

reaudit decreased the determined tax by \$4,647, from \$122,214 to \$117,567, and made corresponding changes to the interest. For Franklin NOD, CDTFA completed two reaudits, which decreased the determined tax by \$7,816, from \$64,247 to \$56,431, and made corresponding changes to the interest.

Appellant waived the right to an oral hearing; therefore, the matters were submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

CDTFA separately issued the Capital NOD and Franklin NOD, and appellant appealed each separately. OTA consolidated the two appeals due to the similarity of the facts and issues. (See Cal. Code Regs., tit. 18, § 30212(a).)

ISSUE

Has appellant established that any further reduction to the measures of unreported taxable sales is warranted?

FACTUAL FINDINGS

1. Appellant, a corporation, operated two gas stations under the name Sarb Enterprises Corp., doing business as Capital Gas Mart, located in West Sacramento, California (Capital) and as Franklin Gas Mart, located in Sacramento, California (Franklin). Each location held its own seller's permit. Capital's seller's permit had an effective start date of January 1, 2014, and Franklin's seller's permit had an effective start date of January 1, 2012. Both seller's permits were closed with an effective date of December 31, 2018.
2. Appellant sold the Capital location prior to commencement of the audit. Appellant reorganized the Franklin location prior to commencement of the audit.
3. Both business locations had minimarts attached. In addition to gas, the Capital location also sold diesel fuel. Sales at the minimarts were comprised of both taxable and non-taxable goods, and included tobacco products, alcohol (only at the Capital location), and lottery tickets.
4. On its sales and use tax returns (SUTRs), appellant reported total sales of \$8,284,508 for Capital, and claimed deductions in the amount of \$5,922,648, amounting to reported taxable sales of \$2,361,860. In addition, appellant claimed credits of \$145,118 for sales

tax pre-paid to fuel suppliers and partial tax exemption credits of \$62,026 on motor vehicle fuel sales. Appellant reported sales on the SUTRs from its point-of-sales (POS) summary sales reports.

5. Appellant reported on its SUTRs total sales of \$6,750,622 for Franklin, and claimed deductions in the amount of \$4,105,208, amounting to reported taxable sales of \$2,645,414. In addition, appellant claimed credits of \$97,104 for sales tax pre-paid to fuel suppliers and partial tax exemption credits of \$95,057 on motor vehicle fuel sales. Appellant reported sales on the SUTRs from its POS reports.
6. For the Capital audit, appellant provided federal income tax returns (FITRs) for years 2015, 2016, 2017, and 2018; a summary of POS system reports for the third quarter 2015 (3Q15) and 3Q18; and purchase invoices for fuel and items sold at the minimart for the audit period.
7. For the Franklin audit, appellant provided FITRs for years 2017 and 2018; product sales reports and POS summary reports for March 2019 and January 2020; and purchase invoices for fuel and items sold at the minimart for the audit period.
8. CDTFA combined the sales information for both locations because appellant consolidated its total sales, purchases, and expenses for both gas station locations when preparing its FITRs. Combined reported taxable sales on the SUTRs totaled \$23,167,659.⁴ Gross receipts reported on FITRs totaled \$23,562,586.⁵ CDTFA could not determine the reason for the differences, and appellant did not provide source documents for the audit.
9. Prior to the reaudit, appellant sold the Capital location to a different corporation. CDTFA estimated the value of furniture, fixtures, and equipment of \$15,000 and gas pumps valued at \$31,981 for a total of \$46,981 in sales of business property subject to use tax for the period 4Q18.⁶

⁴ Combined reported taxable sales on the SUTRs totaled \$5,744,864 for 2015, \$5,793,328 for 2016, \$5,498,426 for 2017, and \$6,131,041 for 2018.

⁵ Gross receipts reported on FITRs were: \$5,744,864 for 2015, \$5,793,327 for 2016, \$5,830,171 for 2017, and \$6,194,224 for 2018.

⁶ Appellant does not dispute this item, and OTA does not address it further.

Capital Minimart Sales

10. For the Capital location minimart sales, CDTFA compared non-taxable food sales from appellant's POS reports with claimed exempt food sales and noted immaterial differences.
11. CDTFA compared recorded lottery sales of \$481,485 to claimed lottery sales deductions of \$458,306 to determine that appellant underclaimed lottery sales deductions by \$23,179, which CDTFA found immaterial.
12. CDTFA used purchase invoices for March 2018 to complete a purchase segregation test⁷ to establish a taxable goods ratio of 74.13 percent. Based on additional invoices provided by appellant, CDTFA reduced the taxable goods ratio to 73.09 percent in a reaudit.
13. CDTFA calculated a taxable goods ratio of 76.36 percent (for both minimart locations), which CDTFA applied to the computed minimart purchases of \$1,191,112 for 2016 and \$1,079,528 for 2017 to arrive at taxable minimart purchases of \$909,533 for 2016 and \$824,328 for 2017. Using 2016 and 2017 sales and purchase records, CDTFA calculated and applied an overall markup factor⁸ of 1.2149 to arrive at audited taxable minimart sales. After adjusting for 1 percent pilferage and CalFresh deductions⁹ of \$19,903 for 2016 and \$19,117 for 2017, CDTFA calculated audited taxable minimart sales of \$1,093,953 for 2016 and \$990,392 for 2017.
14. CDTFA calculated a percentage of error (POE) of 140.21 percent for 2016, 66.23 percent for 2017, and 98.28 percent, combined. Since appellant did not provide 2015 information, CDTFA applied the overall POE of 98.28 percent to 3Q15, 4Q15, and all quarterly periods in 2018. CDTFA also applied the calculated POEs¹⁰ in liability period

⁷ A purchase segregation test is used to establish the proportion of merchandise purchases in various product categories (such as cigarettes and cigars, other tobacco products, sodas, "other" taxable merchandise, food, and supplies) to compute the percentage of taxable merchandise purchases, as well as the percentages of merchandise in each category.

⁸ Markup factor is the amount by which a product's cost is increased to determine its selling price. The markup factor is obtained by dividing sales by costs.

⁹ CalFresh is California's version of the Supplemental Nutrition Assistance Program, formally known as the Federal Food Stamp Program. Sales of eligible food items purchased with CalFresh benefits are exempt from tax. Retailers may claim amounts exceeding 2 percent if the requirements set forth in Regulation section 1602.5(c) are met.

¹⁰ The POEs are 101.79 percent for 2015, 144.48 percent for 2016, 69.17 percent for 2017, and 101.79 percent for 2018.

1 to reported taxable minimart sales, totaling \$823,652, to arrive at additional taxable minimart sales of \$803,887.

15. CDTFA issued an NOD on June 10, 2021, for tax of \$122,214 and credits of \$2,347. Appellant appealed the NOD, and CDTFA issued a decision ordering a reaudit. After the reaudit, CDTFA issued an audit report letter dated June 12, 2023, for tax of \$154,639, credits of \$37,072, and net tax of \$117,967.

Franklin Minimart Sales

16. For Franklin, CDTFA based the audited taxable minimart sales on the markup method using the 1.2149 markup factor calculated in the related audit of Capital. CDTFA calculated POEs of 66.23 percent for 2017 and 98.23 percent overall for 2016 and 2017. 2016 was not included in liability period 2, so in a second reaudit, CDTFA applied the POE of 66.23 percent to reported taxable minimart sales of \$287,255 for 2017 and \$242,660 for 2018 to determine audited taxable minimart sales of \$477,504 for 2017 and \$403,374 for 2018 for total audited taxable sales of \$880,878. These figures resulted in additional taxable minimart sales of \$190,249 for 2017 and \$160,734 for 2018 and total additional taxable minimart sales of \$445,699.
17. CDTFA issued an NOD on June 10, 2021, for tax of \$113,055, credits of \$56,624, and net tax of \$56,431. Appellant appealed the NOD, and CDTFA issued a decision ordering a reaudit. After two reaudits, CDTFA issued an audit report letter dated January 9, 2024, for tax of \$113,055, credits of \$56,624, and a net tax of \$56,431.
18. Appellant timely appealed both NODs to OTA.

DISCUSSION

California imposes sales tax on a retailer's 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.*)

Here, CDTFA was unable to verify sales appellant reported on its SUTRs because appellant failed to provide detailed sales records. Therefore, CDTFA was not able to use a direct audit method (that is, compiling audited sales directly from appellant's records). CDTFA's preliminary analysis of the FITRs, reporting sales information for both the Capital and the Franklin location minimarts, revealed large unexplained differences, of \$331,745 for 2017 and \$63,183 for 2018, between taxable sales reported on the SUTRs and gross receipts reported on the FITRs. CDTFA found no material differences in 2015 and 2016.

CDTFA conducted a markup analysis for the minimarts based on purchases reported on the FITRs and sales reports provided by appellant. CDTFA could not conduct shelf tests because the Capital location was sold prior to the audit, and the Franklin location was reorganized prior to the audit. CDTFA accepted recorded minimart purchases for 2016 and 2017 but found that recorded minimart purchases for 2018 were likely understated and unreliable. CDTFA used combined minimart purchases and minimart sales in 2016 and 2017 to compute a book markup factor of 1.2149. CDTFA used purchase invoices from March 2018, which appellant provided, to determine a percentage of taxable purchases and calculate audited taxable sales. CDTFA computed a POE that it applied to Capital's 3Q14, 3Q15, and all quarters of 2018. CDTFA applied the 2017 POE to Franklin for all quarters of 2018.

OTA finds that it was reasonable for CDTFA to question reported sales and use an indirect audit method to compute appellant's sales. Appellant did not provide sufficient source documents to allow a direct audit. CDTFA used the markup method as the basis for its determination, which is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) CDTFA used appellant's records to the extent CDTFA found them to be

reliable. Thus, OTA finds that CDTFA has met its initial burden to show that its determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

Appellant disputes only the audited measures for minimart sales for both Capital and Franklin. Appellant asserts that the one-month purchase segregation test using March 2018 purchase invoices was not enough to constitute a representative test of appellant's purchases over the audit periods. Appellant further states that it conducted its own purchase segregation test on additional months of purchases, and the results indicate that the additional taxable measure is overstated.

Pursuant to the CDTFA Decisions, which ordered reaudits, appellant furnished additional purchase invoices for the purchase segregation test period of March 2018. CDTFA incorporated the additional invoices into the purchase segregation test which changed the taxable ratio of minimart purchases to 76.36 percent, from 77.75 percent in the original audits. Additionally, the overall POE rates calculated in the reaudits decreased to 98.28 percent from 101.79 percent. Accordingly, the underreported taxable sales decreased as well. For the Capital location, underreported taxable minimart sales for the audit period decreased to \$803,887 from \$832,726. For the Franklin location, CDTFA performed a second reaudit of the Franklin location and used a POE of 66.23 percent calculated for 2017 instead of the combined POE of 98.28 percent because 2016 was not part of liability period 2. As a result, underreported taxable minimart sales decreased to \$350,963 from \$464,263.

Although appellant claims to have performed a more comprehensive purchase segregation test, appellant has not provided supporting documents such as additional purchase invoices or sales invoices. Moreover, appellant has not provided source documents to support its assertion that the taxable ratio for taxable minimart purchases, the POE, or the markup factor used in the reaudits are incorrect. Consequently, OTA finds no basis to recommend further adjustments other than those adjustments already conceded by CDTFA to reduce the taxable ratio of minimart purchases to 76.36 percent and to adjust the POEs accordingly.

In summary, OTA finds that CDTFA computed audited taxable sales based on the best available evidence using a reasonable and rational audit method. Appellant has not identified any errors in CDTFA's computation of audited taxable sales or provided 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 in this case, OTA concludes that no further adjustments are warranted.

HOLDING

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

DISPOSITION

CDTFA’s actions, consisting of reducing appellant’s liabilities, as specified in the reaudits that CDTFA ordered in its decision and otherwise upholding the determinations, are sustained.

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Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

We concur:

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Steven Kim
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Steven Kim
Administrative Law Judge

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