

OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA

In the Matter of the Appeals of:

**PAPA CHINOS GRILL AND GREENS, LLC,  
dba Papa Chino's Grill and Greens**) OTA Case No.: 230914272  
) CDTFA Case IDs: 1-087-504, 1-224-491;  
) 1-873-866, 1-907-777  
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)**OPINION**

Representing the Parties:

For Appellant:

James Dumler, CPA

For Respondent:

Jason Parker, Chief of Headquarters Ops.

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Papa Chinos Grill and Greens, LLC, dba Papa Chino's Grill and Greens, (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> denying appellant's timely petitions for redetermination of two Notices of Determination (NODs) and two protective claims for refund.<sup>2</sup> The first NOD was issued on July 17, 2019, for tax of \$114,263, plus applicable interest, and a negligence penalty of \$11,426.27 for the period April 1, 2015, through March 31, 2018 (first liability period).<sup>3</sup> The second NOD was issued on January 29, 2020, for tax of \$72,561, plus applicable interest, and a negligence penalty of \$7,256.08 for the period April 1, 2018, through September 30, 2019 (second liability period).<sup>4</sup>

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<sup>1</sup> 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.

<sup>2</sup> A taxpayer will sometimes file a petition for redetermination and a claim for refund to protect its right to claim a refund or credit for overpayments discovered in an audit or that may be discovered during the taxpayer's appeal of the NOD. Such claims are frequently referred to as protective claims for refund.

<sup>3</sup> The first NOD was timely issued because on December 21, 2018, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period April 1, 2015, through March 31, 2016, which allowed CDTFA until July 31, 2019, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

<sup>4</sup> Appellant makes no arguments with respect to the imposition of the negligence penalty for both liability periods; thus, this Opinion does not address them further.

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, (Regulation) section 30209(a).

### ISSUE

Are adjustments to the measures of unreported taxable sales warranted?

### FACTUAL FINDINGS

1. Appellant, a limited liability company, operated a restaurant in Chino, California, during the liability periods. Sales consisted of hot prepared food, beer, wine, alcohol, carbonated drinks, and cold food. Appellant also made catering sales.<sup>5</sup> Appellant's seller's permit was opened with an effective date of February 23, 2009, and closed with an effective date of August 8, 2019.
2. Appellant was previously audited for the period April 1, 2009, through June 30, 2013, which disclosed unreported taxable sales of \$1,557,797 based on average daily restaurant sales from a 14-day analysis of cash register z-tapes.<sup>6</sup> In the first audit, CDTFA calculated a percentage of error of 82.55 percent and applied it to the sales reported on appellant's sales and use tax returns (SUTRs).<sup>7</sup>

#### *The First Liability Period*

3. Appellant used monthly sales summary reports to report sales on its SUTRs. For the first liability period, appellant reported total sales of \$1,854,746 and claimed deductions of \$274,128 for exempt sales of food products<sup>8</sup> resulting in reported taxable sales of \$1,580,618. Appellant estimated approximately 14 percent of reported total sales as

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<sup>5</sup> Appellant offered full service off-site catering. Appellant also supplied hot and cold food in bulk (party trays/meals for a single price) where it did not serve the food or provide other services but simply delivered the bulk food orders to customers, which it also referred to as catering sales.

<sup>6</sup> 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). (*Appeal of Amaya*, 2021-OTA-328P.)

<sup>7</sup> In the prior audit, CDTFA examined cash register z-tapes for September 24, 2012, through October 7, 2012, and computed average daily taxable sales of \$2,868. For the third quarter of 2012 (3Q12) and 4Q12, CDTFA multiplied the average daily taxable sales by the number of business days (176 days) to compute audited taxable sales for the two quarters. CDTFA compared audited taxable sales to taxable sales reported on the corresponding SUTRs and computed unreported taxable sales for 3Q12 and 4Q12 and calculated a percentage of error of 82.55 percent.

<sup>8</sup> Appellant erroneously claimed exempt sales of food products as sales for resale on its 4Q15 SUTR.

claimed exempt sales of food products. Appellant excluded off-site catering sales from total sales reported on the SUTRs. Thus, appellant's reported total sales only included sales at its restaurant location.

4. Appellant did not provide a complete set of books and records for the audit. Instead, appellant provided federal income tax returns (FITRs) for calendar years 2015 and 2016; daily sales tracking summary reports for April 1, 2015, through December 31, 2016; daily cash register z-tapes for December 31, 2018, through January 20, 2019; weekly school lunch (off-site catering) sales reports for the first liability period; point-of-sale (POS) hospital transaction reports for September 11, 2015, through May 31, 2019; and sales reports for Kaiser Permanente (Kaiser) for August 6, 2015, through March 30, 2018.
5. CDTFA compared total sales reported on appellant's SUTRs for 2015 and 2016 to the gross receipts reported on appellant's FITRs and found that gross receipts reported to the IRS exceeded total sales reported to CDTFA by \$2,155,690. Appellant stated the differences related to catering sales not reported on the SUTRs.
6. CDTFA compared gross receipts reported on the FITRs for 2015 and 2016 to the corresponding cost of goods sold reported on the FITRs and computed FITR book markups<sup>9</sup> of 188.03 percent for 2015 and 173.85 percent for 2016. Based on its experience in audits of similar businesses in appellant's area, CDTFA believed the FITR book markups were low, which indicated that gross receipts reported on the FITRs were potentially understated, and additional testing was warranted.
7. CDTFA compiled recorded total sales using appellant's weekly sales tracking summary reports for January 3, 2016, through December 25, 2016. CDTFA compared recorded total sales to gross receipts reported on the 2016 FITR noting minimal differences. CDTFA noted that the weekly sales tracking summary reports included restaurant sales and catering sales. However, because appellant did not provide source documents, such as cash register z-tapes for 2016, to support the weekly sales tracking summary reports, CDTFA was unable to verify the accuracy of recorded sales.

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<sup>9</sup> "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 ( $0.30 \div 0.70 = 0.4286$ ). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

8. CDTFA obtained appellant's Form 1099-K data<sup>10</sup> and compiled credit card sales (merchant deposits) and credit card sales ratios for the second quarter of 2015 (2Q15) through 4Q17. However, CDTFA found the credit card sales ratios inconclusive as appellant did not provide supporting documentation, such as merchant statements and bank statements, or verify payment methods and amounts for catering sales.
9. Using the provided daily cash register z-tapes for restaurant sales, CDTFA compiled sales for the period December 24, 2018, through January 20, 2019, and computed a credit card sales ratio of 74.63 percent and average daily taxable sales of \$2,555.90, which is consistent with the average daily sales computed in the prior audit.
10. Using the weekly school lunch sales reports for April 5, 2015, through April 1, 2018, CDTFA compiled catering sales to schools of \$2,428,205.97 for that period. Appellant did not provide source documentation to support recorded amounts. Students' parents ordered lunch meals directly through appellant's website. Appellant delivered the meals to the school, and school personnel distributed the meals to students for consumption at the school facility (school catering sales). CDTFA concluded that school catering sales were exempt under Regulation section 1603(k)(2)(D).<sup>11</sup>
11. Using the weekly sales tracking summary reports for January 10, 2016, through December 25, 2016, CDTFA compiled restaurant sales and catering sales. CDTFA deducted catering sales to schools based on the weekly school lunch sales reports for that period and calculated sales to hospitals. Appellant provided a sample copy of a sales invoice to Kaiser which showed sales of meals for a single price and party trays of hot food. CDTFA concluded that appellant's sales to Kaiser were taxable.
12. Appellant provided hospital sales based on Kaiser sales reports for August 6, 2015, to March 30, 2018, and compiled taxable sales to Kaiser of \$142,607.61 for that period. CDTFA contacted Kaiser and verified the sales from the Kaiser sales reports; thus, CDTFA concluded the Kaiser sales reports were reliable. Because appellant did not

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<sup>10</sup> 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.

<sup>11</sup> Tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met: (1) The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day; (2) the fixtures and equipment used by the caterer are owned and maintained by the school; and (3) the students purchasing the meals cannot distinguish the caterer from the employees of the school. (Cal. Code Regs., tit. 18, § 1603(k)(2)(D).)

report taxable hospital sales on the SUTRs, CDTFA established unreported taxable catering sales to hospitals of \$142,607 (audit item 1).<sup>12</sup>

13. Due to the lack of reliable source documentation for restaurant sales, CDTFA applied the prior audit percentage of error of 82.55 percent to recorded restaurant sales to compute unreported taxable restaurant sales of \$1,304,800 for the first liability period (audit item 2).
14. CDTFA issued the first NOD to appellant on July 17, 2019, based on the above-mentioned audit, with a tax liability of \$114,263 plus applicable interest and a negligence penalty of \$11,426.27.
15. Appellant filed a timely petition for redetermination protesting CDTFA's use of the prior audit percentage and the negligence penalty. Appellant also filed protective claims for refund.

#### *The Second Liability Period*

16. Appellant sold the business on August 8, 2019, and CDTFA prepared a field billing order (FBO)<sup>13</sup> for the second liability period, as explained below.
17. For the second liability period, appellant reported total sales of \$958,298 and claimed deductions of \$139,363 for exempt sales of food products resulting in reported taxable sales of \$818,935. Appellant also reported the sale of fixtures and equipment of \$100,000 in 3Q19. In total, appellant reported a total taxable measure of \$918,935 for the second liability period. As during the first liability period, appellant excluded catering sales from the SUTRs.
18. Appellant provided an amended FITR for calendar year 2018; daily sales tracking summary reports for January 1, 2019, through August 31, 2019; daily cash register z-tapes for January 2, 2019, through August 8, 2019; bank statements for January 2019 through August 2019; hospital sales per Kaiser sales reports for April 2, 2018, through August 6, 2019; and a credit card POS summary with Kaiser invoices for November 2018 through April 2019. Appellant did not provide sales tax worksheets or other documentation to verify the accuracy of appellant's reporting method. The books and records were incomplete and inadequate for sales and use tax audit purposes.

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<sup>12</sup> Appellant does not dispute audit item 1 on appeal; thus this Opinion does not address it further.

<sup>13</sup> CDTFA uses an FBO examination to recommend an additional tax liability using procedures that are not as comprehensive as those used in a regular audit. (CDTFA Audit Manual, §§ 0213.01, 0201.09.)

19. CDTFA compared total sales reported on the SUTRs for 2018 to the corresponding gross receipts reported on the FITR noting gross receipts greatly exceeded total sales. Appellant attributed the difference to catering sales not reported on the SUTRs.
20. CDTFA compared gross receipts reported on the FITR for 2018 to the corresponding cost of goods sold reported on the FITR and computed a book markup of 171.12 percent. Based on the prior audits of appellant, CDTFA believed the book markup was low, which indicated that gross receipts reported on the FITR were potentially understated, and additional testing was warranted.
21. CDTFA obtained appellant's Form 1099-K data and compiled credit card sales (merchant deposits) and credit card sales ratios for 2018. As in the first liability period, appellant did not provide source documents to verify payment methods for catering sales, thus, CDTFA found the computed credit card sales ratios inconclusive.
22. CDTFA compared total sales reported on the SUTRs with total sales recorded on the daily cash register z-tapes for the period 1Q19 through 3Q19 noting that sales per the daily cash register z-tapes exceeded sales reported on the SUTRs for that period. CDTFA also compared taxable sales reported on the SUTRs with taxable sales recorded on the daily cash register z-tapes for the period 1Q19 through 3Q19 noting that sales per the daily cash register z-tapes exceeded sales reported on the SUTRs for that period. CDTFA found that the z-tapes provided were not in numeric sequence, and there were many records missing. CDTFA concluded that the SUTRs were potentially understated, and further analysis was warranted.
23. CDTFA compiled cash sales deposits, credit card sales deposits, and total sales deposits for that period from the bank statements provided by appellant. CDTFA compared credit card sales deposits from bank statements with credit card sales from the daily cash register z-tapes for 1Q19 to 3Q19 noting bank deposits exceeded the cash register z-tapes.
24. Due to the inability to verify the accuracy of recorded sales from the records appellant provided, CDTFA used the same methodology as in the first liability period.
25. CDTFA multiplied taxable restaurant sales reported on the SUTRs for the second liability period by the percentage of error of 82.55 percent to compute unreported restaurant taxable sales of \$676,031 for the second liability period (audit item 1.)
26. Using the Kaiser sales reports for April 2, 2018, through August 6, 2019, CDTFA compiled recorded taxable sales to Kaiser of \$79,921.41 for that period, which were consistent with the credit card POS summaries for Kaiser. Because appellant did not

- report taxable hospital sales on the SUTRs, CDTFA established unreported taxable catering sales to hospitals of \$79,921 (audit item 2).<sup>14</sup>
27. Appellant began making catering sales to a gym/health company, Fuel Meal Prep, during the second liability period. Appellant provided weekly sales summary reports for Fuel Meal Prep for April 2, 2018, through October 16, 2018, but did not provide resale certificates or a contract showing that Fuel Meal Prep was reselling the meals. Using the weekly sales summary reports, CDTFA computed average weekly sales of \$2,504.42 for that period.
  28. Using appellant's sales reports, CDTFA compiled recorded taxable sales of \$68,963 for 2Q18 and 3Q18 and \$6,169.60 for October 1 to 16, 2018. CDTFA computed estimated weekly taxable sales to Fuel Meal Prep for 4Q18 through 3Q19 of \$111,355 (\$6,169.60 for October 1 to 16, 2018 + (\$2,504.42 × 42 weeks)) and total audited taxable sales of \$180,319 (\$68,963 + \$111,355) for the second liability period. Because appellant did not report Fuel Meal Prep sales on the SUTRs, CDTFA established unreported taxable catering sales to Fuel Meal Prep for the second liability period of \$180,319 (audit item 3).<sup>15</sup>
  29. CDTFA issued the second NOD to appellant on January 29, 2020, based on the above-mentioned FBO, with a tax liability of \$72,561 plus applicable interest and a negligence penalty of \$7,256.08.
  30. Appellant filed a timely petition for redetermination protesting the second NOD in its entirety.
  31. CDTFA held an appeals conference with appellant and issued a Decision on August 17, 2023, denying appellant's petitions for both liability periods.
  32. Appellant timely appealed to OTA.

### 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,

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<sup>14</sup> Appellant does not dispute audit item 2 on appeal; thus this Opinion does not address it further.

<sup>15</sup> Appellant does not dispute audit item 3 on appeal; thus this Opinion does not address it further.

§ 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, 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 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.*)

Here, CDTFA found the books and records provided by appellant to be incomplete and unverifiable and thus inadequate for sales and use tax audit purposes. Appellant excluded catering sales from sales reported on its SUTRs although sales of meals and hot food in bulk were subject to sales tax. Other than that omission, appellant failed to explain the discrepancies between the records obtained by CDTFA or provide documents verifying the information provided. In addition, appellant stated that claimed exempt food sales were estimated at 14 to 15 percent. Thus, OTA finds that it was reasonable for CDTFA to question reported sales and to use the results of a prior audit to calculate appellant’s audited taxable restaurant sales. Therefore, OTA concludes that CDTFA has established that its determination is reasonable and rational, and accordingly, the burden shifts to appellant to show errors in the audit.

In its appeal to OTA, appellant submits copies of the letters submitted for its appeal with CDTFA. In the April 25, 2023 letter, appellant contends that it submitted daily cash register z-tapes, daily cash balance worksheet, sales summary worksheets, and bank statements for the period January 2019 through August 2019, and asserts that CDTFA disregarded the information. Appellant argues that the percentage of error established from a review of 2012 cash register z-tapes in the prior audit is not representative of the current liability periods. In its May 12, 2023 letter, appellant further argues that the credit card sales ratio and average daily taxable sales from the 2019 documentation is consistent with CDTFA’s stated expectations from the prior audit, and thus, is reasonable and reliable as a basis for the current audits.

OTA finds the documentation submitted by appellant on appeal to be incomplete and unreliable. For example, the z-tapes provided by appellant were not numeric in sequence, and



many records were missing. Moreover, appellant did not provide source documents to verify payment methods for catering sales so the computed credit card ratios were not reliable. Additionally, appellant failed to provide complete bank statements and source documents in order to verify the validity of the computed credit card sales ratios.

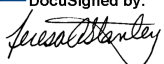
Appellant does not provide any documentation to support its appeal to OTA. Appellant provides no evidence that its business or sales changed significantly to cause the prior audit test results to be unrepresentative of the current liability periods. To satisfy its burden of proof, a taxpayer must prove both: (1) that the tax assessment is incorrect; and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) OTA finds that CDTFA computed audited taxable sales based on the best-available evidence, which is a reasonable and rational method. Appellant provides no documentation or other evidence in support of its contentions from which a more accurate determination could be made. As appellant bears the burden of proof, OTA finds that no adjustment is warranted.

HOLDING


Appellant has not shown that adjustments to the measures of unreported taxable restaurant sales are warranted for either liability period.

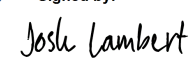
DISPOSITION

CDTFA's action denying the petitions and claims for refund is sustained.

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Teresa A. Stanley  
Administrative Law Judge

We concur:

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Keith T. Long  
Administrative Law Judge

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Josh Lambert  
Administrative Law Judge

Date Issued: 1/7/2025