

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
Q. NGO)
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OTA Case No. 20025882
CDTFA Case ID 845632

OPINION

Representing the Parties:

For Appellant: Hai Vang Dang, CPA

For Respondent: Jason Parker, Chief of
Headquarters Operations

For Office of Tax Appeals: Deborah Cumins,
Business Taxes Specialist III

N. RALSTON: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Q. Ngo (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)¹ in response to appellant’s petition for redetermination of the Notice of Determination (NOD) dated August 12, 2014. The NOD is for \$12,164.17 in tax, plus applicable interest, and a negligence penalty of \$1,216.43, for the period January 1, 2011, through December 31, 2013 (audit period). In its subsequent Decision and Recommendation respondent deleted the negligence penalty and denied the remainder of the petitioned amount.

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, “respondent” shall refer to BOE.

ISSUE

Whether appellant has shown that adjustments are warranted to the audited understatement of reported taxable sales.²

FACTUAL FINDINGS

1. Appellant has operated a fast-food restaurant in Long Beach since May 1987,³ selling hot food, soda, and non-carbonated drinks. The restaurant accepts cash only.
2. During the audit period, appellant reported total sales of \$536,847, claimed deductions for sales tax included of \$44,311, and reported taxable sales of \$492,536.
3. For audit, appellant provided federal income tax returns (FITRs) for 2010 (before the audit period), 2011, and 2012; purchase journals for the last two quarters of 2013; purchase invoices for the third quarter of 2013 (3Q13); and cash register z-tapes⁴ for 30 days in January and February 2014.⁵ Appellant did not provide sales records (i.e., a sales journal or cash register z-tapes) to support sales made during the audit period.
4. In its preliminary review, respondent found that the sales reported on appellant's FITRs substantially reconciled with the amounts reported on the sales and use tax returns (SUTRs).
5. Respondent used the amounts of sales reported on SUTRs and the costs of goods sold reported on FITRs to compute book markups⁶ of 181 percent for 2010, 185 percent for

² At the appeals conference with respondent, appellant also asserted that she was unable, financially, to pay the liability. According to the Decision and Recommendation, respondent explained the process of filing a settlement proposal with respondent's Settlement and Taxpayer Services Bureau. Since the Office of Tax Appeals has no authority to settle a tax liability, and the Office of Tax Appeals' jurisdiction is limited to determining the correct amount of an appellant's tax liability, the Office of Tax Appeals will not address this matter further. (*Appeal of Robinson*, 2018-OTA-059P.)

³ It is not clear from the record whether the restaurant is still operating.

⁴ A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain period of time (i.e., a day or a shift).

⁵ Appellant provided z-tapes for January 5-10, 13-18, 20-24, and 27-29, 2014; and for February 3-8, and 10-13, 2014.

⁶ "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 $\text{markup amount} \div \text{cost}$. In this example, the markup percentage is 42.86 percent ($.30 \div .70 = 0.42857$). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

- 2011, and 164 percent for 2012 (rounded), which respondent found reasonable for this type of business.
6. The costs of goods sold reported on FITRs were lower than the amounts of merchandise purchases recorded in appellant's purchase summary records.
 7. Respondent reduced the recorded purchases by estimated amounts for self-consumption and pilferage, computed at 5 percent and 1 percent, respectively. Using reported sales and the adjusted amounts of purchases, respondent computed book markups of 101 percent for 2011, 91 percent for 2012, and 99 percent for 2013 (rounded). Since those markups were lower than respondent expected,⁷ the audit staff decided that additional investigation was warranted.
 8. Appellant provided cash register z-tapes for January and February 2014 for the 30 days listed above (fn. 5); those tapes showed sales totaling \$22,175 for the 30-day period. Respondent conducted two days of observation tests at the restaurant. For Monday, February 3, 2014, respondent observed sales (net of tax) of \$1,036, and on Tuesday, February 11, 2014, respondent observed sales of \$710. Those totals supported the accuracy of the cash register z-tapes for the two observation days, which reflected sales totals of \$1,025 and \$710, respectively.
 9. Respondent used the sales recorded by appellant on the cash register z-tapes for 30 days to compute average daily sales of \$739 (rounded). It then computed 312 days of operation (52 weeks x 6 days/week) and reduced that figure by 20 days for holidays when the restaurant was closed to establish 292 days of operation for 2013. Respondent computed audited taxable sales of \$215,840 for 2013.⁸
 10. Respondent computed that appellant's purchases for 2013 represented 98.18 percent of purchases for 2012, and purchases for 2012 represented 114.27 percent of purchases for 2011. Accordingly, respondent divided audited sales for 2013, \$215,840, by 98.18 percent to compute audited taxable sales of \$219,830 for 2012. It then divided audited

⁷ The record does not state the range of markups respondent expected, but it had regarded the markups computed using costs of goods sold reported on FITRs as reasonable. Those markups were 164-185 percent.

⁸ The audited sales per day and the audited annual sales, for 2013 and for 2012 and 2011, below, are rounded. However, the actual calculation is $739.18 \times 292 = \$215,840.56$.

taxable sales for 2012, \$219,830, by 1.1427 to compute audited taxable sales of \$192,385⁹ for 2011.

11. Respondent compared audited taxable sales to reported taxable sales for each year to compute percentages of understatement in reported taxable sales of 24.87 percent for 2011, 31.57 percent for 2012, and 25.93 percent for 2013. It applied those percentages to reported taxable sales to compute an understatement of \$135,519 for the audit period.
12. On August 12, 2014, respondent issued an NOD for tax of \$12,164.17 and a negligence penalty of \$1,216.43.
13. On September 11, 2014, appellant filed a petition for redetermination.
14. On November 17, 2016, respondent held an appeals conference. After the conference, appellant provided complete cash register z-tapes and z-tape reports for 2014 and 2015, which respondent would then review.
15. Respondent reviewed the cash register z-tapes provided for 1Q14 and found discrepancies between the records provided during the audit (for 30 days in January and February 2014) and the records provided after the appeals conference. Nevertheless, respondent used the cash register z-tapes for the entire 1Q14 to compute daily taxable sales of \$723 and total sales of \$20,676
16. Respondent concluded that the \$723 was reasonably consistent with the \$739 in daily sales computed during the audit and that no adjustments were warranted.
17. On April 12, 2017, respondent issued a Decision and Recommendation recommending deletion of the negligence penalty and no adjustment to the audited understatement of reported taxable sales.
18. This timely appeal followed.

DISCUSSION

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For 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.) It is the retailer's responsibility to

⁹ OTA computed \$219,841 for 2012 and \$192,377 for 2011 (rounded). OTA presumes the differences are related to rounding.

maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)1.)

When respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent may determine the amount required to be paid based on any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

In general, sales of food are exempt from tax. (R&TC, § 6359.) However, certain sales of food are excluded from the exemption (and are thus subject to tax). As relevant here, sales of food are subject to tax if the food is sold for consumption at facilities provided by the retailer (R&TC, § 6359(d)(2)) or if the food is sold as hot prepared food products (R&TC, § 6359(d)(7)).

When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359(d)(6).) When a retailer's sales fit within this provision, known as the "80/80 rule," the retailer may avoid its application by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)

In this case, it is undisputed that all sales are taxable. (R&TC, § 6359.) For this audit, appellant provided no sales records for the audit period to support the reported sales. In its preliminary review of the records, respondent found that the costs of goods sold claimed on FITRs were less than the amounts of purchases recorded on purchase summary reports. Moreover, when respondent used the recorded purchases and reported sales amounts, it computed book markups of about 100 percent for each year of the audit period, which it considered lower than it expected. Since appellant provided inadequate records for audit, and those records conflicted with the FITRs OTA finds it was necessary for respondent to utilize an indirect audit method. OTA further finds that respondent's projection of audited average daily sales, computed from a test of appellant's recorded sales for 30 days, was appropriate. OTA

therefore finds that respondent has shown that its determination was reasonable and rational. Thus, appellant has the burden to establish that adjustments are warranted.

In her opening brief, appellant states only that she has additional evidence to present. Appellant did not respond to a letter from the Office of Tax Appeals (OTA) asking for a more complete explanation of her arguments. However, at the appeals conference with respondent, appellant argued that the amount of audited average daily sales was not representative of her sales during the audit period, since the two observation tests were conducted after the audit period. Appellant also asserted that respondent made errors when scheduling the totals from the cash register tapes appellant provided during the audit. In addition, appellant stated that her average monthly sales were less than \$20,000, rather than the \$22,175 computed by respondent using the 30 days of cash register tapes.

Regarding appellant's assertion that the audited average daily sales amount was not representative of the audit period, because the observation tests were conducted after the audit period, the observation tests were used only to verify the accuracy of the cash register tapes. The audited average daily sales amount was calculated from appellant's cash register z- tapes for 30 days. However, appellant's argument applies equally to the cash register z-tapes because they also represented sales that occurred after the audit period.

Appellant provided neither summary records nor source documents to support the sales amounts reported for the audit period. Therefore, respondent had no option but to utilize records of sales that took place after the audit period. Moreover, the cash register tapes used by respondent to compute the average daily sales were for 30 days in January and February 2014, the two months immediately following the end of the audit period. It is more likely than not that the average daily sales were consistent between 2013 (the end of the audit period) and the first two months of 2014, and appellant has provided no evidence to the contrary. Respondent's test of 30 days, using appellant's sales records, is sufficient to establish a representative number of daily sales. Appellant's unsupported assertion that the amount is not representative of sales during the audit period is not sufficient to meet her burden of proof. (*Appeal of Talavera, supra.*)

Regarding appellant's assertion that respondent made errors when scheduling the sales amounts from the cash register tapes provided during the audit, appellant has not identified specific errors. As noted previously, respondent did notice discrepancies between the amounts

scheduled in the audit and the amounts shown on cash register tapes provided after the appeals conference. For instance, the cash register tapes provided after the appeals conference did not include tapes for some dates for which respondent had scheduled sales amounts. In addition, the cash register z-tapes provided after the appeals conference included tapes for days that had been identified during the audit as “closed” days for the restaurant.

Using the cash register tapes appellant provided after the appeals conference for the 30 days reviewed during the audit, respondent computed total sales of \$20,676, rather than the \$22,175 computed during the audit. Respondent considered that difference to be evidence that the cash register tapes provided after the conference were incomplete. Moreover, respondent used the tapes provided after the conference for all of 1Q14 to compute average daily sales of \$723 and found that amount to be consistent with the audited amount of average daily sales of \$739. For all these reasons, respondent concluded that the cash register tapes provided after the appeals conference did not support adjustments to the audited amount of taxable sales.

Appellant has not provided persuasive evidence of errors in respondent’s sales calculations based on cash register tapes provided during the audit. Further, the consistency between the audited amount of daily sales, \$739, and the average amount of daily sales computed for 1Q14, \$723, offers strong secondary support for the audit findings, particularly since there is evidence that the cash register tapes provided after the appeals conference were incomplete.

Regarding appellant’s statement that her average monthly sales were less than \$20,000, rather than \$22,175, as computed by the audit staff from available cash register tapes for 30 days, appellant’s unsupported assertion is not sufficient to meet her burden of proof. (*Appeal of Talavera, supra.*) Moreover, while it is not necessary to reach a decision regarding this argument, OTA notes that respondent has used audited sales for the audit period to compute average monthly sales of \$17,446, which is materially less than \$20,000.

Respondent used the best available information to establish the audited average daily sales, and OTA finds that the projection of those sales to the audit period was reasonable for this case. Further, OTA reviewed the audit workpapers and found no errors. Appellant has not provided evidence to show that adjustments are warranted to the audited understatement of reported taxable sales.

HOLDING

Appellant has not shown that adjustments are warranted to the audited understatement of reported taxable sales.

DISPOSITION

Sustain respondent’s decision to delete the negligence penalty and to otherwise deny the petition.

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Teresa A. Stanley
UCC6C6ACCC6A44D...
Teresa A. Stanley
Administrative Law Judge

Date Issued: 1/23/2023