

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

| | | |
|---------------------------------|---|--------------------------|
| In the Matter of the Appeal of: |) | OTA Case No.: 240516257 |
| SW RETAIL GROUP, INC., |) | CDTFA Case ID: 4-555-789 |
| dba Sal's Food Mart |) | |
| |) | |
| |) | |

OPINION

Representing the Parties:

| | |
|-----------------|--|
| For Appellant: | Salah Alkobadi, Representative |
| For Respondent: | Jason Parker, Chief of Headquarters Ops. |

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, SW Retail Group, 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 Notice of Determination (NOD) issued on January 23, 2023. The NOD is for tax of \$92,951, plus applicable interest, for the period January 1, 2019, through December 31, 2021 (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, section 30209(a).

ISSUE

Whether adjustments are warranted to disallowed claimed exempt sales of food.

¹ The NOD was timely issued within the three-year statute of limitations for the period October 1, 2019, through December 31, 2021. (R&TC, §§ 6487(a).) It was also timely issued for the period January 1, 2019, through September 30, 2019, because on October 7, 2022, appellant signed the last in a series of timely and consecutive waivers of the otherwise applicable three-year statute of limitations, which allowed respondent until January 31, 2023, to issue an NOD for that period. (R&TC, § 6488.)

FACTUAL FINDINGS

1. Appellant operates a convenience store with a gas station in Dinuba, California, that sells beer, tobacco products, taxable and nontaxable food products, and miscellaneous taxable merchandise. Appellant also operates a restaurant on the premises that sells Mexican-style cuisine with seating for approximately 10 dine-in customers. Appellant also sold food to go.
2. Respondent initiated an audit for the period October 1, 2018, through September 30, 2021. Subsequently, respondent revised the audit to cover the period January 1, 2019, through December 31, 2021, due to the expiration of the statute of limitations for the last quarter of 2018.
3. Appellant reported total sales of \$10,462,163, claimed deductions totaling \$7,635,046 (comprised of nontaxable sales of food [\$1,505,086], sales tax included [\$427,819], and the motor vehicle fuel (MVF) tax exemption [\$5,702,141]), resulting in reported taxable sales of \$2,827,117 for the liability period. Appellant added sales tax reimbursement to the retail selling price of taxable items and the selling price of gasoline.
4. For audit, appellant provided federal income tax returns (FITRs) for 2019 and 2020, point of sale (POS) reports for the second quarter of 2020 (2Q20) through 4Q21, beer and gas vendor reports for the entire audit period, purchase invoices for September 2020, and sales invoices for October 2022.
5. Respondent considered these records insufficient for sales and use tax purposes. Therefore, respondent verified reported taxable sales through alternative means.
6. Respondent reviewed appellant's purchases reported on appellant's FITRs and determined total purchases of \$2,710,541 for 2019 and \$2,472,769 for 2020, with gas purchases of \$1,795,863 for 2019 and \$1,326,695 for 2020 as shown on gas vendor reports for those years. After subtracting gas purchases for each respective year, respondent computed total audited store purchases of \$914,678 for 2019 and \$1,146,074 for 2020; respondent considered these amounts to be reasonable for this type of business. Therefore, respondent accepted purchases as reported on the FITRs.
7. Respondent conducted a purchase segregation test based on the purchase invoices appellant provided for September 2020. Respondent computed a taxable purchase ratio of 91.76 percent and applied that ratio to audited store purchases to compute audited taxable purchases of \$839,336 for 2019 and \$1,051,672 for 2020. Respondent divided reported taxable sales of \$798,743 for 2019 and \$1,001,352 for 2020 by audited taxable

purchases to compute a markup factor of 0.952 for both years.² Respondent considered these markups to be unreasonable.

8. Respondent calculated the markup for nontaxable purchases by multiplying audited purchases by the nontaxable purchase ratio of 8.24 percent to compute audited nontaxable purchases of \$75,342 ($\$914,678 \times 0.08237 = \$75,342.03$) and \$94,402 ($\$1,146,074 \times 0.08237 = \$94,402.16$) respectively for 2019 and 2020. Respondent divided claimed nontaxable food sales reported on sales and use tax returns (SUTRs) (\$417,682 for 2019 and \$470,076 for 2020) by audited nontaxable purchases to compute a markup factor of 5.544 for 2019 ($\$417,682 \div \$75,342 = 5.5438$) and 4.980 for 2020 ($\$470,076 \div \$94,402 = 4.9795$), with a combined average markup factor of 5.230 ($\$887,761 \div \$169,744 = 5.2299$). Respondent considered this markup factor to be too high. Respondent did not accept the amount of claimed nontaxable sales of food as reported on appellant's SUTRs for the audit period.
9. Therefore, respondent used an alternate approach focusing on appellant's claimed nontaxable sales. Respondent performed a shelf test³ using purchase invoices and the selling prices of nontaxable items, which respondent verified via the store's sales registers for October 2022. Respondent computed an overall markup factor of 1.607 for nontaxable food items. After adjusting audited nontaxable purchases (i.e., \$75,342 and \$94,402 for 2019 and 2020, respectively) for an allowed 1 percent shrinkage, respondent applied the 1.607 markup factor to the audited nontaxable purchases of \$74,589 for 2019 and \$93,458 for 2020, resulting in audited nontaxable sales of \$119,865 ($\$74,589 \times 1.607 = \$119,864.53$) for 2019 and \$150,187 ($\$93,458 \times 1.607 = \$150,187.01$) for 2020. Respondent compared the amount of audited nontaxable sales of food products to claimed nontaxable sales of food products and found differences of \$297,817 and \$319,892 for 2019 and 2020, respectively. Respondent used these differences to compute a percentage of error⁴ of 71.30 percent ($\$297,817 \div \$417,682 = 0.71302$) for 2019, 68.05 percent ($\$319,892 \div \$470,079 = 0.68050$) for 2020, and an average percentage of error of 69.58 percent ($\$617,709 \div \$887,761 = 0.68580$) to be

² A mark up of less than 1.00 is a negative markup, meaning appellant reported that items were sold for less than cost.

³ A shelf test is an accounting comparison of known costs and associated selling prices, which is used to compute markups.

⁴ The percentage of error is the ratio of disallowed claimed nontaxable store sales to claimed or reported nontaxable store sales.

applied to taxable sales reported for 2021. After multiplying the percentages of error by claimed nontaxable sales for the respective quarters, respondent established \$1,047,247 in disallowed claimed nontaxable sales of food for the audit period.⁵

10. Respondent issued the NOD on January 23, 2023, which appellant timely petitioned. Subsequently, respondent issued its decision denying appellant's petition.
11. 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 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.*)

While appellant provided some source documents, it did not provide sufficient records to allow respondent to determine the accuracy of all reported amounts. Consequently, OTA finds that the records provided by appellant were not adequate for sales and use tax purposes. In the absence of reliable records, OTA finds the use of an indirect audit method to compute appellant's sales to be reasonable. In the absence of any other verifiable information,

⁵ Regarding the claimed deduction of \$427,819 for sales tax included, respondent reconciled amounts reported on appellant's SUTRs to amounts recorded in the POS reports and noted a slight credit difference of \$(875.00). Respondent also examined the claimed MVF tax exemption of \$5,702,141, which resulted in a credit of \$(100,010). In addition, there was a \$46,275 difference in taxable measure between gas sales as recorded in the POS reports and reported on SUTRs (without the payment of tax or tax reimbursement). Respondent's Audit Report letter dated January 20, 2023, shows the additional taxable measure is comprised of a single audit item: disallowed claimed food deduction with a measure of \$1,047,247.

respondent used the markup method coupled with the application of a percentage of error to verify the accuracy of appellant’s reported sales. The markup method is a standard and accepted audit procedure. (*Appeal of Amaya*, 2021-OTA-328P.) OTA has examined the audit workpapers and it appears that respondent correctly applied the chosen methodology to reasonably estimate appellant’s taxable sales. Hence, respondent has met its initial burden, and the burden now shifts to appellant to establish that adjustments to the audit liability are warranted.

Appellant asserts that respondent used the wrong markup percentage and that the nontaxable ratio is incorrect. Appellant contends that respondent should use additional months to compute the taxable to nontaxable ratio and that appellant “can provide all invoices.” In a letter dated February 26, 2025, OTA gave appellant the opportunity to provide the invoices as well as any additional information appellant had to support its position. Appellant failed to respond to OTA’s letter or to provide any additional information. Appellant has failed to provide evidence to support its contentions. Thus, there is no basis for any reductions.

HOLDING

Adjustments are not warranted to disallowed claimed exempt sales of food.

DISPOSITION

Respondent’s action denying the petition is sustained.

Signed by:
Natasha Ralston
25E8EE08EE56A78

Natasha Ralston
Administrative Law Judge

We concur:
DocuSigned by:
Michael F. Geary
1A9B52EE88AC4C7

Michael F. Geary
Administrative Law Judge

Signed by:
Josh Lambert
CB1E7DA37831416

Josh Lambert
Administrative Law Judge

Date Issued: 7/17/2025