OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **FOCACCIA CAFÉ, INC.,** **dba Focaccia Market Bakery**	OTA Case No. 230713796 CDTFA Case ID: 2-745-705

OPINION

Representing the Parties:

For Appellant:	David Davari, President Allalleh Khalatbari, Witness[1]
For Respondent:	Nalan Samarawickrema, Hearing Representative Randolph "Randy" Suazo, Hearing Representative Chad Bacchus, Attorney

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Focaccia Café, Inc., dba Focaccia Market Bakery (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[2] denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on April 30, 2021.[3] The NOD is for tax of $145,335 and applicable interest for the period October 1, 2016, through September 30, 2019 (liability period).

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, John O. Johnson, and Sheriene Anne Ridenour held a virtual oral hearing for this matter on September 17, 2024. At the conclusion of the oral hearing, the record was closed, and this

[1] Allalleh Khalatbari also goes by the name Allalleh Davari.

[2] Sales and use taxes were formerly administered by the State Board of Equalization (BOE). 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 BOE.

[3] CDTFA timely issued the NOD to appellant because appellant signed a series of waivers of the otherwise applicable statute of limitations, which extended the deadline for issuing an NOD until July 31, 2021. (R&TC, §§ 6487(a), 6488.)

matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

ISSUE

Whether appellant has shown that further adjustments to unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a California corporation, operates four restaurant locations in San Francisco, California, and one restaurant location in South San Francisco, California. Appellant also provides online sales and catering services. Appellant obtained a seller's permit effective April 1, 2014.[4]
2. In April 2015, appellant underwent an inspection by CDTFA's Statewide Compliance and Outreach Program (SCOP). According to BOE-1164 — Audit Memorandum of Possible Tax Liability — the SCOP inspector indicated that appellant did not charge sales tax on soda at any of appellant's locations, and appellant did not differentiate between orders consumed at its locations and "to-go" orders. The inspector recommended that appellant's "account be considered for [a]udit due to the volume of sales, the number of locations, and that the business deals in both taxable and non-tax sales." The ultimate action of SCOP was "No Action Recommended," and no follow-up date was scheduled.
3. In 2016, appellant launched the use of a new point-of-sale (POS) system.[5]
4. On its sales and use tax returns for the liability period, appellant reported total sales and purchases of $27,619,089, consisting of $22,329,655 of total sales and $5,289,434 of purchases subject to use tax. Appellant also claimed $12,259,896 in total deductions, consisting of: $12,045,201 in nontaxable food products; and $214,695 in sales tax included in gross sales, for a total of $15,359,193 ($27,619,089 - $12,259,896) in reported taxable sales.

[4] Prior to April 1, 2014, appellant's owner operated under two separate seller's permits. On April 1, 2014, appellant's owner closed out the two separate seller's permits, consolidated the businesses under the current seller's permit, and added two new locations.

[5] A POS system typically includes one or more terminals, which are the modern equivalent of cash registers. Depending on the equipment and software, POS systems can generate reports (sometimes referred to as "Z-tapes") which summarize sales activity for the period of time selected by the operator. These reports can include breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable.

5. For the audit, appellant provided its 2018 federal income tax return, POS quarterly sales reports for the first quarter of 2017 (1Q17)[6] through 3Q19, and a detailed schedule of catering and online transactions for the same period. This was appellant's first audit.
6. CDTFA reviewed the POS reports and discovered that while appellant charged additional fees on taxable transactions during the liability period, appellant did not charge sales tax or collect sales tax reimbursement on those fees. Specifically, CDTFA found that appellant added fees to its catering and online sales (service fees), as well as to its catering, online, and restaurant sales to help cover employer healthcare-related obligations mandated by the San Francisco Health Care Security Ordinance (HCSO).[7] To cover appellant's mandated HCSO obligations, appellant opted to voluntarily impose a surcharge fee on the total amount of goods and services sold (HCSO fee).
7. CDTFA determined that from 1Q17 through 3Q19, appellant charged: (1) $982,504 in service fees; and (2) $565,303[8] in HCSO fees. Since POS information was not available for 4Q16, CDTFA used POS data for the 2017 tax year to estimate that appellant charged service fees and HCSO fees totaling $127,610 in 4Q16.[9] Based on this information, CDTFA determined appellant collected a total of $1,675,418[10] in service fees and HCSO fees charged on taxable transactions during the liability period.
8. CDTFA issued the April 30, 2021 NOD to appellant.
9. Appellant timely filed a petition for redetermination disputing the liability and CDTFA held an appeals conference with appellant.

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[6] Appellant indicated that it did not provide a POS quarterly report for 4Q16 for audit because it no longer had access to the old POS system.

[7] HCSO establishes various employer healthcare-related obligations, including covered employers making required health care expenditures on behalf of covered employees. (San Francisco L.E.C., § 21.1.) To cover in whole or in part the expense of complying with HCSO, San Francisco businesses generally opt to either raise the cost of goods and services sold or impose a surcharge fee on the total amount of goods and services sold.

[8] This amount consists of: $345,412 in fees charged on appellant's catering and online sales; $169,852 in fees charged on sales appellant made at its San Francisco locations; and $50,039 fees charged on sales appellant made at its South San Francisco location.

[9] For 2017, appellant charged a total of $510,441 in combined service and mandate fees, for a quarterly average of $127,610 ($510,441 ÷ 4).

[10] OTA calculates a total of $1,675,417 ($982,504 + $565,303 + 127,610). However, OTA finds that any mathematical discrepancies in this matter are attributable to rounding differences and have no impact on the amounts at issue.

10. After the appeals conference, appellant provided additional POS data for its 3Q18 and 2Q19 catering and online sales. Upon examination, CDTFA found the POS data included recorded data for nontaxable catering and online sales and determined adjustments were warranted. Specifically, CDTFA determined that the service fees and HCSO fees appellant charged on its catering and online sales should be reduced to account for the fees charged on nontaxable catering and online sales.
11. CDTFA computed an average taxable sales ratio of 82.63 percent for appellant's catering and online sales, which CDTFA applied towards: (1) $1,062,441[11] in total service fees that appellant charged on its catering sales, for a reduction of $184,499; and (2) $374,142[12] in total HCSO fees that appellant charged on its catering and online sales, for a reduction of $64,972. Based on the adjustments, CDTFA calculated a total reduction of $249,471 ($184,499 + $64,972), and determined appellant collected a revised total of $1,425,947 ($1,675,418 - $249,471) in service fees and HCSO fees charged on taxable transactions during the liability period.
12. CDTFA issued a decision on April 6, 2023, ordering a reaudit to apply the taxable sales ratio of 82.63 percent to the service fees and the HCSO fees appellant charged on its catering and online sales, and to reduce the taxable measure by $249,471, from $1,675,418 to $1,425,947, but otherwise denied the petition for redetermination.
13. Appellant filed this timely appeal.
14. During the hearing, Allalleh Khalatbari was sworn in as a witness.

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 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,

[11] This amount consists of $982,504 in service fees appellant charged on its catering sales from 1Q17 through 3Q19, and $79,937 in service fees charged on appellant's catering sales for 4Q16, as estimated by CDTFA.

[12] This amount consists of $345,412 in HCSO fees appellant charged on its catering and online sales from 1Q17 through 3Q19, and $28,731 in HCSO fees charged on appellant's catering and online sales for 4Q16, as estimated by CDTFA.

§ 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 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*.) Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).)

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. However, a mandatory payment designated as a tip, gratuity, or service charge, including such payment associated with catering services, is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. (Cal. Code Regs., tit. 18, § 1603(h), (i).) Taxable gross receipts do not include the amount of any tax imposed by any city within the State of California upon or with respect to retail sales or storage, use, and consumption of tangible personal property, measured by a stated percentage of sales price, whether imposed upon the retailer or the consumer. (R&TC, § 6012(c)(5), (6).) However, the HCSO fee at issue in this matter is not a tax imposed by San Francisco; rather, it is a surcharge fee appellant opted to add to its sales in order to recoup appellant's costs to comply with HCSO.

Appellant's POS records show that appellant collected service fees it added to its catering and online sales and HCSO fees it added to its catering, online, and restaurant sales. There does not appear to be any dispute that appellant collected $1,425,947 in service fees and HCSO fees on taxable transactions during the liability period, and that both fees were a mandatory payment designated as a tip, gratuity, or service charge. OTA finds that it was reasonable and rational for CDTFA to conclude that the $1,425,947 in service fees and HCSO fees is subject to tax; accordingly, CDTFA's determination is presumed correct. Therefore, appellant has the burden to establish that further adjustments are warranted.

Appellant argues that it did not collect sales tax reimbursement on the service fees and HCSO fees because it reasonably relied on erroneous advice from CDTFA. Specifically, appellant argues it relied on advice provided in a prior audit, and on communication between appellant and CDTFA when appellant was implementing its new POS system. Moreover, appellant contends that during the SCOP investigation, CDTFA audited appellant but did not inform appellant that the service fees and HCSO fees were subject to tax.

If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered written advice. (Cal. Code Regs., tit. 18, § 1705(c).) For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. (*Ibid*.)

R&TC section 6596(a) provides that if a person's failure to make a timely return or payment was due to that person's reasonable reliance on written advice from CDTFA, the person may be relieved of any sales or use taxes imposed. A taxpayer's request for written advice from CDTFA must set forth the specific facts and circumstances of the activity or transactions for which the advice is requested. (R&TC, § 6596(b)(1); Cal Code Regs., tit. 18, § 1705(b)(1).) The taxpayer may be eligible for relief if, in reasonable reliance on the written advice, the taxpayer failed to charge or collect sales tax reimbursement or use tax from its customer. (R&TC, § 6596(b)(3).) There is no applicable legal provision that would allow for relief of taxes based on reliance on oral advice. (See R&TC, § 6596(b)(2); Cal. Code Regs., tit. 18, § 1705(a); see *Appeal of Salam and Perveen*, 2019-OTA-041P.)

Appellant's reference to the SCOP investigation as an audit is understandable, especially since BOE-1164 is titled Audit Memorandum of Possible Tax Liability; however, the reference is nonetheless misplaced. While a SCOP investigation may result in a taxpayer being referred for an audit, SCOP is nevertheless an outreach program that focuses on advising and educating taxpayers, as opposed to auditing taxpayers.[13] Furthermore, even if the SCOP investigation was an audit, there is no indication that CDTFA investigated the service fees or HCSO fees upon which it provided written advice; rather, the notations on the BOE-1164 are limited to sales tax on soda and the difference between orders sold for consumption at appellant's locations and

[13] See www.cdtfa.ca.gov/taxes-and-fees/SCOP/

"to-go" orders. Moreover, since the SCOP investigation, appellant changed POS systems; therefore, the facts and conditions relating to the activities or transactions appear to have changed from those which occurred during the period of operation in the SCOP investigation.

Appellant also contends that it reasonably relied on communication between it and CDTFA when appellant was implementing its new POS system. Appellant asserts that since it was located about a block away from a CDTFA district office, it found in-person meetings with CDTFA representatives more efficient. Appellant claims that during the liability period, it met with CDTFA representatives on approximately 140 occasions to proactively ensure that appellant's new POS system transactions were in compliance with the Sales and Use Tax Law. Appellant contends that CDTFA representatives reviewed each menu item on the new POS system, line by line, to ensure all taxable sales were taxed in accordance with the Sales and Use Tax Law. Appellant asserts that at no point during the numerous meetings did CDTFA inform appellant the service fees and HCSO fees were subject to tax.

Appellant does not contend, and the evidence does not show, that CDTFA provided appellant written advice regarding whether the service fees and HCSO fees are subject to tax. As noted above, R&TC section 6596 only authorizes relief of tax liability when there is reasonable reliance on written advice; there is no legal authority allowing relief of the tax liability based on reliance on oral advice. (R&TC, § 6596(a); Cal. Code Regs., tit. 18, § 1705(a); see *Appeal of Salam & Perveen*, *supra*.) Therefore, there is no basis to grant relief of the liability pursuant to R&TC section 6596. Appellant did not contend that adjustments are warranted on any other basis, and OTA finds no grounds to support any adjustments.

Appellant also argues that since it did not collect sales tax reimbursement on the service fees and HCSO fees, appellant does not have the funds to remit the tax, and that appellant is financially struggling. However, inability to pay does not provide a basis for reducing or deleting the liability, and OTA does not have the authority to relieve appellant's liability based on inability to pay.[14]

[14] Following the appeal, appellant may wish to contact CDTFA to discuss a payment plan or offer in compromise options.

HOLDING

Appellant has not shown that further adjustments to unreported taxable sales are warranted.

DISPOSITION

CDTFA's decision to reduce the taxable measure to $1,425,947 and to otherwise deny the petition for redetermination is sustained.

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Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

We concur:

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Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

Date Issued: 11/20/2024