OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **KUKSAN CORPORATION,** **dba Gas Depot**	OTA Case No. 230713794 CDTFA Case ID: 1-635-807

OPINION

Representing the Parties:

For Appellant: Seung Yong Hur, President

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Ada Kassa, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Kuksan Corporation (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 October 4, 2019.[2] The NOD is for tax of $21,986, plus applicable interest, and a negligence penalty of $2,198.64, for the period January 1, 2015, through June 30, 2019 (liability period).[3]

Appellant waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides the matter based on the written record.

[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 March 22, 2019, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period January 1, 2015, through September 30, 2016, which allowed CDTFA until October 31, 2019, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

[3] The NOD included a credit adjustment of $6.19 for Payments/Credits.

ISSUES[4]

1. Are adjustments to the unreported taxable minimart sales warranted?
2. Are adjustments to the unreported sales subject to the district sales taxes warranted?
3. Was appellant negligent?

FACTUAL FINDINGS

1. Appellant, a California corporation, operated an independent gasoline and diesel station with a minimart located in Manteca, California. Minimart sales during the liability period included taxable items and nontaxable food products, such as snacks and candies. From February 1, 2018, to June 30, 2019, an unrelated third party operated a coffee shop within the minimart and reported the coffee shop sales under a separate seller's permit.
2. Appellant's seller's permit had an effective start date of May 14, 2004, and appellant closed its business and seller's permit with an effective date of May 13, 2019.[5]
3. Appellant was previously audited three times,[6] the latest for the period of January 1, 2012, through December 31, 2014. In that audit, CDTFA established additional taxable minimart sales based on a markup of taxable minimart purchases.
4. On its sales and use tax returns (SUTRs) for the liability period, appellant reported taxable sales of $2,277,297.[7] Appellant stated that sales journals were used to report sales, but the sales journals were not provided to the auditor.
5. For the audit, appellant provided the following books and records: federal income tax returns (FITRs) for calendar years 2015, 2016, and 2017, and incomplete gas, diesel and minimart sales reports and summaries.

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[4] The sale of fixtures and equipment (F&E) of $10,000 at close out was addressed in CDTFA's Decision. However, appellant reported the $10,000 F&E in the second quarter 2019 return. The sales tax due was withheld in the escrow. Accordingly, appellant does not owe additional tax with respect to this sale.

[5] Appellant previously argued that Tippy's Café operated a minimart on the premises from February 1, 2018, to June 30, 2019. Tippy's Café operated under its own seller's permit, and it is unclear whether it continued to operate after appellant closed out its seller's permit.

[6] OTA's record does not include any of the prior audits; however, appellant does not dispute that it was previously audited three times.

[7] OTA's record does not include the information reported on appellant's SUTRs. CDTFA's Decision states that appellant reported total sales of $4,485,904 for the liability and claimed deductions for nontaxable sales of food products of $2,208,607, resulting in reported taxable sales of $2,277,297. Appellant does not dispute these numbers.

6. CDTFA performed a vendor survey[8] and obtained minimart merchandise purchase data from appellant's known vendors.[9]

7. CDTFA computed taxable minimart sales using the markup method based on the minimart merchandise purchase data and information obtained from the prior audit covering the period October 1, 2012, through December 31, 2014.

8. Using the minimart merchandise purchase data, CDTFA compiled total and taxable merchandise purchases for 2015, 2016, and 2017.[10] CDTFA utilized a purchase segregation test[11] of merchandise purchases for the third quarter of 2014 (3Q14) using the prior audit to compute taxable merchandise purchases. For taxable years beginning on or after January 1, 2022, R&TC section 19132.5 allows an individual taxpayer to request a one-time abatement of a timeliness penalty. As the taxable year at issue is the 2021 taxable year, this provision does not apply in this case.

9. In the prior audit, CDTFA estimated that purchases compiled for 3Q14 were understated by 25 percent.[12] Thus, CDTFA computed yearly total vendor minimart purchases of $89,458 for 2015, $86,327 for 2016, and $93,194 for 2017. Using the 3Q14 purchase segregation test, CDTFA computed taxable minimart purchase ratios of 77.80 percent for 2015, 78.01 percent for 2016, and 78.98 percent for 2017.

10. CDTFA accepted the minimart cost of goods sold of $143,388 reported on the FITR for 2015 and utilized the audited vendor minimart purchases of $86,327 for 2016 and $93,194 for 2017, which were higher than reported on the FITRs for 2016 and 2017. For

[8] An audit process in which CDTFA requests a taxpayer's merchandise purchase data from their vendors. This method is sometimes used when a taxpayer's records are inadequate for audit purposes.

[9] CDTFA used the vendor survey to audit the minimart. CDTFA accepted appellant's reported taxable sales of gasoline and diesel fuel.

[10] Although these merchandise purchases would technically be nontaxable merchandise purchases for purposes of resale by appellant, for consistency with CDTFA's Decision, this Opinion colloquially uses the terms "taxable merchandise" or "taxable purchases" to refer to merchandise of a type that appellant would resell in a taxable retail sale, and "nontaxable merchandise" to refer to merchandise of a type that appellant would resell in an exempt or nontaxable transaction (such as food products, other than hot prepared foods).

[11] A purchase segregation test is used to establish the proportion of merchandise purchases in various product categories (such as beer, wine, carbonated beverages, tobacco products, "other" taxable merchandise, and food) to compute the percentage of taxable merchandise purchases, as well as the percentages of merchandise in each category.

[12] CDTFA based this estimate on its own experience with similar businesses and a "normal purchasing cycle."

2018, CDTFA estimated appellant's minimart purchases to be the same as 2017 and established audited total minimart purchases of $416,103 for the years 2015 to 2018, combined.[13]

11. CDTFA then applied the taxable minimart purchase ratios[14] to the corresponding audited total minimart purchases of $326,109 for years 2015 to 2018 to establish taxable minimart purchases.

12. CDTFA applied a markup factor of 1.4054[15] to the audited minimart taxable purchases after allowing a 1 percent adjustment for pilferage. Audited taxable minimart sales were compared to reported taxable minimart sales revealed an error ratio of 118.33 percent for 2015, 56.98 percent for 2016, 60.90 percent for 2017, 135.59 percent for 2018, and 90.73 percent for the four years combined. The 90.73 average error percent was applied to the reported minimart taxable sales for 1Q19 and 2Q19 periods. After applying the error ratios to reported taxable minimart sales, CDTFA calculated unreported minimart taxable sales of $229,414 for the liability period.

13. Appellant operated its business in San Joaquin County, an area with a district tax rate of 1 percent, but failed to report that district tax on its 2Q18 taxable sales of $276,352, resulting in a separate measure of tax for taxable sales subject to the 1 percent district tax.

14. CDTFA issued appellant an NOD with a tax liability of $21,986, plus applicable interest, and imposed a negligence penalty of $2,198.64, because this is not appellant's first audit, and similarly to the current audit, the prior audit utilized vendor surveys and a markup method to determine the prior audit's deficiency measure.

15. On October 21, 2019, appellant filed a timely petition for redetermination protesting the liability. CDTFA issued a Decision on June 5, 2023, denying the petition.

16. Appellant timely appealed to OTA.

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[13] $143,388 + $86,327 + $93,194 + $93,194 = $416,103.

[14] The taxable minimart purchase ratio of 78.98 percent (from 2017) was used for 2018 because merchandise purchase data was not available for 2018.

[15] According to CDTFA audit workpapers, the markup factor was based on the taxable book markup of 40.54 percent established in the prior audit covering the period January 1, 2012, to December 31, 2014. The 40.54 percent of taxable book markup was in line with the markup of 42.63 percent for 2009 and 37.97 percent for 2010 calculated in a prior audit. Per CDTFA's verification comments, appellant did not disagree with the 40.54 percent markup.

DISCUSSION

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

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 proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to 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, CDTFA may determine the amount required to be paid based on any information which is in its possession or may come into its possession. (R&TC, § 6481.) 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 appellant 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*.)

CDTFA determined appellant's books and records were incomplete and not reliable and used an indirect audit approach to arrive at the unreported taxable minimart sales. CDTFA's use of the markup method as the basis for its determination is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) Considering appellant's failure to provide records and supporting documentation, CDTFA used the best information available to establish audited sales (e.g., minimart merchandise purchase data obtained from appellant's vendors, prior audit sample period purchase segregation, and prior audit markup). Therefore, OTA concludes that CDTFA's determination was reasonable and rational, and accordingly, the burden of proof shifts to appellant to show error in the audit.

In its appeal to OTA, appellant states that it disagrees with CDTFA's Decision but has not stated the specific reasons for its disagreement. During CDTFA's appeal process, appellant stated that the minimart was operated by a third party that was operating a coffee shop in part of the minimart. Appellant, therefore, alleges that it should not be responsible for the unreported taxable minimart sales for the period covering January 1, 2018, through May 13, 2019. In

support of its contention, appellant provided a lease contract with the third-party owners, dated October 30, 2017, and covering the period January 1, 2018, through December 31, 2024. CDTFA requested additional supporting evidence, such as canceled rent checks and a security deposit check, which appellant did not provide. Although CDTFA agreed that a third party occupied and ran a coffee shop from February 1, 2018, through June 30, 2019, CDTFA also noted that the third party reported and paid sales tax on its sales from the coffee shop, but not the minimart. Moreover, appellant claimed nontaxable food sales on its SUTRs in 2018 and 2019, which indicated that appellant operated the minimart until the business closed.

Despite several opportunities to submit documentation supporting its disagreement with CDTFA's Decision, appellant has not provided any evidence or argument that would indicate CDTFA's conclusion was erroneous. Appellant cannot carry its burden simply by asking OTA to find unidentified errors in CDTFA's determination. (*Appeal of Amaya*, *supra*.)

In summary, OTA finds that CDTFA computed the unreported minimart taxable sales based on the best available information and recognized audit procedures. Appellant has not identified any errors in CDTFA's computation of the unreported minimart taxable sales or provided new documentation or other evidence from which a more accurate determination could be made. Therefore, OTA has no basis to adjust unreported taxable minimart sales.

Issue 2: Are adjustments to the unreported sales subject to district sales taxes warranted?

California imposes a statewide combined state, local, and county tax rate pursuant to the Sales and Use Tax Law (R&TC, § 6001 et seq.) and the Bradley-Burns Uniform Local Sales and Use Tax Law (R&TC, § 7200 et seq.). In 1969, the state legislature enacted the Transactions and Use Tax Law (R&TC, § 7251 et seq.), which, subject to certain requirements, allows local jurisdictions to impose a district tax. (R&TC, §§ 7251.1, 7261(a), 7262; Cal. Code. Regs., tit. 18, § 1827(a).) A retailer engaged in business in a jurisdiction imposing the district tax is required to collect the tax. (*Ibid*.)

Appellant's business was in San Joaquin County, which imposed a 1 percent district tax during the liability period. Appellant reported the district tax in each quarterly period except for 2Q18. Thus, it was reasonable for CDTFA to establish a separate measure of tax for unreported sales of $276,352 in 2Q18, that were subject to the 1 percent district tax. Appellant claimed at audit that there was no place on the SUTR to report the district tax but did not dispute that it was

payable. Appellant provides no argument with respect to unreported district tax on appeal with OTA.

OTA, therefore, finds CDTFA correctly included the unreported sales subject to the district tax and concludes no adjustment is warranted.

Issue 3: Was appellant negligent?

R&TC section 6484 provides that, if any part of a deficiency is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d. 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal.App.4th 434, 447.) In *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 323), it was held that a negligence penalty is applicable where errors are continued from one audit to the next.

CDTFA imposed the negligence penalty because the errors found in this audit were the same types of errors found in the previous audit in which CDTFA determined appellant failed to report taxable sales. Although appellant has not specifically disputed the negligence penalty, OTA addresses this issue out of an abundance of caution.

In the current audit, CDTFA determined that appellant's books and records were insufficient and could not reasonably be used to audit appellant's taxable sales. As a result, CDTFA used an indirect audit approach by examining vendor-verified purchases and a prior audit's purchase segregation test and markup analysis to establish the unreported taxable minimart sales. Appellant had three prior audits, with the last of these revealing similar reporting errors. Appellant's continued failure to exercise due care in reporting its taxes is evidence of negligence. In addition, appellant did not provide complete sales records for the liability period. The absence of or incompleteness of records is grounds for a finding of negligence. (Cal. Code Regs., tit. 18, § 1698(k).) Therefore, OTA finds that appellant's failure to improve its recordkeeping and reporting accuracy is strong evidence of negligence, and the negligence penalty was properly applied.

Given the above reasons, OTA concludes that appellant was negligent, and CDTFA's imposition of the negligence penalty was justified.

HOLDINGS

1. Appellant has not shown that adjustments to the unreported taxable minimart sales are warranted.
2. Appellant has not shown that adjustments to the unreported sales subject to the district sales taxes are warranted.
3. Appellant was negligent.

DISPOSITION

OTA sustains CDTFA's denial of appellant's petition for redetermination.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Andrew Wong
Administrative Law Judge

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Asaf Kletter
Administrative Law Judge

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