

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No.: 230813959
EVERGROW INVESTMENTS INC.,)	CDTFA Case ID: 234-037
dba 6001 California Market)	
)	
)	

OPINION

Representing the Parties:

For Appellant: Shelley Wienke, President

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Daniel Cho, Attorney

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Evergrow Investments Inc., dba 6001 California Market (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on February 18, 2014. The NOD is for tax of \$130,676.65, plus applicable interest, and a negligence penalty of \$13,067.68² for the period January 1, 2009, through December 31, 2011 (liability period).³

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 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 On appeal, appellant has not raised any contentions with respect to the negligence penalty. Accordingly, the Office of Tax Appeals finds that the negligence penalty is not at issue and will not discuss it further.

³ The NOD was timely because on October 29, 2013, appellant signed a waiver of the statute of limitations for the liability period through October 31, 2014.

ISSUE

Whether any adjustments to the measure of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant operated a supermarket known as 6001 California Market in San Francisco, California. During the liability period, appellant reported total sales of \$3,330,018, and claimed deductions for nontaxable sales of \$2,833,719, which resulted in reported taxable sales of \$496,299.
2. For the audit, appellant did not provide a complete set of books and records such as a general ledger, journals, sales invoices, or cash register z-tapes.⁴ Instead, appellant provided the following: federal income tax returns for fiscal years 2009, 2010, 2011, and 2012;⁵ sales and use tax returns; sales and use tax worksheets; an incomplete set of purchase invoices; and inventory reports.
3. Upon audit, CDTFA compared the total sales that appellant reported on its sales and use tax returns for the liability period to the gross receipts that appellant reported on its federal income tax returns for 2009 through 2012, which revealed minimal differences.⁶
4. CDTFA also performed a markup analysis based on amounts reported on appellant's returns.
 - a. To calculate the overall markup, CDTFA subtracted the cost of goods sold (COGS) of \$2,443,420 reported on appellant's federal income tax returns for 2009 through 2011 from appellant's reported total sales excluding tax (ex-tax) of \$3,284,503, which resulted in a gross margin of \$841,083. CDTFA then compared the gross margin to the COGS of \$2,443,420 reported on appellant's federal income tax return to compute an overall markup of 34 percent.
 - b. To calculate appellant's markup on taxable sales, CDTFA compared appellant's reported taxable sales of \$496,299 for the liability period to audited taxable purchases of \$1,381,505. CDTFA's calculation of audited taxable purchases is based on a review of appellant's inventory reports, which revealed taxable

⁴ 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).

⁵ Appellant filed federal income tax returns on a fiscal year basis from April 1 to March 31 of the subsequent years.

⁶ CDTFA's review included the period July 1, 2008 through December 31, 2008, which was outside of the liability period.

inventory ratios of 51.38 percent for 2009, 56.25 percent for 2010, and 61.24 percent for 2011. CDTFA applied the taxable inventory ratios to the COGS reported on appellant's federal income tax returns for each year, to find taxable purchases of \$1,381,505 for the liability period. When compared to reported taxable sales of \$496,299, appellant's taxable purchases revealed a markup of negative 64.08 percent for the liability period.

- c. To calculate appellant's markup on nontaxable sales, CDTFA compared appellant's reported nontaxable sales of \$2,788,168 for the liability period to audited nontaxable purchases of \$1,061,915. CDTFA's calculation of nontaxable purchases was made by subtracting appellant's audited taxable purchases of \$1,381,505 from the COGS of \$2,443,420 reported on appellant's federal income tax returns for the liability period. When compared to reported nontaxable sales of \$2,788,168, appellant's nontaxable purchases revealed a markup of 162.56 percent for the liability period.

CDTFA found that appellant's markup on nontaxable sales was higher than expected. Additionally, because appellant's markup on nontaxable sales was negative, CDTFA determined that further investigation was warranted.

5. CDTFA used appellant's purchase invoices to schedule taxable purchases of \$51,007 for the period April 1, 2010, through June 30, 2010. CDTFA used this information to perform a purchase segregation test⁷ and calculate purchase ratios of 5.64 percent for liquor, 38.77 percent for wine, 16.88 percent for beer, 11.01 percent for tobacco, 7.22 percent for carbonated drinks, 15.85 percent for sundries, and 4.64 percent for newspapers and magazines.
6. CDTFA performed a shelf-test⁸ comparing appellant's purchases to appellant's sales price to calculate audited markups for each taxable purchase category, including 29.91 percent for liquor, 36.81 percent for wine, 52.66 percent for beer, 30.79 percent for tobacco, 51.35 percent for carbonated drinks, 49.52 percent for sundries, and 22 percent for newspapers and magazines.

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

⁸ A shelf-test is an accounting comparison of known costs and associated selling prices used to compute markups.

7. CDTFA multiplied the markup rate for each purchase category by its purchase ratio to calculate weighted markups of 1.69 percent for liquor; 14.27 percent for wine; 8.89 percent for beer; 3.39 percent for tobacco; 3.71 percent for carbonated drinks; 7.85 percent for sundries; and 1.02 percent for newspapers and magazines. When taken together, CDTFA calculated an average weighted markup of 40.82 percent.
8. To calculate audited taxable sales, CDTFA reduced appellant's audited taxable purchases of \$1,381,505 by \$33,540 for self-consumption subject to use tax⁹ and a 1 percent reduction for pilferage to calculate adjusted taxable purchases of \$1,334,485. CDTFA then applied the taxable markup of 40.82 percent to adjusted taxable purchases to calculate audited taxable sales of \$1,878,974. When compared to reported taxable sales of \$496,299, this revealed a deficiency measure of \$1,382,675.
9. On February 18, 2014, CDTFA issued the NOD to appellant. Appellant filed a timely petition for redetermination, disputing the measure of unreported taxable sales, which CDTFA denied.
10. This timely appeal followed.

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, § 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, 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 Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a

⁹ Audited self-consumption subject to use tax is an estimate based on statements made by appellant's president and other individuals. Appellant does not dispute this audit item.

result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant did not provide a complete set of books and records for the audit. Upon audit, CDTFA reviewed appellant's federal income tax returns to calculate a markup of negative 64.08 percent for taxable sales. A negative markup would mean that the taxpayer is selling tangible personal property for less than it paid. Thus, CDTFA reasonably concluded that appellant's books and records were unreliable and that further audit was warranted.

When CDTFA cannot compute taxable sales from appellant's records, it is appropriate to use an indirect method. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) To calculate the taxable measure, CDTFA used a markup audit method based on a shelf-test, and appellant's purchase inventory records. The markup method is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) As such OTA finds that it was rational for CDTFA to use the markup audit method to calculate audited taxable sales, and that the results seem reasonable. Accordingly, the burden shifts to appellant to prove that a reduction is warranted. (See *Appeal of Talavera, supra.*)

On appeal, appellant asserts that a reduction to the measure of unreported taxable sales is warranted. Appellant disputes the use of its tax returns to calculate taxable sales. Appellant argues that its 2011 return was audited by the IRS. However, appellant has not provided any evidence or information to show that the numbers it reported on its own federal return are inaccurate or were subject to adjustments by the IRS. Additionally, appellant has not provided any explanation for how the alleged IRS audit affects the liability in this appeal. Appellant's unsupported assertions are insufficient to meet its burden of proof. Accordingly, appellant has not shown that adjustments are warranted.¹⁰

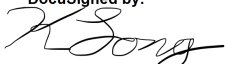
¹⁰ On appeal to CDTFA, appellant argued that it had provided complete books and records, including purchase journals with detailed information, which CDTFA failed to include in the audit report. However, appellant has not raised that argument on appeal to OTA, nor has appellant provided copies of the alleged purchase journals.

HOLDING

No adjustments to the measure of unreported taxable sales are warranted.


DISPOSITION

CDTFA's decision denying appellant's petition for redetermination is sustained.


DocuSigned by:


Keith T. Long
Administrative Law Judge

We concur:

Signed by:


Josh Lambert
Administrative Law Judge

Signed by:


Suzanne B. Brown
Administrative Law Judge

Date Issued: 4/25/2025