OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **BOTTLEJOCKIES, INC.,** **dba Zeph's One Stop**	OTA Case No. 230613692 CDTFA Case IDs: 1-709-218; 2-516-016

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Bottlejockies, Inc. dba Zeph's One Stop (appellant) appeals respondent California Department of Tax and Fee Administration's (CDTFA's) decision denying the following: (1) appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on September 30, 2019; and (2) appellant's protective claim for refund filed on October 25, 2019.[1] The NOD is for tax of $57,728, plus applicable interest, and a negligence penalty of $5,772.84 for the period January 1, 2015, through December 31, 2017 (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.

ISSUES

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

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" refers to BOE.

[2] CDTFA timely issued the NOD because appellant waived the otherwise applicable three-year statute of limitations and extended CDTFA's issuance deadline to January 31, 2020. (See R&TC, §§ 6487(a), 6488.)

FACTUAL FINDINGS

1. During the liability period, appellant was a California corporation doing business as Zeph's One Stop in Salinas, California. It made retail sales of alcoholic beverages and sundry items (e.g., candy, chips, chocolate bars, and beef jerky), and provided catering services for alcohol at social events such as weddings.
2. For the liability period, appellant reported total sales of $2,091,140 and taxable sales of $1,364,893. Appellant claimed total deductions of $726,247, comprised of the following: nontaxable labor sales of $638,284; nontaxable sales for resale of $56,559; sales tax reimbursement included in total sales of $22,183; and "other" sales of $9,221.
3. Appellant claimed deductions for nontaxable sales for resale of $56,559 and "other" sales of $9,221 in the third quarter of 2015 (3Q15) and 1Q16, respectively. Appellant did not claim any deductions for nontaxable labor sales for those same quarters.
4. Upon audit (appellant's first), appellant provided the following books and records: federal income tax returns (FITRs) for 2015, 2016, and 2017, and incomplete point-of-sale (POS) data for the liability period. Appellant also provided purchase invoices and catering invoices for May 2019 and June 2019, respectively (i.e., for time periods after the liability period).
5. During the audit, appellant clarified that it mistakenly classified and claimed deductions for nontaxable labor sales as nontaxable sales for resale of $56,559 in 3Q15 and "other" sales of $9,221 in 1Q16. Thus, for the liability period, appellant intended to claim deductions for nontaxable labor sales totaling $704,064 ($638,284 + $56,559 + $9,221).
6. CDTFA determined that most of appellant's $704,064 in claimed/misclassified nontaxable labor deductions related to appellant's catering services for taxable alcohol sales at social events (specifically, bartender wages), which rendered sales of these services taxable as well. Accordingly, CDTFA disallowed $632,274 of the $704,064 in claimed/misclassified deductions for nontaxable labor,[3] determining that appellant made unreported taxable sales in that same disallowed amount.

[3] CDTFA determined that the balance of $71,790 in claimed/misclassified deductions related to appellant's nontaxable in-store sales of food products (for which appellant failed to claim a deduction).

7. CDTFA added a negligence penalty to the determination for two reasons: appellant failed to keep books and records that would support its reported taxable sales and claimed deductions; and appellant could not provide a credible explanation for its reporting errors.
8. On September 30, 2019, CDTFA issued the NOD to appellant.
9. On October 25, 2019, appellant timely petitioned for redetermination and filed a protective claim for refund for any sales or use taxes overpaid for the liability period.
10. On May 30, 2023, CDTFA issued a decision denying appellant's petition for redetermination and claim for refund.
11. This timely appeal to OTA followed.

DISCUSSION

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

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sale of all tangible personal property sold in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) "Gross receipts" mean the total amount of the sale price of the retailer's retail sale, including any services that are part of the sale. (R&TC, § 6012(a), (b).) "Sale" means and includes the furnishing, preparing, or serving of food, meals, or drinks for a consideration. (R&TC, § 6006(d).) With respect to caterers and catering services specifically, tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food and for the labor of serving the meals, whether performed by the caterer, the caterer's employees, or subcontractors. (Cal. Code Regs., tit. 18, § 1603(i)(3)(A).) 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.) 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 compute and determine the amount required to be paid on the basis of any information within its possession or that 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.) If CDTFA meets its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The taxpayer bears the burden of proof as to all issues of fact unless the law specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence unless the law also specifies otherwise. (Cal. Code Regs., tit. 18, § 30219(b).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) To satisfy its burden of proof, a taxpayer must prove both (1) that the tax assessment is incorrect, and (2) the proper amount of the tax. (*Ibid*.)

Here, CDTFA determined that appellant's charges for catering services were taxable because appellant provided these services in connection with its taxable sales of alcohol at social events such as weddings. CDTFA's determination accords with California Code of Regulations, title 18, (Regulation) section 1603(i)(3)(A). Accordingly, OTA finds CDTFA's determination to be reasonable and rational. The burden of proof now shifts to appellant to establish that a different result is warranted.

On appeal, appellant asserts that the audit liability is overstated because the charges CDTFA determined were taxable are for exempt labor. However, appellant has not supported its assertion with any evidence or documentation. Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (See *Appeal of AMG Care Collective*, *supra*.) Moreover, appellant has not explained how or why the labor services at issue fall outside the purview of Regulation section 1603(i)(3)(A) or are otherwise exempt. Accordingly, OTA finds that appellant has not carried its burden of proof and concludes that the $632,274 amount of unreported taxable sales should not be reduced.

Issue 2: Whether appellant was negligent.

CDTFA added a negligence penalty of $5,772.84 to the determination because appellant failed to keep books and records supporting its reported taxable sales and claimed deductions, and because appellant could not provide a credible explanation for its reporting errors.

On appeal, appellant notes that this was appellant's first audit and asserts that the negligence penalty is not warranted.

If any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Negligence is generally defined as 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.)

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

Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Here, appellant either did not keep or did not provide the records needed to substantiate or support its claimed deductions and reported taxable sales. Upon audit, appellant only provided limited records: FITRs for 2015, 2016, and 2017; incomplete POS data for the liability period; and purchase invoices for May 2019 and catering invoices for June 2019 (which are for time periods after the liability period). Appellant did not provide complete source documents for the liability period, such as cash register tapes, purchase invoices, or sales receipts. Appellant also claimed that more than 30 percent of its reported total sales constituted exempt labor

charges, but either did not keep or did not provide any books and records that could substantiate such deductions. Appellant's failure to maintain and keep complete and accurate records is evidence of negligence.

Regarding reporting, appellant reported taxable sales of $1,364,892 but did not report taxable sales of $632,274, which is equivalent to a 46.32 percent error rate ($632,274 ÷ $1,364,892). Additionally, during the audit, appellant conceded that it mistakenly claimed deductions for nontaxable sales for resale of $56,559 in 3Q15 and "other" sales of $9,221 in 1Q16 when it should have claimed these as nontaxable labor sales (which CDTFA mostly disallowed upon audit). Further, CDTFA's audit revealed that appellant failed to claim any deductions for its nontaxable in-store sales of food products during the liability period.[4] Appellant's underreporting of taxable sales and misreporting of deductions also constitute evidence of negligence.

Although this was appellant's first audit, given appellant's lack of records, a reporting error rate nearing 50 percent, misclassified alleged deductions in two quarters, and failure to claim another type of deduction throughout the liability period, OTA finds that appellant could not have had a good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law. Accordingly, OTA concludes that appellant was negligent and CDTFA's addition of the negligence penalty to the liability was warranted.

[4] See footnote 3, *ante*, page 2

HOLDINGS

1. The amount of unreported taxable sales should not be reduced.
2. Appellant was negligent, and CDTFA's addition of the negligence penalty was warranted.

DISPOSITION

CDTFA decision to deny appellant's petition for redetermination and claim for refund is sustained.

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Andrew Wong
Administrative Law Judge

We concur:

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Sheriene Anne Ridenour
Administrative Law Judge

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Josh Aldrich
Administrative Law Judge

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