

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
R. ALBAHU

) OTA Case No.: 240716793
) CDTFA Case ID: 4-857-720
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)
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OPINION

Representing the Parties:

For Appellant: R. Albahu
For Respondent: Nalan Samarawickrema, Hearing Rep.
Christopher Brooks, Attorney
Jason Parker, Chief of Headquarters Ops.
Interpreting: Mona Jaber, Arabic Interpreter

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, R. Albahu (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant’s timely petition for redetermination of a Notice of Determination (NOD) issued on April 28, 2023. The NOD is for tax of \$34,053, plus applicable interest, and a negligence penalty of \$3,405.35 for the period July 1, 2019, through June 30, 2022 (liability period).

Office of Tax Appeals (OTA) Panel Members Teresa A. Stanley, Amanda Vassigh, and Sheriene Anne Ridenour held an oral hearing for this matter in Sacramento, California on September 17, 2025. At the conclusion of the oral hearing, the record was closed and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, section 30209(b).

ISSUES

1. Whether adjustments to the disallowed claimed exempt sales are warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, operates a convenience store in San Francisco, California, selling taxable and nontaxable items such as ice cream, alcohol, cigarettes, lottery tickets, hot sandwiches, and other known convenience store amenities. The business also sells alcohol through Drizly, a marketplace facilitator.¹
2. Appellant's seller's permit was opened with an effective start date of March 15, 2019.
3. For the liability period, appellant reported total sales of \$3,888,409 and claimed deductions of \$2,879,861, which consisted of sales for resale of \$55,000, exempt sales of food products of \$2,326,026, sales tax reimbursement included in total sales of \$86,195, and "other" deductions of \$412,640 which represented Drizly sales, resulting in reported taxable sales of \$1,008,548. Appellant reported sales based on bank deposits; however, it is unknown how appellant calculated nontaxable and taxable sales.
4. In June 2002, the convenience store experienced flooding.
5. In August 2002, CDTFA notified appellant it would be conducting an audit for the liability period. Appellant provided federal income tax returns (FITRs) for 2020 and 2021; bank statements from October 1, 2019, through June 30, 2022; Drizly sales summaries from second quarter of 2020 (2Q20) through 3Q22; and the POS summaries from December 1, 2022, through February 28, 2023 (which is outside the liability period). CDTFA also obtained appellant's Form 1099-K information for the period 1Q19 through 4Q21.² Appellant did not provide documentation for the liability period to support claimed food deductions. This is appellant's first audit.
6. CDTFA compared the gross receipts reported on the FITRs to the total sales reported on the sales and use tax returns (SUTRs) and noted a credit difference of \$63,305 in 2020 and a debit difference of \$27,275 in 2021. Appellant did not provide an explanation regarding the differences found. CDTFA also calculated markups³ of 46.71 percent in

¹ R&TC sections 6040 through 6041.6 are part of what is known as the Marketplace Facilitator Act. R&TC section 6041(b) defines a marketplace facilitator. 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.)

² Form 1099-K, Payment Card and Third Party Network Transactions, is an IRS form that reports 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 records payments made by any electronic means, including, but not limited to, credit cards, debit cards, and third-party payment apps and networks.

- 2020 and 27.31 percent in 2021 based on reported sales without payment of tax or tax reimbursement (ex-tax) and the cost of goods sold from the FITRs.
7. Due to the lack of complete books and records, CDTFA was unable to segregate the cost of goods sold into taxable and exempt items; therefore, it was not possible to calculate the reported taxable markup. CDTFA also scheduled the bank deposits for the period October 1, 2019, through June 30, 2022, and no excess deposits were noted. However, CDTFA concluded the average reported taxable sales ratio of 26.53 percent seemed low for the types of items available for sale.⁴ Consequently, CDTFA determined further testing was necessary to verify the reported taxable sales ratio.
 8. Due to the incomplete books and records provided during the audit pertaining to the liability period, CDTFA chose to use an indirect audit method and used the December 2022, January 2023, and February 2023 POS summary reports. CDTFA determined that the sales tax collected, as noted in the reports, could not be used in place of a purchase segregation since the POS reports were not within the audit period. Furthermore, appellant did not provide source documentation to support the POS reports to ensure the sales tax recorded was accurate. Therefore, CDTFA segregated the product categories into taxable and exempt items and calculated nontaxable sales of 38.49492 percent and taxable sales of 61.51 percent, which was higher than the average reported taxable ratio of 26.53.⁵
 9. Based on the reported amounts, appellant claimed Drizly sales separately for the 4Q20 and 2Q22 periods, and included the Drizly sales in the claimed food deductions for the 2Q20, 3Q20, and 1Q21 through 1Q22 periods.⁶ Using the Drizly sales summaries, CDTFA calculated total Drizly sales of \$1,672,855 for the period 2Q20 through 2Q22.
 10. CDTFA then reduced the reported total sales of \$3,888,409 by the sales tax reimbursement included in total sales of \$86,195 and computed \$3,802,214 in reported

³ “Markup” is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer’s cost is \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is $\text{markup amount} \div \text{cost}$. In this example, the markup percentage is 42.86 percent ($0.30 \div 0.70 = 0.42857$).

⁴ During the liability period, reported taxable sales varied between 23.17 percent (for 2Q20) and 42.94 percent (for both 3Q19 and 4Q19).

⁵ Differences are due to rounding.

⁶ CDTFA allowed Drizly sales that were incorrectly claimed as food deductions, and notified appellant that going forward, Drizly sales need to be reported under marketplace facilitator.

total sales ex-tax. Then, since Drizly, as a marketplace facilitator, is responsible for collecting and paying the sales tax, CDTFA subtracted the \$1,672,855 in Drizly sales from the reported total sales ex-tax for the audit period of \$3,802,214, to establish the total ex-tax sales net of Drizly sales of \$2,129,359 for the audit period. CDTFA then applied the nontaxable sales ratio of 38.492 percent to the sales (ex-tax, net of Drizly) of \$2,129,359 to compute audited exempt sales allowed of \$819,638.

11. CDTFA compared the reported exempt sales (excluding Drizly) of \$1,207,006 to the audited exempt sales allowed of \$819,638 to compute a difference of \$387,368. CDTFA noted a credit difference of \$12,216 for the period 2Q22; however, due to lack of supporting documentation CDTFA did not allow the credit and the sales were accepted as reported for the quarter. Thus, the disallowed credit of \$12,216 was added back to establish the disallowed claimed exempt sales of \$399,584 for the audit period. Based on the lack of records, including source documentation, to support the claimed deductions, CDTFA determined the understatement of \$399,584 was due to negligence and added a 10-percent negligence penalty to the liability.
12. CDTFA offered to conduct an on-site observation known as a shelf-test⁷ and to perform a purchase segregation to reexamine the taxable and nontaxable ratios for one quarter during and another quarter after COVID-19, to take an average of the two quarters to determine if the taxable sales are reported correctly. However, appellant did not allow CDTFA to conduct a shelf test and did not provide CDTFA with purchase invoices for the purchase segregations.
13. On April 28, 2023, CDTFA issued appellant the aforementioned NOD, and appellant timely filed a petition for redetermination disputing the NOD.
14. On June 24, 2024, CDTFA issued a decision denying appellant's petition for redetermination.
15. Appellant timely appealed to OTA.
16. During the appeal, CDTFA discovered that the calculation for claimed exempt sales incorrectly included sales tax reimbursement. Therefore, CDTFA conducted a reaudit to exclude the sales tax reimbursement, which resulted in reduction of the disallowed claimed exempt sales for liability period by \$76,424, from \$399,584 to \$323,160. As a result, the tax at issue was reduced by \$6,523, from \$34,053 to \$27,530, with

⁷ A shelf test is a comparison of known costs and selling prices and is used in audit to calculate the markup of specific items or classes of items.

corresponding reductions to applicable interest, and the negligence penalty was reduced from \$3,405.35 to \$2,752.96.

DISCUSSION

Issue 1: Whether adjustments to the disallowed claimed exempt sales are 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.) All of a retailer's gross receipts are presumed subject to tax unless the retailer can prove otherwise. (R&TC, § 6091.) Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot prepared food are subject to sales tax. (R&TC, § 6359(a), (d)(7), (e); Cal. Code Regs., tit. 18, § 1603(a)(2)(A), (e)(1).) 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.*)

Appellant generally bears the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) To satisfy its burden of proof, a taxpayer must prove both that the tax assessment is incorrect and what the proper amount of tax should be. (*Ibid.*)

Statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 765, 769.) The taxpayer bears the burden of showing that its sales qualify for the

exemptions. (*Ibid.*; *Appeal of Snowflake Factory LLC*, 2020-OTA-270P.) Any doubt must be resolved against the right to an exemption. (*Associated Beverage Co. v. State Bd. of Equalization* (1990) 224 Cal.App.3d 192, 211.)

Generally, CDTFA prefers to determine the accuracy of reported amounts using a direct audit methodology.⁸ However, CDTFA is authorized to determine a liability on the basis of any information in its possession (R&TC, § 6481; *Appeal of Amaya*, 2021-OTA-328P); and if a taxpayer's records are insufficient for a direct audit methodology (or if the provided records are deemed unreliable), it becomes necessary for CDTFA to compute the taxpayer's sales using an indirect audit methodology. (R&TC, § 6481, *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.)

Here, appellant failed to provide complete records for the liability period and failed to provide source documentation to support the reported sales and claimed deductions. Based on a lack of documentation provided for the liability period, OTA finds CDTFA choosing to employ an alternative, indirect audit methodology was appropriate. Further, CDTFA offered to conduct an on-site observation known as a shelf-test, which appellant declined. Based on the foregoing, 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.

Appellant contends that the audit liability is overstated for many reasons. Specifically, appellant contends that the audit failed to consider "certain legitimate deductions and credits to which [appellant is] entitled [to] under the tax laws" and that during COVID-19 appellant purportedly sold mostly nontaxable grocery items. Appellant also contends that the audit failed to properly apply marketplace facilitator law, and that the POS summaries CDTFA used were outside the liability period causing an "inflated and unrealistic estimate of [appellant's] taxable sales." Additionally, appellant asserts that when an undercover auditor visited the store in September 2022 to do an undercover sandwich purchase, the auditor asked appellant if the sandwiches were hot and that appellant, "as the owner, told [the auditor] the truth, that [the]

⁸ A direct audit method is one that enables CDTFA to determine taxable sales directly from business records, and generally without estimates or extrapolation, such as by simple tabulation of taxable sales evidenced by sales invoices or cash register tapes. A direct audit methodology based on complete and accurate business records is generally the most accurate.

sandwiches were cold.”⁹ Appellant also asserts that the flood in June 2022 destroyed appellant’s POS system and records, and damaged appellant’s inventory, shelves, and other parts of the store.

Regarding appellant’s contentions that the audit failed to consider deductions and credits to which appellant is entitled, the retailer bears the burden of establishing its entitlement to any claimed deduction or exemption. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443.) Appellant has not specified which deductions and credits the audit allegedly failed to consider; moreover, appellant has provided no documentation substantiating entitlement to any claimed deduction, exemption, or credit that the “audit failed to consider.” While appellant also contends that the audit failed to properly apply marketplace facilitator law, OTA notes that CDTFA allowed Drizly sales that were incorrectly claimed as food deductions. Furthermore, CDTFA correctly subtracted the \$1,672,855 in Drizly sales from the reported total sales ex-tax since Drizly, as a marketplace facilitator, is responsible for collecting and paying the sales tax. Appellant has not indicated how the audit purportedly failed to properly apply marketplace facilitator law, and OTA finds CDTFA’s audit of Drizly sales is aligned with the law.

Concerning appellant’s contention that the audit did not consider that during COVID-19 appellant purportedly sold mostly nontaxable grocery items, appellant has provided no source documentation substantiating the items appellant sold during the liability period. Appellant provides photos of inside the store, which appellant contends he posted online in 2020 to show the neighborhood that the store had bread, milk, and essential items. The photos are individually hand-labeled indicating that a photo is of: the deli during COVID-19; the shelves during COVID-19; a middle shelf; the right shelf in the store; the cooler doors of the deli; and the ice cream section and dairy products. However, appellant does not provide screenshots of the

⁹ Sales of food products are considered taxable sales of hot food items when a taxpayer’s premises include microwave ovens if (1) the food is of the type which is normally consumed at above room temperature and (2) the microwave ovens are accessible only to the vendor. (Business Taxes Law Guide annotation 550.1753 (1/23/78).) An annotation is a summary of a legal ruling by or opinion of CDTFA’s legal department. Annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) Nevertheless, OTA may consider and afford some weight to an annotation. (See, e.g., *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.)

It appears to OTA that appellant is referring to when an undercover auditor purchased a sandwich at the store in September 2022, and when the auditor asked appellant if the sandwiches were hot, appellant informed the auditor they were cold but that he could make them hot, showing the auditor his microwave and conventional oven. It is unclear if the sandwich the auditor bought is the type which is normally consumed at above room temperature or if the auditor opted for appellant to warm the sandwich; nevertheless, the \$10.99 sandwich rang up as \$11.08 after tax, thus the sandwich sale was subject to tax.

photos from the online site he asserts he posted the pictures onto, which could possibly substantiate the date of the photos.¹⁰ OTA finds piecemeal photos, especially undated photos, of the store do not substantiate appellant's contention that during COVID-19 appellant sold mostly nontaxable grocery items.

As for appellant's contention that the flood in June 2022 destroyed appellant's POS system and records, and damaged appellant's inventory, shelves, and other parts of the store, appellant has provided no documentation that the store was not operational at any point during the liability period, such that it would impact sales. Appellant also has not provided documentation, such as an insurance claim, substantiating the extent and impact of the flood. Appellant contends that the POS summaries CDTFA used were outside the liability period, thus causing an "inflated and unrealistic estimate of [appellant's] taxable sales." However, as discussed above, OTA finds CDTFA's use of an alternative, indirect audit methodology appropriate due to appellant failing to provide complete records for the liability period. Moreover, while appellant contends that the audit is "inflated and unrealistic," appellant has not established by documentation or other evidence what the proper amount of tax should be. (*Appeal of AMG Care Collective, supra.*)

Appellant bears the burden of showing that the sales qualify for the exemptions. (*Appeal of Snowflake Factory LLC, supra.*) Appellant has not supported his assertions with evidence or documentation. Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (See *Appeal of AMG Care Collective, supra.*) Accordingly, OTA finds that appellant has not carried his burden of proof and concludes that adjustments to the disallowed claimed exempt sales are not warranted.

Issue 2: Whether appellant was negligent.

R&TC section 6484 provides if any part of the 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. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal.App.4th 434, 447.)

¹⁰ None of the photos are month/day/year date stamped by the camera. While one photo is dated, it is only dated "August 6" without the year.

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to: (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 of 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 complete and accurate records will be considered evidence of negligence or intent to evade the tax. (Cal. Code Regs., tit. 18, § 1698(k).)

In analyzing the issue of negligence, OTA must consider whether the taxpayer has been previously audited. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Generally, a negligence penalty should not be added when the taxpayer has not been previously audited, but there are circumstances where a penalty in a first audit would be appropriate. (*Ibid.*) For instance, a negligence penalty should be upheld in a first audit if the taxpayer's bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A); see *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

Here, appellant did not provide for audit source documentation to support the reported amounts and claimed deductions. As such, CDTFA had to use an indirect audit method to determine sales. The audit disclosed disallowed claimed exempt sales of \$323,160 which, when compared to reported taxable sales of \$1,008,548, results in an error rate of approximately 32 percent. OTA finds that such an error rate is indicative of negligence. Although a negligence penalty is not generally recommended for a first audit, the penalty is appropriate when the inadequacy of a taxpayer's records and reporting cannot be attributed to the taxpayer's good faith and reasonable belief the records were in substantial compliance with legal requirements. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Appellant contends that the POS system and supporting documentation were damaged in the flood. While appellant provides three pictures, which appellant asserts are pictures of the store and POS system damaged, the photos are not date stamped by the camera.¹¹ In addition,

¹¹ The descriptions with the photos indicate the date "July 2022".

the pictures do not indicate how, if at all, supporting documentation was destroyed in the flood, as the flood damage appears to be isolated to a certain area of the store. Moreover, appellant has not provided insurance paperwork for the flood damage, which would explain in more detail the extent of the damage and what damage, if any, was done to the POS system or documents. Also, even if the POS system was damaged due to flooding, appellant failed to back up the POS information. OTA finds such a failure is also indicative of negligence.


In light of the above, OTA finds that appellant has not established that the understatement can be attributed to a good faith and reasonable belief his bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. Accordingly, OTA finds appellant was negligent, and the negligence penalty was properly imposed.

HOLDINGS

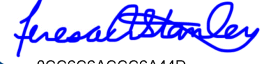
1. Adjustments to the disallowed claimed exempt sales are not warranted.
2. Appellant was negligent, and the negligence penalty was properly imposed.

DISPOSITION

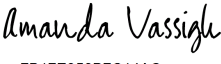
The disallowed claimed exempt sales shall be reduced to \$323,160 and the negligence penalty shall be reduced to \$2,752.96, as conceded by CDTFA. Otherwise, CDTFA's action is sustained.

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 Sheriene Anne Ridenour
 Administrative Law Judge

We concur:
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 Teresa A. Stanley
 Administrative Law Judge

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 Amanda Vassigh
 Administrative Law Judge

Date Issued: 12/17/2025