OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 20106813
ROYAL KHYBER ENTERPRISES, INC.	CDTFA Case ID: 146-030
dba Royal Khyber Indian Cuisine	

OPINION

Representing the Parties:

For Appellant:	Arun Puri, Owner[1] Anthony Azavedo, Representative Amrit Kafle, Representative
For Respondent:	Ravinder Sharma, Hearing Representative Chad Bacchus, Attorney Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Craig Okihara, Business Taxes Specialist III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Royal Khyber Enterprises, Inc., dba Royal Khyber Indian Cuisine, (appellant) appeals a February 21, 2020 Decision and a September 23, 2020 Supplemental Decision issued by the California Department of Tax and Fee Administration (respondent)[2] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated May 9, 2016.[3] The NOD is for $33,107.28 in tax, plus applicable interest, for the period October 1, 2010, through September 30, 2013 (liability period).

[1] Mr. Puri identified himself as one of the owners of the corporation and explained that his wife is the other owner. On various documents signed by Mr. Puri, he identifies himself as appellant's vice-president.

[2] Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (board). In 2017, the California Legislature transferred most of the board's administrative (i.e., non-adjudicatory) functions to respondent effective July 1, 2017. (Gov. Code, § 15570.22.) When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to the board.

[3] The NOD was timely issued because on February 17, 2016, appellant signed the most recent in a series of consecutive waivers of the otherwise applicable three-year statute of limitations. The waiver allowed respondent until October 31, 2016, to issue an NOD for the period October 1, 2010, through June 30, 2013. (See R&TC, §§ 6487(a), 6488.)

Office of Tax Appeals (OTA) Administrative Law Judges Keith T. Long, Andrew J. Kwee, and Michael F. Geary held a hearing in this matter on May 9, 2023, in Cerritos, California. At the conclusion of the hearing, the parties submitted the matter, and OTA closed the record. By letter dated August 4, 2023, OTA reopened the record, pursuant to California Code of Regulations, title 18, section 30304(a), to develop a complete record for OTA's Opinion. By letter dated September 21, 2023, OTA acknowledged receipt of respondent's post-hearing submission, confirmed that appellant had not submitted a post-hearing brief, and informed the parties that OTA had again closed the record.

ISSUES

1. Are adjustments to the amount of unreported taxable sales warranted?[4]
2. Are adjustments to the amount of excess tax reimbursement warranted?[5]

FACTUAL FINDINGS

1. At all relevant times, appellant, a corporation dba Royal Khyber Indian Cuisine, operated an upscale restaurant, with a full bar, located in Santa Ana, California. The restaurant was open daily for lunch and dinner.[6] Appellant also offered catering. Appellant's seller's permit, which respondent issued with an effective start date of November 1, 1998, remains active.
2. Appellant offered discount coupons: Groupon, Inc. vouchers (Groupons) and Restaurant.com certificates (certificates).[7] Both types of coupons were sold through independent third parties.

[4] The audit items included in this issue are unreported taxable sales measured by $234,758 (based on the cash-sales-ratio method) and unreported taxable mandatory tips of $94,819.

[5] The audit items included in this issue are excess tax reimbursement on redemption of Restaurant.com certificates, measured by $62,334, and excess tax reimbursement on redemption of Groupon, Inc. vouchers, measured by $64,041.

[6] The restaurant was open 11:30 a.m. through 10:30 p.m. on Friday and Saturday, and 11:30 a.m. to 9:30 p.m. on the other five days of the week.

[7] Groupon, Inc. and Restaurant.com are online marketplaces where customers can purchase coupons or vouchers, which, as relevant here, entitle the purchaser to a discount off the regular price of food and/or beverages.

3. Respondent prepared an audit, which was superseded by a revised audit. These Factual Findings will focus on respondent's determination of unreported taxable sales and excess sales tax reimbursement determined in the revised audit dated March 17, 2016.

4. On its sales and use tax returns (SUTRs) for the liability period, appellant reported total sales of $1,744,452 and claimed deductions totaling $41,776 for sales for resale, resulting in reported taxable sales of $1,702,676.[8] Appellant also reported purchases of $18,830 subject to use tax, resulting in a total reported taxable measure of $1,721,506.[9]

5. For audit, appellant provided federal income tax returns (FITRs) for fiscal years ending September 30, 2011, September 30, 2012, and September 30, 2013;[10] point-of-sale (POS) sales summaries for April 29, 2014, through May 8, 2014, and June 1, 2014, through September 30, 2014 (all after the liability period); bank statements for the liability period; various cash register sales receipts for October 2014, and March 2015 (all after the liability period); and an Excel spreadsheet (prepared by appellant) that purports to contain data from credit card sales for the liability period. Appellant did not provide cash register z-tapes,[11] sales journals, purchase journals, or source documentation, such as guest checks, cash register tapes, or merchandise purchase invoices, for the liability period.

6. Respondent compared gross receipts reported on the FITRs for 2011, 2012, and 2013 to the corresponding total sales reported on the SUTRs and found that gross receipts exceeded reported total sales by $232,625, $113,960, and $18,830, respectively. Appellant did not explain the reason for the differences. Respondent compared gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs and

[8] Dollar amounts referred to in this Opinion may be rounded for ease of reference.

[9] Appellant asserts that the $18,830 was actually additional sales for resale, which it erroneously reported as purchases subject to use tax. Thus, it claims to have had sales for resale of $60,606 ($41,776 + $18,830) resulting in taxable sales of $1,683,846 ($1,744,452 - $60,606) for the liability period. According to the audit work papers, Schedule 414M, respondent did not include the $18,830 in reported taxable sales or purchases subject to use tax, and these changes had no impact on the determination of appellant's liability.

[10] Appellant's fiscal year was from October 1 of one year to September 30th of the next year. This Opinion will refer to the returns by the year the taxable year closed.

[11] 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).

computed a book markup of 271.69 percent for the three fiscal years combined.[12] While respondent considered the FITR book markup to be adequate for appellant's business, appellant did not provide documentation supporting COGS, and thus respondent could not verify the reliability of the calculated book markup. Due to the incomplete records provided for the liability period and the large unexplained differences between FITRs and SUTRs, respondent concluded that additional testing would be required to verify reported taxable sales.

7. Using the bank statements and other data, respondent compiled credit card deposits from sales revenue (excluding mandatory and optional tips or gratuities) of $1,981,937, cash deposits from sales revenue of $139,295,[13] deposits from Groupon, Inc. totaling $20,823, and total bank deposits from sales proceeds of $2,142,057 ($1,981,937 + $139,295 + $20,823) for the liability period.[14] Respondent removed sales tax reimbursement at the applicable tax rate to calculate total bank deposits from sales proceeds, excluding tips and sales tax reimbursement, of $1,981,992 for the liability period, which respondent erroneously compared to reported net taxable transactions for the liability period of $1,721,506 to calculate an unexplained difference was $260,486.[15] Respondent concluded that the unexplained difference was further indication that reported sales were understated.

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[12] "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 markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. The most accurate way to determine book markup is to compare actual cost and actual selling price per item.

[13] This amount appears to be net of loans and non-sales related transfers, only.

[14] When a retailer is engaged in the business of making retail sales of tangible personal property (TPP), the retailer's bank deposits, net of deposits from sources other than sales of TPP, are evidence of gross receipts from the retail sale of TPP.

[15] By "net taxable transactions" the Opinion refers to reported total sales revenue less revenue from reported nontaxable sales for resale plus the cost of purchases subject to use tax, which in this case would be calculated as follows: $1,744,452 – $41,776 + $18,830 = $1,721,506. The comparison should have been to total reported sales of $1,744,452, which would have included the actual claimed sales for resale of $60,606 (see footnote 9, *supra*) the revenue from which would have been included in total sales revenue deposited. Also, even if appellant was wrong about mistakenly reporting sales for resale as purchases subject to use tax, there should have been no amount added for purchases subject to use tax, since such purchases typically result in withdrawals, not deposits. The correct comparison would have revealed an unexplained difference of $237,540 (without considering revenue from Restaurant.com certificates, which would still constitute evidence that reported sales were understated).

8. Respondent obtained 2011, 2012, and 2013 Form 1099-K[16] data from the Internal Revenue Service. Respondent noted that credit card deposits from sales proceeds compiled from bank statements were consistent (with minor variances) with the corresponding credit card sales compiled from Form 1099-K data. Respondent decided to establish credit card sales using Form 1099-K data. However, because Form 1099-K data was not available for October 1, 2010, through December 31, 2010 (4Q10), respondent added credit card deposits from sales proceeds of $214,413 for 4Q10 compiled from the bank statements to credit card sales of $2,103,913 for January 1, 2011, through September 30, 2013, compiled from Form 1099-K data to compute total credit card sales of $2,318,326 for the liability period. As explained below, respondent computed an optional tips ratio of 10.42 percent and a mandatory tips ratio of 4.09 percent.[17] From the total credit card sales of $2,318,326, respondent removed optional tips of $241,570 ($2,318,326 × 10.42 percent) and mandatory tips of $94,819 ($2,318,326 × 4.09 percent) to compute audited credit card sales excluding tips of $1,981,937 ($2,318,326 - $241,570 - $94,819). Respondent applied the cash-to-credit sales ratio of 3.51 percent (as explained below) and computed audited cash sales, excluding tips, of $69,566 ($1,981,937 × 3.51 percent).[18] Respondent added audited credit card sales, audited cash sales, audited Groupon and certificate redemptions of $62,711[19] (as explained below) to compute audited total sales of $2,114,214 ($1,981,937 + $69,566 + $62,711). Respondent divided audited total sales for each quarterly reporting period by 1 plus the applicable sales tax rate to compute audited taxable sales of $1,956,264 for the liability period. Upon comparison to the taxable measure of

[16] Form 1099-K is used to report payments made to a taxpayer by payment card (e.g., credit or debit cards) processing companies (e.g., Visa, MasterCard, or American Express), third-party network (e.g., Venmo or PayPal), and others (e.g., Groupon, Inc.) who make payments to taxpayers that exceed certain thresholds. It is authorized by the Internal Revenue Service for tax administration purposes. (See 26 C.F.R. § 1.6050W–1.)

[17] As used in this Opinion, the term "mandatory tips" includes mandatory tips, gratuities, or service charges, as is more fully discussed below.

[18] Credit and cash sales ratios are generally calculated as a percentage of total sales, that is, as a credit sales-to-total sales ratio or a cash sales-to-total sales ratio. In this case, however, respondent calculated and used a cash sales-to-credit sales ratio, which is how the Opinion will refer to that ratio.

[19] This amount includes the amount respondent believed the customer had paid (cost) for the Groupons ($38,207) and certificates ($24,504) redeemed.

$1,721,506 reported on the SUTRs for the liability period, respondent computed unreported taxable sales of $234,758. This audit item is in dispute.

9. Using the POS sales summaries appellant provided for April 29, 2014, through May 8, 2014, respondent compiled, as relevant here, recorded cash sales (including tax) of $972, credit card sales (including tax and mandatory and optional tips) of $17,571, credit card tips (optional) of $2,226, mandatory tips (cash and credit card) of $470, and payment via Groupons or certificates (other tender)[20] of $968.[21] Using the POS sales summaries appellant provided for June 1, 2014, through September 30, 2014, respondent compiled, as relevant here, recorded cash sales (including tax) of $7,161, credit card sales (including tax and mandatory and optional tips) of $253,500, credit card tips (optional) of $25,985, mandatory tips (cash and credit card) of $10,672, and other tender of $8,342.[22] Respondent added the recorded amounts from the POS sales summaries for April 29, 2014, through May 8, 2014, and June 1, 2014, through September 30, 2014, to the amounts obtained in the observation test[23] (as explained below) to compute cash sales of $8,163, credit card sales of $272,162, credit card tips of $28,361, mandatory tips of $11,142, credit card sales (excluding mandatory and optional tips) of $232,659 ($272,162 - $11,142 - $28,361), and "other tender" of $9,330. Respondent calculated a credit card tips ratio of 10.42 percent ($28,361 ÷ $272,162) and a mandatory tips ratio of 4.09 percent ($11,142 ÷ $272,162). Respondent also computed a cash-to-credit sales ratio of 3.51 percent ($8,163 ÷ $232,659).

10. Respondent performed an observation test to verify sales recorded in the POS sales summaries. Respondent performed site observations on Thursday, May 8, 2014, from 11:30 a.m. to 2:00 p.m., and Wednesday, March 4, 2015, from 5:00 p.m. to 9:30 p.m. For the two partial days combined, respondent compiled, as relevant here, cash sales of

[20] Appellant stated that it recorded Groupon and certificates, and gift certificate redemptions as "other tender." This Opinion will refer to such payments, collectively, as other tender.

[21] Respondent appears to have calculated this amount at customer's cost (face value of Groupon or certificate × discount percentage) for Groupons of $720 ($1,440 × 50 percent) + certificates of $172 ($430 × 40 percent) + gift certificates of $76.

[22] Respondent calculated this at customer's cost for Groupons of $5,305 ($10,610 × 50 percent) + certificates of $2,168 ($5,420 × 40 percent) + gift certificates of $869.

[23] Respondent noted that May 8, 2014 sales from the observation were already included in the POS sales summaries but this duplication had an immaterial effect in appellant's favor.

$29, credit card sales (including tips) of $1,092, credit card tips of $149, no mandatory tips, and other tender of $20. Respondent found the sales during the observation test were consistent with recorded sales in the POS sales summaries. Thus, respondent concluded that the POS sales summaries provided were reliable and further site observation days were not warranted.

11. Appellant told respondent that Groupon and certificate redemptions were recorded in the POS sales summaries as "other tender," and that it did not include other tender in sales reported on the SUTRs. Respondent determined that customers were able to purchase Groupons at 50 percent of face value (e.g., a $100 face value Groupon cost $50) and certificates at 40 percent of face value. Appellant provided sample cash register sales receipts for sales where the customer used a coupon, and these showed that appellant charged sales tax on the total sales price and subtracted the face value of the coupon from the total amount due, including tax. Thus, respondent concluded it needed to calculate the amount of excess tax reimbursement collected by appellant.

12. Appellant provided Form 1099-Ks issued by Groupon, Inc. for the liability period and informed respondent that the amounts shown of the Forms 1099-K were the face value of the Groupons sold. Respondent accepted appellant's representation and compiled the amounts reported on Groupon, Inc.'s Forms 1099-K , which totaled $76,411 for the liability period. Respondent multiplied those amounts by 50 percent to compute what it believed was the amount paid by the customer for the Groupons of $38,207. Thus, respondent computed the discount of $38,204 ($76,411 - $38,207). Respondent multiplied the discount for each quarterly reporting period by the applicable sales tax rate to compute excess tax reimbursement collected of $3,042 for the liability period. Respondent divided the excess tax reimbursement by the state tax rate to convert the excess tax reimbursement to a measure of $64,041.[24] This audit item is in dispute.

[24] To illustrate how respondent viewed these transactions, for a Groupon with a face value of $100, the customer paid $50 to Groupon, Inc. If the customer redeemed the Groupon on a $200 transaction, the amount subject to sales tax (state, county, local, and district) was the $50 the customer paid for the Groupon plus the additional consideration paid of $100 ($200 - $100) totaling $150 ($50 + $100). Because appellant charged sales tax reimbursement on $200, it collected excess tax reimbursement on the $50 ($200 - $150) discount. At a sales tax rate (state, county, local, and district) of 8 percent, appellant has collected $4 of excess tax reimbursement. It is not clear from the evidence why, when respondent then converted the excess tax reimbursement collected on Groupon sales, it used the 4.75 percent state sales tax rate only, but in OTA's view, the conversion of excess sales tax to a taxable measure is merely a practical convenience and immaterial to this analysis.

13. Appellant informed respondent that it received none of the proceeds from the sales of certificates sold by Restaurant.com. According to respondent, however, appellant provided various copies of Restaurant.com sales reports for the liability period.[25] Respondent compiled the face value of certificates sold and computed average quarterly sales of $5,105. Thus, for the liability period, respondent computed sales of certificates at face value totaling $61,255. Respondent multiplied the face value by 40 percent, which it believed to be the amount paid for the certificate, to compute the amount paid by the customer for the certificates of $24,504. Respondent computed the discount of $36,751 and then multiplied the discount for each quarterly reporting period by the applicable sales tax rate to compute excess tax reimbursement collected of $2,961 for the liability period. Respondent divided the excess tax reimbursement by the state tax rate to convert the excess tax reimbursement to a measure of $62,334.[26] This audit item is in dispute.

14. As noted previously, respondent removed mandatory and optional tips to compute audited credit card sales. Respondent established a separate measure of tax for mandatory tips. Respondent examined the cash register sales receipts appellant provided and noted that an 18 percent tip was automatically added on cash register sales receipts for parties of six or more and recorded in the POS sales summaries. Appellant's menu dated September 9, 2012 (i.e., within the liability period), indicated that an "18% gratuity may be added for parties of 6 or more" and Yelp.com reviews also supported that it was appellant's policy to add a mandatory tip for parties of 6 or more. Thus, respondent determined that the mandatory tips were includable as part of taxable sales.[27] Respondent divided total credit card sales of $2,318,326 by 1 plus the aforementioned 4.09 percent

[25] These reports are not in evidence.

[26] To illustrate how respondent viewed these transactions, for a certificate with a face value of $100, the customer would pay $40 to Restaurant.com. If the customer redeemed the certificate on a $200 transaction, the amount subject to sales tax (state, county, local, and district) was the $40 the customer paid for the certificate plus the additional consideration paid of $100 ($200 - $100) totaling $140 ($40 + $100). Because appellant charged sales tax reimbursement on $200, it has collected excess tax reimbursement on the $60 ($200 - $140) discount. At a sales tax rate (state, county, local, and district) of 8 percent, appellant has collected $4.80 of excess tax reimbursement.

[27] A mandatory payment designated as a tip, gratuity, or service change is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. (Cal. Code Regs., tit.18, § 1603(g).)

mandatory tips ratio to compute unreported taxable mandatory tips of $94,819 for the liability period. This audit item is in dispute.

15. Respondent discussed self-consumption with appellant. Appellant stated that the cost of self-consumed alcohol, carbonated drinks, and other taxable items was approximately $185 per quarter.[28] Thus, respondent computed the unreported cost of taxable merchandise self-consumed of $2,220 ($185 × 12 quarters) for the liability period.[29] This audit item is not in dispute.
16. Respondent issued an NOD to appellant on May 9, 2016, based on the revised audit, with a tax liability of $33,107, plus applicable interest.
17. Appellant filed a timely petition for redetermination disputing the NOD in its entirety.
18. Respondent held an appeals conference with appellant, and subsequently issued the Decision denying the petition.
19. Appellant filed a timely request for reconsideration reiterating its disagreement with the computation of audited taxable sales. Appellant argued that respondent arbitrarily rejected information appellant provided and used estimates and unverified data to calculate audited taxable sales. Respondent issued a Supplemental Decision on September 23, 2020, finding that no adjustments were warranted and again denying the petition.
20. This timely appeal followed.
21. OTA asked the parties to submit post-hearing briefs to provide additional contentions and information regarding appellant's revenue from the sale of Groupons and certificates. In its request, OTA informed the parties that Forms 1099-K are used to report payments made in settlement of reportable payment transactions and generally set forth the total dollar amount of aggregate reportable payment transactions for each participating payee without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts or any other amounts. OTA also asked the parties to clearly state their respective positions regarding revenue received by appellant from the sale of certificates.
22. In the request for post-hearing briefs, OTA asked appellant to: (1) identify all evidence that supported its contention that the Forms 1099-K provided to respondent reported the

[28] This equates to approximately two dollars per day.

[29] This is a use tax measure.

face amount of Groupons; and (2) state whether it disagreed with the inclusion of $25,504 purportedly received from Restaurant.com, explain the legal and factual bases for your disagreement, and identify all admitted evidence that supported its position. Appellant did not respond to the request.

23. In the request for post-hearing briefs, OTA asked respondent if it agreed that the Forms 1099-K issued by Groupon, Inc. to appellant indicated payments to appellant during the liability period totaling $76,411, to state the factual and legal bases for respondent's inclusion in appellant's taxable sales measure of only approximately one-half of the amounts stated on the Forms 1099-K issued by Groupon, Inc. to appellant and, if respondent would seek to correct the error, to explain how it proposed to do so. Respondent explained in its post-hearing brief that it had erroneously considered only approximately one-half of the revenue paid to appellant by Groupon, Inc., and that it did not plan to correct its error because the difference in measure was immaterial, and it benefited appellant.

24. In the request for post-hearing briefs, OTA also asked respondent to state the factual and legal bases for including in appellant's audited taxable sales measure $25,504 purportedly received from Restaurant.com. Respondent explained that appellant provided sales reports for Restaurant.com for the period October 2010, through September 2013 and that respondent used these sales reports to determine average quarterly sales of certificates of $5,105, which it reduced to $2,042, the amount it believed the customers paid for the certificates.

DISCUSSION

Issue 1: Are adjustments to the amount of unreported taxable sales warranted?

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

hot food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).)

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).) 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).)

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 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, 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 the context of food or beverage service, a mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. (Cal. Code Regs., tit., 18, § 1603(g).) It is presumed that when the retailer adds an amount to the bill as a tip and then presents the bill to the customer, the tip is mandatory, but the presumption may be rebutted by documentary evidence that proves the customer specifically requested and authorized that the gratuity be added to the amount billed.[30] (Cal. Code Regs., tit., 18, § 1603(g)(2)(C).) A statement on the bill or invoice that the amount added by the retailer is a "suggested tip" or an "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge. (*Ibid*.)

[30] OTA interprets this latter requirement to refer to a request and authorization that occurs after service of the meal and before a bill including a mandatory tip is presented for payment.

Here, appellant's books and records provided for audit were incomplete. Appellant did not provide sales tax worksheets, sales journals, purchase journals, or source documentation, such as cash register tapes, guest checks, or merchandise purchase invoices, for the liability period. Thus, respondent was unable to verify sales reported on appellant's SUTRs for the liability period using a direct audit method (that is, compiling audited sales directly from appellant's records). Respondent's preliminary analysis found unexplained and substantial differences between total sales reported on appellant's SUTRs and gross receipts reported on appellant's FITRs. Respondent also found differences between taxable sales reported on appellant's SUTRs and bank deposits of appellant's sales proceeds. These findings were indications that appellant's reported sales may have been understated. Accordingly, OTA finds that respondent's decision to use an indirect audit method to compute the bulk of appellant's sales was a reasonable one.[31]

The next question is whether respondent used a methodology that was reasonably calculated to estimate appellant's tax liability. (See *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613.) OTA has previously found that respondent's use of a credit card sales ratio – typically one that uses the ratio of credit card sales to total sales – was reasonable and rational.[32] (*Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) The cash-to-credit sales ratio methodology used here is substantially similar. OTA finds that the use of this methodology was reasonably calculated to estimate appellant's tax liability.[33]

Lastly, the evidence shows that respondent correctly applied the methodology. Respondent used reliable data to determine credit card sales: Form 1099-K data obtained from the IRS (for 1Q11 through 3Q13) and appellant's bank statements (for 4Q13), which substantially agreed with the Form 1099-K data. Respondent determined cash sales from appellant's daily summaries of the POS data for the two test periods and the two observation periods, essentially all information provided by appellant. Respondent determined coupon sales

[31] Respondent used a more direct audit methodology, based on appellant's records and third-party data (Forms 1099-K and Restaurant.com sales reports) to determine cash sales and coupon sales.

[32] As previously stated, a "credit card sale" is one where payment has been made by credit or debit card or a third-party network, like PayPal.

[33] OTA acknowledges that there also may have been other indirect audit methodologies that either party might have used for the same purpose.

from reliable third-party data. OTA has reviewed the audit calculations, and they appear to be correct, except as further discussed below.

Retailers may issue coupons, in either paper or paperless form, which entitle the customer to buy TPP at a price that is either reduced to a specific amount or by a percentage off the regular price. When the retailer receives no compensation from the sale of a coupon accepted by the retailer as part of the purchase price, the coupon represents a true price reduction resulting in a corresponding reduction in the retailer's gross receipts from the sale. (Cal. Code Regs., tit. 18, § 1671.1((b)(4).) However, if the customer has previously paid for the coupon, including by making payment to a third party, like Groupon, Inc. or Restaurant.com, the portion of the coupon price that is paid to the retailer who accepts the coupon must be included in that retailer's gross receipts.[34] (*Ibid*.)

The evidence shows that appellant received part of the proceeds from the sale of Groupons. Appellant's bank statements show deposits of such proceeds, and appellant readily admitted during the audit that it received revenue from the sale of Groupons. The Forms 1099-K data showing Groupon, Inc.'s payments to appellant are particularly persuasive. This evidence shows that appellant received $76,411 from Groupon, Inc. during the audit period. Relying on appellant's representation that the amounts shown on Groupon, Inc.'s Forms 1099-K were the face value of the certificates, respondent understated this revenue by $38,204 ($76,411 - $38,207). This is an error in appellant's favor, and respondent states that it will assert the additional amount only to offset any other adjustment in appellant's favor found by OTA.[35] There is at least one such adjustment.

There is insufficient evidence to support respondent's conclusion that appellant received additional revenue totaling $24,504 from the sale of certificates. Appellant stated during the audit that it received no money from the sale of certificates. Appellant informed respondent that customers who purchase certificates at a discounted price must spend twice the face value of the coupon at the restaurant. In essence, appellant explained that it received customer referrals and advertising in exchange for what amounted to a discount of 60 percent or less. This is a credible

[34] Any additional amounts paid by the customer (for TPP, not for tips or tax) at the time the coupon is redeemed must also be included in gross receipts. (R&TC, §§ 6012, 6051.)

[35] This error in appellant's favor may be partially offset by respondent's inclusion of revenue totaling $24,504 that respondent believes appellant received from the sale of certificates. There is insufficient evidence to establish that appellant received revenue from the sale.

explanation of how the certificates worked. Appellant's bank statements do not show any deposits from Restaurant.com and respondent provided no Forms 1099-K data to show that appellant received revenue from the sale of certificates. While the audit work papers indicate that there were "third-party reports" to support respondent's inclusion of the $24,504 in additional measure, none were provided. Finally, the evidence indicates that respondent believed at the time that the entire amount paid by the customer for a coupon should be included in gross receipts, regardless of to whom it was paid. Accordingly, OTA finds that respondent incorrectly included the $24,504 in the measure of unreported taxable sales, which still leaves a net error of $13,700 in appellant's favor. OTA therefore concludes that respondent has established that its determination is reasonable and rational. Consequently, the burden shifts to appellant to establish a more accurate measure. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Appellant contends that respondent's audit calculations are erroneous and that, according to its analysis, unreported taxable sales were $91,545 for the liability period. Appellant submitted its own calculations, which begin with audit schedule 1R-12A-7, Total Credit Card Deposits per Taxpayer, dated October 16, 2015, in which appellant compiled credit card sales of $2,228,758 from its vendor's Excel files.[36] Using its POS sales summaries for May 1, 2014, through July 31, 2014, appellant computed a 2.83 percent ($4,494 cash sales ÷ $158,792 credit card sales excluding tips) cash-to-credit sales ratio. Appellant applied the cash-to-credit sales ratio to credit card sales of $2,228,758 and computed cash sales of $63,073. Appellant combined credit card sales of $2,228,758, cash sales of $63,073, Groupon sales deposits of $20,823, and return deposits of $4,241 to compute total sales of $2,316,894.[37] Appellant computed taxable sales, net of 26.25 percent (18 percent for tips and 8.25 percent for sales tax), of $1,831,536 for the liability period.[38] Appellant compared net taxable sales of $1,831,536 to taxable sales it computed and asserted during the audit of $1,739,991 and calculated unreported taxable sales of $91,545 for the liability period.

[36] During the audit, appellant asserted that taxable sales should be $1,739,991 for the liability period. Audit schedule 1R-12A-7 summarized appellant's computation of taxable sales.

[37] Groupon sales deposits of $20,823 and return deposits of $4,241 for the liability period were compiled from bank statements by respondent on audit schedule 12A-3b, Daily Deposits per Bank Statements.

[38] OTA notes the difference between total sales of $2,316,894 and net taxable sales of $1,831,536 is $485,358 which is 26.5 percent ($485,360 ÷ $1,831,536) for tips and sales tax.

Appellant asserts that 97 percent of customers of fine dining establishments will pay by credit card and contends that its cash sales are less than 3 percent of total sales. In its Request for Appeal, appellant states "We DO NOT deposit any cash in the bank. Actually, we are always taking money out of our bank account to distribute the Tips, Gratuities, etc. (MINIMUM 18%) to the Staff." (Emphasis in original). The evidence shows that appellant was making some deposits of cash, $139,295 for the liability period. Regardless, cash deposits from sales proceeds were not used in respondent's computation of audited taxable sales. Thus, cash deposits provide no basis for adjustments to audited taxable sales.

Appellant has not identified any errors in respondent's computation of the audited cash-to-credit sales ratio of 3.51 percent. Instead, it presented its own calculation of taxable sales using a cash-to-credit sales ratio of 2.83 percent, which appellant computed from its POS sales summaries for 92 days. Respondent calculated a 3.51 percent cash-to-credit sales ratio for 132 days, plus the two periods of observation. Appellant's analysis does not constitute evidence from which a more accurate estimate of the cash-to-credit sales ratio can be made.

Nor does appellant's analysis establish a more accurate estimate of credit card sales. Appellant refers to audit schedule 1R-12A-7, dated October 16, 2015, which summarized appellant's own computation of credit card sales for the liability period. Appellant provided a copy of the final page of the audit schedule, but it has not provided the supporting merchant statements, and the credit card sales compiled from the available Form 1099-K data for January 1, 2011, through September 30, 2013, are greater than the corresponding credit card sales from appellant's credit card sales summary. OTA is not persuaded that appellant has established a more accurate calculation of credit card sales.

Appellant contends that respondent neglected to consider a credit card loan. Audit comments on audit schedule 12A-3b state that appellant asserted during the audit that a personal credit card was used to loan the business $20,000 ($10,000 each on July 25, 2011, and August 8, 2011). During the audit, appellant did not provide documentation for these alleged loans. In its appeal to OTA, appellant provided an excerpt from its FYE September 30, 2014 FITR (Form 1120, Schedule L) highlighting a balance of loans from shareholders of $160,000.

However, the Form 1120, Schedule L does not establish that credit card loans were made during the liability period.[39] OTA finds that respondent correctly allowed claimed non-sales income.

Appellant argues that the audited optional tips percentage of 10.42 percent is grossly underestimated and that such tips average over 20 percent. In its opening brief, appellant calculated taxable sales by multiplying all sales (cash and credit card) by 18 percent to calculate optional tips.[40] Appellant states "We provided our Dinner Menu to Auditor which clearly states that we charge a minimum of 18% Tips/Gratuity" (emphasis in original), and it asserts that respondent reviewed the menu and verified that it charges a minimum of 18 percent for tips. Appellant alleges that similar fine dining establishments in its area averaged tips of approximately 22 percent during the liability period. Appellant states that since 1999, it has been located in an affluent area near entertainment venues, and high-end stores and restaurants and that it has been recognized for its fine dining, winning many awards.[41] Appellant provided photos of the restaurant and surrounding area, and approximately 450 credit card transaction receipts as examples of tip amounts exceeding 18 percent.[42] Appellant did not provide the corresponding cash register tapes.

Appellant appears to misunderstand how respondent calculated the optional tips ratio, which represents the comparison of credit card tips to credit card sales *including* tips and sales tax reimbursement. To illustrate, on a $100 taxable sale, an optional tip of 18 percent would be $18, sales tax reimbursement at 8 percent would be $8, and the total paid by credit card would be $126 ($100 + $18 + $8). Thus, while in the example the tip was 18 percent, the credit card optional tips ratio would be only 14.29 percent ($18 ÷ $126).

Appellant's assertion that optional tips are grossly understated is not supported by credible evidence. Respondent computed the credit card tips ratios (10.42 percent for optional

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[39] As indicated above, respondent did not use cash deposits from sales proceeds to compute audited taxable sales. However, respondent did look at cash deposits (and other amounts) in one of its preliminary tests to determine whether additional investigation was required. In that test, respondent considered and allowed for non-sales deposits to the extent that they could be verified. Those verified non-sales deposits totaled $159,350 and included a $9,000 deposit on August 12, 2011. There was no similar deposit in July 2011.

[40] Audit schedule 1R-12A-7 summarized appellant's computation of taxable sales. In its calculation of taxable sales during the audit period, appellant multiplied all sales by a (mandatory and optional) tip ratio of 16.51 percent to calculate tips of $367,968.

[41] Much of appellant's argument at the hearing focused on what appellant views as "the whole issue": that appellant's customers are not the type that would tip less than 20 percent.

[42] The receipts were from 2015, 2016, 2017, and 2018, with the vast majority being from 2016.

tips and 4.09 percent for mandatory tips) by comparing data recorded in appellant's own POS sales summaries and the observation test. Appellant's arguments are based on unsupported assertions by Mr. Puri and over 445 copies of non-sequential guest checks that appear to have been selected not at random, but to support appellant's argument. On the basis of the evidence, OTA finds that appellant has not established a more accurate optional tips ratio.

Regarding mandatory tips, appellant argues that the audited mandatory tips percentage of 4.09 percent is too high. Appellant asserts that during the liability period, it did not have any POS system and therefore was not able to charge any automatic gratuity. Appellant argues that once it installed the POS system, on November 8, 2013, mandatory tips never exceeded 0.01 percent.

Appellant's argument that it was unable to add mandatory tips before it began using a POS system is unpersuasive. It would have been no more difficult to add a mandatory tip than it would have been to allow a customer to add a tip. The customer need only be informed that a mandatory tip of 18 percent will be added to the bill, but the customer was free to add a larger tip if the customer so desired. While it appears from some of the evidence that appellant concedes that it added mandatory tips for parties of 6 or more (large parties) after it began using the POS system, Mr. Puri was no less adamant in some of his testimony at the hearing that only the customer, not appellant, adds the tip. Nevertheless, there is abundant evidence that mandatory tips were added to checks for large parties after the liability period.[43] Appellant recorded such tips, and Yelp reviews refer to appellant's mandatory tip policy.[44] There is sufficient evidence to establish that mandatory tips were also added during the liability period. Appellant's menu, one that bears the date September 9, 2012, more than a year before the end of the liability period, states that "18% gratuity may be added for parties of 6 or more." Appellant offered no persuasive evidence or argument that there were changed circumstances or other factors that caused appellant to change its practices regarding mandatory tips after the liability period. OTA finds that appellant's mandatory tip policy after the liability period was just a continuation of its policy during the liability period and that appellant has not proved a more accurate mandatory tip ratio than the 4.09 percent estimated by respondent.

[43] According to the POS summaries, appellant also added mandatory tips for some parties of less than 6.

[44] In its opening brief, appellant appears to argue for a higher optional tip when it states, "We provided our Dinner Menu to Auditor which clearly states that we charge a minimum of 18% Tips/Gratuity." (Emphasis in original.)

In summary, OTA finds that respondent computed audited taxable sales based on the best-available evidence. Except as otherwise indicated above, the evidence does not show that respondent erred in its determination of audited taxable sales, and appellant has not established a more accurate measure. Consequently, no adjustments to the determined amount of unreported taxable sales are warranted.

Issue 2: Are adjustments to the amount of excess tax reimbursement warranted?

As stated above, when the retailer receives no compensation from the sale of a coupon accepted by the retailer as part of the purchase price, the coupon represents a true price reduction resulting in a corresponding reduction in the retailer's gross receipts from the sale. (Cal. Code Regs., tit. 18, § 1671.1(b)(4).) However, if the customer has previously paid for the coupon, including by making payment to a third party, like Groupon.com, the portion of the coupon price that is paid to the retailer who accepts the coupon, as well as any other amounts paid by the customer at the time the coupon is redeemed, must be included in that retailer's gross receipts. (*Ibid*.)

When an amount represented by a retailer to a customer as constituting reimbursement for sales taxes due is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the retailer, the amount so paid is excess tax reimbursement. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).) Excess tax reimbursement is charged when sales tax reimbursement is computed on a transaction which is not subject to tax, when sales tax reimbursement is computed on an amount in excess of the amount subject to tax, when sales tax reimbursement is computed using a rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the tax reimbursement on a billing. (Cal. Code Regs., tit. 18, § 1700(b)(1).) Unless the retailer refunds the excess tax collections to the customers who paid it, the retailer must pay the excess tax reimbursement to respondent. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).)

Appellant disagrees with respondent's determination that the restaurant collected excess sales tax reimbursement on transactions where the customer used a coupon as partial payment, but its explanation, and the evidence it provided to illustrate the point, essentially confirms that sales tax was charged on total sales, including the face value of the coupon. Thus, appellant charged sales tax reimbursement on the true price reduction.

Appellant's confusion may come from the application of sales tax to retailer coupons customers purchase through third-party websites (such as Groupon and Restaurant.com). When such coupons were redeemed, appellant's gross receipts included all payments that were made to the retailer by the third party (Groupon and Restaurant.com) plus any additional payment toward the purchase of food or beverages (i.e., not including tax and gratuity) at the time of the sale. Conversely, the true price reduction – the face value of the coupon less what appellant received from the sale of the coupon – was not part of appellant's gross receipts, and no sales tax was due on that amount. The sales tax reimbursement that appellant collected on the true price reduction was excess tax reimbursement. Because appellant did not – and for practical reasons could not – refund the excess tax reimbursement to the customers from whom appellant collected it, appellant must pay the excess tax reimbursement to the state. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).)

Respondent computed the amount of excess tax reimbursement collected and then divided the excess tax reimbursement by 4.75 percent, the State portion of the sales tax, to compute $64,041 for Groupons and $62,334 for certificates. As discussed above, respondent miscalculated additional gross receipts from the sale of Groupons and certificates. It also miscalculated the true price reductions. Appellant does not dispute that customers paid 50 percent of face value for Groupons. Appellant received $76,411 from Groupon, Inc. The true discount would have been at least equal to that amount, which means that the excess tax reimbursement collected on sales that included Groupons tendered in partial payment would have been more than twice the amount determined by respondent.[45] Also, given OTA's finding, above, that appellant received no revenue from the sale of certificates, the entire face amount of certificates tendered during the liability period would constitute the measure of excess sales tax collected on sales that included certificates tendered in partial payment. Thus, instead of calculating the excess tax reimbursement using discounts totaling $74,955 ($38,204 (Groupons) + $36,751 (certificates), respondent should have calculated the excess tax reimbursement using the true price reductions totaling $137,666 ($76,411 (Groupon) + $61,255 (certificates). Both errors are in appellant's favor, and there is nothing left to offset.

[45] Groupon, Inc. made its money by selling Groupons. It would not have given the entire purchase amount to appellant.

Appellant has not identified any errors in respondent's computation of the audited coupon redemptions or provided any evidence from which a more accurate determination could be made. Accordingly, OTA has no basis upon which to recommend any adjustments to the determined amount of excess tax reimbursement.

HOLDINGS

1. Adjustments to the determined amount of unreported taxable sales are not warranted.
2. Adjustments to the determined amount of excess tax reimbursement are not warranted.

DISPOSITION

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

DocuSigned by:
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Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

Date Issued: 11/14/2023