OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21098711
	CDTFA Case IDs: 261-284; 195-719
MATTNJEREMY, INC.,	
dba MedMen Long Beach	

OPINION

Representing the Parties:

For Appellant: Richard G. Stack, Attorney

For Respondent: Jason Parker, Chief of Headquarters Ops.

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

A. WONG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, MattnJeremy, Inc. (appellant), dba MedMen Long Beach, appeals respondent California Department of Tax and Fee Administration's (CDTFA's) decision to partially deny appellant's petition for redetermination with respect to a Notice of Determination (NOD) that CDTFA timely issued on April 10, 2018, for the period January 1, 2015, through June 30, 2015 (the first NOD),[1] and to fully deny appellant's petition with respect to another NOD that CDTFA timely issued on April 23, 2019, for the period July 1, 2015, through December 31, 2017 (the second NOD).[2]

The first NOD was for a tax liability of $31,032, plus applicable interest, and a negligence penalty of $3,103.22. The second NOD was for a tax liability of $93,832, plus applicable interest, and a negligence penalty of $9,383.16. In its decision, CDTFA reduced the amount of unreported taxable sales for the period January 1, 2015, through June 30, 2015, from $344,800 to $230,058, which related to the first NOD. CDTFA did not reduce unreported

[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 the BOE.

[2] CDTFA timely issued the second NOD because appellant waived the applicable three-year statute of limitations and extended CDTFA's deadline for issuing it. (See R&TC, §§ 6487(a), 6488.)

taxable sales of $1,005,425 for the period July 1, 2015, through December 31, 2017, which related to the second NOD. The aggregate amount of unreported taxable sales at issue in this appeal is $1,235,483.

Appellant waived its right to an oral hearing, so the Office of Tax Appeals (OTA) decides this matter based on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

ISSUES

1. Whether the aggregate amount of unreported taxable sales should be further reduced.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated a marijuana dispensary in Long Beach, California. During the period January 1, 2015, through December 31, 2017 (audit period), appellant only sold products for delivery with no in-store sales (i.e., customers ordered products from appellant by phone, fax, or email).[3]
2. For the audit period, appellant reported total sales of $1,360,706, claimed total deductions of $89,902, and reported taxable sales of $1,270,804.
3. Upon audit, appellant provided bank statements for the audit period, as well as its federal income tax returns for 2015 and 2016. Appellant did not provide any sales journals, general ledgers, purchase journals, or sales invoices for audit. CDTFA independently obtained from the Franchise Tax Board (FTB) federal Forms 1099-K (*Payment Card and Third Party Network Transactions*) for the period January 1, 2015, through December 31, 2016.[4]
4. CDTFA expected marijuana dispensaries to make some cash sales, but appellant's bank statements did not record any cash deposits. CDTFA also noted that appellant's reported sales for 2016 exceeded its non-cash bank deposits by $11,980. CDTFA believed that this difference indicated that appellant made some cash sales.

[3] Prior to the audit period, the City of Long Beach had revoked all storefront business licenses for marijuana dispensaries, including appellant's.

[4] Form 1099-K is an IRS form that reports the monthly and annual amounts a bank, credit card company, or third-party network paid to a merchant during a given time period. Form 1099-K records payments made by any electronic means, including but not limited to credit cards, debit cards, and third-party payment apps and networks.

5. Previously, CDTFA audited appellant for the period April 1, 2010, through September 30, 2012, and found that appellant was making cash sales. During that prior audit, CDTFA scheduled appellant's recorded sales for each month in the period April 2010 through September 2012. For that period, appellant recorded total cash sales of $1,057,983. Beginning in August 2011, appellant accepted credit cards and recorded total credit card sales of $928,461 for the period August 2011 through September 2012. Over that period, monthly recorded cash sales declined from $79,591 to $4,495.

6. During the audit at issue here, CDTFA noted that the credit card sales reported on Forms 1099-K for 2015 substantially agreed with total sales appellant reported on its sales and use tax returns for 2015. Thus, CDTFA found that appellant did not report any cash sales during 2015. When questioned about the absence of cash sales proceeds deposited during the current audit period, appellant asserted that it did not accept cash as a form of payment during the current audit period. CDTFA asked appellant for evidence that it had discontinued accepting cash as a form of payment, but appellant provided none. As a result, CDTFA concluded that appellant made some cash sales during the current audit period but did not deposit any of that cash into its bank account. Because appellant did not provide any books or records (such as sales journals or sales invoices) that CDTFA could use to establish the amount of appellant's cash sales or total sales, CDTFA decided to compute appellant's sales using the credit-card-sales-ratio method.[5]

7. In its prior audit of appellant for the period April 1, 2010, through September 30, 2012, appellant had also provided inadequate records, so CDTFA also used the credit-card-sales-ratio method to compute sales, estimating a credit-card-sales ratio of 40 percent (i.e., 40 percent of appellant's total sales were paid for by credit/debit cards with the remaining 60 percent paid by cash). According to the audit working papers for the prior audit, CDTFA and appellant "agreed that approximately 40% of [appellant's] total sales were made with credit/debit cards," and that agreement was based on "a collaborative effort, available information, and [CDTFA's] auditing experience of the medical marijuana dispensary industry." Using the credit-card-sales-ratio method, CDTFA

[5] The credit-card-sales-ratio method typically uses data from third-party sources, such as bank statements or Forms 1099-K, which show amounts paid to a merchant by a bank, credit card company, or third-party network when the customer pays for goods or services using a debit card, credit card, PayPal, or similar non-cash payment. If a reasonable estimate of the ratio of such non-cash sales to total sales can be made, an equally reasonable estimate of total (i.e., cash and non-cash) sales can also be made.

computed unreported taxable sales of $2,086,413, which represented an error ratio of 105 percent when compared to reported taxable sales of $1,986,447.[6]

8. In the audit at issue here, CDTFA originally used the same estimated credit-card-sales ratio of 40 percent to establish audited sales for the current audit period.

9. Initially, appellant would not waive the applicable statute of limitations and extend CDTFA's deadline to issue an NOD, so CDTFA issued the first NOD for the first six months of the current audit period (January 1, 2015, through June 30, 2015). Using the Forms 1099-K it had acquired, CDTFA compiled credit card deposits of $250,134 for the period January 1, 2015, through June 30, 2015. After removing sales tax from this amount, CDTFA computed credit card deposits, excluding sales tax, of $229,481. CDTFA divided this amount by the estimated credit-card-sales ratio of 40 percent to compute audited taxable sales of $573,704 for the period January 1, 2015, through June 30, 2015. CDTFA compared this amount to reported taxable sales for the same period, and computed unreported taxable sales of $344,800 for the period January 1, 2015, through June 30, 2015. This was the measure for the tax liability noticed in the first NOD. CDTFA also imposed a 10 percent negligence penalty for the following three reasons: (1) appellant did not provide any books and records for audit; (2) appellant's reporting error rate of 150.63 percent was material; and (3) appellant committed the same errors disclosed in the prior audit.

10. Appellant timely filed a petition for redetermination with respect to the first NOD.

11. Subsequently, in a reaudit, CDTFA inadvertently increased the estimated credit-card-sales ratio from 40 percent to 50 percent, which then reduced the audited amount of unreported taxable sales for the period January 1, 2015, through June 30, 2015, from $344,800 to $230,058.

12. For the period July 1, 2015, through December 31, 2017, CDTFA calculated unreported taxable sales as follows. Using the Forms 1099-K for that period, CDTFA compiled credit card deposits of $734,797. From this amount, CDTFA removed sales tax to compute credit card deposits, excluding sales tax, of $674,125. CDTFA divided this

[6] In this prior audit, CDTFA initially recommended imposing a negligence penalty because appellant did not make adequate books and records available to CDTFA for examination and had materially underreported its taxable sales. However, CDTFA ultimately declined to impose a negligence penalty because the audit was appellant's first, and appellant's attention had been diverted from proper bookkeeping during the audit period towards attempting to legitimize its cannabis dispensary business in the face of governmental regulation/pressure.

amount by the estimated credit-card-sales ratio of 50 percent to compute audited taxable sales of $1,348,250 for the period July 1, 2015, through December 31, 2016. Upon comparing this amount to reported taxable sales for that period, CDTFA computed unreported taxable sales of $662,115 for the period July 1, 2015, through December 31, 2016, which represented an error ratio of 96.5 percent. CDTFA then applied the error ratio of 96.5 percent to reported taxable sales for 2017 to compute unreported taxable sales of $343,310 for 2017. In total, CDTFA computed unreported taxable sales of $1,005,425 ($662,115 + $343,310) for the period July 1, 2015, through December 31, 2017. For this period, CDTFA also added a 10 percent negligence penalty for three reasons: (1) appellant did not keep the required books and records that a reasonable person would keep; (2) appellant's reporting errors were materially significant; and (3) during the audit period, appellant repeated the same errors disclosed in the prior audit.

13. CDTFA subsequently issued the second NOD to appellant.

14. Appellant timely filed a petition for redetermination with respect to the second NOD.

15. On August 30, 2021, CDTFA issued its decision to partially grant and partially deny appellant's petition. As noted earlier, CDTFA reduced the amount of unreported taxable sales for the period January 1, 2015, through June 30, 2015 (from $344,800 to $230,058), but CDTFA did not reduce the $1,005,425 amount for the period July 1, 2015, through December 31, 2017. Accordingly, the aggregate measure of tax for the entire audit period is now $1,235,483 ($230,058 + $1,005,425).

16. Appellant's timely appeal to OTA followed.

17. In its opening brief, CDTFA provides copies of several pages from appellant's website for various days in 2015 and 2016.[7] The information from appellant's website discloses the following: (a) throughout each iteration, appellant's website indicated that all new customers were required to pay in cash; (b) in earlier iterations, appellant's website stated, "PLEASE HAVE EXACT AMOUNT" and "NOW ACCEPTING CREDIT CARDS!;" (c) in later iterations, appellant's website, under "New Patient Info," stated, "Cash only for your first delivery. ([W]e do accept credit card after at 3% rate of the

[7] CDTFA found these webpages on "The Wayback Machine" (web.archive.org), which is a website that can be used to access historical webpages for various websites. The dates of the website images range from February 3, 2015, through December 24, 2017, which are within the audit period.

total charge)"; (d) in later iterations, under "Delivery," appellant's website stated, "We accept Credit Card [sic]! (3% of total charges will be added)"; and (e) throughout each iteration, appellant's website contained no statement that appellant only accepted credit/debit cards.

18. During a conference with the parties, OTA requested that they supplement the evidentiary record with any third-party evidence, such as online customer reviews, that would corroborate their assertions regarding appellant's alleged no-cash, credit-card-only policy. Appellant did not respond. CDTFA responded by producing reviews of appellant's business that customers had posted on an online review website (Yelp.com) during the audit period. These reviews make no mention of any no-cash, credit-card-only policy for appellant.

DISCUSSION

Issue 1: Whether the aggregate amount of unreported taxable sales should be further reduced.

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of 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, 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. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax required to be paid to the state by any person, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or that may come into its possession. (R&TC, § 6481.)

In the case of an appeal, CDTFA bears the initial burden of proving that its deficiency determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P; see also *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924, and *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950.) For CDTFA's initial burden, the amount of proof required is minimal: CDTFA's determination is presumed correct if supported by a minimal factual foundation. (See *Appeal of Myers*, *supra*; see also *Schuman Aviation Co. Ltd. v. U.S.*,

supra, at p. 950.) If CDTFA carries its initial, minimal burden of proving that its determination was reasonable and rational, then CDTFA's determination is presumed correct, and the burden of proof shifts to the taxpayer to prove that CDTFA's determination is wrong and that a different result is warranted. (*Appeal of Talavera*, *supra*.)

The appellant bears the burden of proof as to all issues of fact unless the law specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence unless the law also specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(b).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.)

For the audit at issue, appellant did not provide any sales journals, general ledgers, purchase journals, or sales invoices. Thus, appellant's books and records were incomplete and not sufficient to verify the accuracy of appellant's reported sales using a direct audit approach. However, CDTFA was able to obtain from FTB appellant's credit card sales information, which was recorded in the Forms 1099-K for the period January 1, 2015, through December 31, 2016 (i.e., two-thirds of the audit period).

The record shows that appellant made substantial amounts of cash sales during the *prior* audit period but, during the audit at issue, appellant did not provide any evidence that it had implemented or enforced a no-cash, credit-card-only policy during the *current* audit period. Additionally, as discussed in more detail below, CDTFA has provided evidence that, throughout the current audit period, appellant's website stated that new customers must pay with cash, which suggests that appellant did in fact make cash sales during the current audit period. Accordingly, OTA concludes that CDTFA has provided a minimal factual foundation for its finding that appellant made cash sales in addition to its credit card sales during the current audit period.

Because of the evidence that appellant made cash sales during the audit period, the insufficient books and records provided by appellant upon audit (including a lack of documentation for the amount of cash sales), and the availability of appellant's credit card sales information sourced from the Forms 1099-K, CDTFA utilized an indirect audit approach, the credit-card-sales-ratio method. The credit-card-sales-ratio method is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) Thus, OTA finds that it was appropriate for CDTFA to use the credit-card-sales-ratio method to compute appellant's sales in the current audit.

For the credit-card-sales-ratio method utilized here, CDTFA initially used an estimated credit-card-sales ratio of 40 percent, which CDTFA had established in its prior audit of appellant. According to the prior audit's working papers, CDTFA and appellant had agreed upon the estimated 40 percent credit-card-sales ratio and collaboratively established it based on "available information" and CDTFA's experience auditing medical marijuana dispensaries. Because of the lack of direct evidence documenting the amount of appellant's cash sales during the current audit period, OTA concludes that it was reasonable for CDTFA to use the estimated 40 percent credit-card-sales ratio that the parties had agreed to in the prior audit. Upon reaudit, CDTFA inadvertently increased the estimated credit-card-sales ratio to 50 percent. Because there is an inverse relationship between the credit-card-sales ratio and total sales, CDTFA's inadvertent adoption of a higher credit-card-sales ratio lowered the amount of unreported taxable sales, which benefited appellant. Based on the foregoing, OTA concludes that CDTFA has met its initial burden to show that its determination was reasonable and rational. Accordingly, it is presumed that CDTFA's determination is correct, and the burden of proof now shifts to appellant to show by a preponderance of the evidence that CDTFA's determination is wrong and that a different result is warranted.

On appeal, appellant initially argues that there is no factual or legal basis for CDTFA to conclude that appellant made cash sales. Rather, appellant asserts that CDTFA made unwarranted assumptions based on its experience auditing marijuana dispensaries and its notion that most businesses make cash sales. Appellant contends that it is not appropriate for CDTFA to compare appellant's business during the current audit period to any business with a storefront or to its own business during the prior audit because, during the current audit period, appellant operated a delivery-only business.

Further, appellant asserts that it made no cash sales during the current audit period for two reasons: (1) it would be unsafe for its delivery drivers to carry cash; and (2) in the prior audit, CDTFA unjustifiably determined that 60 percent of appellant's total sales were cash sales, and thus, after the prior audit, appellant consciously decided to not accept cash payments during the current audit period.

Additionally, according to appellant, the $11,980 difference between reported sales and bank deposits in 2016 is immaterial, and CDTFA has not established that this difference constitutes evidence of cash sales. Appellant also argues that it is improper for CDTFA to place

appellant in the position of having to "prove a negative" by requiring evidence showing that appellant made no cash sales. In support, appellant cites to the case of *United States v. Janis* (1976) 428 U.S. 433 (*Janis*), in which the U.S. Supreme Court noted that "where the assessment is shown to be naked and without any foundation" then the burden shifts to the taxing authority [there, the IRS] to show facts that link the taxpayer to the alleged omitted income. Appellant also cites *Carson v. United States* (5th Cir. 1977) 560 F.2d 693 (*Carson*), in which the court found that the IRS had no evidence that the taxpayer was engaged in bookmaking so an assessment for wagering excise taxes could not stand.[8]

OTA has already noted that CDTFA bears the initial burden of proof, which is minimal, and analyzed the evidentiary record to determine whether CDTFA carried this burden. OTA concluded that CDTFA has provided a minimal factual foundation for its finding that appellant made cash sales during the audit period, carried its initial burden to show that its determination was reasonable and rational, and thus shifted to appellant the burden of proving by a preponderance of the evidence that CDTFA's determination is wrong and that a different result is warranted. With its initial arguments on appeal, appellant attempts to argue otherwise by relying upon unsupported assertions, which are not sufficient to satisfy its own burden of proof (see *Appeal of Talavera, supra*.), as well as inapposite and distinguishable federal case law. Accordingly, OTA finds that appellant's initial arguments on appeal lack merit and will not address them further. Instead, OTA will focus on the balance of appellant's arguments, which mainly revolve around its website and the issue of whether the website shows that appellant continued to make cash sales during the audit period.

As noted above, in its opening brief, CDTFA provided copies of several pages from appellant's website for various days in 2015 and 2016. In response, appellant initially claimed that it did not update its website after it closed its storefront in 2013. On that basis, appellant asserted that the webpages CDTFA presented were old pages that were not in effect during the current audit period.

In reply, CDTFA disputes appellant's claims. CDTFA notes that the images of appellant's websites it provided are clearly dated and show that appellant regularly updated the following information on its website during the audit period: the minimum purchase amount by

[8] *Janis* and *Carson* are distinguishable because OTA found that CDTFA supplied a minimal factual foundation for its determination.

new customers; its menus; and cut-off times for accepting delivery orders. As a specific example, CDTFA points out that the minimum purchase amount for new customers changed from $40 (per the November 9, 2015 version of appellant's website) to $50 (per the April 19, 2016 version of appellant's website), and back to $40 (per the June 11, 2017 version of appellant's website). However, while the minimum purchase amounts varied, CDTFA notes that, throughout those dates, there was a constant notation on the website indicating that new customers were required to pay in cash. CDTFA also observes a notation added to the website in the latter half of 2016, which stated that three percent would be added to amounts paid by credit card. CDTFA opines that a three percent charge for credit card sales added to listed sale prices is inconsistent with a policy to accept only credit/debit card payments.

In subsequent briefing, appellant again asserts that it did not accept cash payments during the current audit period. Appellant claims that it established a no-cash policy sometime in 2014, after one of its drivers was robbed of cash and products. According to appellant, it distributed to its drivers card readers that utilized the "Square" payment processing technology service, which charged three percent on all transactions. Appellant alleges that its managers verbally communicated this policy to its delivery drivers, implying that there was no written documentation of the purported policy change. With its subsequent brief, appellant included seven declarations from two corporate officers, four delivery drivers, and one customer. Using nearly identical language, the declarations state that delivery drivers accepted payment by credit/debit cards only and were prohibited from accepting cash.

Regarding its website's statement that all new customers were required to pay in cash, appellant claims that it had briefly implemented such a policy after a new customer had initiated a fraudulent charge-back on a credit card payment. Appellant asserts that, after ending this policy, it did not update its website and remove this policy because its webmaster had left the company. According to appellant, it could only change information about available products and their pricing, but could not eliminate the language requiring cash payments from new customers.

Here, appellant concedes that it routinely changed information about products and pricing on the website but claims that it was not able to eliminate the language stating that new customers were required to pay cash. OTA finds it implausible that appellant would be able to revise some but not all the information on its website. Accordingly, OTA is not convinced of the

veracity of appellant's allegation nor persuaded that the requirement for new customers to pay cash was simply a misstatement on the website throughout the audit period.

Moreover, there are other indicators that appellant made cash sales during the audit period, specifically in the archived copies of appellant's website pages provided by CDTFA on appeal. Various entries say, "*Now* accepting credit cards" (italics added), which suggests that credit cards were, at that time, a new payment option *in addition* to cash. Also, the website pages make no mention of a no-cash, credit-card-only policy. Further, there is an entry on one website page that says, "please have exact amount," which must refer to cash payments because credit/debit card payments are already processed for an exact amount. Additionally, appellant charged three percent of the sale price for credit card payments. If appellant only accepted card payments, it would have little reason to increase the sale price by three percent; appellant could simply raise the sale price of its product by three percent to incorporate the charge instead of separately adding it. This suggests that appellant had a base cash price and made cash sales.

Finally, as noted above, during a conference with the parties, OTA requested that they supplement the record with any third-party evidence, such as online customer reviews, that would corroborate their assertions regarding appellant's alleged no-cash, credit-card-only policy. Appellant did not respond, but CDTFA produced reviews of appellant's business that customers had posted on Yelp.com during the audit period. These reviews make no mention of any no-cash, credit-card-only policy by appellant. Accordingly, OTA finds that the evidentiary record lacks any third-party evidence that appellant implemented or enforced a no-cash, credit-card-only policy during the audit period.

To summarize, OTA finds that the notations on the website (stating new customers are required to pay cash; credit cards are accepted; exact amount is necessary; and a three percent charge will be added to credit card sales) all represent evidence that appellant accepted cash payments as well as credit/debit card payments. Further, appellant has not provided any convincing evidence that it implemented or enforced a no-cash, credit-card-only policy during the audit period. Finally, OTA does not find the seven almost-identical declarations persuasive because all available evidence in the record contradicts the declarants' assertions. For these reasons, OTA is not persuaded by appellant's argument that it only accepted card payments and its recorded sales were correct. And because appellant has not disputed CDTFA's use of the credit-card-sales-ratio method or the estimated credit-card-sales ratio of 50 percent, or raised any

other argument, OTA concludes that appellant has not overcome the presumption of correctness that attaches to CDTFA's determination, and the aggregate amount of unreported taxable sales should not be further reduced.

Issue 2: Whether appellant was negligent.

If any part of a 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. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Taxpayers are required to maintain and make available for examination on request by CDTFA all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to, the following: (a) normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

If a taxpayer has been notified of reporting errors committed during an audit period, and continues to commit the same reporting errors during a subsequent audit period, then that is also evidence of negligence. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-323.) Further, a taxpayer's failure to report numerous transactions is evidence of negligence if the failure had nothing to do with the taxpayer's accounting system. (*Id.* at p. 323.)

Here, CDTFA imposed the negligence penalties on appellant for three reasons: (1) appellant did not maintain the required books and records; (2) the amount of unreported taxable sales is large in relation to reported taxable sales; and (3) appellant repeated the errors disclosed in the prior audit in the current audit period. Appellant protests the negligence penalties but has not provided any specific arguments against them.

As stated previously, appellant failed to provide upon audit any sales journals, general ledgers, purchase journals, or sales invoices. CDTFA previously audited appellant for the period April 1, 2010, through September 30, 2012, received inadequate books and records for audit examination, and considered adding a negligence penalty but ultimately did not.[9] Thus, prior to the start of the current audit period, appellant knew, or should have known, of its responsibility to maintain and make available for examination upon request by CDTFA complete books and records. Appellant's failure to do so is evidence of negligence.

Additionally, despite evidence that appellant made cash sales during the audit period, appellant's bank statements did not record any cash deposits. Instead, appellant's reported sales were consistent with its bank statements, except for additional reported amounts of $11,980 for 2016. Thus, except for $11,980, appellant reported none of its cash sales for the audit period. OTA finds that appellant's failure to record and report cash sales is also evidence of negligence.

Moreover, this is the second audit of appellant that resulted in a substantial understatement of reported taxable sales. In the prior audit, for the period April 1, 2010, through September 30, 2012, CDTFA used the credit-card-sales-ratio method and computed unreported taxable sales of $2,086,413, which represented an error ratio of 105 percent when compared to reported taxable sales of $1,986,447. For the current audit period, CDTFA again used the credit-card-sales-ratio method and computed unreported taxable sales of $1,235,483 (both NODs combined). OTA finds that appellant repeated its error of not reporting all its cash sales from the prior audit period to the current audit period. Appellant had been notified of its prior reporting errors, which it committed in the prior audit period, and continued to commit the same reporting errors during the current audit period. This, too, is evidence of negligence. (See *Independent Iron Works, Inc. v. State Bd. of Equalization*, *supra*, at pp. 321-323.)

For the reasons described, OTA finds that appellant was negligent during the current audit period.

[9] See footnote 6, *ante*, page 4.

HOLDINGS

1. The aggregate amount of unreported taxable sales should not be further reduced.
2. Appellant was negligent.

DISPOSITION

Sustain CDTFA's decision to reduce the amount of unreported taxable sales for the period January 1, 2015, through June 30, 2015, from $344,800 to $230,058, and to otherwise deny appellant's petition for redetermination.

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

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Keith T. Long
Administrative Law Judge

Date Issued: 12/12/2023