

December 31, 2018 (liability period).⁵ In addition, respondent imposed a finality penalty of \$5,082.80 because appellant did not pay or petition the NOD before it became final. On January 9, 2020, respondent assessed a collection cost recovery fee of \$950 pursuant to R&TC section 6833(a), to cover costs incurred for collection of the unpaid liabilities.⁶ Subsequently, respondent performed a reaudit and reduced the deficiency measure by \$3,774, resulting in a reduction of appellant's tax liability to \$50,544.

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, section 30209(a).

ISSUE

Whether further adjustments to the measure of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a partnership, operated a restaurant located in Rosamond, California, with a seller's permit effective from October 1, 2015, through November 21, 2018.
2. For the liability period, appellant reported total sales of \$984,797 with no deductions, resulting in taxable sales of \$984,797.
3. For the audit, appellant provided copies of bank statements for July through December 2016, 2017, and 2018; some handwritten guest checks; and Profit and Loss Statements for 2015, 2016, 2017, and January through October of 2018. Appellant claimed that it provided sales receipts to its accountant to prepare the monthly Profit and Loss Statements, which the accountant used to prepare and file the sales and use tax returns (SUTRs). This was appellant's first audit.
4. Respondent found the records provided by appellant to be inadequate for sales and use tax audit purposes because source documentation was not provided to verify the accuracy of the reported taxable sales. Additionally, respondent obtained Form 1099-K (1099-K)⁷

⁵ The negligence penalty was applied to the period from October 1, 2015, through September 30, 2018; the failure-to-file penalty was applied to the period October 1, 2018, through December 31, 2018.

⁶ R&TC section 6833(a) provides that a collection cost recovery fee shall be imposed on any person who fails to pay an amount of tax, interest, penalty, or other amount due and payable under the Sales and Use Tax Law.

⁷ Federal Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (credit cards, debit cards, PayPal, etc.). Its use for tax administration purposes is authorized by the IRS.

data, which reflected credit card sales exceeding reported taxable sales by \$29,451 and \$29,916 for 2016 and 2017, respectively. Moreover, the credit card deposits on the bank statements exceeded the reported taxable sales by \$80,786 for 2018. Additionally, appellant's credit card receipts reported on the 1099-K reports exceeded the gross receipts reported on the federal income tax returns (FITRs) by \$97,908 for 2015 through 2018. Furthermore, the credit card receipts reported on the 1099-Ks, exclusive of sales tax reimbursement and estimated 10 percent optional credit card tips,⁸ reveal credit card sales ratios ranging between 103.23 percent and 132.39 percent.⁹ Based on these differences, respondent determined that appellant failed to report all of its credit card sales and any cash sales on the SUTRs for the liability period.

5. Appellant did not provide detailed source documents to support sales, such as guest checks, cash register z-tapes, sales journals, purchase invoices or purchase journals for the liability period. As such, respondent was unable to verify appellant's reported taxable sales, or to compute appellant's credit card ratio. Therefore, based on prior audits of similarly situated businesses, respondent used an estimated 67.90 percent credit card sales ratio and 10 percent credit card tip ratio to estimate unreported taxable sales.
6. Using the credit card projection of sales audit method, respondent computed unreported taxable sales of \$682,500 for the liability period. In addition, respondent estimated \$10,000 in taxable sales of fixtures and equipment upon closeout of the business.¹⁰
7. On July 25, 2019, respondent issued the NOD to appellant for tax of \$50,828, plus interest, a 10 percent negligence penalty of \$4,551.88,¹¹ and a failure-to-file penalty of \$530.95.¹²

⁸ Because appellant failed to provide detailed sales records or copies of the wages and tips reported to the Employment Development Department and the IRS, respondent was unable to calculate the percentage of optional credit card tips. Therefore, based on prior audits of similarly sized businesses in similar locations, respondent estimated optional credit card tips of 10 percent.

⁹ This results in an average of 111.74 percent for the liability period.

¹⁰ Appellant did not dispute this audit item on appeal; thus, OTA will not discuss it further.

¹¹ Appellant has not disputed the negligence penalty on appeal; thus, OTA will not discuss it further.

¹² Appellant has not disputed the failure-to-file penalty on appeal nor submitted a statement under penalty of perjury setting forth the factual basis supporting relief as required by R&TC section 6592(b); thus, OTA will not discuss it further.

8. Appellant did not file a timely petition for redetermination; therefore, the NOD went final on August 26, 2019. Because appellant did not timely file a petition or pay in full the tax portion of the NOD before it became final, respondent imposed a finality penalty of \$5,082.80.¹³
9. On September 7, 2019, appellant filed a letter protesting the NOD, which respondent accepted as an administrative protest.
10. On June 22, 2021, appellant made two payments totaling \$10,552.71, which were applied toward the NOD.
11. Respondent held an appeals conference with the parties on July 14, 2022. Appellant contended in part that respondent's credit card ratio did not accurately represent appellant's business and that respondent should allow a credit card tip ratio of 15.72 percent.
12. Following respondent's appeals conference, appellant submitted copies of its federal income tax returns (FITRs) for 2015 through 2018 and a sales tax worksheet showing a tax balance due of \$5,174 for the liability period.
13. On February 6, 2023, respondent issued the Decision recommending a reaudit to recompute the audited taxable sales using the credit card receipts from the 1099-Ks for 2015, 2017, and 2018, but otherwise denying appellant's administrative protest for lack of source documentation.
14. On reaudit, respondent recalculated the credit card sales using the additional 1099-Ks and made an adjustment reducing the deficiency measure by \$3,774. Respondent made no other adjustments because appellant did not provide evidence supporting its claim that the projected credit card ratio and tip percentage were not representative of its business.
15. 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

¹³ Appellant has not disputed the finality penalty on appeal nor submitted a statement under penalty of perjury setting forth the factual basis supporting relief as required by R&TC section 6592(b); thus, OTA will not discuss it further.

administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to 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 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.*)

When a restaurant that accepts credit cards does not provide respondent with books and records sufficient to verify the accuracy of reported sales using a direct audit approach, it is appropriate for respondent to utilize the credit-card-sales-ratio method, an indirect audit approach. (*Appeal of Amaya*, 2021-OTA-328P.)

Here, the books and records appellant provided to respondent were incomplete and inadequate for sales and use tax purposes. Due to the lack of source documentation such as cash register z-tapes, sales journals, purchase invoices, and purchase journals, respondent was unable to verify appellant's reported sales using a direct method (that is, by compiling audited sales directly from appellant's records). Accordingly, respondent's use of the credit-card-sales-ratio method was appropriate. Moreover, the 1099-K data and credit card bank deposits constitute reliable evidence from a third party (i.e., merchant card processors) of appellant's sales, from which respondent could establish audited sales. Here, available 1099-Ks obtained by respondent revealed that credit card sales exceeded reported taxable sales, indicating that not all sales transactions made during the liability period were reported on appellant's SUTRs.¹⁴ The credit card receipts on the 1099-Ks also exceeded the gross receipts on the FITRs. Additionally, on reaudit, respondent considered the additional FITRs and updated 1099-K data provided by

¹⁴ As noted above, the 1099-K data reflected credit card sales that exceeded reported taxable sales by \$29,451 and \$29,916 for 2016 and 2017 respectively.

appellant and recomputed the credit card ratio, reducing the taxable measure by \$3,774. Although appellant claimed that the projected credit card ratio and tip allowance did not accurately reflect appellant's business operations, appellant has not substantiated its claim with source documents. Without supporting documentation showing that the projected 67.90 percent credit card ratio and 10 percent credit card tip ratio are inaccurate, there is not an adequate basis to make further adjustments to the deficiency measure. Therefore, respondent has established that its determinations are reasonable and rational, and accordingly, the burden shifts to appellant to establish that adjustments are warranted.

On appeal, appellant makes no arguments in support of its position nor provides any new evidence. Attached to its appeal letter are copies of its FITRs for 2015 through 2018 and a sales tax worksheet for the liability period, all of which were previously submitted to and considered by respondent in the reaudit. Instead, appellant requests relief on the basis of financial hardship because appellant is no longer in business and has no funds to pay the liability. Insofar as the documents that appellant has already provided during audit and resubmitted on appeal, they fail to support appellant's position that respondent's projected credit card ratio does not accurately reflect appellant's taxable sales. Appellant has not provided any supporting documents to compute its sales using a direct audit method. Therefore, absent source documentation such as cash register z-tapes, sales journals, purchase invoices, and purchase journals, appellant has not met its burden of proving that its taxable sales were less than that projected by the credit card ratio method.

With respect to appellant's requests, there is no provision in the Sales and Use Tax Law that allows OTA to relieve a taxpayer's tax liability based on financial hardship. (See *Appeals of Dauberger, et al.* (82-SBE-082) 1982 WL 11759.) However, following this appeal, appellant may wish to contact respondent to learn about any programs that might provide assistance, such as respondent's Offer in Compromise program or installment payment plans.

HOLDING

Appellant has not established that further adjustments to the measure of unreported taxable sales are warranted.

DISPOSITION

Respondent’s action is sustained. The liability shall be redetermined as provided in respondent’s decision.

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

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Keith T. Long
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Keith T. Long
Administrative Law Judge

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

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