 percent penalty have been met.

The law provides for relief of the 40 percent penalty if the person's failure to make a timely remittance of sales tax reimbursement is due to reasonable cause or circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. (R&TC, § 6597(a)(2)(B).) As discussed above under Issue 2, CDTFA's auditor observed appellant properly access the data to provide the sales reports to CDTFA, and thus there is no reasonable explanation, other than intentional disregard of the law, to explain appellant's failure to review its own POS data and report the recorded taxable sales to CDTFA.

To the contrary, appellant had the requisite knowledge to access and review the POS

[10] See CDTFA Audit Schedule R1-12A, column O.

[11] See CDTFA Audit Schedule R1-12A-1, column E, rows 11, 12, 14, and 15 (row 13 represents 4Q18, the quarter for which the R&TC section 6597 penalty was not imposed, and this analysis excludes that quarter).

data, and appellant's representative, Mr. Saifie, demonstrated to CDTFA that he had the requisite knowledge and skills to access the data and generate reports using the data. Furthermore, appellant did in fact report such data to its franchisor, HAL, which is demonstrated by the fact that HAL turned appellant's reports over to CDTFA. Nevertheless, appellant reported unrealistic daily and quarterly sales amounts to CDTFA, which are not believable in light of appellant's documented monthly operating expenses.

In summary, appellant knew that the amounts being reported on its SUTRs bore no relation the amounts recorded in its own records. OTA rejected the explanations provided by appellant (e.g., embezzlement, inability to pay, unreliable data) as unsupported under the facts. As such, there is no basis for relief of the penalty.

HOLDINGS

1. Appellant failed to establish a basis for any adjustments to the measure of unreported taxable sales.
2. The negligence penalty was properly imposed.
3. Appellant is liable for the 40 percent penalty.

DISPOSITION

The measure of tax shall be reduced as conceded by CDTFA by $61,660, from $2,202,356 to $2,140,696. In all other respects, CDTFA's action is sustained.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

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Eddy Y.H. Lam
Administrative Law Judge

Date Issued: 5/4/2023