OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **ROYAL KHYBER ENTERPRISES INC., dba Royal Khyber Indian Cuisine**	OTA Case No. 230412991 CDTFA Case ID: 1-966-166

OPINION

Representing the Parties:

For Appellant: Arun K. Puri, Vice President

For Respondent: Jason Parker, Chief of Headquarters Ops.

L. KATAGIHARA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Royal Khyber Enterprises Inc., dba Royal Khyber Indian Cuisine, (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's administrative protest of a Notice of Determination (NOD).[2] The NOD, issued on January 17, 2020, is for tax of $18,313 plus applicable interest for the period July 1, 2014, through June 30, 2017 (liability period).[3] In accordance with R&TC sections 6561 and 6565, after 30 days passed without appellant's payment or petition of the NOD, CDTFA imposed a finality penalty of $1,831.30.[4]

[1] 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.

[2] Under regulations promulgated by CDTFA, if a taxpayer files a petition for redetermination after the due date specified in California Code of Regulations, title 18, (Regulation) section 35007, CDTFA may accept the petition for redetermination as an administrative protest; however, such an appeal does not qualify as a valid petition for redetermination. (Cal. Code Regs., tit. 18, § 35019.)

[3] The NOD was timely issued because appellant signed a series of waivers of the otherwise applicable three-year statute of limitations, the latest of which allowed CDTFA until April 30, 2020, to issue an NOD for the period July 1, 2014, through December 31, 2016. (See R&TC, §§ 6487(a), 6488.)

[4] Appellant does not dispute the finality penalty so it is not discussed 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).

ISSUES

1. Whether an adjustment to the measure of unreported taxable sales is warranted.
2. Whether an adjustment to the measure of unreported taxable mandatory gratuities is warranted.

FACTUAL FINDINGS[5]

1. Appellant operates a restaurant in Santa Ana, California, doing business as Royal Khyber Indian Cuisine.
2. During the liability period, appellant reported total sales of $2,203,198 and claimed deductions of $57,530 for nontaxable sales for resale, resulting in reported taxable sales of $2,145,668.
3. For the audit, appellant provided quarterly reports for the liability period generated by its point-of-sale system (POS reports). The POS reports reflected appellant's total sales for each quarter in the liability period according to type of payment (e.g., cash, credit card, gift card, voucher, or "other"). For payments listed as "other," appellant provided detailed sales reports for the first quarter of 2017 (1Q17) and 2Q17. Appellant also provided bank statements for the entire liability period, various sales receipts dated within the liability period, and federal income tax returns for fiscal years ending September 30, 2014, and September 30, 2015.
4. Based upon its review of appellant's business and its records, CDTFA determined, and appellant has not disputed, that all of appellant's sales of food were taxable under R&TC section 6359(d)(6) and Regulation section 1603(c) (also known as the "80-80 rule").[6]
5. According to the POS reports, appellant recorded transactions of $2,793,226 during the liability period, comprised of the following: (1) $2,332,596 in sales paid by cash or

[5] Hereafter, dollar amounts within this Opinion are rounded.

[6] Additional information regarding the 80-80 rule is provided below.

credit card (excluding tips); (2) $26,383 in sales paid by event,[7] gift card, or voucher; (3) $135,429 of "other" sales, which included sales paid by Groupon certificates; (4) $297,350 of tips; and (5) $1,468 of complimentary food and drinks.[8]

a. CDTFA considered the recorded sales paid by cash, credit card, event, gift card, or voucher, which totaled $2,358,979, to be taxable. From this amount, appellant removed the sales tax included in those payments ($174,739), to calculate a taxable measure of $2,184,239 for this specific category.

b. Appellant argued to CDTFA that the sales it recorded under the category "other" were nontaxable. CDTFA examined the detailed sales reports for 1Q17 and 2Q17 and conducted a random sampling of 50 of the 508 recorded transactions. Appellant did not provide any supporting documentation showing that sales tax did not apply to any of the 50 sampled transactions. Still, CDTFA considered 7.3232 percent of the transactions to be nontaxable sales.[9] Consequently, CDTFA reduced the "other" transactions by 7.3232 percent, then subtracted the sales tax included in those nontaxable transactions ($9,297), to calculate taxable "other" sales of $116,215.[10]

c. For tips, CDTFA noted that appellant's menu stated that an 18 percent gratuity would be added to the bill for parties of six or more (mandatory gratuity). Appellant's sales receipts also revealed the addition of an 18 percent charge for mandatory gratuity. Appellant's POS reports reflected that appellant collected mandatory gratuities of $60,403, which were subject to tax.[11]

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[7] Neither party has provided additional information explaining the payment method described as "event" in appellant's POS reports.

[8] CDTFA did not include the complimentary food transactions in the audit.

[9] These included sales to "Mr[.] and Mrs[.] Puri" (which CDTFA considered to be self-consumption) and payments made with various discounts and coupons. CDTFA determined these amounts were immaterial and, on that basis, deemed the transactions nontaxable sales.

[10] The mathematical discrepancy is due to rounding.

[11] The summary sales reports showed mandatory gratuities of $65,475. However, CDTFA noted that appellant added sales tax to mandatory gratuities for some transactions in 1Q17 and 2Q17. Because CDTFA performed a more extensive sales tax accrual analysis for 1Q17 and 2Q17, which presumably would have included the tax collected on mandatory gratuities, CDTFA excluded $5,072 of the mandatory gratuities from the audited measure.

6. In total, appellant's records reflected taxable sales of $2,300,454 ($2,184,239 in sales paid by cash, credit card, event, gift card, or voucher + $116,215 of "other" sales) and $60,403 of taxable mandatory gratuities for the liability period. However, in its sales and use tax returns for the liability period, appellant only reported taxable sales of $2,145,668, and did not report its mandatory gratuities as taxable.
7. Therefore, CDTFA's audit resulted in a measure of tax for unreported taxable sales in the amount of $154,786 ($2,300,454 - $2,145,668) and a measure of tax for unreported taxable mandatory gratuities in the amount of $60,403.[12]
8. CDTFA issued its NOD to appellant on January 17, 2020.
9. Appellant did not timely pay or petition the NOD. Consequently, on February 19, 2020, CDTFA issued to appellant a demand for payment.
10. On February 27, 2020, appellant filed an untimely petition for redetermination, which CDTFA accepted as an administrative protest.
11. On February 27, 2023, CDTFA issued a decision denying appellant's administrative protest.
12. This timely appeal followed.

DISCUSSION

Issue 1: Whether an adjustment to the measure of unreported taxable sales is 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.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination on request by CDTFA. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

The general rule is that the sale of food products for human consumption is exempt from tax. (R&TC, § 6359; Cal. Code Regs., tit. 18, § 1602.) However, certain sales of food products

[12] CDTFA also asserted measures of tax associated with appellant's collection of excess tax reimbursement and self-consumption of resale inventory, but appellant has not raised these measures as issues in its appeal to OTA, and thus, are not discussed further.

are excluded from the exemption and are thus subject to tax. (See R&TC, § 6359; Cal. Code Regs., tit. 18, §§ 1503, 1574, 1603.) As relevant here, food products are subject to tax when they are: (1) served as a meal by a restaurant or a similar establishment whether served on or off the premises; (2) sold as hot prepared food products; or (3) furnished, prepared, or served for consumption at facilities provided by the retailer. (R&TC, § 6359(d)(1), (2) & (7); Cal. Code Regs., tit. 18, § 1603 (a)(2)(A), (e) & (f).)

When over 80 percent of the retailer's gross receipts are from sales of food products and over 80 percent of the retailer's retail sales of food products are subject to tax, the 80-80 rule applies. (R&TC, § 6359(d)(6); Cal. Code Regs., tit. 18, § 1603(c)(3).) Under the 80-80 rule, tax applies to sales of cold food products (which includes sales for a separate price of hot bakery goods and hot beverages) in a form suitable for consumption on the retailer's premises even though such food products are sold on a "take-out" or "to go" order. (Cal. Code Regs., tit. 18, § 1603(c)(1)(A), (3).) However, a retailer may avoid the application of the 80-80 rule by keeping a separate accounting of its sales of cold food to-go. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).).

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 AMG Care Collective*, 2020-OTA-173P.) 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 tax. (*Ibid*.)

Here, CDTFA conducted its audit using a direct audit approach. That is, CDTFA examined and relied on appellant's own records to calculate the audited taxable measure. (See CDTFA's Audit Manual, § 0404.05.)[13] Specifically, CDTFA compared the sales recorded in

[13] CDTFA's Audit Manual is an advisory publication providing direction to CDTFA staff administering the Sales and Use Tax Law and applicable regulations. OTA is not required to follow CDTFA's Audit Manual; however, OTA may look to CDTFA's Audit Manual for guidance when evaluating the reasonableness of CDTFA's determination. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

appellant's point-of-sale system to appellant's reported sales to calculate appellant's unreported taxable sales. Pursuant to R&TC section 6091, all of appellant's sales are presumed taxable until the contrary is established. Appellant has not specifically contested the applicability of the 80-80 rule and there is no indication in the evidentiary record that the 80-80 rule does not apply. In addition, appellant has not claimed or provided evidence that it kept a separate accounting of its sales of cold food to-go. Consequently, OTA finds that CDTFA's use of a direct audit approach and its determination that all of appellant's sales were taxable (excluding a few concessions), was reasonable and rational. Therefore, the burden of proof shifts to appellant to prove both that CDTFA's tax assessment is incorrect, and the proper amount of tax. (*Appeal of AMG Care Collective, supra*.)

On appeal, appellant states that it disagrees with the measure of unreported taxable sales but does not explain the basis for its disagreement. Nor has appellant asserted what it believes to be the proper amount of tax. Appellant has not provided any documentary evidence in this appeal, let alone evidence to prove that its recorded sales were nontaxable. An unsupported assertion is not sufficient to satisfy appellant's burden of proof. (*Appeal of AMG Care Collective, supra*.) Accordingly, appellant has not established that an adjustment to the measure of unreported taxable sales is warranted.

Issue 2: Whether an adjustment to the measure of unreported taxable mandatory gratuities is warranted.

"Gross receipts" means the total amount of the sale price, including any services that are part of the sale. (R&TC, § 6012(a), (b)(1).) A "sale" includes the furnishing, preparing, or serving for a consideration of food, meals, or drinks. (R&TC, § 6006(d).)

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. (Cal. Code Regs., tit. 18, § 1603(g), (h).)[14] A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. (*Ibid*.) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

[14] Regulation section 1603(g) applies to transactions occurring prior to January 1, 2015, and Regulation section 1603(h) applies to transactions occurring on or after January 1, 2015.

(Cal. Code Regs., tit. 18, § 1603(g)(2)(A), (h)(3)(A).)[15] As relevant here, when a menu contains a statement that notifies customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. (Cal. Code Regs., tit. 18, § 1603(g)(2)(B), (h)(3)(B).) Any amount added by the retailer is presumed to be automatically added and mandatory. (*Ibid.*) This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount or gratuity be added to the bill. (Cal. Code Regs., tit. 18, § 1603(g)(2)(C), (h)(3)(C).) Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (*Appeal of AMG Care Collective*, *supra*.)

Here, appellant's menu notified customers that an 18 percent mandatory gratuity would be added to the bill for parties of six or more, and appellant's sales receipts reflect the addition of such gratuity. Consequently, CDTFA's determination that appellant's added gratuities of $60,403 were mandatory, and thus taxable, was reasonable and rational. Therefore, the burden of proof shifts to appellant to controvert the presumption by providing documentary evidence that its customers specifically requested and authorized the gratuity be added to the bill. (Cal. Code Regs., tit. 18, § 1603(g)(2)(C), (h)(3)(C).)

On appeal, appellant argues, without any specificity, that the measure of unreported taxable mandatory gratuities is incorrect, and the amount should be less. However, appellant has not provided any documentary evidence to either support its assertion or support a finding that its customers specifically requested and authorized the gratuity be added to the bill. Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (*Appeal of AMG Care Collective*, *supra*.) As such, OTA finds that an adjustment to the measure of unreported taxable mandatory gratuities is not warranted.

[15] OTA notes that for transactions occurring on or after January 1, 2015, when a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory. (Cal. Code Regs., tit. 18, § 1603(h)(2).) Neither party has presented evidence that such circumstances are present here. Thus, OTA's summary of the law herein focuses on retailers that do not maintain records for purposes of reporting the amounts to the IRS. (See Cal. Code Regs., tit. 18, § 1603(h)(3).)

HOLDINGS

1. An adjustment to the measure of unreported taxable sales is not warranted.
2. An adjustment to the measure of unreported taxable mandatory gratuities is not warranted.

DISPOSITION

CDTFA's action in denying the administrative protest is sustained.

Signed by:
Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

Signed by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

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