OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **D. FAWZY,** **dba PepperForever2004 and Henry's Catering**	)	OTA Case No. 230813958 CDTFA Case IDs: 2-898-702, 3-223-119

OPINION

Representing the Parties:

For Appellant: Josefino Bote, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

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

G.TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, D. Fawzy, doing business as (dba) PepperForever2004 and Henry's Catering, (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] partially denying appellant's timely petitions for redetermination of two Notices of Determination (NODs).[2] The first NOD dated June 10, 2021, is for tax of $56,131, and interest, for the period July 1, 2017, through June 30, 2020 (later liability period). The second NOD dated October 26, 2021, is for tax of $57,839, and interest, for the period July 1, 2013, through June 30, 2016 (earlier liability period).

CDTFA prepared a reaudit of the later liability period that reduced the determined measure of unreported taxable sales by $144,284, from $724,279 to $579,995, which will result

[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] The NODs were timely issued because on June 10, 2021, CDTFA issued an NOD for the later liability period which was within the applicable three-year statute of limitations for the period July 1, 2017, through June 30, 2020. (R&TC, § 6487(b).) On October 26, 2021, CDTFA issued an NOD for the earlier liability period which was within the applicable eight-year statute of limitations for the period of July 1, 2013, through June 30, 2016, as appellant did not hold a valid permit and therefore, did not file sales and use tax returns for the earlier liability period. (R&TC, § 6487(b).)

in a $11,181 reduction to the tax for the first NOD (from $56,131 to $44,949) and corresponding reductions to the applicable interest.

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).

ISSUE

Whether additional adjustments to the amount of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a sole proprietor, dba Pepperforever2004 and/or Henry's Catering,[3] operated a food preparation and delivery business from her home in Fontana, California. Appellant also sold wine on eBay.
2. Appellant applied for and obtained a seller's permit with a start date of July 1, 2016, for sales of wine products. For the periods at issue, appellant filed sales and use tax returns (SUTRs) on a fiscal year reporting basis.[4]
3. Appellant was selected for a routine sales and use tax audit covering the period of July 1, 2017, through June 30, 2020, the later liability period. In response to a records request appellant provided the following records: federal income tax returns (FITRs) for 2017, 2018 and 2019; sales invoices for the period covering February 11, 2021, through March 19, 2021 (after the later liability period); a "Henry's Catering" menu; bank statements covering the periods of fiscal year 2017/2018 (FY 17/18) and FY 19/20; and eBay sales records covering FY 17/18 and FY 19/20. CDTFA obtained Form 1099-K[5] data for the later liability period from an internal database.

[3] CDTFA researched appellant online during the initial audit and found a matching business on ezcater.com under the dba "Henry's Catering," which matched the payee name on appellant's Form 1099-K data. CDTFA confirmed this information with appellant's representative, that Henry's Catering is the same business as Pepperforever2004. Appellant is not a caterer, as the term is defined in Regulation section 1603(i), as appellant did not serve the food and instead generally had the food delivered by a third party.

[4] Appellant's fiscal year began on July 1 and ended on June 30 of the following calendar year.

[5] Form 1099-K is a return filed with the Internal Revenue Service by payment settlement entities (e.g., credit and debit card processing companies and PayPal) to report payments provided to taxpayers such as appellant; this information is available to CDTFA internally.

4. Appellant reported on the SUTRs total sales of $3,683 and claimed nontaxable sales in interstate and foreign commerce of $295, resulting in reported taxable sales of $3,388 for the later liability period.
5. CDTFA compared total sales reported on SUTRs for calendar years 2017, 2018, and 2019[6] to the corresponding gross receipts reported on the FITRs. Gross receipts exceeded total sales by $242,155 for 2017, $291,723 for 2018, $194,719 for 2019, and $728,597 for the three years combined. Appellant explained that the differences related to non-taxable food sales included in gross receipts reported on the FITRs but excluded from total sales reported on the SUTRs.
6. CDTFA scheduled available sales invoices provided by appellant, which covered the period of February 11, 2021, through March 19, 2021. CDTFA reviewed these invoices and noted that only one invoice in the test period regarded food it deemed of a type served in a cold state. CDTFA calculated a taxable sales percentage of 95.66 percent.
7. CDTFA scheduled and reviewed Form 1099-K data for years 2017, 2018, and 2019, which totaled $713,298 in credit card sales.
8. CDTFA used the Form 1099-K data for periods 3Q17 through 4Q19 and then added credit card sales per bank statements for 1Q20 and 2Q20 to arrive at total audited credit card sales of $641,653 for the later liability period.
9. CDTFA calculated book markups[7] and found them to be reasonable for the industry, but since cost of goods sold could not be verified, CDTFA did not pursue further markup analysis. Therefore, CDTFA continued with an alternative methodology of credit card sales ratio application. Based on the bank statements scheduled covering the later liability period, CDTFA calculated a credit card sales ratio of 92.81 percent for FY 17/18, 82.81 percent for FY 18/19, 75.71 percent for FY 19/20, and an overall ratio of 84.42 percent.

[6] CDTFA calculated the average quarterly total reported sales from the FY SUTRs, which were used to compute total reported sales for each calendar year.

[7] 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 markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (0.30 ÷ 1.00 = 0.30).

10. CDTFA then applied these calculated ratios from the bank statements to the total audited credit card sales for each of the FYs to arrive at total audited sales per credit card sales ratio for each of the FYs: $270,602 for 17/18, $284,943 for 18/19, and $204,129 for 19/20, for a total of $759,674.
11. CDTFA applied the audited percentage of taxable sales calculated of 95.66 percent to the total audited sales per credit card sales ratio to arrive at audited taxable sales per credit card sales ratio of $258,858 for FY17/18, $272,576 for FY 18/19, and $195,270 for FY 19/20, for a total of $726,704. CDTFA then compared this amount to reported taxable sales of $3,388 to arrive at $723,316 of unreported taxable sales per credit card sales ratio for the later liability period.
12. CDTFA further reviewed the audited taxable sales from eBay and deemed appellant's reporting of eBay sales as reliable and no further testing was warranted as the total sales were minimal. This item is not disputed, and therefore, OTA does not discuss this item further.
13. CDTFA combined audited taxable eBay sales of $963 and the unreported taxable sales per credit card sales ratio of $723,316 to arrive at the total unreported taxable sales of $724,279 for the later liability period.
14. CDTFA issued a timely NOD to appellant dated June 10, 2021, for the later liability period, with a tax liability of $56,131, plus applicable interest.
15. Appellant filed a timely petition for redetermination on June 18, 2021, disputing the NOD issued for the later liability period.
16. Upon appeal, appellant provided additional sales invoices that supported a reduction in the percentage of taxable sales. Appellant discussed the audit with the CDTFA audit supervisor who ordered changes to the audit to reduce the percentage of taxable sales based on the new sales invoices submitted and to allow a reduction for nontaxable delivery charges. These changes were completed but have not yet been billed by CDTFA.
17. Based on the new sales invoices provided, CDTFA recalculated the audited taxable food sales percentage and reduced it from 95.66 percent to 78.73 percent. This reduced the audited taxable sales by $128,613. The nontaxable delivery charges deduction allowance reduced audited taxable sales by $15,670. In total, the changes ordered reduced the original audited taxable food sales by $144,283, bringing the unreported taxable food sales in the reaudit to $579,033 for the later liability period.

18. CDTFA held a consolidated appeals conference for both liability periods on January 12, 2023, and subsequently issued a Decision that ordered adjustments to the later liability period in accordance with its September 28, 2021 reaudit. CDTFA otherwise denied the petitions with no further adjustments warranted.
19. During the appeal of the later liability period, CDTFA discovered that appellant made sales of food items prior to obtaining her seller's permit. Further review disclosed that appellant had Form 1099-K statements for credit card sales as far back as 2011 for the catering business.
20. Based on this information, CDTFA revised appellant's seller's permit start date to July 1, 2013. During the audit, appellant filed late SUTRs for the earlier periods of July 1, 2013, through June 30, 2016 (FY14/15, FY15/16, and FY16/17). CDTFA then created an audit covering the earlier liability period. CDTFA requested books and records for the earlier liability period; however, none were provided. CDTFA obtained credit card sales information through CDTFA's internal database for the basis of the audit of the earlier liability period.
21. Appellant explained to CDTFA during the initial audit that all sales made were for cold food items only and no hot food items were sold, and therefore, no sales tax was collected. Appellant stated that all food was cooked, prepared, and stored in appellant's refrigerator to be cooled or frozen overnight, and then packaged in bulk for delivery to appellant's customers using insulated boxes. Appellant further asserted that appellant only delivered, by way of third party, the food to the customers and never served it. Appellant stated that her customers were pharmaceutical sales representatives who purchased the food to host lunch or dinner parties at medical facilities (e.g., hospitals and doctor's offices) for nurses and other staff, for marketing purposes. Appellant further explained that all sales were nontaxable, and appellant did not keep any records of the sales.
22. Due to lack of records for this earlier period, CDTFA used the same audit methodology and percentages computed in the reaudit of the later liability period.
23. CDTFA scheduled Form 1099-K data covering the earlier liability period, in the amount of $796,099. CDTFA then applied the credit card sales ratio from the later liability period of 84.42 percent to compute the audited total sales per credit card sales ratio (delivery included) to arrive at $943,022.

24. CDTFA took the audited total sales per credit card sales ratio (delivery included) and applied the percent of taxable sales ratio of 78.73 percent, computed from the later liability period, to arrive at $742,441 audited taxable sales (delivery included).
25. CDTFA adjusted for nontaxable delivery charges by applying 2.62 percent computed from the later liability period to $742,441 to arrive at a nontaxable delivery charges allowance of $19,452. CDTFA subtracted $19,452 from $742,441 to arrive at total audited taxable sales of $722,989 for the earlier liability period.
26. CDTFA issued a timely NOD to appellant dated October 26, 2021, for the earlier liability period, with a tax liability of $57,893, plus applicable interest.
27. Appellant filed a timely petition for redetermination on November 2, 2021, disputing the NOD issued for the earlier liability period.
28. As noted previously, CDTFA held a consolidated appeals conference with appellant, and subsequently issued a Decision on June 26, 2023. CDTFA ordered changes to the later liability period in accordance with the reaudit dated September 28, 2021, but otherwise denied the petitions.
29. Appellant timely appealed to OTA disputing both liability periods and their respective proposed tax liabilities.
30. On appeal, OTA requested additional briefing from appellant on the issue of appellant's alleged sales of cold food only, and from CDTFA regarding the exclusion of certain invoices and the treatment of gratuities in the estimate of gross receipts. Appellant supplied OTA with letters from two clients each declaring that their purchases of food from appellant were in a cold state and required reheating by them prior to serving.

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).)

Taxpayers are required to maintain and make available for examination on request by CDTFA, or its authorized representative, 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 SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (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 the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) 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.) 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.) The taxpayer bears the burden of showing that its sales qualify for the exemptions. (*Appeal of Snowflake Factory LLC*, 2020-OTA-270P.)

Food products for human consumption are exempt from sales and use tax. (R&TC § 6359.) The exemption does not apply, however, when food is "sold as hot prepared food products." (R&TC § 6359(d)(7).) "Hot prepared food products" means those products, items, or components "which have been prepared for sale in a heated condition and are sold at any temperature which is higher than the air temperature of the room or place where they are sold." (Cal. Code Regs., tit. 18, § 1603(e)(1).) If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs (e.g., a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, even though it may have cooled due to delay). (*Ibid*.) On the other hand, the sale of a toasted sandwich not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product. (*Ibid*.) When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which

includes cold components or side items, tax applies to the entire established price, regardless of itemization on the sales check. (*Ibid*.)

Here, appellant's books and records provided for the later liability period were inadequate for sales and use tax audit purposes; CDTFA was unable to verify sales appellant reported on her SUTRs for the liability period using a direct audit method (that is, compiling audited sales directly from appellant's records). Appellant failed to provide complete sales invoices, purchase invoices, and profit and loss statements for the audited periods. Therefore, CDTFA had to rely on an indirect audit methodology (e.g., the credit card sales ratio method). For the earlier liability period, appellant did not provide any books and records. CDTFA's preliminary analysis in the later liability period found large unsupported differences between reported taxable sales and reported gross receipts. CDTFA did note that the book markups computed were reasonable; however, purchases could not be verified, and therefore, the markup method was not pursued. For each audit, CDTFA used the credit card sales ratio method as the basis for its computations. The credit card sales ratio method is a standard audit procedure that is effective in establishing taxable sales because it relies on readily verifiable third party information: the amount of credit card receipts. (See *Appeal of Amaya*, 2021-OTA-328P.) Under these circumstances, OTA finds that it was reasonable for CDTFA to question appellant's reported sales and rationally designed a methodology for estimating appellant's total sales. CDTFA used the best available information and proceeded with the credit card sales ratio method as the basis for its determinations, which is a recognized and accepted accounting procedure.

Gross receipts, however, are not the central issue here, but rather their taxability, which is presumed unless the retailer can prove otherwise. (R&TC, § 6091.) During the audit, CDTFA determined that appellant's provided food items were "sold as hot prepared food items" based on a conclusion that (a) the nature of the food items being offered were of a type "typically delivered hot," and (b) the price charged was unlikely for cold food. For example, CDTFA determined that meat lasagna, shrimp scampi, stuffed chicken, chicken piccata, seabass fillet, and shish kebab, are "typically delivered hot when part of a catered meal." Consequent to that determination, invoiced items of a type CDTFA concluded were "typically delivered hot when part of a catered meal" were scheduled as taxable. Because hot and cold items sold together are treated as wholly taxable, invoices including items deemed "typically served hot" were treated as wholly taxable. Examining invoices in this way, CDTFA produced a taxability ratio of

78.73 percent (78.73 percent of appellant's sales were deemed sales of "hot prepared food items" and subject to tax).[8]

Appellant argued during CDFTA's internal appeals process, as she does here, that *all* food items were sold and delivered in a cold/frozen condition as customers needed the food in that condition (due to the nature of the presentations by client pharmaceutical companies to attract attendance by medical staff with varying lunch schedules). Appellant brought to the CDTFA appeals conference samples of her catered food items (including items that would be served hot, but which she asserted were intended to be sold and delivered cold and later re-heated by the customer) packaged in large foil trays and stored in an insulated box as an examples of how her food items were delivered during the liability periods. Appellant also supplied an undated menu which included the statement "FRESH FROZEN/COLD FOOD MENU" at the top. Upon request for additional information, appellant provided OTA two letters from clients representing "two of the biggest and longtime clients" of appellant. Each letter indicated their food items were delivered cold and required reheating by them prior to being served.

CDTFA argues that it is "hard to believe that cold/frozen meals would be delivered to nurses to defrost or reheat such meals in the appliances typically available to staff in a workplace, such as a microwave." CDTFA found appellant "has not presented any persuasive evidence from the liability periods to establish that the food items she sold that are typically delivered hot as part of a catered meal . . . were actually delivered cold or frozen." In addition, CDTFA found delivery in tin pans was not determinative, as hot foods are delivered in similar containers, and also that appellant lacked accompanying evidence like declarations from customers, photographs of delivered items, invoices specifying cold status upon delivery, or such capital expenditures as large freezers and refrigerators.

While culinary convention might dictate that meat lasagna, as an example, be *served* hot, the bridge to such food *types* being presumed *sold as hot prepared food* is conjecture. By CDTFA's own admission, appellant is not a caterer serving food. (See Cal. Code Regs., tit. 18, § 1603(i)(1).) Certainly, it can be generalized that meat lasagna, as an example, is typically *served* hot. But R&TC section 6359(d)(7) only treats as taxable food products "when . . . *sold as hot* prepared food" and there is no reason to presume that meat lasagna was sold as hot simply because it is typically served hot. Grocers and other food retailers routinely sell frozen meat lasagna.

[8] CDTFA's initial audit scheduled a taxability ration of 95.66 percent, but was later reduced on reaudit to 78.73 percent after appellant supplied additional records.

Nevertheless, overcoming the presumption of taxability requires appellant present evidence that, based upon all the facts and circumstances, shows it is more likely than not that appellant's food items were *not* sold as hot prepared food. The record is short on such details. While conceivable that the purchasers (here mostly alleged to be pharmaceutical sales representatives serving medical staff at hospitals) and their facilities were capable of handling meals delivered cold but served hot, such a conclusion is neither inescapable based on the circumstances presented here nor supported by the evidence presented. Appellant must overcome the presumption of taxability by more than assertion. (*Appeal of Talavera, supra*.) If the prepared food items typically served hot were sold and delivered cold, it would be reasonable to expect evidence of instructions given to the purchaser for proper re-heating. Additionally, it would be reasonable to expect some evidence that purchasers were aware, whether through advertising, invoices, or other communications, that items typically served hot were sold in a cold state intended for the purchaser to reheat. Appellant's supplied menu standing alone is insufficient as it cannot be tied to the audit period or established as having been supplied to customers. Similarly, while appellant supplied letters from at least two customers attesting to the delivery of items for reheating, the record is lacking in establishing those customers represented a significant portion of appellant's sales. Additionally, the letters fail to supply sufficient details regarding the circumstances of the delivery, preparation, and servicing cold food to be re-heated. Given the reasonable questions raised concerning how cold food delivered to pharmaceutical sales representatives at a hospital might be received, re-heated, and served by them, something more than the assertion of purchasing the food and reheating it would be necessary in order that they might serve as a credible representation for *all* of appellant's sales. One does not have to presume an item typically served hot was also sold as hot prepared food. Nevertheless, if appellant sold food cold intended for heating to be served hot, there should be documentary evidence indicating customers knew this and were prepared to manage the transition of the food from cold delivery to service in a hot state for consumption. That record is lacking here.

In summary, OTA finds that CDTFA computed audited gross receipts based on the best-available evidence and used the credit card sales ratio method as the basis for both liability periods appropriately, which is a reasonable and rational method. Appellant has not identified any errors in CDTFA's computation of audited gross receipts. In the absence of sufficient evidence to overcome the presumption of taxability, appellant has failed to carry her burden of proof, and OTA has insufficient grounds to reverse CDTFA's determination.

HOLDING

No additional adjustments to the amount of unreported taxable sales are warranted.

DISPOSITION

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

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

We concur:

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Sheila Pacheco
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For

Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Steven Kim
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Steven Kim
Administrative Law Judge

Date Issued: 12/10/2025