

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:	)	OTA Case No.: 240716742
<b>CARIB ENTERTAINMENT, INC,</b>	)	CDTFA Case ID: 4-794-153
<b>dba New Karibbean City</b>	)	
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**OPINION**

Representing the Parties:

For Appellant: Richard Ali, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Crystal Spratley,  
Business Taxes Specialist

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Carib Entertainment, Inc (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent) denying appellant’s timely petition for redetermination of a April 7, 2023 Notice of Determination (NOD). The NOD is for tax of \$84,315, plus applicable interest, and a negligence penalty of \$8,431.46 for the period January 1, 2019, through December 31, 2021 (liability period).<sup>1</sup>

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

**ISSUES**

1. Are adjustments to the amount of unreported taxable sales warranted?
2. Did respondent correctly impose the negligence penalty?<sup>2</sup>

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<sup>1</sup> The NOD was timely issued because on January 4, 2023, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period January 1, 2019, through September 30, 2019, which allowed respondent until April 30, 2023, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

<sup>2</sup> Appellant does not specifically address the negligence penalty in its submissions; but appellant is not represented by a lawyer or a tax professional, and it did not clearly concede the negligence issue. Therefore, OTA will address the negligence issue out of an abundance of caution.

FACTUAL FINDINGS

1. Appellant, a corporation doing business as (dba) New Karibbean City (NKC), operated a night club with a full bar and private seating areas with bottle service in downtown Oakland.<sup>3</sup> Appellant opened the seller's permit effective July 1, 2015, and closed the permit effective September 30, 2023. While appellant dba NKC had not been previously audited, the sole corporate officer, R. Ali, operated the business as a sole proprietor dba Karibbean City until he closed that seller's permit for that business effective June 30, 2015.
2. NKC sold food and drinks, had a dance floor, and offered entertainment, including disc jockeys and live music.<sup>4</sup> Appellant charged a cover charge, which was paid either at the door or in advance online. The business was open Wednesdays and Thursdays from 12:00 p.m. to 9:00 p.m. and on Fridays and Saturdays from 12:00 p.m. to 2:00 a.m.<sup>5</sup> It was closed Sunday through Tuesday.
3. On its sales and use tax returns (SUTRs) for the liability period, appellant reported total sales of \$127,700 and claimed no deductions, resulting in reported taxable sales of \$127,700. Sales were reported for the first quarter of 2019 (1Q19) through 3Q19 only. Appellant reported no sales for the remainder of the liability period.
4. According to respondent, appellant provided the following book and records: federal income tax returns (FITRs) for 2019 and 2020; QuickBooks profit & loss (P&L) statements for 2019, January through June 2020, and July 2020 through June 2021;<sup>6</sup> Clover point-of-sale (POS) system sales reports for 2021;<sup>7</sup> Harbortouch POS system

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<sup>3</sup> According to the decision, NKC had six private seating areas that were offered for \$400, which included one bottle of liquor and mixers.

<sup>4</sup> According to the audit workpapers, food sales were not included in the audit.

<sup>5</sup> Prior to the liability period, the City of Oakland issued NKC an after-hours permit, which allowed NKC to remain open until 4:00 a.m. However, it is apparently undisputed that the City revoked the after-hours permit in March 2019 and did not reinstate it until after the liability period.

<sup>6</sup> The P&L statement for July 2020 through June 2021 showed no amounts recorded.

<sup>7</sup> A POS system typically includes one or more terminals at which sales can be recorded. Depending on the equipment and software, POS systems can generate receipts for the customer showing items purchased, sales price, sales tax added, amount tendered, cash or credit, and change provided, if any. POS systems can also produce various reports for the retailer, which can summarize sales activity for the period of time selected by the operator and can include breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable. Appellant stated that it used a Clover POS system during 2021, but it also stated that the system was repossessed during 2021.

“1099K reports”<sup>8</sup> for 2019 and 2020;<sup>9</sup> Harbortouch credit card deposit reports for 2019 and 2020;<sup>10</sup> QuickBooks general ledger (GL) for the liability period; and bank statements for January 2019 through September 2020 and July 2021 through November 2021. Respondent considered these books and records inadequate for sales and use tax purposes.

5. Respondent compared gross receipts reported on FITRs to total sales reported on SUTRs for 2019 and 2020 and noted material differences of \$216,370 and \$73,885, respectively. A comparison of sales, excluding admission or cover charges, recorded in appellant’s P&L statements and sales reported on SUTRs revealed underreported taxable sales of \$115,185 for 2019, \$50,641 for 2020, and \$23,953 for 2021.
6. Respondent compared sales recorded on P&L statements to sales reported on SUTRs and noted that recorded amounts exceeded reported amounts for every quarter with the differences totaling \$115,185 for 2019 and \$50,641 for 1Q20.<sup>11</sup>
7. Relying on information found on various internet and social media sites, respondent identified 77 special entertainment events that occurred at NKC during the liability period.<sup>12</sup> The number of events per quarter were as follows:
 

1Q19: 5	1Q20: 23	1Q21: 1
2Q19: 11	2Q20: 1	2Q21: 0
3Q19: 11	3Q20: 0	3Q21: 2
4Q19: 18	4Q20: 0	4Q21: 5
8. Based on two online articles about NKC, one that stated the club’s capacity was 700 persons and another that stated its capacity was 752 persons, respondent

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<sup>8</sup> Form 1099-K is an IRS form titled, “Payment Card and Third Party Network Transactions,” Payment card (e.g., credit or debit cards) processors and third-party networks (e.g., Venmo or PayPal) use the Form 1099-K to report (to the IRS) payments made to a taxpayer. (See 26 C.F.R. § 1.6050W–1.) There are no Forms 1099-K in OTA’s record.

<sup>9</sup> Appellant stated that it used a Harbortouch POS system for 2019 and 2020. The audit workpapers indicate that the Harbortouch 1099K reports were not used as deposits were lower than what appellant recorded in QuickBooks.

<sup>10</sup> This appears to be just a different description of the document just described as “1099-K reports.” OTA finds no other document in its record that fits this description.

<sup>11</sup> Appellant recorded sales in its P&L statements for all quarters of 2019 and 1Q20 only. As stated above, it reported no sales after 3Q19. According to the audit workpapers, appellant stated that there were no sales for July 2020 through June 2021.

<sup>12</sup> Respondent obtained event dates and details to create a timeline of events at appellant’s business by using appellant’s website, Facebook, Eventbrite, Yelp, and Do the Bay.

estimated the venue's capacity at 500 attendees and assumed the following for each event:

- attendance at 75 percent of capacity (375 attendees);
- bottle service of \$2,400<sup>13</sup>; and
- 3 drinks per person at an average price of \$9.72 per drink.<sup>14</sup>

Respondent thus computed estimated taxable sales per event of \$13,335 ((500 x .75) x (3 x \$9.72) + \$2,400); using that amount, respondent calculated audited taxable sales of \$1,026,795 for the liability period.<sup>15</sup>

9. Although appellant's reported taxable sales for 1Q19 were \$2,325 more than respondent determined for that quarter, respondent did not allow appellant the benefit of a credit for that amount because appellant did not provide books and records sufficient to support a claim for refund or credit. Consequently, respondent deducted reported taxable sales from audited taxable sales (plus the disallowed credit) to calculate unreported taxable sales from events of \$901,420 (\$1,026,795 + \$2,325 - \$127,700).
10. Respondent also did a calculation, using the same assumptions, that added all other Fridays and Saturdays (i.e., those for which special entertainment events were not scheduled) in 1Q19 through 1Q20, which added the equivalent of 66 events, or \$880,110 to the estimated measure. However, respondent opted for a more conservative approach using the original 77 events only.
11. Respondent issued the NOD to appellant.
12. Appellant filed a timely petition for redetermination.
13. On February 7, 2024, respondent held an appeals conference as part of its internal appeals process. Appellant did not attend, but it later submitted written argument, explaining that it had not received notice of the appeal conference.
14. On June 11, 2024, respondent issued its decision.
15. This timely appeal followed.

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<sup>13</sup> This would be a single use of each of the six private seating areas per event.

<sup>14</sup> Respondent calculated the average drink price using appellant's POS report for 4Q21.

<sup>15</sup> Respondent did not include cover charges in its estimate of taxable sales.

## DISCUSSION

### Issue 1: Are adjustments to the amount of unreported taxable sales 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. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Appellant did not provide sales receipts or other source documents for audit. The POS system data and bank records that it provided were incomplete, and the bank records did not show any cash deposits.<sup>16</sup> While P&L statements generally agreed with total sales reported on FITRs, those amounts differed substantially from amounts reported on SUTRs. OTA finds that respondent correctly concluded that the books and records appellant provided for audit were incomplete or otherwise unreliable, and that respondent could not use the provided records to verify reported taxable sales. Under the circumstances, respondent's conclusion that it could not use a direct audit method was both reasonable and rational.<sup>17</sup> When respondent cannot compute taxable sales from appellant's records, it is appropriate to use an indirect audit approach to calculate the taxable measure. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.)

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<sup>16</sup> This Opinion will discuss appellant's contrary assertion below.

<sup>17</sup> A direct audit method is one that enables respondent to verify taxable sales directly from the taxpayer's business records. Generally, a direct audit involves a simple tabulation of taxable sales evidenced by source documents, such as sales invoices, cash register tapes, or verifiable POS data. A direct audit approach based on complete and accurate business records is generally the most accurate.

There are a number of accepted indirect audit approaches. These usually rely on third party data or other information that allow respondent to estimate taxable sales. One is the markup method which, in its most useful form, allows respondent to use verified cost of goods sold (COGS) and sales prices for representative samples to calculate the retailer's markup, which can then be applied to verified total COGS for the liability period to determine total and taxable sales. Another is the credit card sales ratio method, which 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 paid for goods or services using a debit card, credit card, PayPal, or similar non-cash payment. If a reasonable estimate of the ratio of such non-cash sales to total sales can be made, which requires reasonably accurate data regarding non-cash sales and total sales for at least a representative period, and the auditor has an accurate record of all non-cash sales during the liability period, an equally reasonable estimate of total (i.e., cash and non-cash) sales can be made. Here, respondent did not have sufficient reliable data to use either of these indirect audit methods. Ultimately, respondent exercised its discretion, granted to it by R&TC section 6481, and chose to estimate appellant's taxable sales by focusing on 77 special entertainment events that appellant held during the liability period: 45 events during 2019, 24 events during 2020, and 8 events during 2021.

OTA first notes that the Legislature placed no specific limitations on respondent's authority to determine taxable measures on the basis of "any information within its possession or that may come into its possession." Nevertheless, OTA requires respondent to at least demonstrate that its determination has a rational basis and constitutes at least a reasonable estimate of the deficiency. (*Appeal of Talavera, supra.*) OTA will therefore examine respondent's audit for compliance with that standard with a focus on five elements: methodology, identification of events, attendance estimates, price estimates, and "sales per attendee" estimates.

The evidence shows that respondent rationally designed a methodology for estimating sales on the basis of estimated attendance and sales at special entertainment events. The methodology would not capture taxable food and beverages sales made during the thousands of hours that NKC was operating when special events were not happening, and it would not

capture food sales during those events, but those limitations favor appellant and will not be disturbed.<sup>18</sup>

Regarding whether respondent correctly identified the special entertainment events that occurred, the evidence indicates that all events were advertised on social media and some advertisements invited advanced ticket purchase. It is not always clear why respondent selected some events and not others that appear to have been promoted on social media. Nevertheless, OTA finds that respondent has provided prima facie evidence that the 77 special entertainment events occurred at NKC during the liability period.

The parties dispute the number of possible attendees at the events. One online article, which appears to be an investigative piece published by KQED radio, a National Public Radio affiliate, in March 2019 states that the club's maximum occupancy was 752. Another online article published in *The Gleaner* on December 21, 2011, which purports to describe an interview with the booking manager, states that the club was a 700-person capacity venue. Appellant argues that the club has a 500-person capacity, but he has provided nothing to support that claim. OTA finds that the two online articles are persuasive evidence of occupancy limitations. On that basis, OTA finds that the club's capacity was in excess of 700 persons, and that respondent's estimate that the special entertainment events attracted 375 attendees, slightly over 50 percent of capacity per event, is reasonable.

Regarding the final two elements, OTA finds that respondent's estimated average drink price (\$9.72), which was based on appellant's recorded sales during 4Q21, is reasonable,<sup>19</sup> and that respondent reasonably estimated that each attendee consumed three drinks throughout the course of each event. However, respondent assumes that some of those attendees used the private seating areas for which appellant provided a bottle of liquor. Based on the limited information in the record, OTA estimates that four people would use each private seating area. Therefore, instead of 375 attendees purchasing drinks, there would have been 351 attendees purchasing drinks.

In addition, OTA also finds that respondent incorrectly attributed the \$400 private seating area cost to taxable beverages. Some portion of that charge was for the privilege of using the private seating area. Sales of food and beverages served in a restaurant are subject to tax.

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<sup>18</sup> Seventy-four of the 77 events were on Friday or Saturday nights; two were on a Thursday (one being Halloween); and one was on a Tuesday (New Year's Eve). Allowing five hours for each event (9:00 p.m. to 2:00 a.m.) leaves 36 hours of non-event operation per week. That would total 1,872 hours in 2019, 468 hours in 1Q20, and additional time after COVID-19 restrictions were lifted in the latter part of 2021.

<sup>19</sup> Appellant has not argued otherwise.

(R&TC, § 6359(d)(1), (2).) OTA is not aware of any provision of the Sales and Use Tax Law that would impose sales tax on the lease of private space under the circumstances shown by the evidence here.<sup>20</sup> A standard 750 milliliter bottle of liquor contains 25.4 ounces. Using 1-ounce pours per drink, a bottle would make 25 servings. Using respondent's estimate of \$9.73 per drink, a reasonable charge for the bottle would be \$243. Taking spillage into consideration, OTA finds that a reasonable apportionment of the charge is 50 percent (\$200) for the taxable beverages.

Based on the foregoing, OTA finds that respondent has shown that, with the exception of the adjustments just described, the NOD was based on an audit that respondent rationally designed to compute a reasonable estimate of appellant's taxable sales based on data that was in respondent's possession, and that the audit in fact produced that result. Therefore, the burden of proof shifts to appellant to establish that a result differing from respondent's determination, as adjusted above, is warranted.

Appellant argues that respondent's findings substantially overstate appellant's taxable sales. It contends that:

- the loss of its after-hours permit caused a 75 percent reduction in sales.
- The club shut down until 4Q21 due to the COVID-19 pandemic.
- The photographs upon which respondent based attendance estimates were from its most successful events that occurred when appellant still operated after hours and are not representative of the liability period.
- Attendance was at close to 7 percent of capacity.
- Appellant deposited cash receipts into its bank account.
- During the COVID-19 pandemic, appellant's POS system was repossessed.
- Form 1099-K data showed minimal sales; and
- Appellant's typical credit card sales ratio was 80 percent.

While appellant's P&L statements for 2Q19 show a 58 percent reduction in sales, OTA's record does not contain source documents to support those recorded amounts, and OTA has insufficient evidence to judge how the loss of the after-hours permit affected appellant's business. If anyone would be in a position to provide evidence of attendance at special

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<sup>20</sup> There are circumstances when the cost of leasing premises is included in gross receipts subject to tax, such as when a caterer's charge for leased premises is a guarantee against a minimum purchase of food or beverages. (Cal. Code Regs., tit. 18, § 1603(i)(4).) "Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable." (*Ibid.*)

entertainment events (or any other time), it would be appellant; but it provided no evidence.<sup>21</sup> Similarly, if, as appellant asserts, respondent incorrectly reported that the provided bank statements did not show any cash deposits, appellant could and should have provided the bank statements to prove it. Also, appellant did not indicate when its POS system was repossessed; it did not provide any evidence regarding the repossession; and it did not explain how it recorded sales without its POS system. Finally, OTA finds no Forms 1099-K in the record, and appellant has not explained how it calculated the claimed 80 percent credit card sales ratio. As with some of appellant's other arguments, there is insufficient evidence in OTA's record to establish a reliable credit card sales ratio.

Accordingly, OTA finds that the following adjustments to the amount of unreported taxable sales are warranted: estimated taxable sales per event should be reduced from \$13,335 per event to \$11,435 per event.<sup>22</sup> That adjustment should reduce total taxable sales for the liability period from \$1,026,795 to \$880,495 (\$11,435 x 77) and audited unreported taxable sales for the liability period from \$901,420 to \$753,495 (\$880,495 – \$127,000).

Issue 2: Did respondent correctly impose the negligence penalty?

Generally, if any part of a liability for which a deficiency determination is made is due to negligence, respondent must add a penalty equal to 10 percent of the determined tax deficiency. (R&TC, § 6484.) 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

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<sup>21</sup> According to the audit workpapers, on January 31, 2023, appellant stated that it would request ticket sales data from Eventbrite, a third-part ticket retailer, to refute respondent's attendance assumptions, but there is no Eventbrite data in OTA's record.

<sup>22</sup> The calculation is (351 attendees x 3 drinks x \$9.72) + (6 seating areas x \$200) = \$11,435.16.

provide accurate records is evidence of negligence and may result in 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.) In summary, appellant was required to exercise that level of ordinary business care and prudence that one should expect from a businessperson who has clear, statutory record-keeping and tax-reporting obligations.

Appellant did not address any of its arguments to the negligence penalty. OTA broadly interprets appellant's arguments, outlined in the discussion of Issue 1, to oppose the negligence penalty on the following grounds:

- appellant was hampered in its record keeping and tax reporting efforts by the COVID-19 pandemic and the resulting restrictions on appellant's operations;
- appellant was hampered in its record keeping and tax reporting efforts by repossession of its POS system in 2021;
- the audit overstates unreported taxable sales, and actual unreported taxable sales were not such as warranted a negligence penalty; and
- the penalty should not have been applied to this first audit of appellant.

OTA understands that the COVID-19 pandemic was hard on businesses like NKC. Many did not survive the shutdown. Appellant did survive, at least for a time, reporting \$328,549 in income for 2022, the first full year of unrestricted operation following the pandemic. That income was just 8 percent below what NKC reported as income for 2019 (\$356,560), the last year of unrestricted operations before the pandemic. Regardless of how the pandemic affected appellant's ability to attract and serve customers, there is no evidence that it altered appellant's obligations or abilities to maintain and provide adequate records and accurately report taxable sales.

As already indicated above, OTA's record is devoid of evidence regarding the repossession of appellant's POS system. The evidence shows that respondent counted just eight special entertainment events in 2021: one in 1Q21; two in 3Q21; and five in 4Q21. There is a POS system report for 4Q21 in evidence, and appellant has not explained why the repossession of its POS system prevented it from maintaining adequate books and records and accurately reporting taxable sales during any other quarters in 2021.

OTA has already found that appellant failed to prove its entitlement to adjustments to the taxable measure. Appellant's argument to the contrary here fails for the same reasons discussed above.

While it is true that a negligence penalty generally should not be added to deficiency determinations made in the first audit of a taxpayer, it is not clear that appellant is entitled to the protection of this rule, and, in any event, the penalty can be imposed in a first audit if there is evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations.<sup>23</sup> (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) The evidence shows that appellant did not maintain and provide adequate books and records. Additionally, appellant's own records reveal underreported taxable sales of \$115,185 for 2019, \$50,641 for 2022, and \$23,953 for 2021, and audited unreported taxable sales that are much more than those amounts. For nine of the quarters at issue, appellant reported no taxable sales, and for six of those there were audited taxable sales from special entertainment events. Consequently, OTA finds that the evidence shows that appellant's recordkeeping and reporting errors cannot be attributed to the appellant's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. OTA therefore finds that respondent correctly imposed the negligence penalty.

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<sup>23</sup> This was appellant's first audit; but it was not the first audit of appellant's owner. Appellant's sole shareholder, doing business as Karibbean City, was audited. However, respondent did not argue this point or provide any relevant information regarding the Karibbean City audit. Therefore, this Opinion will not discuss it further.

HOLDINGS


1. Adjustments to the amount of unreported taxable sales are warranted.
2. Respondent correctly imposed the negligence penalty.


DISPOSITION

OTA directs respondent to adjust the amount of unreported taxable sales by reducing estimated taxable sales per event from \$13,335 per event to \$11,435, and recalculating total and unreported taxable sales and the negligence penalty accordingly. Respondent’s action denying appellant’s petition for redetermination is otherwise sustained.

DocuSigned by:  
  
 Michael F. Geary  
 Administrative Law Judge

We concur:

DocuSigned by:  
  
 Andrew Wong  
 Administrative Law Judge

Signed by:  
  
 Suzanne B. Brown  
 Administrative Law Judge

Date Issued: 8/22/2025