OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 21078259
	) CDTFA Case ID 1-708-631
T. LE	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	T. Le Th. Le, Appellant's Spouse
For Respondent:	Randy Suazo, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, T. Le (appellant) appeals respondent California Department of Tax and Fee Administration's (CDTFA's) decision denying appellant's petition for redetermination of a Notice of Determination (NOD) dated June 30, 2020.[1] The NOD is for tax of $18,121, plus applicable interest, for the period of October 1, 2016, through September 30, 2019 (audit period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Keith T. Long, and Andrew J. Kwee held an oral hearing for this matter in Cerritos, California, on February 15, 2023. At the conclusion of the hearing, the record remained open to receive

[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.

[2] CDTFA timely issued the NOD because appellant waived the otherwise applicable statute of limitations and consented to extend the deadline for issuing an NOD until October 31, 2020. (See R&TC, §§ 6487(a), 6488.)

additional submissions from the parties. Following the parties' submissions, the record closed on April 18, 2023, and this matter was submitted for an opinion.[3]

ISSUES

1. Whether adjustments to the amount of disallowed claimed exempt food sales are warranted.
2. Whether adjustments to the amount of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, operated a business in Anaheim, California, from January 2, 2015, through August 26, 2019. At the beginning of the audit period, appellant did business under the name "OC Poultry & Rotisserie Market." On January 1, 2017, appellant changed the business's name to "OC Tasty Chicken & Bánh Mì."[4]
2. In January 2017, appellant revised its paper menu, a photo of which was included in the evidentiary record before OTA.[5] The paper menu consisted of six panels.
3. The paper menu's first panel listed the business's name, contact information, and opening hours. It also described appellant's business as a "Vietnamese Deli & Food to Go [sic]," and depicted a stylized bowtie-wearing rooster carrying a baguette. Below the rooster was the slogan "Come Hungry & Leave Happy."
4. The paper menu's second through fifth panels contained the following food categories: "Vietnamese Bánh Mì" (listing 14 variations including chicken rotisserie, fried egg, veggies with cheese);[6] "Entrees" (listing eight items including rice plates, noodles, chicken curry, salads, etc.); "Full Course Meals" (listing four items including rotisserie

[3] The English version of the Opinion will be the official version of this Opinion. Any differences in the translated version are not binding on OTA or the parties. The differences, if any, shall have no legal effect. The translated version is provided as a courtesy only. If there are any questions related to the information contained in the translated version, refer to the official Opinion for clarification. Please note that the official version of the Opinion published on OTA's website may be later updated to include non-substantive (errata) revisions. However, the translated version will not be updated for errata revisions.

[4] According to appellant, bánh mì is a Vietnamese-style sandwich.

[5] The record contains no prior version of appellant's paper menu.

[6] There is also a "Veggie's Delight" bánh mì sandwich.

chicken, lemongrass steak, grilled pork); "Side Orders" (listing seven items including spring rolls, egg rolls, green salad); "From the Roaster" (listing seven items comprising various cooked meats or poultry by the pound or by individual unit); and "Beverages" (comprised of various Vietnamese coffees; yogurt slushies and smoothies/slushes; and hot, cold, fruit-flavored, and milk teas).

5. The top two-thirds of the paper menu's sixth and final panel described "Catering & Party Trays," which included bánh mì platters, pots of chicken curry or beef stew, and rotisserie chicken trays. The bottom third of the panel was reserved for "Fresh Poultry From The Farm," and listed the following five items for sale: young brown hen/rooster for a unit price; white hen by the pound; chicken feet by the pound; duck for a unit price; and chicken eggs.
6. Hanging inside appellant's business were large poster boards with the names, pictures, and prices of food items from some of the paper menu's categories (specifically, "Vietnamese Bánh Mì," "Entrees," and "Full Course Meals"). Similar poster boards hung in the business's windows, next to the entrance, and faced outwards. Images of beverages also hung inside the business and in its front window.
7. Outside appellant's business was a large sign with the business's name, "OC Tasty Chicken & Bánh Mì," and the stylized rooster. Below the sign were the following words: "VIETNAMESE SANDWICHES * FOOD TO GO * COFFEE & BOBA DRINKS."
8. Inside appellant's business were four tables with chairs.
9. Against one wall were four shelves that held snack items such as cookies, chips, and candies, as well as food products that could not be consumed on the premises (e.g., dry noodles/ramen, bottled marinade and sauces, and bags/boxes of sugar). Some household items (i.e., laundry detergent, air freshener spray, and bottled hand soap) occupied half a shelf. Above the shelves hung a banner listing the beverage menu items, as well as four large pictures depicting brown eggs and uncooked whole poultry.
10. The business also had two display refrigerators mainly containing drinks (bottled and canned carbonated beverages, teas, energy drinks, and water) and some raw eggs, a refrigerated display case containing iced coffees, teas, and fresh coconuts, and a heated case with puff pastries.

11. For the audit period, appellant reported total sales of $413,378 (including a final sale of fixtures and equipment for $8,750 in the third quarter of 2019 (3Q19)), claimed exempt sales of food products of $236,494, and reported taxable sales of $176,884.

12. For the audit, which began in September 2019, appellant provided federal income tax returns (FITRs) for 2016, 2017, and 2018; bank statements for 2016, 2017, 2018 and 2019; an Excel spreadsheet that summarized total daily sales; and vendor receipts for 2017 and 2018. Appellant did not provide source documents for sales, stating during the audit that he had recently thrown out many boxes of daily sales receipts dating back to 2014. Appellant also indicated during the audit that he could not reprint them or provide batch reports regarding his sales because he did not have a point-of-sale (POS) system.[7]

13. Because appellant did not provide any POS sales invoices or batch reports, CDTFA could not verify appellant's reported taxable and nontaxable sales or the daily sales recorded in appellant's Excel spreadsheet. And because appellant had closed its business before CDTFA began the audit in September 2019, CDTFA did not have an opportunity to visit and observe the business while it was operating.

14. Instead, CDTFA searched for appellant's business on an online search engine (Google) and a business review website (Yelp.com), and found both reviews and over 500 pictures, including of the business's interior, exterior, and paper menu. Yelp.com categorized appellant's business as a Vietnamese fast-food restaurant.

15. Based on these, CDTFA determined that appellant's business was mainly a fast-food restaurant with a small grocery section. CDTFA further determined that 90 percent of all the food products appellant sold were taxable by virtue of appellant providing tables for consumption at the business premises, or because they were hot prepared foods, and the remaining 10 percent were exempt food products and/or not suitable for consumption on the premises (i.e., dry noodles, marinade and sauces, sugar, etc.). CDTFA also concluded that appellant's business satisfied the "80-80 rule" (described below) so that all of appellant's sales of food suitable for consumption on the premises were subject to tax and that no deduction was warranted for sales of restaurant menu items sold as cold food "to

[7] In a June 30, 2020 letter to appellant, under the heading "Reporting Method," CDTFA states that appellant utilized a Clover POS system. It is not clear from the record how or why CDTFA concluded that appellant utilized a POS system. In any case, the issue is not relevant to OTA's analysis, and OTA will not address the issue of whether a POS system existed further.

go." Accordingly, CDTFA disallowed 90 percent, or $212,845, of appellant's claimed total deduction of $236,494 for exempt food sales for the audit period.[8]

16. CDTFA then used the markup audit approach to analyze whether appellant's reported sales were accurate.

17. CDTFA found that the gross receipts appellant reported on his FITRs reconciled with the total sales appellant reported on his sales and use tax returns. CDTFA reduced the costs of goods sold that appellant claimed on his FITRs by 2 percent for self-consumption and 1 percent for spoilage. CDTFA then used both the gross receipts that appellant reported on his FITRs and the adjusted costs of goods sold to compute book markups of 88.74 percent for 2016, 161.58 percent for 2017, and 183.62 percent for 2018.[9]

18. CDTFA found the book markups for 2016 and 2017 to be lower than expected but the markup for 2018 to be reasonable. In reaching this conclusion, CDTFA referred to the recent audits of three restaurants for which it had computed an average markup of 188.35 percent: (a) an Asian restaurant in Garden Grove with a markup of 188.37 percent; (b) an Asian restaurant in Westminster with a markup of 193.12 percent; and (c) a Thai restaurant in Orange with a markup of 183.56 percent. All three restaurants were within 23 miles of appellant's business.

19. To calculate audited taxable sales on a markup basis, CDTFA further reduced the adjusted costs of goods sold by an estimated 10 percent for the costs of appellant's exempt food sales. CDTFA then added a markup of 183.62 percent (derived from appellant's own records for 2018) to costs of goods sold (adjusted for exempt food sales) to compute audited taxable sales of $190,720 for 2016, $133,946 for 2017, and $122,523 for 2018.

20. For 2016 and 2017, CDTFA reduced audited taxable sales of $190,720 and $133,946 by reported taxable sales of $55,685 and $50,997 to compute audited understatements of reported taxable sales of $135,035 and $82,949, respectively. Then CDTFA reduced

[8] The disallowed total deduction of $212,845 was apportioned among the following time periods within the audit period: $19,441 to 4Q16; $77,637 to 2017; $69,977 to 2018; and $45,790 to the first three quarters of 2019.

[9] "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 he 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 (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup) is one that is calculated from the retailer's records.

those resulting amounts by $76,805 and $77,637, the audited amounts of disallowed claimed exempt food sales for 2016 and 2017, to compute unreported taxable sales on a markup basis of $58,230 and $5,312, respectively. In other words, for 2016 and 2017, the total amounts of understatement of reported taxable sales ($135,035 and $82,949, respectively) represent the differences between audited and reported taxable sales. But CDTFA then segregated these differences between disallowed claimed exempt food sales on the one hand ($76,805 and $77,637, respectively) and unreported taxable sales established on a markup basis on the other ($58,230 and $5,312, respectively).

21. For 2018, the same computation (audited taxable sales of $122,523 less reported taxable sales of $58,384) resulted in an understatement of $64,139, which was $5,838 less than the audited amount of disallowed claimed exempt food sales of $69,977. However, since CDTFA had accepted appellant's reported sales for 2018 as reasonable (based on the 183.62 percent book markup for that year), it did not reduce the audited understatement of $69,977 to $64,139. Instead, CDTFA regarded the disallowed claimed exempt food sales of $69,977 as the entire audited understatement of reported taxable sales for 2018.

22. For the audit period, the total audited understatement of reported taxable sales was $232,714, which was comprised of disallowed claimed exempt food sales of $212,845[10] and unreported taxable sales of $19,869 established on a markup basis.[11]

23. On July 1, 2020, CDTFA issued to appellant an NOD for tax of $18,121, plus interest.

24. On July 10, 2020, appellant filed a timely petition for redetermination.

25. On June 21, 2021, CDTFA issued a Decision denying appellant's petition.

26. This timely appeal followed.

27. During this appeal, CDTFA could not provide a copy of what its auditor reviewed on Google and Yelp.com to make CDTFA's determination, but provided the following instead: all Yelp.com reviews of appellant's business regardless of when they were posted; and pictures of appellant's business that had been posted on Yelp.com during the audit period.

[10] $212,845 is 90 percent of claimed deductions of $236,494 for the audit period.

[11] $58,230 unreported taxable sales for 2016 ÷ 4 quarters per year = $14,557 unreported taxable sales for 4Q16 + $5,312 unreported taxable sales for 2017 = $19,869 unreported taxable sales.

DISCUSSION

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property in this state unless a 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, it is presumed 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 on request by CDTFA. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax or other amount required to be paid by any person, or if any person fails to make a return, CDTFA may compute and determine the amount required to be paid upon the basis of 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 meets 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 Amaya, supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) To satisfy the burden of proof, a taxpayer must prove that: (1) the tax assessment is incorrect; and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, *supra*.)

Issue 1: Whether adjustments to the amount of disallowed claimed exempt food sales are warranted.

In general, gross receipts from the sale of food products for human consumption are exempt from tax. (R&TC, § 6359(a); Cal. Code Regs., tit. 18, § 1602(a)(1).) The term "food products" includes meat, fish, eggs, vegetables, fruit, sugar, candy, gum, coffee, tea, milkshakes (and other similar type beverages that are partly composed of milk or require the use of milk in

their preparation), bakery products, coconut, and sauces. (R&TC, § 6359(b); Cal. Code Regs., tit. 18, § 1602(a)(1).) "Food products" also include all fruit juices, vegetable juices, and other beverages, whether liquid or frozen, including all beverages composed in part of fruit or vegetable juice and concentrates, powders, or other bases for such beverages, and noncarbonated bottled water intended for human consumption. (Cal. Code Regs., tit. 18, § 1602(a)(2).)

However, for purposes of the exemption, "food products" does not include carbonated bottled waters or carbonated beverages. (Cal. Code Regs., tit. 18, § 1602(a)(2).) Thus, carbonated water and beverages are not exempt from tax.

Further, sales of "food products" are excluded from the exemption and are thus subject to tax in the following three specific circumstances: (1) when the food products are served as a meal by a restaurant or a similar establishment whether served on or off the premises (R&TC, § 6359(d)(1); Cal. Code Regs., tit. 18, § 1603(a)(2)(A)); (2) when the food products are sold as hot prepared food products (R&TC, § 6359(d)(7); Cal. Code Regs., tit. 18, § 1603(e)); and (3) when the food products are furnished, prepared, or served for consumption at facilities provided by the retailer (R&TC, § 6359(d)(2); Cal. Code Regs., tit. 18, § 1603(f)). As relevant here, tax applies to sales of sandwiches and other foods sold in a form suitable for consumption at tables, chairs, or counters provided by the retailer. (Cal. Code Regs., tit. 18, § 1603(f).)

Tax also applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller's premises even though such food products are sold on a "take-out" or "to go" order when a seller meets both of the following criteria (a.k.a., the "80-80 rule" referenced above): (a) over 80 percent of the seller's gross receipts are from sales of food products; and (b) over 80 percent of the seller's retail sales of food products are subject to tax. (R&TC, § 6359(d)(6); Cal. Code Regs., tit. 18, § 1603(c)(1)(A), (3).) When the seller satisfies the 80-80 rule, the seller's sales of cold food products that are suitable for consumption on the seller's premises are subject to tax no matter how great the quantity purchased. (Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)

A seller who meets both criteria of the 80-80 rule may elect to separately account for the sale of take-out or to-go orders of cold food products that are suitable for consumption on the seller's premises so that the gross receipts from the sale of those food products are exempted

from tax. (Cal. Code Regs., tit. 18, § 1603(c)(1)(A).) But failure to maintain the required separate accounting and documentation will revoke the seller's election. (*Ibid*.)

The term "suitable for consumption on the seller's premises" means food products furnished in a form that requires no further processing (e.g., cooking, heating, thawing, or slicing) by the purchaser and in size that ordinarily may be immediately consumed by one person (e.g., a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie). (Cal. Code Regs., tit. 18, § 1603(c)(2)(A).) Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form *not* suitable for immediate consumption. (Cal. Code Regs., tit. 18, § 1603(c)(2)(A)2.) The term "suitable for consumption on the seller's premises" does not include cold food products that obviously would not be consumed on the premises of the seller (e.g., a cold party tray or a whole cold chicken). (Cal. Code Regs., tit. 18, § 1603(c)(2)(A).)

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food-related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. (Cal. Code Regs., tit. 18, § 1603(c)(2)(B).) For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. (*Ibid*.)

Here, appellant did not provide any cash register receipts, sales tickets, or other records from which CDTFA could verify his claimed deductions for exempt food sales. Accordingly, CDTFA reviewed descriptions, photos, and reviews of appellant's business from online sources such as Google and Yelp.com to conclude that appellant operated as a fast-food restaurant (with a small grocery section) that satisfied the 80-80 rule so that all of appellant's sales of food suitable for consumption on his premises were subject to tax. Specifically, CDTFA determined that 90 percent of all the food products appellant sold were taxable because they were hot prepared foods or because of the tables and chairs appellant provided for consumption on his premises. Based on this conclusion, CDTFA disallowed 90 percent (or $212,845, rounded) of appellant's claimed deduction of $236,494 for exempt food sales for the audit period.

OTA will examine whether CDTFA's determination that 90 percent of appellant's food sales is taxable is reasonable and rational. Because CDTFA based this determination on its finding that appellant satisfied the 80-80 rule, OTA will first examine whether that finding itself

is reasonable and rational. If so, then OTA will specifically examine whether CDTFA reasonably and rationally disallowed 90 percent of appellant's claimed deduction for exempt food sales for the audit period.

For purposes of determining whether appellant satisfied the 80-80 rule, OTA will consider all food related activities conducted by appellant at its place of business, whether characterized as a fast-food restaurant, grocery store, fresh poultry market, or a hybrid of all three. (See Cal. Code Regs., tit. 18, § 1603(c)(2)(B).)

Regarding the first criterion of the 80-80 rule, it is undisputed that, during the audit period, over 80 percent of appellant's gross receipts were from sales of food products. The record corroborates that appellant mainly sold food products; the only products sold by appellant that would *not* qualify as "food products" are carbonated beverages (i.e., sodas and carbonated water) and some household goods (e.g., laundry detergent, air freshener spray, and bottled hand soap), which only occupied half of a shelf in appellant's business. Based on the menu, photos, and reviews in the evidentiary record, OTA finds it highly unlikely that sales of these non-food items would constitute 20 percent or more of appellant's gross receipts. Thus, CDTFA's conclusion that appellant satisfied the first criterion of the 80-80 rule is reasonable and rational.

Next, regarding the second criterion of the 80-80 rule, appellant's menu suggests that, during the audit period, the vast majority of appellant's menu items were taxable because they fell into at least one of the following three categories of taxable food products: (1) food products served as a meal (encompassing the menu's "Full Course Meals" category); (2) hot prepared food products (encompassing most menu categories including "Vietnamese Bánh Mì," "Entrees," "Side Orders," "From the Roaster," and "Catering & Party Trays");[12] and (3) food products furnished, prepared, or served for consumption at the four tables plus chairs provided by appellant (encompassing most of the categories already mentioned, plus "Beverages," but not "Catering & Party Trays"). Only the "Fresh Poultry From The Farm" menu items (i.e., whole poultry, chicken feet, and eggs) would not fall into any of the three categories of taxable food products just mentioned. Further, the online reviews and photos of appellant's business that were made or posted during the audit period indicate that appellant's customers primarily purchased bánh mì sandwiches, hot entrees/meals, and beverages, the retail sales of which are all

[12] The only food items from these menu categories that would not likely qualify as hot prepared foods are two "veggie" bánh mì sandwiches, a green salad, and all items in the "Fresh Poultry From The Farm" category.

taxable as noted above. In contrast, the online reviews from the earlier part of the audit period only occasionally mention retail sales of exempt food products such as fresh poultry, chicken feet, or raw eggs, and these items (mainly the eggs) only appear in a fraction of the online photos. These reviews also only make passing reference to other exempt food products such as sauces. Later reviews (circa mid-2017 and onward) do not reference these exempt food products at all. Accordingly, OTA finds that it was reasonable and rational for CDTFA to conclude that over 80 percent of appellant's retail sales of food products during the audit period were subject to tax and that appellant satisfied both criteria of the 80-80 rule.

Because OTA finds that CDTFA's conclusion that appellant satisfied the 80-80 rule was reasonable and rational, CDTFA's determination that tax also applies to appellant's take-out and to-go sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on appellant's premises is also reasonable and rational. Therefore, appellant's take-out and to-go sales of iced/cold beverage menu items, veggie bánh mìs, green salads, puff pastries, and hot coffee during the audit period are subject to taxation.

Finally, OTA turns to CDTFA's conclusion that 90 percent of all the food products appellant sold during the audit period were taxable and the remaining 10 percent were not. Exempt food products sold by appellant consisted of raw eggs, sugar, sauces, candy, and noncarbonated water. Food products that were unsuitable for consumption on appellant's premises and thus not taxable consisted of dry noodles/ramen, raw whole poultry, and uncooked chicken feet. Based on a review of the record, including appellant's menu, online photos, and reviews of appellant's business from the audit period (as well as CDTFA's audit working papers), OTA finds that, except for 2018, CDTFA's conclusion that these exempt food items did not comprise more than 10 percent of appellant's total sales during the audit period is reasonable and rational.

For 2018, CDTFA disallowed claimed exempt food sales of $69,977. However, OTA finds that the computation of this figure does not correspond to the computation of the understatements for 2016 and 2017. As noted previously, CDTFA estimated that 10 percent of appellant's sales were exempt sales of food not suitable for consumption on appellant's business premises. To incorporate that estimate into the audit computations, CDTFA further reduced the adjusted costs of goods sold for 2016, 2017, and 2018 by 10 percent. CDTFA then utilized the

book markup for 2018 (183.62 percent) to compute audited taxable sales of $122,523 for 2018. But CDTFA computed that 183.62 percent book markup for 2018 using an amount of costs of goods sold that it had not reduced by the costs of appellant's exempt sales.

OTA concludes that the amount of unreported taxable sales for 2018 should be $64,139 (the difference between audited taxable sales of $122,523 and reported taxable sales of $58,384), notwithstanding the fact that CDTFA had computed disallowed claimed exempt food sales of $69,977 for that year by multiplying the claimed exempt sales by 90 percent. In reaching this conclusion, OTA finds that CDTFA's computation for 2018 did not allow 10 percent of appellant's sales as food not suitable for consumption on appellant's premises. Thus, OTA finds that the audited understatement for 2018 should be reduced by $5,838 ($69,977 - $64,139).

Apart from this, OTA finds that CDTFA has carried its minimal, initial burden of showing that its determination was reasonable and rational, and the burden of proof now shifts to appellant to establish that further reductions to CDTFA's determination is warranted.

On appeal, appellant offers five arguments: (1) appellant lacks the ability to pay the tax liability due to economic hardship; (2) appellant's audited taxable sales are overstated because the photos in the record show no customers, the online reviews were provided by friends and relatives, and appellant's business was not a typical "restaurant" so it lacked market appeal; (3) CDTFA's estimate that 90 percent of his total sales were of taxable hot food is overstated; (4) appellant's summary records and reported sales were accurate; and (5) appellant's claimed exempt food sales included nontaxable sales for resale that CDTFA mistakenly disallowed. OTA will examine each of these five arguments in turn.

First, regarding appellant's inability to pay the tax liability derived from CDTFA's determination due to economic hardship,[13] this consideration is not relevant to whether CDTFA's determination should be reduced,[14] so OTA will not address it or similar types of arguments further.

Second, appellant asserts that many of the photos of his business posted on Yelp.com show no customers, many of the online reviews were made-up and posted by friends and family

[13] In a post-hearing brief, appellant suggests that he has paid off the tax liability at issue with credit cards so that the purchaser of his business could receive a tax clearance certificate.

[14] Appellant also contends that he did not write-off business-related losses on his income tax returns because it would disqualify him from receiving an income-restricted subsidy for health insurance. This contention is also not relevant to the issue of whether CDTFA's determination should be reduced.

in exchange for free food,[15] and his business was neither a typical fast-food restaurant nor a full-service restaurant (or even a butcher shop), so it lacked both market appeal and paying customers, apparently implying that his audited tax liability is overstated. However, appellant has not supplied any documentation or evidence related to this argument that would support a reduction to CDTFA's determination, so OTA finds this argument vague and unpersuasive.

Third, appellant argues that CDTFA's estimate that 90 percent of his total sales were of taxable hot food is overstated and exaggerated, testifying at the oral hearing that his hot-food sales ranged daily from 20 to 45 percent of his total sales during the audit period and were constrained by the prior day's unsold meat inventory from its butcher shop. Appellant also alleges that he donated leftover bread and unsold hot foods to a homeless shelter, due to a lack of customers. However, appellant has again not supplied any documentary evidence either corroborating his testimony or otherwise showing that more than 10 percent of his food sales were of exempt food products.[16] Appellant's testimony alone does not overcome the preponderance of contrary documentary evidence in the record. Thus, OTA is not persuaded by this argument.

Fourth, appellant contends that the Excel spreadsheet summarizing his daily sales, which he provided to CDTFA upon audit, was accurate and that he correctly reported his total and taxable sales during the audit period. But appellant has not provided any source documents that would support his argument, stating during the audit that he had recently thrown out many boxes of daily sales receipts from the audit period. Appellant also indicated during the audit that he could not reprint them or provide batch reports regarding his sales because he did not have a point-of-sale (POS) system. For lack of support, OTA finds this argument unpersuasive.

Fifth, appellant asserts that he made nontaxable sales of uncooked food to other businesses for resale, and provided letters from two businesses as support. Each letter includes an estimated amount of sales for resale per month (one estimate is $300-$500; the other estimate is $200-$400). However, neither of the letters includes any detailed information such as dates of

[15] In the record, there are nearly 550 reviews, spanning years, posted by numerous reviewers from California and some other states. OTA finds it unlikely that a business would consistently comp reviewers with food for such a sustained period.

[16] At the oral hearing, appellant also testified that he did not set up tables and chairs in his business for customers to eat at but rather for his meat/poultry customers' children, who could sit and wait while poultry was being butchered. OTA notes that this might explain the presence of a few chairs, but not four tables.

purchase; sales invoice numbers; specific descriptions or quantities of items purchased; or amounts paid for each purchase.

As noted previously, appellant's sales are presumed subject to tax. (See R&TC, § 6091.) Since appellant did not timely obtain resale certificates from his customers, he has the burden of proving that the sales in question were sales for resale. (See R&TC, § 6092; Cal. Code Regs., tit. 18, § 1668(a).) To carry his burden, appellant must show that, as relevant here, his customers either resold the property at issue or held it for resale without prior use by the customer. (See Cal. Code Regs., tit. 18, § 1668(e).) However, appellant has not even produced sales invoices that could identify the property at issue. Thus, OTA finds that no adjustment is warranted for alleged nontaxable sales for resale included in appellant's claimed exempt food sales.

For the reasons stated above, OTA finds that appellant has not shown that further adjustments are warranted to the disallowed claimed exempt food sales.

Issue 2: Whether adjustments to the amount of unreported taxable sales are warranted.

As noted previously, for appellant's business, CDTFA computed book markups of 88.74 percent for 2016, 161.58 percent for 2017, and 183.62 percent for 2018. CDTFA considered the markup for 2018 to be within the range of markups expected for this business. Moreover, CDTFA used the markups from the audits of three similar restaurants to compute an average markup of 188.35 percent, which it regarded as support for the validity of appellant's markup of 183.62 percent for 2018. Since the book markups for 2016 and 2017 were lower than this, CDTFA decided to establish sales on a markup basis.

The markup audit method is a well-established audit method that has been shown effective and reliable if it is based on sufficient information to establish a reasonable markup and cost of taxable merchandise sold. (*Appeal of Amaya*, *supra*.) Here, CDTFA based both the markup and costs of taxable goods sold on appellant's own records. Accordingly, OTA finds that CDTFA's determination of appellant's unreported taxable sales is reasonable and rational.

On appeal, appellant disputes CDTFA's description of the three restaurants mentioned above as "similar businesses." Appellant asserts that his business was a unique poultry and mini market and doubted that CDTFA had identified similar businesses.

Here, OTA notes that CDTFA used appellant's own records (the 2018 FITR) to establish the audited markup of 183.62 percent. Although appellant's business had elements of a mini market and poultry shop, based on its menu, as well as online pictures and reviews from the audit

period, it was primarily a restaurant. In fact, appellant's paper menu from January 2017 described the business as a "Vietnamese deli," and this description is corroborated by the business's mascot, a stylized rooster carrying a baguette (used for appellant's bánh mì sandwiches). Another indicator that appellant's business was primarily a restaurant was the slogan on its menu, "Come Hungry & Leave Happy," suggestive of an invitation to prospective customers to eat at appellant's facilities, which included four tables with chairs. CDTFA used the markups of three similar businesses (i.e., Asian- or Thai-style restaurants) only as support to show that appellant's book markup for 2018 was reasonable. Since the audited markup is the book markup reflected by appellant's own FITR for 2018, OTA finds that appellant has not established that the audited markup is excessive.

Further, OTA has reviewed CDTFA's markup computations and has found no errors in its assumptions or calculations, except for the $5,838 reduction to the amount of disallowed claimed exempt food sales that OTA recommended above. Thus, OTA finds that no adjustments to the amount of unreported taxable sales established on a markup basis by CDTFA are warranted.

HOLDINGS

1. CDTFA shall reduce the amount of disallowed claimed exempt food sales for 2018 by $5,838, from $69,977 to $64,139. Appellant has not established that further reductions are warranted.
2. No adjustment to the amount of unreported taxable sales is warranted.

DISPOSITION

CDTFA's action in denying appellant's petition is partly reversed. CDTFA shall reduce the amount of disallowed claimed exempt food sales for 2018 by $5,838, from $69,977 to $64,139, as determined by OTA. Otherwise, OTA sustains CDTFA's decision.[17]

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

Date Issued: 07/05/2023

[17] As noted earlier, appellant asserts that he has paid off the tax liability at issue with credit cards so that the purchaser of his business could receive a tax clearance certificate. This appeal before OTA does not include a claim for refund; therefore, OTA's holding and disposition do not order a refund. The time to file a claim for refund generally expires six months from the date a determination becomes final. (See R&TC, § 6902(a)(1).)