OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **MEGA PIZZA & GRILLE, LLC**	OTA Case No. 240115181 CDTFA Case IDs: 2-997-718, 2-978-995

OPINION

Representing the Parties:

For Appellant: Mitchell Stradford, Representative

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, Mega Pizza & Grille, LLC (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) and a corresponding protective claim for refund of any sales or use tax overpaid during the period covered by the NOD. The NOD was issued on July 23, 2021, for tax of $175,843, plus applicable interest, and a negligence penalty of $17,584.32 for the period July 1, 2017, through June 30, 2020 (liability period).[1]

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, section 30209(a).

[1] The NOD was timely issued because on October 2, 2020, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period July 1, 2017, through December 31, 2017, which allowed CDTFA until July 31, 2021, to issue an NOD. (See R&TC, §§ 6487(a), 6488.) CDTFA reports that the sales and use tax return for the first quarter of 2018 (1Q18) was filed late on October 11, 2018; thus, the NOD, which was issued on July 23, 2021, was timely for 1Q18 since the statute of limitations for 1Q18 would not have expired until October 10, 2021, three years from the date of the late filing.

ISSUE[2]

Are adjustments to the measure of unreported taxable sales, which were based upon a credit card to sales ratio analysis, warranted?

FACTUAL FINDINGS

1. Appellant, a limited liability company, operated two businesses in Culver City, California during the liability period: Mega Pizza & Grille, a restaurant that served pizza, salads, and Persian- and Scandinavian-style cuisines; and Mega Sweet Moments, an ice creamery. Appellant's seller's permit was opened with an effective start date of December 1, 2015. Mega Sweet Moments began operations on February 8, 2018, and closed prior to the commencement of the audit.[3]
2. For the liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of $1,443,312, deductions of $1,042,885,[4] and taxable sales of $400,427. Appellant also reported the sale of fixtures and equipment of $5,750 in the fourth quarter of 2019 (4Q19); thus, appellant reported total taxable sales of $406,177.[5] Appellant's SUTRs incorporated sales and deductions for both businesses. The parties do not dispute that the 80/80 rule applies to appellant.[6]

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[2] Appellant did not raise any issue with respect to the negligence penalty on appeal. This Opinion does not address it further.

[3] The audit of Mega Sweet Moments did not disclose unreported taxable sales and is therefore not at issue in this appeal. CDTFA excluded Mega Sweet Moments' credit card receipts from its calculation of unreported taxable sales.

[4] Appellant claimed deductions of $993,069 for nontaxable sales of food products; $17,892 for "other," representing nontaxable tips; and $31,924 for sales tax reimbursement included in reported total sales.

[5] Appellant prepared amended SUTRs for 1Q20 and 2Q20, which appellant submitted to CDTFA during the audit fieldwork and are not reflected in the amounts stated above.

[6] Although gross receipts from the sale of "food products" for human consumption 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).) When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359(d)(6).) When a retailer's sales fit within this provision, known as the "80/80 rule," the retailer may avoid its application by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. Tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).) For purposes of the tax exemption, the term "food products" does not include carbonated or effervescent bottled waters; spirituous, malt and vinous liquors; and carbonated beverages. (R&TC, § 6359(b)(3); Cal. Code Regs., tit. 18, § 1602(a)(2).)

3. Appellant did not provide any books and records for audit.
4. CDTFA obtained appellant's state income tax return data for calendar year 2018. Appellant's reported total sales exceeded reported gross receipts, which appellant could not explain. CDTFA found appellant's gross receipts unreliable.
5. CDTFA compared taxable sales reported on the SUTRs for 2018 to the corresponding cost of goods sold as reported on the 2018 state income tax return and computed a reported taxable sales book markup of 71.95 percent. Based on its experience in audits of similar restaurants, the markup was low and outside of the range for the industry, indicating that reported taxable sales may be understated.
6. CDTFA obtained appellant's Form 1099-K[7] data. CDTFA compiled credit card sales of $1,736,791 for July 1, 2017, through December 31, 2019. The Form 1099-K data revealed credit card sales in excess of the total sales appellant reported in its SUTRs for the same period. This indicated to CDTFA that appellant did not report all of its credit card and/or cash sales on its SUTRs.
7. Appellant did not provide CDTFA with books and records to determine a credit card sales ratio and credit card tip ratio. Due to COVID-19 restrictions, CDTFA could not perform an observation test to establish a credit card sales ratio and credit card tip ratio. Thus, CDTFA estimated a credit card tip ratio of 15 percent, and a credit card sales ratio of 70 percent based on its experience in audits of similar restaurants.
8. For Mega Pizza & Grille, CDTFA computed credit card sales, excluding nontaxable credit card tips and sales tax reimbursement, of $1,372,455.
9. After applying the 70 percent credit card sales ratio, CDTFA computed audited taxable sales of $1,960,649 for July 1, 2017, through December 31, 2019.
10. CDTFA compared audited taxable sales to reported total sales of $359,728 for July 1, 2017, through December 31, 2019, to compute unreported taxable sales of $1,600,921.

[7] 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. Forms 1099-K includes payments made by electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

11. After appellant submitted amended SUTRs for 1Q20 and 2Q20, which disclosed additional taxable sales of $146,886 for 1Q20 and 2Q20, combined, CDTFA established a separate measure of tax for that amount.
12. CDTFA issued the NOD to appellant on July 23, 2021, with a tax liability of $175,843, plus applicable interest, and a negligence penalty of $17,584.32.
13. Appellant filed a timely petition for redetermination disputing the NOD.
14. CDTFA issued a Decision on January 5, 2024, denying appellant's petition and protective claim for refund.
15. 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 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 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 failed to provide its books and records for audit; thus, CDTFA was unable to verify sales reported on appellant's SUTRs for the liability period using a direct audit method (that is, compiling audited sales directly from appellant's records). Taxpayers are

required to maintain and make available for examination on request by CDTFA, or its authorized representative, 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 sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (3) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Given appellant's lack of records, OTA finds that it was reasonable for CDTFA to use an indirect audit 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 audit procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) The Form 1099-K data reported to the IRS by appellant's credit card payment processors summarized appellant's credit card sales and are a reliable source of data from which to establish audited 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.

Appellant contends that the credit card sales ratio is not representative of its business. However, appellant has not indicated what it believes is a representative credit card sales ratio for the liability period. Appellant has not provided any verifiable documentary evidence supporting a credit card sales ratio greater than 70 percent. Accordingly, OTA finds no basis to recommend any adjustment.

In summary, OTA finds that CDTFA computed audited taxable sales based on the best available evidence, which is reasonable and rational. Appellant has not identified any errors in CDTFA's computation of audited taxable sales or provided new documentation, or other evidence in support of its contention, from which a more accurate determination could be made. Moreover, appellant cannot carry its burden simply by asking OTA to find unidentified errors in CDTFA's determination. (*Appeal of Amaya*, *supra*.) As appellant bears the burden of proof in this case, OTA concludes that no adjustments to the measure of tax are warranted.

HOLDING

Appellant failed to establish that adjustments to the measure of unreported taxable sales are warranted.

DISPOSITION

CDTFA's action denying appellant's petition and protective claim for refund is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

Signed by:
Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

Date Issued: 2/6/2025