OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 221011706
	CDTFA Case ID: 3-081-618
PAN PIZZA AND WINGS LLC	

OPINION

Representing the Parties:

For Appellant:	Mandeep Dhaliwal, LLC Managing Member[1]
For Respondent:	Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Pan Pizza and Wings 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 August 23, 2021. The NOD is for tax of $15,078.00, plus applicable interest, and a negligence penalty of $1,507.79 for the period April 1, 2018, through March 31, 2021 (audit period).[2]

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

[1] Briefing in this matter was completed on May 9, 2023. On July 13, 2023, appellant submitted a power of attorney naming Ken Howard as its representative.

[2] CDTFA noted in its brief that it timely issued the NOD because it mailed the NOD within three years after August 28, 2018, the date on which appellant filed its return for the second quarter of 2018. (See R&TC, § 6487(a).) Appellant does not dispute the timeliness of the NOD.

ISSUES[3]

1. Is a reduction to the audited understatement of reported taxable sales warranted?
2. Was the negligence penalty properly imposed?
3. Is relief of interest warranted?

FACTUAL FINDINGS

1. Appellant operates a pizza and wing restaurant located in Roseville, California.
2. For the audit period, appellant reported total sales of $55,400 and claimed no deductions, thus reporting taxable sales of $55,400.
3. For the audit, which is appellant's first, appellant provided its bank statements for the period April 2018 through May 2020. Although appellant used a point-of sale (POS) system to record sales during the audit period, it did not submit POS records either for audit or on appeal.
4. CDTFA obtained appellant's federal income tax returns for the years 2018 and 2019 and its Form 1099-K (1099-K) data for the period April 1, 2018, through December 31, 2019.[4] The 1099-K data revealed sales paid by electronic means (credit card sales) of $117,039, excluding sales tax reimbursement, for the period April 1, 2018, through December 31, 2019, which exceeded appellant's reported total sales of $31,300 for the same period. Additionally, appellant's bank deposits of $154,054, excluding sales tax reimbursement, for the period April 1, 2018, through May 31, 2020, exceeded appellant's reported total sales of $34,600 for the same period.
5. Due to substantial discrepancies in appellant's records, CDTFA used the 1099-K data. However, the available documentation was not sufficient to determine appellant's average credit-card-sales-to-total-sales ratio (credit-card-sales ratio), and due to the

[3] Although appellant's sales were subject to Placer County district tax at the rate of 0.5 percent beginning April 1, 2019, appellant had reported and remitted the district tax only for the third quarter of 2020. Therefore, CDTFA added district tax on appellant's reported taxable sales of $23,800 for the periods April 1, 2019, through June 30, 2020, and October 1, 2020, through March 31, 2021, to its determination. Although appellant disputed this second audit item at a CDTFA appeals conference, it has not made any argument on the matter on appeal to OTA. Accordingly, OTA will not discuss that audit item further.

[4] Form 1099-K is an IRS 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.

COVID-19 pandemic's impact on restaurant businesses, CDTFA did not perform observation testing. Therefore, CDTFA relied on the average credit-card-sales ratio of 70.69 percent computed from data for a similar pizza restaurant also located in Roseville, California.

6. For the period April 1, 2018, through December 31, 2019, CDTFA divided total credit card sales of $117,039, excluding sales tax reimbursement, by the credit-card-sales ratio of 70.69 percent to compute audited sales of $165,563.[5]

7. Audited sales of $165,563 exceeded appellant's reported total and taxable sales of $31,300 for the same period by $134,263, which represents a reporting error rate of 428.96 percent ($134,263 ÷ $31,300). CDTFA applied the reporting error rate to appellant's reported taxable sales of $24,100 for the period for which CDTFA had not obtained 1099-K data (the first quarter of 2020 (1Q20) through 1Q21), which resulted in additional taxable sales of $103,379 for that period. To allow for the estimated impacts of the COVID-19 pandemic on appellant's sales, CDTFA reduced the additional taxable sales for 1Q20, 4Q20, and 1Q21 by 30 percent, and reduced the additional taxable sales for 2Q20 and 3Q20 by 50 percent (COVID adjustment). In total, CDTFA reduced the audited amount of unreported taxable sales for the period January 1, 2020, through March 31, 2021, by $37,448, and established unreported taxable sales of $200,194 for the audit period.

8. CDTFA based the August 23, 2021 NOD on unreported taxable sales of $200,194[6] and unreported district tax of $23,800 on reported taxable sales. Additionally, CDTFA imposed a 10 percent negligence penalty.

9. Appellant timely filed a petition for redetermination. In its Decision issued on October 20, 2022, CDTFA denied the petition in its entirety.

10. This appeal followed.

11. Subsequently, CDTFA obtained appellant's 1099-K data for the period January 1, 2020, through March 31, 2021, and compiled credit card sales of $168,304, excluding sales tax

[5] In the absence of evidence showing that appellant's customers included tips in their credit card payments, CDTFA made no adjustments to allow for tips.

[6] Some documents in OTA's record report unreported taxable sales of $200,196. The nominal difference is due to rounding and had no effect on the appeal outcome.

reimbursement for that period.[7] Using the credit-card-sales ratio of 70.69 percent would result in an increase to the unreported taxable sales for this time period by $59,711, from $65,931 to $135,641. CDTFA does not assert an increase to the determination.

DISCUSSION

Issue 1: Is a reduction to the audited understatement of reported taxable sales warranted?

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property sold in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) 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).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may 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.) 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.) 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. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, the only records provided by appellant were bank statements for the period April 2018 through May 2020, which showed bank deposits that substantially exceeded appellant's reported total sales for the same period. CDTFA then obtained appellant's 1099-K data for the period April 1, 2018, through December 31, 2019, which showed that appellant's credit card sales substantially exceeded its reported total sales for the same period. In the absence of other records, CDTFA relied on the 1099-K data and performed a credit-card-sales-

[7] Average credit card sales of $33,761 per quarter for the period January 1, 2020, through March 31, 2021 ($168,804 ÷ 5 quarters), substantially exceeded average credit card sales of $16,648 per quarter for the seven previous quarters within the audit period ($116,538 ÷ 7).

ratio analysis, using an average credit-card-sales ratio of 70.69 percent, to establish audited taxable sales. Ordinarily, CDTFA would establish an average credit-card-sales ratio from a taxpayer's records or from observations of the taxpayer's business. However, here, given the absence of records and given that the restaurant industry had been severely impacted by the COVID-19 pandemic at the time the audit was conducted, OTA finds that it was reasonable for CDTFA to rely on an average credit-card-sales ratio computed for a similar business prior to the pandemic. CDTFA then reduced the sales it had computed for the period January 1, 2020, through March 31, 2021, to allow for the estimated impacts of the COVID-19 pandemic. A review of appellant's 1099-K records for 2020 shows that the COVID adjustments resulted in a significant understatement of audited taxable sales; however, CDTFA has not asserted an increase to the measure of unreported taxable sales.

During this appeal, at OTA's request, CDTFA filed an additional brief that explained its calculation of the tax due. OTA has reviewed the audit procedures and computations and finds that the basis for CDTFA's determination was both reasonable and rational. Thus, the burden of proof shifts to appellant to establish with documentation or other evidence that a reduction to the audited understatement of reported taxable sales is warranted.

Although appellant argued in its petition for redetermination that the credit-card-sales ratio of 70.69 percent used in the audit resulted in a significant overstatement of audited taxable sales, appellant has provided no documentation or other evidence to support its assertion that approximately 95 percent of its sales were paid by credit card.[8] On appeal, appellant requests a "thorough calculation for how tax owed was calculated to be over $20,000." However, appellant has identified no errors in the audit computations and has provided no evidence showing that any adjustments are warranted.

It is noteworthy that appellant has the records sufficient to support a direct audit (i.e., POS records) but has not provided them, either during the audit or subsequently on appeal. A party's failure to produce evidence that is within its control gives rise to a presumption that such evidence is unfavorable to its case. (See, e.g., *Appeal of Bindley*, 2019-OTA-179P.) When a taxpayer is in a position to refute the evidence and chooses not to do so, the failure "necessarily gives rise to an inference that [the evidence] would not have been favorable to [the taxpayer's]

[8] The bank statements provided by appellant show that cash deposits represented 15.65 percent of its total adjusted deposits, which controverts appellant's assertion that only 5.00 percent of its sales were paid with cash.

case." (*O'Dwyer v. Commissioner* (4th Cir. 1959) 266 F.2d 575, 584; *Stoumen v. Commissioner* (3rd Cir. 1953) 208 F.2d 903, 907.) If less satisfactory evidence is offered when it was within the power of a party to produce more satisfactory evidence, the evidence offered should be viewed with distrust. (Evid. Code, § 412.)

Appellant does not dispute that it maintained a POS system throughout the audit period. For unexplained reasons, appellant did not provide these records for audit or during this appeal. Appellant provided only some bank statements. The presumption arises that had appellant produced the POS records, those records would not have been favorable to appellant's case. Thus, based on the foregoing, OTA concludes that there is no basis for a reduction to the audited understatement of reported taxable sales.

Issue 2: Was the negligence penalty properly imposed?

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co*. (1955) 44 Cal.2d 310, 317; see also *People v. Superior Court* (2016) 248 Cal.App.4th 434, 447.)

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed and to determine the correct tax liability. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (1) normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules or working papers used in connection with the preparation of tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide complete and accurate records will be considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

In analyzing the issue of negligence, OTA must consider whether the taxpayer has been previously audited. (See Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Generally, a negligence penalty should not be added when the taxpayer has not been previously audited, but there are circumstances where a penalty in a first audit would be appropriate. (*Ibid*.) A negligence

penalty should be upheld in a first audit when the evidence establishes that taxpayer's bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

At the CDTFA appeals conference, appellant argued that its owner was new to the United States and did not understand its sales and use tax obligations. Additionally, according to CDTFA, appellant asserted that it was willing to work with CDTFA during the audit but CDTFA's goal was to "punish" it for its mistakes.

Appellant has provided no explanation of how it computed total sales and taxable sales for reporting purposes. CDTFA notes that appellant recorded its daily sales in a POS system and estimated its taxable sales on its sales and use tax returns. On appeal, appellant does not address the negligence penalty. OTA notes that both appellant's bank deposits and its credit card sales substantially exceeded the reported amounts. The audited understatement of $200,194 represents an error ratio of 361 percent when compared to appellant's reported taxable sales of $55,400 (i.e., $200,194 ÷ $55,400), with appellant reporting less than one-fourth of its taxable sales. The magnitude of this understatement is egregious. Moreover, appellant's electronic sales reported on Form 1099-K (including the data for 1Q20 through 1Q21) of $285,843 greatly exceeded reported taxable sales of $55,400, as did appellant's bank deposits. Appellant's failure to report more than three-fourths of its taxable sales is strong evidence of negligence in reporting.

Although appellant used a POS system to record its sales, appellant failed to provide data or sales reports from its POS system, purchase summaries, invoices showing its fixed asset purchases, or any of the other records normally maintained by a prudent businessperson, other than bank statements for a portion of the audit period. Appellant's failure to provide records constitutes additional strong evidence of negligence.

This was appellant's first audit. Although a negligence penalty is not generally recommended for a first audit, the penalty is appropriate when the inadequacy of a taxpayer's records and reporting cannot be attributed to the taxpayer's good faith and reasonable belief that the records and reporting were in substantial compliance with legal requirements. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) While appellant argued on appeal that its owner was new to the

United States and did not understand its sales and use tax obligations, taxpayers are charged with knowledge of the law, and ignorance of the law is no defense. (See, e.g., *MacFarlane v. Dept. of Alcoholic Beverage Control* (1958) 51 Cal.2d 84, 90 [stating that knowledge of the law is presumed].) Moreover, it takes no special knowledge of the Sales and Use Tax Law to keep accurate sales records and provide them to CDTFA upon request. In light of all of the above, OTA finds that appellant has not established that the understatement can be attributed to a good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. Accordingly, OTA concludes that CDTFA properly imposed the negligence penalty.

Issue 3: Is relief of interest warranted?

The imposition of interest is mandatory. (R&TC, § 6482.) There is no statutory right to interest relief. (R&TC, § 6593.5.) The law allows CDTFA, in its discretion, to relieve all or any part of the interest imposed on a person under the Sales and Use Tax Law where the failure to pay tax is due in whole or in part to an unreasonable error or delay by an employee of CDTFA acting in his or her official capacity. (R&TC, § 6593.5(a)(1).) Such a delay means, for example, an unreasonable failure to work on an appeal. (*Appeal of Micelle Laboratories, Inc*., 2020-OTA-290P.) An unreasonable error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or a failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must submit to CDTFA a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c).) Appellant bears the burden of proof to show interest relief is warranted. (Cal. Code Regs., tit. 18, § 30219.)

Appellant has not filed the requisite request for relief of interest, signed under penalty of perjury. However, appellant asserts that "penalties" are continually being charged on its liability and argues that the "penalties" should have stopped accruing once its appeal was filed. Because interest has continued to accrue on appellant's unpaid tax liability, OTA infers that appellant is requesting relief of interest for the period during which its appeal is being considered.

As stated above, the imposition of interest is mandatory, with no exceptions for liabilities while an appeal is pending. Appellant has not provided a request for relief signed under penalty of perjury, and CDTFA did not issue an adverse decision on such a request. As such, OTA lacks jurisdiction to determine is relief from interest is warranted.

HOLDINGS

1. No reduction to the audited understatement of reported taxable sales is warranted.
2. Appellant was negligent, and the penalty was properly imposed.
3. No relief of interest is warranted.

DISPOSITION

CDTFA's action denying appellant's petition is sustained.

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Teresa A. Stanley
Administrative Law Judge

I concur:

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Andrew Wong
Administrative Law Judge

Date Issued: 9/14/2023

M. GEARY, Administrative Law Judge, concurring:

I join in the majority's holdings and the disposition of this appeal. However, while I am not averse to making an appropriate evidentiary assumption when the evidence and the law support it, I cannot join in the majority's statement, in dictum, that Pan Pizza and Wings LLC (appellant) failed to provide point-of-sale records when it was within appellant's power to do so, and that such failure somehow bolsters what was already a sound decision.

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Michael F. Geary
Administrative Law Judge

Date Issued: 9/14/2023