OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **ROCKSTAR DOUGH, LLC,** **dba Streetcar Merchants**	OTA Case No.: 240917401 CDTFA Case ID: 4-977-546, 05-181-288

OPINION

Representing the Parties:

For Appellant: James Dumler, CPA

For Respondent: Jason Parker, Chief of Headquarters Ops.

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Rockstar Dough, LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination (petition) of a Notice of Determination (NOD) issued on June 5, 2023. The NOD is for tax of $345,604, plus applicable interest, and a penalty of $34,560.43 for the period October 1, 2019, through September 30, 2022 (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, (Regulation) section 30209(a).

ISSUES

1. Whether adjustments are warranted to the audited taxable measure.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated two restaurants serving food and alcohol in San Diego, California. Appellant held a seller's permit effective from June 19, 2014, through June 30, 2023. Appellant utilized third-party food delivery services such as Uber Technologies

[1] The NOD was timely issued because on January 6, 2023, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period October 1, 2019, through December 31, 2019, which allowed CDTFA until July 31, 2023, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

(Uber Eats), GrubHub Holdings, Inc. (GrubHub), DoorDash, Inc. (DoorDash), and Postmates, Inc. (Postmates). Appellant was previously audited for the period October 1, 2016, through September 30, 2019, where CDTFA established an understatement of $3,470,001, an error rate of 466.38 percent, and a credit card sales ratio of 81.4 percent.[2]

2. Appellant reported on its Sales and Use Tax returns (SUTRs) total sales of $1,720,717, exempt food sales of $548,592, and taxable sales of $1,172,125 for the liability period. The SUTRs show that district taxes were not reported for third quarter of 2019 (3Q19), 4Q21 and 2Q22.
3. Upon audit, appellant did not provide books and records to support the amounts reported on the SUTRs. CDTFA obtained Form 1099-K data from Franchise Tax Board for the periods 2019, 2020, and 2021.[3]
4. CDTFA disallowed the claimed food deduction of $548,592 since the food deduction was disallowed in the prior audit based on appellant's statement that it netted the nontaxable sales from total sales when reporting, and therefore, the deduction was claimed in error. CDTFA determined that appellant falls under the 80-80 rule based on observations, a review of appellant's menu, and available seating; and thus, CDTFA concluded that all of appellant's sales of food are subject to tax.[4]

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[2] A credit card sales ratio analysis typically involves the use of third-party data, such as bank statements or IRS Forms 1099-K, which show amounts paid to a merchant by a bank, credit card company, or third-party network when the customer pays for goods or services using a debit card, credit card, PayPal, or similar form of non-cash payment. If a reasonable estimate of the ratio of such non-cash sales to total sales can be made, an equally reasonable estimate of total (i.e., cash and non-cash) sales can be made.

[3] A 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.

[4] Generally, a sale of cold food to-go is exempt from tax. (Cal. Code Regs., tit. 18, § 1603(c)(1)(B).) However, there is a special "80-80" rule under which a sale of cold food to-go in a form suitable for consumption on the retailer's premises (e.g., a cold sandwich) is subject to tax. This rule applies when more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of the retailer's sales of food are otherwise subject to tax. (R&TC, § 6359(d)(6); Cal. Code Regs., tit. 18, § 1603(c)(1)(A), (c)(3).) However, even when a retailer is covered by this rule, it may avoid its application by keeping a separate accounting of its sales of cold food to-go in a form suitable for consumption on the retailer's premises. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).) Therefore, where a retailer separately accounts for these sales, they are exempt from tax, but if the retailer does not do so, these sales are subject to tax unless the retailer is not covered by the "80-80" rule.

5. CDTFA analyzed Form 1099-K sales data for October 1, 2019, to December 31, 2021, totaling $4,826,805 from the following merchants: Square, Inc. and Block, Inc., Uber Eats,[5] GrubHub, DoorDash, and Postmates. CDTFA backed out tips and sales tax from the total credit card sales and applied the credit card sales ratio of 81.40 percent, calculated in the prior audit, to establish audited taxable sales of $4,265,303. CDTFA then compared audited taxable sales to reported taxable sales of $890,250 and found a difference of $3,375,053.
6. CDTFA reduced the taxable sales difference by the disallowed food sales of $482,185 to calculate unreported taxable sales of $2,892,869 for the period October 1, 2019, through December 31, 2021.
7. CDTFA then calculated a 379.11 percentage of error ($3,375,053 ÷ $890,250) and applied the error rate to the reported amounts for periods without Form 1099-K sales data to establish unreported taxable sales for 1Q22, 2Q22 and 3Q22. CDTFA reduced the unreported taxable sales for these quarters by the disallowed food sales of $66,407 to calculate unreported taxable sales of $1,002,218 for 1Q22 through 3Q22.
8. CDTFA captured the amounts reported on the SUTRs for 4Q19, 4Q21 and 2Q22 and assessed the unreported district tax measure of $243,759 ($55,448 + $94,629 + $93,682).
9. On June 5, 2023, CDTFA issued the NOD totaling $424,680.81 consisting of tax of $345,604, applicable interest, and a negligence penalty of $34,560.43.
10. Appellant timely petitioned the NOD.
11. CDTFA issued the decision denying appellant's petition.
12. This timely appeal follows.

DISCUSSION

Issue 1: Whether adjustments are warranted to the audited taxable measure.

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

[5] Uber Eats sales data is included in the total. However, Uber Eats elected to be a marketplace facilitator instead of a delivery network company and began collecting and reporting sales tax on sales starting April 1, 2021. A marketplace facilitator that is registered with CDTFA and facilitates the retail sale of tangible personal property (TPP) by a marketplace seller is the retailer selling the TPP sold through its marketplace. (R&TC, § 6043.) Therefore, the audit only includes Uber Eats Form 1099-K sales data through 1Q21 totaling $1,457,358 which is included in the credit card sales data.

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 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. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

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).) 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 or vinous liquors, or carbonated beverages. (R&TC, § 6359(b)(3); Cal. Code Regs., tit. 18, § 1602(a)(2).) 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. Exemptions from tax are strictly construed against the taxpayer who has the burden of proving that the statutory requirements have been satisfied. (*H. J. Heinz Co. v. State Bd. of Equalization* (1962) 209 Cal.App.2d 1, 4.)

Here, appellant failed to provide any books and records for the liability period; thus, CDTFA was unable to verify sales appellant reported on its SUTRs for the liability period using a direct audit method, that is, compiling audited sales directly from appellant's records. Thus,

OTA finds that it was reasonable for CDTFA to use an indirect audit method to compute appellant's sales. 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. CDTFA's use of the credit card sales ratio method as the basis for its determination is a recognized and accepted accounting procedure. (See *Appeal of Amaya*, 2021-OTA-328P.) 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 appellant's opening brief, appellant contends that the arguments made on its petition with CDTFA are still valid and that appellant will provide support for those contentions through this appeals process. In appellant's petition dated June 9, 2023, appellant contends that the NOD is incorrect and/or inappropriate for the following reasons: (1) There are valid exempt sales of cold food sold on a to-go basis not accounted for in the audit; and (2) The estimated credit card ratio is low and not indicative of the business' operations during the audit period.

Appellant has not identified any valid exempt sales of cold food sold on a to-go basis or stated what it believes is a representative credit card sales ratio for the liability period. Appellant has not provided any documentation from the liability period, such as cash register Z-tapes, with which CDTFA could perform additional testing for the computation of the credit card sales ratio, and unsupported assertions are not sufficient to satisfy appellant's burden of proof. (See *Appeal of Talavera*, *supra*.) Accordingly, OTA finds no basis to recommend any adjustment to the audited taxable measure.

As to whether appellant made nontaxable sales of food "to go," OTA first notes that appellant did not provide any books and records for the audit. CDTFA found that appellant satisfied the criteria for the 80-80 rule to apply. Therefore, tax applies to all of appellant's sales, including sales of cold food in a form suitable for consumption on appellant's premises, unless appellant kept a separate accounting of to-go sales of cold food. As discussed above, CDTFA's finding is reasonable and rational. Appellant has not provided any evidence that the 80-80 rule does not apply. Appellant also has not provided a separate accounting of its to-go sales of cold food or any other evidence that it made nontaxable food sales. Appellant's unsupported assertions are insufficient to meet its burden of proof. (*Appeal of Talavera*, *supra*.)

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 any evidence with which a more accurate determination could be made. Moreover, appellant does not carry its burden simply by

asking OTA to find unidentified errors in CDTFA's determination. (See *Appeal of Amaya*, *supra*.) As appellant has not met its burden of proof in this case, OTA concludes that no adjustments to the measure of tax are warranted.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. Although the term "negligence" is not specifically defined in the Sales and Use Tax Law, it is a common legal concept and is generally defined as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc*. (2017) 7 Cal.App.5th 1129, 1157-1158.) A taxpayer must maintain and make available for examination on request by respondent 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 returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to, the following (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; and (3) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and provide accurate records is evidence of negligence and may result in the imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 1698(k).) A negligence penalty also can be based on reporting errors. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-323.)

It is undisputed that appellant failed to provide adequate books and records. Generally, that is evidence of negligence. (Cal. Code Regs., tit. 18, § 1698(k).) This was appellant's second audit and appellant had significant understatement in both audits (466.38 error rate in the prior audit and 379.11 error rate in the second audit). Appellant's failure to correct errors from the first audit which were the same kind of errors as the current audit is further evidence of negligence.

Therefore, OTA finds that appellant did not exercise the care that a reasonably prudent person would exercise under similar circumstances. OTA concludes that the negligence penalty was properly imposed, and that appellant has failed to establish that it was not negligent.

HOLDINGS

1. Adjustments are not warranted to the audited taxable measure.
2. Appellant was negligent.

DISPOSITION

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

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

We concur:

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Steven Kim
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Steven Kim
Administrative Law Judge

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

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