

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 220911330
PHO ANH BINH, INC.,)	CDTFA Case ID: 2-848-763
dba Pho Anh)	
)	
)	
)	

OPINION

Representing the Parties:

For Appellant: Hai V. Dang, Representative

For Respondent: Jason Parker,
Chief of Headquarters Operations

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

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Pho Anh Binh, Inc., doing business as Pho Anh, (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA) ordering a reaudit but otherwise denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated May 28, 2021.¹ The NOD is for tax of \$38,282, plus applicable interest, and a negligence penalty of \$3,828.23, for the period January 1, 2018, through September 30, 2020 (liability period).²

In accordance with the Decision, CDTFA prepared a reaudit dated July 21, 2022, which reduced the total taxable measure by \$86,070, from \$437,500 to \$351,430 and resulted in a corresponding reduction to the tax and penalty. In preparation for an Office of Tax Appeals (OTA) hearing, CDTFA prepared a second reaudit dated April 12, 2023, which reduced the total

¹ The NOD was timely issued because on March 25, 2021, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period January 1, 2018, through June 30, 2018, which allowed CDTFA until October 31, 2021, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

² Appellant has not disputed the negligence penalty in its appeal here; thus, OTA does not discuss it further.

taxable measure by \$10,349, from \$351,430 to \$341,080, which will also result in the reductions to the tax and penalty.

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

ISSUE

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

FACTUAL FINDINGS

1. Appellant, a corporation, operated a restaurant serving Vietnamese-style food located in Riverside, California. Appellant did not have sales of alcohol. The restaurant had a seating capacity of approximately 30 customers and was open from 9:00 a.m. to 10:00 p.m. daily. Appellant was issued its seller's permit with an effective start date of December 12, 2017.
2. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of \$724,992, claiming deductions of \$55,318 for sales tax reimbursement included in reported total sales and \$37,472 for "other" representing optional tips, resulting in reported taxable sales of \$632,202. Appellant stated that sales information was provided to its outside accountant who prepared the SUTRs but did not provide the source for the sales information to verify the reporting method.
3. For audit, appellant provided cash register z-tapes³ for November 2019; bank statements for January 1, 2020, through September 30, 2020; and merchandise purchase invoices for November 2019. Appellant failed to provide other requested books and records such as sales tax worksheets, sales journals, credit card settlement reports, cash register receipts or guest checks, or purchase journals for the liability period. CDTFA found the records provided were incomplete and inadequate for sales and use tax audit purposes.
4. Appellant provided federal income tax returns (FITR) for 2018 and 2019. CDTFA compared gross receipts, excluding sales tax reimbursement, reported on the FITRs to taxable sales reported on the corresponding SUTRs noting no difference in 2018;

³ 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).

however, gross receipts exceeded taxable sales by \$20,391 in 2019.⁴ CDTFA noted that the FITRs reflected a net loss in each year. CDTFA compared gross receipts to the corresponding cost of goods sold reported on the FITRs and computed FITR book markups⁵ of 107.82 percent for 2018 and 109.76 percent for 2019. Based on the book markups, CDTFA concluded that additional testing was needed to verify reported taxable sales.

5. CDTFA prepared a cash flow analysis for 2018 and 2019. Based on gross receipts and expenses, excluding depreciation (a non-cash expense), from the FITRs and annual household expenses,⁶ CDTFA calculated a negative cash flow in each year. In other words, appellant's reported gross receipts would not be sufficient to support appellant's sole shareholder's living expenses and continue operating the restaurant. CDTFA decided to use the credit card sales ratio method to compute audited taxable sales.
6. Using the cash register z-tapes for November 2019, CDTFA compiled total sales (excluding sales tax) of \$26,189, sales tax reimbursement of \$2,289, cash sales (including sales tax) of \$2,341, credit card sales (including sales tax) of \$26,137, and computed a credit card sales ratio of 99.80 percent ($\$26,137 \div \$26,189$).⁷ Because appellant did not provide sufficient books and records, CDTFA was unable to verify the credit card sales ratio, and instead estimated a credit card sales ratio of 70 percent.

⁴ The difference appears to be optional tips included in reported gross receipts on the FITR.

⁵ "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is $\text{markup amount} \div \text{cost}$. In this example, the markup percentage is 42.86 percent ($0.30 \div 0.70 = 0.42857$). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

⁶ Estimated annual family budget for a two-working-parent family in Riverside County from the California Budget and Policy Center report, Making Ends Meet: How Much Does It Cost to Support a Family in California (December 2017).

⁷ In its Decision, CDTFA noted an error in the calculation. CDTFA should have divided credit card sales (including sales tax) of \$26,137 by total sales (including sales tax) of \$28,478 which would result in a credit card sales ratio of 91.78 percent. This result would not likely change CDTFA's conclusion that the cash register z-tapes were not reliable.

7. CDTFA obtained Form 1099-K⁸ data for 2018 and 2019, from the IRS. CDTFA compiled credit card sales of \$542,476 for that period. Upon comparison, appellant's credit card sales exceeded reported taxable sales for 2018 and 2019.⁹ CDTFA expected reported taxable sales to exceed credit card sales since taxable sales would include cash sales; thus, CDTFA found that the calculated credit card sales ratios were too high and further evidence that reported taxable sales were understated.
8. Appellant provided bank statements for the period January 1, 2020, through September 30, 2020.¹⁰ CDTFA compiled bank deposits from sales proceeds of \$212,512 which exceeded taxable sales of \$169,735 reported on the SUTRs by \$42,777 for that period. CDTFA noted that appellant made cash deposits in only two of the nine months, April 2020 and June 2020. As such, CDTFA concluded that the bank statements did not reflect all cash sales. Because credit card sales are deposited directly into appellant's bank account by the credit card processing service, CDTFA concluded that credit card sales deposits shown on the January 2020 through September 2020 bank statements of \$206,314 were reliable.
9. In total, CDTFA computed credit card sales of \$748,790 (\$542,476 + \$206,314) for the liability period.¹¹ CDTFA divided credit card sales by the 70 percent credit card sales ratio and computed audited taxable sales of \$1,069,702 (rounded). Upon comparison to reported taxable sales of \$632,202 for the liability period, CDTFA calculated unreported taxable sales of \$437,500.

⁸ Form 1099-K is an IRS form titled, "Payment Card and Third-Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third-party network, during a given time period. Form 1099-K includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

⁹ OTA notes that credit card sales included sales tax, thus, in comparing to reported taxable sales, CDTFA should have reduced credit card sales for the sales tax included. OTA computes a credit card sales ratio of 107.86 percent ($(\$542,476.00 \div 1.0875) \div \$462,467.00$). This result would not likely change CDTFA's conclusion that reported taxable sales were understated.

¹⁰ Bank deposits are not gross receipts. (R&TC, § 6012(a).) However, where, as here, a retailer is engaged in the business of making retail sales of tangible personal property, the retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of tangible personal property, which evidence CDTFA can use to determine audited taxable sales when sales cannot be accurately established using a direct approach because of a lack of adequate records.

¹¹ CDTFA did not make an adjustment for credit card tips because tips were not made on credit card sales based on the cash register z-tapes for November 2019.

10. To test whether the audit measure was reasonable, CDTFA computed audited markups of 227.08 percent and 194.07 percent, respectively, which CDTFA found was reasonable,¹² and thus supported the reasonableness of the audited taxable sales. Using audited taxable sales for 2018 and 2019, CDTFA performed a cash flow analysis that showed a positive cash flow which CDTFA found was adequate and thus supported that audited taxable sales were reasonable. Although CDTFA noted that appellant's type of business can have a credit card sales ratio of at least 80 percent, the audited taxable sales markups and cash flow analysis supported that the 70 percent credit card sales ratio produced reasonable results.
11. CDTFA issued an NOD to appellant on May 28, 2021, based on the audit with a tax liability of \$38,282, plus applicable interest, and a negligence penalty of \$3,828.23.
12. On June 3, 2021, appellant filed a timely petition for redetermination protesting the NOD in its entirety. After an audit discussion meeting on June 11, 2021, appellant provided October 2019 cash register z-tapes and bank statements for January 1, 2018, through October 31, 2019. CDTFA reviewed the documentation and found they were unreliable to support any adjustments because of the inability to compute a reliable credit card sales ratio since no cash transactions were evident in the bank statements. During appellant's appeal to CDTFA, appellant provided credit card settlement reports for January 2019 through December 2020, and cash register z-tapes for January 2019, through September 30, 2020.
13. CDTFA issued a Decision dated May 24, 2022, ordering a reaudit to recompute audited taxable sales allowing for sales tax included in credit card sales. CDTFA otherwise denied the petition.
14. CDTFA performed a reaudit dated July 21, 2022. For each quarter, CDTFA divided credit card sales by one plus the applicable sales tax rate and computed credit card sales, excluding sales tax reimbursement, of \$688,542 (\$498,829 for the 2018 and 2019 combined + \$189,714 for 2020) (rounded) for the liability period. CDTFA divided credit card sales, excluding sales tax reimbursement, by the 70.00 percent credit card sales ratio and computed audited taxable sales of \$983,632 for the liability period. Using audited taxable sales for 2018 and 2019, CDTFA computed audited markups of 202.51 percent

¹² During the agency-level appeal, CDTFA stated that it expected a markup at least 200 percent.

and 170.60 percent, respectively, which CDTFA found was reasonable and thus supported that audited taxable sales were reasonable. Upon comparison to reported taxable sales of \$632,202 for the liability period, CDTFA calculated unreported taxable sales of \$351,430 which will reduce the tax liability to \$30,750 and negligence penalty to \$3,075.04.

15. Appellant timely appealed to OTA.
16. OTA requested additional briefing from CDTFA to address the Form 1099-K data for January 2020, through September 2020, as compared to the bank statements for the same period, and evidence in support of CDTFA's application of the 70 percent ratio. In response, CDTFA conducted a reaudit based on additional Form 1099-K information, for the period January 2020, through September 2020. The second reaudit decreased the taxable measure by \$10,350 from \$351,430 to \$341,080, resulting in a reduction of tax from \$30,750 to \$29,843, and a reduction of the penalty from \$3,075.04 to \$2,984.38, plus applicable interest.
17. Appellant did not provide a response to CDTFA's second reaudit.

DISCUSSION

Issue: Whether further adjustments to the amount of unreported taxable sales are 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 purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481,

6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*) 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. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Here, appellant's books and records provided for audit were incomplete and inadequate for sales and use tax audit purposes; thus, CDTFA was unable to verify sales reported on appellant's SUTRs for the liability period using a direct audit method. CDTFA's preliminary analysis found low book markups in both 2018 and 2019 and unusually high credit card sales ratios. These were indications that reported taxable sales may have been understated. Based on the insufficient records and the low book markups, CDTFA decided to use an indirect audit method, here the credit card sales ratio method, to compute appellant's sales. CDTFA's use of the credit card sales ratio method as the basis for its determination is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) OTA also finds that Form 1099-K data and credit card sales deposits are evidence from a third party (merchant card processors) of appellant's sales paid by credit card and are reliable sources of data from which to establish audited sales. Accordingly, OTA finds that CDTFA has established that its determination is reasonable and rational, and accordingly the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

Appellant contends that the assessment is based on an industry comparison. Appellant argues that reported sales are supported by point-of-sale system (POS) sales receipts. Appellant also asserts that it had very little hours of operation during the pandemic.

Appellant did not submit any documentation for its appeal here. Even if the POS sales receipts were provided, it is not the task of OTA to conduct an audit of appellant's books and records. It is appellant's burden to show error in the determination, and appellant must point to an error in the determination and provide proof of the error. (*Appeal of Amaya*, *supra*.) Furthermore, CDTFA is not required to accept as conclusive evidence the taxpayer's books and records, even though these were in agreement with each other, where CDTFA, using recognized and standard accounting procedures, established in an audit that the books and records did not

disclose the correct amount of tax liability. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610.) Based on its preliminary analysis, CDTFA concluded that it was unable to rely on recorded sales and thus, could not compute audited taxable sales by compiling sales directly from appellant's records.

OTA understands that appellant is disputing the estimated 70 percent credit card sales ratio because it claims that the ratio is too low and the sales ratio results in overstating audited taxable sales. Appellant has not specifically stated what it believes its credit card sales ratio was, shown that its credit card sales ratio is greater than 70 percent by providing verifiable evidence, or identified any errors in CDTFA's computation of audited taxable sales that would warrant adjustments. Appellant's assertion that it had very little hours of operation during the pandemic is unpersuasive here because the amount of credit card sales represents the credit card sales made during the time period appellant was open regardless of the number of hours. Accordingly, OTA finds no basis to recommend adjustment.

In summary, OTA finds that CDTFA computed audited taxable sales based on the best-available evidence. CDTFA's post audit analysis of the audited sales markup supports the reasonableness of audited taxable sales. Regarding appellant's credit card sales ratio assertion, appellant has not provided credible or competent evidence in support. As appellant bears the burden of proof in this case, OTA concludes that no further adjustments to unreported taxable sales are warranted.

HOLDING

Appellant has not shown that further adjustments to the taxable measure are warranted.

DISPOSITION

CDTFA’s action in reducing the total taxable measure to \$341,080, the tax to \$29,843, with corresponding changes to the penalty and interest, but otherwise denying appellant’s petition is sustained.

Signed by:
Kim Wilson
4E8E740EDB984CD...

Kim Wilson
Hearing Officer

We concur:
DocuSigned by:
Josh Aldrich
48745BB806914B4...

Josh Aldrich
Administrative Law Judge

DocuSigned by:
K Long
DC88A60D8C3E442...

Keith T. Long
Administrative Law Judge

Date Issued: 8/20/2024