

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 230112416
MEX-DINING INC.,)	CDTFA Case ID: 069-027
dba La Cocina Bar & Grill)	
)	
)	

OPINION

Representing the Parties:

For Appellant: Amador Lopez, President

For Respondent: Jason Parker, Chief of Headquarters Ops.

For the Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Mex-Dining Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on September 20, 2017. The NOD is for a tax liability of \$97,978.65, plus applicable interest, for the period July 1, 2012, through June 30, 2015 (liability period).²

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

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.

² The NOD was timely issued because on June 6, 2017, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period July 1, 2012, through September 30, 2014, which allowed respondent until January 31, 2018, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

ISSUE

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

FACTUAL FINDINGS

1. Appellant, a corporation doing business as La Cocina Bar and Grill, operated a bar and restaurant in Santa Clarita, California. Appellant obtained a seller's permit effective January 1, 1998. During the audit, appellant's business hours were as follows: 11:30 a.m. to 10:00 p.m., Monday through Thursday; and 11:00 a.m. to 11:00 p.m., Friday through Sunday.
2. During the liability period, appellant reported total sales of \$8,169,284, and claimed deductions for nontaxable sales of \$671,873, which resulted in taxable sales of \$7,497,411.
3. Upon audit, appellant provided the following: federal income tax returns for 2012, 2013, and 2014; bank statements for January 1, 2015, through June 30, 2015; daily recap sheets for the first quarter of 2015 (1Q15); merchandise purchase invoices for January 1, 2015, through June 30, 2015; and monthly sales reports and guest checks for 1Q16. According to the audit workpapers, appellant stated that its books and records were damaged by fire and water for periods prior to 2015. CDTFA also obtained Form 1099-K data from the IRS for the period 2012 through 2015.³
4. CDTFA compared the gross receipts, excluding sales tax reimbursement, that appellant reported on its federal income tax returns to the taxable sales that appellant reported on its sales and use tax returns and found no differences. CDTFA also compared the gross receipts that appellant reported on its federal income tax returns to the corresponding

³ 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.

- reported cost of goods sold and calculated book markups of 177.75 percent for 2012, 193.09 percent for 2013, and 186.80 percent for 2014.⁴
5. CDTFA performed a full-day site observation on Tuesday, January 12, 2016. Appellant then provided cash register z-tapes and credit card settlement reports for that day to CDTFA.⁵ CDTFA compared the sales that were observed during the site test with the sales totals from the cash register tapes, noting minor differences. According to the audit workpapers, the differences may be due to a power outage, which caused the cash registers to be closed out on the next business day. CDTFA used the cash register z-tapes to compute a credit card sales ratio of 73.57 percent and a credit card tip ratio of 15.43 percent for that day.
 6. CDTFA also calculated a credit card sales ratio based on the comparison of sales reported in appellant's Form 1099-K data to the taxable sales reported on appellant's sales and use tax returns. According to the Form 1099-K data, appellant made credit card sales totaling \$8,306,545 during the liability period. CDTFA reduced appellant's credit card sales by credit card tips of \$1,281,686⁶ and the applicable sales tax rate to calculate credit card sales less tip and sales tax reimbursement of \$6,447,034. When compared to reported taxable sales of \$7,497,411, appellant's credit card sales less tips and sales tax reimbursement represented a credit card sales ratio of 85.99 percent.
 7. To calculate the measure of unreported taxable sales, CDTFA compiled the sales recorded on appellant's guest checks for the period January 1, 2016, through January 7, 2016. CDTFA compared the guest checks to the daily sales recorded in appellant's monthly sales summaries, found immaterial differences, and concluded that appellant's monthly sales reports were reliable for determining a credit card sales ratio.

⁴ "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 \$0.70 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 ($0.30 \div 0.70 = 0.42857$). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is $\text{profit amount} \div \text{sales price}$. In the above example, the gross profit margin is 30.00 percent ($0.30 \div 1.00 = 0.30$).

⁵ A cash register z-tape is the portion of the cash register tape that summarizes sales by category for a certain time period (e.g., a day or a shift).

⁶ This amount was calculated by multiplying the credit card sales reported in the Form 1099-K data by the January 12, 2016 credit card sales tip ratio of 15.43 percent.

CDTFA used appellant's credit card sales close-out reports to compile appellant's taxable credit card sales of \$384,369 and credit card tips of \$59,710 for January and February 2016. CDTFA calculated a credit card tip ratio of 13.45 percent⁷ for these two months (recorded tip ratio).

8. Using the monthly sales reports, CDTFA compiled appellant's recorded food sales, bar sales, and gift certificate sales for January and February 2016. CDTFA found that appellant's total recorded food and bar sales for those two months measured \$502,011. CDTFA compared appellant's taxable credit card sales of \$384,369 to appellant's total recorded food and bar sales for January and February 2016, which resulted in a credit card sales ratio of 76.57 percent (recorded credit card sales ratio).
9. CDTFA reduced the credit card sales reported on appellant's Form 1099-K data of \$8,306,454 by the recorded tip ratio of 13.45 percent to calculate credit card sales excluding tips of \$7,189,237 for the liability period. CDTFA then divided audited credit card sales excluding tips by the recorded credit card sales ratio of 76.57 percent to calculate audited total sales of \$9,389,103. CDTFA reduced audited total sales of \$9,389,103 by the sales tax rate for each quarter⁸ to calculate audited taxable sales of \$8,616,920. When compared to reported taxable sales, appellant's audited taxable sales revealed an understatement of \$1,119,509.⁹
10. CDTFA calculated achieved markups from appellant's audited taxable sales of 235.22 percent for 2012, 252.34 percent for 2013, and 264.07 percent for 2014. The audit measure was consistent with the projection of unreported taxable sales calculated following the January 12, 2016 observation test.

⁷ This amount was calculated dividing credit card tips of \$59,710 by \$444,079 (consisting of appellant's taxable credit card sales of \$384,369 plus credit card tips of \$59,710) for January and February 2016.

⁸ The sales tax rate was 8.75 percent in 3Q12 and 4Q12. The sales tax rate was 9 percent for the remainder of the liability period.

⁹ The audit also resulted in a liability amount for appellant's self-consumption of taxable merchandise measuring \$22,343 for the liability period, and a credit for nontaxable sales of gift certificates measuring \$48,426. On appeal to OTA, appellant has not raised any contentions or argument with respect to these audit items. Accordingly, OTA finds that they are not in dispute and will not discuss them further.

11. On September 20, 2017, CDTFA issued an NOD to appellant for a tax liability of \$97,978.65, plus applicable interest. Appellant filed a petition for redetermination, which CDTFA denied.
12. This timely appeal followed.

DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, 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, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met 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, appellant did not provide a complete set of books and records for the audit. During the audit, CDTFA computed book markups of 177.75 percent for 2012, 193.09 percent for 2013, and 186.80 percent for 2014, which CDTFA considered low for this type of business. Further, CDTFA compared the credit card sales reported on appellant's Form 1099-K data to the total sales reported on appellant's sales and use tax returns and found a credit card sales ratio of 85.99 percent, which CDTFA considered too high for this type of business. Because CDTFA could not verify the accuracy of either the book markup or credit card sales ratio, it was reasonable for CDTFA to continue the audit. When CDTFA cannot compute taxable sales from

appellant's records, it is appropriate to use an indirect approach to calculate the taxable measure. (See *Appeal of Amaya*, 2021-OTA-328P.)

Upon audit, CDTFA relied on appellant's monthly sales summaries to calculate a credit card sales ratio. CDTFA then applied that credit card sales ratio to appellant's Form 1099-K data to project appellant's taxable sales. OTA has previously found that the credit card sales ratio is a recognized and accepted audit method. (*Appeal of Amaya, supra.*) OTA notes that the audited credit card sales ratio of 76.57 percent is supported by a similar credit card sales ratio that CDTFA calculated during the one-day January 12, 2016 observation test.¹⁰ Accordingly, it was reasonable for CDTFA to calculate the credit card sales ratio from appellant's available books and records, and the results appear reasonable. Therefore, the burden shifts to appellant to show whether a reduction is warranted. (*Appeal of Talavera, supra.*)

On appeal, there is no dispute that appellant made credit card sales totaling \$8,306,454 during the liability period. However, appellant asserts that the credit card sales ratio is incorrect. Appellant argues that the credit card sales ratio should be 89.04 percent (as opposed to the audited 76.57 percent). Based on the asserted credit card sales ratio, appellant contends that it actually over reported taxable sales by \$102. Despite this contention, appellant has not provided any additional evidence in support of these contentions (i.e., books, records, or source documents). Instead, appellant's contentions are based on a complex calculation, which applies a 15.43 percent tip ratio and a nine percent sales tax rate.

OTA notes several issues with appellant's asserted calculation of taxable sales. First, appellant appears to use the credit card tip ratio calculated by CDTFA during the January 12, 2016 observation test. Although this rate was calculated by CDTFA, it was not relied on for the audit. Rather, CDTFA used the tip ratio of 13.45 percent, which was calculated from appellant's books and records for January and February 2016. This larger data set (which includes the single day of observation) is more likely to yield an accurate tip rate. Thus, without additional evidence, OTA finds no basis to increase the tip rate from 13.45 percent to 15.43 percent. Therefore, OTA rejects appellant's asserted tip ratio.

Next, appellant uniformly applies a 9 percent sales tax rate to their calculation of taxable sales. However, during the liability period, the sales tax rate fluctuated between 8.75 percent for

¹⁰ As discussed above, CDTFA calculated a credit card sales ratio of 73.57 percent during the one-day January 12, 2016 observation test.


3Q12 through 4Q12, and 9 percent for the remainder of the liability period. By applying a 9 percent sales tax rate to the entire liability period, appellant artificially inflates the amount of sales tax reimbursement collected during 3Q12 and 4Q12. This results in an improper reduction to appellant’s taxable sales for those quarters. On the other hand, CDTFA’s audit methodology applies the correct sales tax rate in each quarter, which yields a more accurate calculation. As discussed above, CDTFA’s audit methodology is both reasonable and rational. Appellant has not provided sufficient evidence to show that the calculation is incorrect or that the measure of unreported taxable sales should be reduced. Appellant has not met its burden of proof.

HOLDING

No adjustments to the measure of unreported taxable sales are warranted.


DISPOSITION

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

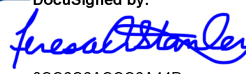
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Keith T. Long
Administrative Law Judge

We concur:

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Josh Lambert
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 12/15/2023