2024-OTA-034
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20046132
	) CDTFA Case ID 118-032
LIQUOR LOCKER, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Marc Bral, CPA Maria Cristobal, Accountant
For Respondent:	Randolph "Randy" Suazo, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Richard Zellmer Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Liquor Locker, Inc. (appellant) appeals a decision, as amended by a supplemental decision, issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] denying appellant's petition for redetermination of the Notice of Determination (NOD) dated June 20, 2016. The NOD is for tax of $165,144.76, plus applicable interest, for the period July 1, 2011, through June 30, 2014 (audit period).

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Lauren Katagihara, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on February 16, 2023. At the conclusion of the hearing, the parties submitted the matter, and OTA closed the record.

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

ISSUES

1. Whether appellant has shown that adjustments are warranted to the audited taxable measure.
2. Whether interest relief is warranted.

FACTUAL FINDINGS

1. Appellant has operated a liquor store in Los Angeles since March 2002.
2. For the audit period, appellant reported total sales of $4,238,855, and claimed deductions of $627,822 for exempt sales of food products and $294,940 for sales tax reimbursement included in reported total sales, resulting in reported taxable sales of $3,316,093.
3. For audit, appellant provided the following: federal income tax returns for 2011, 2012, 2013; bank statements for one of its bank accounts; a general ledger for the audit period; cash register z-tapes[2] for six days in January 2016; and purchase invoices for November 2014. Appellant did not provide cash register z-tapes, sales journals, purchase invoices, or purchase journals for any periods within the audit period. While appellant states that its sales and use tax returns were prepared on the basis of bank records, it did not provide all bank records, despite CDTFA's numerous requests for the records, and the records that were provided indicate appellant deposited receipts from the business in at least one bank account for which it provided no records.[3] CDTFA considered appellant's books and records incomplete and inadequate for sales and use tax purposes.
4. CDTFA compared appellant's deposits shown on the provided bank statements to reported total sales and found the deposits exceeded reported total sales by $533,323.
5. CDTFA obtained Forms 1099-K for appellant's business for the period July 1, 2011, through December 31, 2013.[4] Using the Forms 1099-K, CDTFA compiled credit card deposits of $3,255,701 for the period July 1, 2011, through December 31, 2013. CDTFA

[2] The z-tape is the portion of the cash register tape that summarizes sales for a given period of time.

[3] According to the audit workpapers, appellant's president "indicated that [appellant] operates using 4 bank accounts." However, only one set of bank statements were provided. For the bank account for which bank statements were provided, there are eight months within the period July 1, 2011, through December 31, 2013, showing no credit card deposits at all, which further supports the conclusion that bank records were incomplete.

[4] Form 1099-K is an IRS form titled "Payment Card and Third Party Network Transactions" issued to merchants which shows the monthly and annual amount paid to the merchant by a credit card company or third party network during a given time period.

subtracted this amount from appellant's reported total sales of $3,265,692 for that same period to compute sales paid for with cash of $9,991, which represents less than 1 percent of reported total sales. CDTFA found that the low percentage of cash sales was evidence of unreported sales.

6. CDTFA also examined Form 1099-K data to calculate appellant's credit card sales totaling $3,715,466 for the period from the first quarter of 2011 (1Q11) through 4Q13.

7. CDTFA contacted appellant's vendors to obtain information regarding appellant's taxable merchandise purchases. CDTFA received responses from 10 of appellant's vendors. For one of the vendors, Santa Monica Distributing, Inc., CDTFA noted that a significant amount of purchases were non-taxable food items. CDTFA tested four purchase invoices from Santa Monica Distributing, Inc., and found that 81.31 percent of the purchases from that vendor were taxable items. CDTFA applied the 81.31 percent ratio to the amount of purchases obtained from that vendor to compute taxable merchandise purchases from that vendor.

8. Using the purchase information from the 10 vendors (totaling $2,231,726), and purchase information from appellant's general ledger regarding purchases from other vendors totaling $119,142, CDTFA compiled audited taxable merchandise purchases of $1,043,228 for 2012 and $1,307,640 for 2013, or $2,350,868 for both years combined.

9. CDTFA compared these amounts of audited taxable merchandise purchases to reported taxable sales to compute book markups of -9.29 percent for 2012 and -15.21 percent for percent for 2013.[5] The negative book markups mean that reported taxable sales are less than the audited taxable merchandise purchases (i.e., appellant was selling merchandise for less than cost). Based on the incomplete books and records, the negative book markups, and the analysis of credit card and cash sales, CDTFA concluded that additional testing would be needed to verify reported taxable sales. CDTFA decided to use the markup method to compute appellant's taxable sales.

[5] "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 (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and profit margin are different. The profit is the sales price minus the cost. The formula for determining the profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (.30 ÷ 1.00 = 0.3).

10. CDTFA prepared an audit, a revised audit, a reaudit, and a second reaudit.[6] In the revised audit, CDTFA performed a shelf test,[7] comparing costs from purchase invoices from November 2014 to selling prices posted on the shelf on January 8, 2015, or provided orally by appellant to compute markups and concluded that the markups were 40.42 percent for liquor, 30.56 percent for wine, 24.91 percent for cigarettes and tobacco products, 39.40 percent for beer, 67.01 percent for carbonated drinks, and 52.45 percent for other taxable items.[8] These individual product category markups were weighted based on the ratio of purchases in each product category to compute an audited weighted markup of 37.70 percent for all taxable merchandise.[9]

11. The above-mentioned audited taxable merchandise purchases were reduced by 1 percent for pilferage to compute the audited cost of taxable goods sold of $2,327,360 for 2012 and 2013 combined. CDTFA added the audited weighted markup of 37.70 percent to the audited cost of taxable goods sold to compute audited taxable sales of $3,204,774 (rounded) for 2012 and 2013, combined. CDTFA compared audited taxable sales to reported taxable sales to compute unreported taxable sales of $1,149,738 for 2012 and 2013, combined. CDTFA compared unreported taxable sales for 2012 and 2013 combined to reported taxable sales for that same period to compute an error ratio of 55.95 percent, which was applied to reported taxable sales for the remaining quarterly periods in the audit (3Q11, 4Q11, 1Q14, and 2Q14) to compute unreported taxable sales of $705,529 for those periods. In total, CDTFA computed unreported taxable sales of $1,855,267 for the audit period ($1,149,738 + $705,529).

12. On June 20, 2016, CDTFA issued the NOD, which is based on the revised audit.

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[6] Revised audits are done after the original audit but before issuance of the NOD. Reaudits are done after issuance of the NOD.

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

[8] As indicated below, CDTFA later realized that the auditor used the wrong formula to calculate markups for four categories of merchandise (liquor, wine, cigarette, and sundry items) and as a result computed the profit margin instead of the markup. (See footnote 5, above.) This error was repeated in the first reaudit, discussed below. When this Opinion discusses a "markup" calculated in the revised audit or first reaudit, it will be referring to what CDTFA believed it was calculating, not what it was actually calculating.

[9] CDTFA determined the ratios in a purchase segregation test, which segregated the merchandise purchases shown in the November 2014 purchase invoices into the various product categories and determined the ratio of each product category purchase to total purchases.

13. Appellant filed a timely petition for redetermination of the NOD.

14. CDTFA held an appeals conference with appellant on October 24, 2017.

15. In its Decision issued on June 12, 2018, CDTFA denied appellant's petition.

16. Appellant provided additional documentation and filed a request for reconsideration of CDTFA's Decision.

17. In the Supplemental Decision, dated January 22, 2019, CDTFA ordered a reaudit to make allowances for self-consumption and changes in inventory, and to also make adjustments to the markup calculations if supported by evidence to be provided by appellant.

18. CDTFA prepared a first reaudit. In the first reaudit, audited taxable merchandise purchases of $2,350,868 for 2012 and 2013 combined was reduced by $15,614 to account for beginning and ending inventory, 1 percent for pilferage, and 2 percent for self-consumption, to compute audited cost of taxable goods sold of $2,327,360 for 2012 and 2013 combined.[10] CDTFA also made various corrections to the markup calculations, resulting in audited markups of 37.70 percent for liquor, 30.56 percent for wine (unchanged from the revised audit), 25.43 percent for cigarette and tobacco products, 38.01 percent for beer, 65.69 percent for carbonated beverages, and 51.70 percent for other taxable merchandise. These markups were weighted, based on the purchase segregation test, to compute an audited weighted markup of 35.78 percent for all taxable merchandise (compared to 37.70 percent in the revised audit). CDTFA added the audited markup of 35.78 percent to the audited cost of taxable goods sold of $2,327,360 to compute audited taxable sales of $3,160,089 (rounded) for 2012 and 2013, combined. CDTFA compared audited taxable sales to reported taxable sales to compute unreported taxable sales of $1,105,053 for 2012 and 2013, combined. CDTFA compared unreported taxable sales for 2012 and 2013 combined to reported taxable sales for that same period to compute an error ratio of 53.77 percent, which was applied to reported taxable sales for the remaining quarterly periods in the audit, to compute unreported taxable sales of $705,529 for those periods. In total, for the reaudit, CDTFA computed unreported taxable sales of $1,699,182 for the audit period ($1,105,053 + $594,129).

[10] OTA notes an error in this calculation. OTA calculates that the correct amount of audited cost of taxable goods sold should be $2,265,501. This error was addressed in the second reaudit.

19. The first reaudit also included a separate taxable measure of $69,352 for the unreported cost of self-consumed taxable merchandise. Thus, the total taxable measure calculated in the first reaudit is $1,768,534 ($1,699,182 + $69,352).

20. CDTFA conducted a second reaudit to consider additional documents submitted by appellant. CDTFA made a minor adjustment to the inventories and corrected the above-mentioned error in calculating cost of taxable goods sold, resulting in an audited cost of taxable goods sold of $2,265,023 for 2012 and 2013, combined. In computing the markup, CDTFA made an allowance for bulk sales of liquor.[11]

21. However, CDTFA discovered a material error in prior audits. Instead of calculating the audited markup (which is the gross profit divided by the cost of the item), the auditor erroneously calculated the gross profit margin (which is the gross profit divided by the selling price of the item). Correcting the error *increased* the affected markups. Calculating the markups correctly resulted in markups of 56.51 percent for liquor (compared to 37.70 percent in the first reaudit), 43.81 percent for wine (compared to 30.56 percent in the first reaudit), 34.09 percent for cigarette and tobacco products (compared to 25.43 percent in the first reaudit), 38.01 percent for beer (unchanged from the first reaudit), 65.69 percent for carbonated drinks (unchanged from the first reaudit), and 107.00 percent for other taxable merchandise (compared to 51.70 percent in the first reaudit).

22. The markups for each of the product categories were then weighted, based on the segregation test, to compute an audited weighted markup of 50.39 percent for all taxable merchandise (compared to 35.78 percent in the first reaudit). CDTFA added the audited markup of 50.39 percent to the audited cost of taxable goods sold of $2,265,023 to compute audited taxable sales of $3,406,367 (rounded) for 2012 and 2013, combined. CDTFA compared audited taxable sales to reported taxable sales to compute unreported taxable sales of $1,351,331 for 2012 and 2013, combined. CDTFA compared the combined unreported taxable sales for 2012 and 2013 to reported taxable sales for that

[11] In computing the 56.51 percent markup for liquor, CDTFA made an adjustment for bulk sales based on a shelf test of bulk liquor sales appellant provided for 2014. CDTFA compared costs from purchase invoices from 2014 to the bulk selling prices provided by appellant, or its employee, and computed a 50.59 percent markup for bulk sales of liquor. CDTFA also computed a markup of 59.94 percent for regular sales of liquor, in the same manner as was done for the other product categories. These markups were weighted 36.71 percent for bulk sales and 63.29 percent for regular retail sales to compute the markup for liquor of 56.51 percent.

same period to compute an error ratio of 65.76 percent. CDTFA applied the error ratio to reported taxable sales for the remaining quarterly periods in the audit, to compute unreported taxable sales of $829,234 for those periods. In total, CDTFA computed unreported taxable sales of $2,180,565, for the audit period ($1,351,331 + $829,234).

23. Like the first reaudit, the second reaudit also included a separate taxable measure of $69,337 for the unreported cost of self-consumed taxable merchandise. Thus, the total taxable measure determined in the second reaudit is $2,249,902 ($2,180,565 + $69,337), which is greater than the unreported taxable sales of $1,855,267 determined in the revised audit that the NOD is based on. CDTFA reports that the statute of limitations for increasing the NOD has expired, and thus the NOD cannot be increased.[12]

24. Appellant filed the instant appeal with OTA.

DISCUSSION

Issue 1: Whether appellant has shown that adjustments are warranted to the audited taxable measure.

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.)

[12] CDTFA may increase the amount of an NOD only if CDTFA asserts an increase at or before a hearing before OTA. (R&TC, § 6563(a).) Also, as relevant here, the increase must be asserted within three years after the first NOD was issued or within three years after the time tax records requested by CDTFA are made available, whichever is later. (R&TC, § 6563(a)(1).) Nonetheless, any potential adjustments to the measure of tax in the NOD may be offset against underpayments for the same period as established by second reaudit. (R&TC, § 6483; *Appeal of Praxair*, 2019-OTA-310P.)

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.) 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*.) 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*, 2020-OTA-173P.) 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 correct. (*Appeal of AMG Care Collective*, *supra*.)

Here, appellant did not provide complete records (e.g., cash register z-tapes, sales journals, purchase invoices, complete bank records, or purchase journals for any periods within the audit period). Also, CDTFA calculated negative book markups for taxable merchandise of - 9.29 percent for 2012 and -15.21 percent for 2013, by comparing audited taxable merchandise purchases to reported taxable sales.[13] Based on Form 1099-K data, CDTFA found that reported total sales were only $9,991 greater than credit card deposits, resulting in less than 1 percent of reported total sales being paid for with cash. Also, CDTFA compared appellant's bank deposits to reported total sales and found the deposits exceeded reported total sales by $533,323. Under these circumstances, OTA finds that CDTFA's use of an indirect method was reasonable and rational.

Moreover, OTA finds that CDTFA's use of the markup method, a recognized and accepted accounting procedure, was reasonable and rational. (*Appeal of Amaya*, *supra*.) CDTFA performed a shelf test and computed an audited weighted markup. CDTFA used the audited weighted markup to establish an error ratio between audited taxable sales for 2012 and 2013, and reported taxable sales for the same period. CDTFA then applied the error ratio to the remainder of the audit period. Subsequently, CDTFA revised the audit and conducted two reaudits to address appellant's additional submissions as well as errors. The use of vendor records and appellant's ledger, in conjunction with the shelf test and segregation test, to compute the audited taxable sales was reasonable and rational. Therefore, OTA finds that CDTFA has

[13] Negative book markups are problematic because retail businesses, like appellant's, generally exist to make a profit and do not routinely sell products below cost.

met its initial burden to show that its determination was reasonable and rational; and the burden of proof shifts to appellant to show that adjustments are warranted.

As a preliminary matter, OTA notes that the second reaudit shows a taxable measure of $2,249,902, which is $394,635 greater than the taxable measure of $1,855,267 in the revised audit, which is the basis for the NOD. CDTFA concedes that it cannot assert an increase of the liability because such an increase is barred by the statute of limitations. However, if the evidence establishes that appellant is entitled to a reduction of the measure of tax asserted in the NOD, CDTFA is entitled to offset against the reduction the additional underpayments established in the second reaudit. (R&TC, § 6483; *Appeal of Praxair*, 2019-OTA-301P.) Thus, appellant would need to support an adjustment greater than $394,635 in order to receive a reduction to the determined amount.

On appeal, appellant makes several contentions as follows: (1) additional adjustments are warranted for the bulk sales of liquor; (2) the audited taxable merchandise purchases is baseless; (3) CDTFA inappropriately used vendor records; (4) the vendor survey is flawed because appellant maintained its books and records on a cash basis whereas the vendor survey is on an accrual basis; (5) the shelf test was inaccurate; (6) the shrinkage, theft, and self-consumption allowances should be increased; (7) an entirely new audit should be conducted; (8) a bank deposit analysis should have been used; (9) the audited average daily cash sales is unreasonable; and (10) the audit should be set aside because CDTFA did not perform a reasonableness test. OTA will examine each contention in turn.

Bulk Sales of Liquor

Appellant contends that it made bulk sales of liquor at lower-than-normal markups of 10 to 15 percent. Appellant contends that the bulk sales account for 30 to 40 percent of its sales of liquor. Appellant asserts that the bulk sales have not been accounted for in the audit shelf test. As explained above, CDTFA computed a markup of 50.59 percent for bulk sales of liquor by comparing costs from purchases invoices from 2014 to the bulk selling prices provided by appellant. Appellant has not provided any documentation to support a lower markup for bulk sales or shown errors in CDTFA's shelf test that resulted in the 50.59 percent markup for bulk sales of liquor. OTA finds that no further adjustment is warranted for appellant's arguments regarding bulk sales.

Audited Taxable Merchandise Purchases

Appellant contends that CDTFA should not have used a percentage of error for purchases, and consequently, the audited taxable merchandise purchases are totally baseless. OTA's review of audit schedule 1R-12E in the revised audit discloses that CDTFA removed estimated purchases. The remaining taxable merchandise purchases of $2,350,868 were compiled on an actual basis using information from appellant's vendors and appellant's general ledger. Thus, there were no percentages of error used to calculate taxable merchandise purchases in the revised audit, the reaudit, or the second reaudit. OTA finds that no adjustment is warranted to the audited taxable merchandise purchases.

Use of Vendor Records

Appellant contends that CDTFA should not have used a combination of information from vendors and information from appellant's records to compile taxable merchandise purchases. However, appellant did not provide a complete set of purchase invoices for periods within the audit; so CDTFA was unable to verify the accuracy of merchandise purchases recorded in the general ledger. CDTFA solicited purchase information from appellant's vendors, but not all the vendors responded. CDTFA used the information it received to establish taxable merchandise purchases. CDTFA also used information from appellant's records to establish taxable merchandise purchases for the vendors who did not respond to CDTFA's inquiry. Appellant has not shown error in its own ledger nor has it shown error in the vendors' records. Thus, OTA rejects appellant's argument that it was inappropriate to use its ledger combined with vendor records.

Appellant also contends that the four purchase invoices used to determine that 81.31 percent of the purchases from Santa Monica Distributing, Inc. represent taxable merchandise purchases is too small of a sample size. Appellant, however, did not provide evidence indicating that a larger sample size would result in a lower taxable measure. Thus, OTA rejects this contention.

Accrual or Cash Basis

Appellant contends that the audit is erroneous because the audit has been done on an accrual basis, while reported taxable sales are on a cash basis. Regarding the method of accounting (cash basis versus the accrual method), this is not relevant because all retailers are

required to report their sales tax liability on an accrual basis (R&TC, §§ 6452(a), 6453; Cal. Code Regs., tit. 18, § 1642(c)), and CDTFA performs audits presuming that is the case. Thus, OTA finds that it was appropriate for CDTFA to compute appellant's sales on an accrual basis, and OTA further finds that appellant's cash-basis method of reporting to be incorrect. To the extent that appellant's reporting on a cash basis has resulted in unreported sales, such unreported sales are properly included in the audit liability.

Shelf Test

Appellant notes that the shelf test was done using costs from November 2014 purchase invoices, and January 8, 2015 selling prices either posted on the shelf or provided orally by appellant. Appellant argues that this is an incorrect method of computing the markup because the costs and selling prices should be from the same month. In performing a shelf test, OTA would expect CDTFA to compare the selling prices used in the shelf test to the actual costs of those specific items. This can be achieved by comparing costs and selling prices that were in effect at about the same point in time. Here, there is a two-month difference between the date of the purchases of the items in the shelf test and the date of the sale of those items. It is likely that appellant's merchandise costs remained consistent during that two-month period. Although it is possible that appellant's merchandise costs increased during that two-month period,[14] appellant has not provided purchase invoices from January 2015, or otherwise shown that the actual costs of the items included in the shelf test are greater than the costs used in the audit. Likewise, it is also possible that appellant's selling prices could have been lower in November 2014, but appellant has not provided documentation or evidence in support. Therefore, OTA finds that appellant has not met its burden of proof.

Shrinkage, Theft, and Self-Consumption Allowances

Appellant contends that the combined allowance for shrinkage, theft, and self-consumption should be increased to 4 percent. Here, CDTFA made an allowance of 1 percent for shrinkage and 2 percent for self-consumption or a combined allowance of 3 percent. Here, CDTFA followed its guidelines found in CDTFA's Audit Manual (Audit Manual)

[14] Using higher costs in the shelf test would result in a lower markup.

section 0407.10.[15] Moreover, appellant has not provided documentation to support its assertion that additional adjustments for shrinkage, theft, and self-consumption are warranted. (See *Appeal of Talavera*, 2020-OTA-022P.) Thus, OTA finds that no further adjustments for shrinkage, theft, and self-consumption are warranted.

New Audit

Appellant contends that the audit, revised audit, reaudit, and second reaudit should be discarded, and an entirely new audit should be conducted. Appellant claims that it was promised a reaudit, which appellant interprets to be an entirely new audit, because of the errors in the initial audit. Appellant argues that it eventually provided a complete set of records and alleges that CDTFA refused to review those records.[16] Appellant asserts that the markup calculations contain numerous errors, in addition to the alleged errors discussed above. In support, appellant submitted Exhibits R1 - R8. According to appellant's taxable sales summary, appellant underreported its taxable sales by $201,648 for the last six months in 2011, $125,423 for 2012, $425,187 for 2013, and $83,751 for the first six months in 2014, for a total of $836,009 for the audit period. Appellant also asserts that its underreporting for the audit period should be reduced by $216,881 for overreporting in 2016. In sum, appellant asserts that its unreported measure of taxable sales should be $619,128 as opposed to the measure of $2,249,902 determined in the second reaudit.

OTA first notes that although appellant claims to have provided CDTFA with complete books and records, appellant did not provide OTA with a copy of its records even though there were multiple opportunities for it to do so (e.g., during briefing, in response to the Prehearing Conference Statement Requests, or 15 days prior to the hearing). (See Cal. Code Regs., tit. 18, section 30420(a).) Therefore, OTA cannot directly evaluate appellant's records. However, the comments and revisions in CDTFA's audit workpapers tend to demonstrate that, after the initial

[15] The Audit Manual summarizes CDTFA's audit policies and procedures. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) OTA may look to it for guidance in interpreting the law; however, the Audit Manual is not binding legal authority, and should not be cited as such. (*Ibid.*) As such, OTA must exercise its own independent judgement in determining the weight, if any, to afford CDTFA's construction of the law, as set forth in the Audit Manual. (*Ibid.*)

[16] OTA lacks jurisdiction to determine whether appellant is entitled to a remedy for CDTFA's actual or alleged violation of any substantive and procedural right to due process under the law, unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal. (See Cal. Code Regs., tit. 18, § 30104(d).)

document production, appellant submitted additional documents and those submissions were reviewed by CDTFA. After review, CDTFA made corrections or revisions to the audit in the revised audit, the reaudit, and the second reaudit. However, CDTFA also discovered its own error in calculating the markup (compared to the gross profit margin) during the second reaudit. Correcting the markup errors was detrimental to appellant because doing so increased the measure of tax, as discussed above.

With respect to the "promise of a reaudit," which appellant erroneously interprets to be an entirely new audit, the evidence in the record does not establish that an entirely new audit would result in a more accurate determination, nor has appellant provided any authority to support such an entitlement.[17] Even if an entirely new audit were performed, appellant has not provided records or other evidence that would allow OTA to verify the accuracy of the information contained in Exhibits R1 - R8, or that the unreported taxable measure for the audit period should be reduced to $619,128. As appellant must support its assertions by documentary or other evidence, appellant has not met its burden of proof to show that a new audit is warranted.

Bank Deposit Analysis

Appellant contends that CDTFA should not have used the markup method to compute taxable sales. Appellant argues that the markup method is not applicable to its business. Appellant contends that bank deposits should be used to compute its sales. The markup method is an approved and accepted method of computing taxable sales. (*Appeal of Amaya*, *supra*.) As discussed above, OTA has rejected appellant's specific arguments regarding the markup calculations, and thus, appellant has not shown that the markup method has produced inaccurate results as shown in the second reaudit. Therefore, appellant must show that using bank deposits would produce a more accurate result than using the markup method.

OTA notes that CDTFA complied appellant's credit card deposits for the period July1, 2011, through December 31, 2013, which totaled $3,255,701. In contrast, the bank statements appellant provided to CDTFA show credit card deposits of only $585,392 for that same period. For the period July 1, 2011, through December 31, 2013, there are eight months for

[17] CDTFA may issue a determination on the basis of any information within its possession or that may come into its possession. (R&TC, §§ 6481, 6511.) There is nothing in the R&TC that specifies the method that CDTFA shall use, such as the entirely new audit that appellant requested.

which the bank statements show no credit card deposits at all. In other words, the bank statements appellant provided do not include substantial amounts of credit card deposits.[18] It is more likely than not that the missing credit card deposits were made into one of appellant's three other bank accounts, the records for which are not in evidence. The bank statements are therefore incomplete, and do not show that a bank deposit analysis would result in a more accurate determination.

Unreasonable Average Daily Cash Sales

Appellant contends that the audit results in average cash sales of $1,700 per day, which appellant argues is unreasonably high for appellant's business. Appellant contends that CDTFA should have performed a physical observation of the business to verify the cash sales.

According to audit schedule 12C-2, cash deposited into appellant's business bank accounts totaled $4,569,970 for the 1,276-day period of January 1, 2011, through June 30, 2014. OTA calculates average cash deposits of $3,581 per day ($4,569,970 ÷ 1,276 days), which is much greater than the $1,700 per day amount that appellant argues is unreasonably high. OTA finds that average cash sales of $1,700 per day is not unreasonably high because appellant's own bank records reflect that it deposited much more than that on a daily basis during the audit period.

Reasonableness Test

Appellant notes that section 0407.05 of the Audit Manual states that, when an indirect method (such as the markup method) is used, the results should be compared to the results of another indirect method. This is often referred to as a reasonableness test. Appellant implies that the audit should be disregarded because CDTFA did not use another indirect method to compute sales.

However, OTA notes that on audit schedule 12C-1, CDTFA added credit card deposits as recorded on Forms 1099-K of $3,255,701 for the period July 1, 2011, through December 31, 2013, to cash deposits as recorded in bank statements of $3,183,472 for the same period to compute total sales of $6,439,173. CDTFA subtracted reported total sales for that same period of $3,265,692 to compute unreported total sales of $3,173,481. Unreported total sales of

[18] The credit card deposit data is further supported by the Form 1099-K data that shows that appellant made credit card sales of $3,715,466 for the period 1Q11 through 4Q13.

$3,173,481 is much greater than the unreported taxable sales of $1,652,054 for the period July 1, 2011, through December 31, 2013, as computed in the second reaudit. OTA finds that the analysis of cash and credit card deposits is another indirect method of computing sales, which satisfies the "reasonableness test" requirement in Audit Manual section 0407.05.

Based on OTA's finding that appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made, OTA concludes that appellant has failed to meet its burden of establishing that a reduction to the measure of unreported taxable sales is warranted.

Issue 2: Whether interest relief is 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 grant relief of all or any part of interest imposed on a person under the Sales and Use Tax Law where the failure to pay the 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).) 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 failure to act by, the taxpayer. (R&TC, 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5.) When CDTFA denies a request for relief of interest, OTA will review that decision for abuse of discretion. (*Appeal of Micelle Laboratories, Inc.*, *supra*; see *Appeal of Gorin*, 2020-OTA-018P.)

Appellant requests interest relief only for the period of time that OTA delayed the in-person hearings due to COVID-19.

Appellant made no argument and offered no evidence to establish unreasonable error or delay by CDTFA, and OTA has no legal authority to grant relief of interest that accrues as a result of acts or omissions by OTA.[19] Based on the foregoing, appellant has not shown that interest relief is warranted.

[19] OTA notes that appellants request for appeal came to OTA in late April of 2020. Subsequently, there was briefing by the parties, and other procedural matters were addressed. This appeal was first scheduled for a prehearing conference and oral hearing on April 27, 2021, and May 18, 2021, respectively. Appellant requested a postponement for health issues, which was granted. The appeal was then scheduled for a prehearing conference and oral hearing on June 1, 2021, and June 22, 2021, respectively. At the June 1, 2021 prehearing conference, appellant

HOLDINGS

1. Appellant has not shown that adjustments to the audited taxable measure are warranted.
2. Appellant has not established that interest relief is warranted.

DISPOSITION

CDTFA's action in denying appellant's petition for redetermination is sustained.

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
Michael J Geary
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

Date Issued: 5/22/2023

requested a postponement so that the appeal could be heard in-person instead of a virtual (electronic) oral hearing via Webex. Appellant's request was granted. OTA began hearing in-person hearings on a limited basis in late 2021 but did not resume its regular schedule of in-person hearings until approximately April of 2022.