OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. HOQUE,** **dba ORANGE OLIVE MINI MARKET**	)	OTA Case No.: 240415993 CDTFA Case ID: 4-420-315

OPINION

Representing the Parties:

For Appellant: Bisrat Worku, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, M. Hoque dba Orange Olive Mini Market (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination (petition) of a Notice of Determination (NOD) issued on December 12, 2022. The NOD is for tax of $53,206, plus applicable interest, and a penalty of $5,320.63 for the period July 1, 2018, through June 30, 2021 (liability period).[1]

In preparation for this appeal, CDTFA prepared a reaudit dated April 21, 2025, which decreased the excess sales tax collected by $692, from $8,070 to $7,378, decreased the unreported taxable sales by $69,335, from $582,418 to $513,083,[2] resulting in a decrease of tax of $6,059, from $53,206 to $47,147, reduced the penalty by $606.63, from $5,320.63 to $4,714, and also reduced applicable interest.

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

[1] The NOD was timely issued because on July 1, 2022, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period July 1, 2018, through December 31, 2019, which allowed respondent until January 31, 2023, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

[2] There is a $1 immaterial difference between the audit work papers and the Final Reaudit Results letter which is due to rounding.

ISSUES

1. Whether further adjustments are warranted to the audit liability.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated a mini market selling taxable non-food items, both taxable and nontaxable food items, alcoholic beverages, and lottery tickets in Orange, California.
2. During the liability period, appellant reported total sales of $333,971 on its sales and use tax returns (SUTRs) and claimed a deduction for nontaxable food products of $109,305, resulting in reported taxable sales of $224,666.
3. Upon audit, appellant provided the following limited records: federal income tax returns (FITRs) for 2018, 2019, and 2020; sales receipts for July 2021; and bank statements for July 2018, through March 2021. CDTFA, through an inter-agency agreement, had access to IRS Form 1099-K (1099-K) data which shows electronic payments made to appellant.[3]
4. CDTFA compared gross receipts reported on appellant's FITRs for 2018, 2019, and 2020, with gross sales (excluding tax) reported on appellant's SUTRs and found differences of $88,519, $31,449, and $52,656, respectively.[4] CDTFA then determined the quarterly amounts for each year since the liability period began with the third quarter of 2018 (3Q18).
5. CDTFA calculated appellant's book markups for 2018, 2019, and 2020 of 67.60 percent, 66.45 percent, 77.64 percent, respectively, and an overall markup of 70.25 percent using FITRs. CDTFA then calculated appellant's markups for 2018, 2019, and 2020 of -3.59 percent, 30.56 percent, 18.88 percent, respectively, and an overall markup of 13.01 percent using reported total sales on the SUTRs. CDTFA also calculated appellant's taxable sales markups for 2018, 2019, and 2020 of -17.11 percent,

[3] Form 1099-K is an IRS Form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant (here, appellant) by a bank, credit card company, or third party network, during a given time period. Form 1099-K includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

[4] CDTFA included total sales reported on appellant's first quarter 2018 (1Q18) and 2Q18 SUTRs in order to make a comparison between reported total sales and the FITR for 2018, since 1Q18 and 2Q18 are not part of the liability period. The amount of 2018 in the liability period is calculated as follows: $88,519 ÷ 4 quarters = $22,130 per quarter × 2 quarters = $44,260.

9.0 percent, -2.31 percent, respectively, and an overall markup of -5.11 percent using taxable sales reported on the SUTRs.[5]

6. CDTFA compared 1099-K receipts of $459,275 for the liability period with gross receipts of $333,971 reported on the SUTRs and found that 1099-K receipts were higher than gross receipts by $125,304. CDTFA found that the difference was indicative that not all cash and electronic payments were included in the total sales reported on the SUTRs for the liability period.

7. CDTFA could not calculate the taxable sales ratio based on the limited books and records, so CDTFA looked at three similar businesses to calculate a taxable sales ratio of 80.49 percent.[6] CDTFA applied this taxable sales ratio to the unreported gross sales found on the FITRs to arrive at unreported taxable sales per FITRs of $103,320.

8. CDTFA analyzed appellant's bank statements for July 2018, through March 2021, and classified the deposits as either taxable or nontaxable. CDTFA did not find evidence of lottery sales being included in the bank statements provided by appellant. CDTFA found that for 2019 and 2020 the lottery sales exceeded bank deposits by $123,521 ($450,190 - $326,669) and $116,427 ($430,502 - $314,075), respectively. CDTFA concluded that appellant must have had a separate bank account for his lottery sales.

9. CDTFA determined that appellant's bank deposits from taxable sales totaled $920,725, including food delivery service deposits of $3,646.[7] Since the deposits were net of commissions, CDTFA added back commissions at the rate of 15 percent for Postmates and Grubhub and 30 percent for Uber Eats and then removed tax included in the deposits. CDTFA calculated audited third-party food delivery sales of $8,889 for the

[5] "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 $7 and it charges customers $10, the markup is $3. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (3 ÷ 7 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. When a markup calculation is based on actual purchase costs and sales prices, a negative book markup indicates that the retailer sold goods at a loss (i.e., less than the retailer's cost).

[6] The three similar businesses had the following markups and taxable ratios: (1) 29.10 percent markup and 88.06 percent taxable ratio; (2) 35.57 percent markup and 64.19 taxable sales ratio; and (3) 35.47 percent markup and 89.22 percent taxable sales ratio. The overall markup for the three businesses was 33.38 percent, and the overall taxable sales ratio was 80.49 percent. The markup from the three businesses was not used to markup purchases since CDTFA was not able to verify the purchases on the FITRs.

[7] Appellant contracted with Postmates and Grubhub for food delivery services beginning in July 2020, and October 2020, respectively. The amounts deposited in appellant's bank account were net of commissions for the service: Postmates $3,275 and Grubhub $370.

period 3Q18 through 1Q21. The third-party delivery sales were added to audited gross sales per bank deposits of $920,725 to determine total audited sales of $929,614. The taxable sales ratio of 80.49 percent was applied to total audited sales to determine audited taxable sales of $748,246. Next, CDTFA compared audited taxable sales to reported taxable sales of $205,883, less unreported taxable sales per FITRs of $103,320, to determine additional unreported taxable sales per bank statements of $439,043 ($748,246 - $205,883 - $103,320).

10. Since the bank statement deposits were only through 1Q21, CDTFA calculated a 213.25 percentage of error (POE) ($439,043 ÷ $205,883) to apply to reported taxable sales for 2Q21 of $18,783 to determine audited taxable sales per POE of $40,055.
11. Based on a review of appellant's sales receipts, CDTFA determined that appellant was collecting sales tax at an 8.75 percent tax rate when the tax rate was 7.75 percent during the liability period. CDTFA determined that appellant had audited taxable sales with excess sales tax collected on $807,084 in measure ($224,666 reported + $103,320 unreported taxable sales per FITR + $439,043 additional unreported taxable sales per bank statements + $40,055 additional taxable sales per POE) or $8,070 in excess tax reimbursement ($807,084 × (8.75 - 7.75 percent).
12. CDTFA issued the NOD on December 12, 2022.
13. On January 2, 2023, appellant timely filed a petition for the entire amount of the NOD but did not provide specific contentions.
14. CDTFA issued its decision on April 3, 2024, denying the petition.
15. Appellant timely appealed to OTA.
16. In preparation for this appeal, CDTFA prepared a reaudit dated April 21, 2025, to correct the following errors: (1) 1099-K amounts for Uber Eats were not net of commissions so the commissions did not need to be added back in to determine gross receipts; (2) 1099-K sales for Uber Eats was added for 1Q21; (3) an allowance for sales tax included in the bank statements was made; (4) the audited taxable sales ex-tax amount was recalculated using the tax rate collected by appellant, not the actual tax rate. In summary the reaudit decreased the excess sales tax collected by $692, from $8,070 to $7,378, decreased the unreported taxable sales by $69,335, from $582,418 to $513,083, resulting in a decrease of tax of $6,059, from $53,206 to $47,147, reduced the penalty by $606.63, from $5,320.63 to $4,714, and also reduced applicable interest.

DISCUSSION

Issue 1: Whether further adjustments are warranted to the audit liability.

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 CDTFA is not satisfied with the amount of tax reported by the taxpayer, 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.) 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*.)

Here, appellant provided limited books and records for CDTFA to examine to validate reported gross receipts. CDTFA found low book markups and unexplained differences between recorded and reported sales which led CDTFA to believe that reported sales were potentially understated. Thus, OTA finds that it was reasonable for CDTFA to question reported sales and use an indirect audit method to compute appellant's sales. CDTFA's use of the bank deposit analysis method as the basis for its determination is a recognized and accepted accounting procedure. (See *Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) In addition, CDTFA utilized 1099-K data since the limited sales receipts provided were found to be unreliable. Under these circumstances, OTA finds CDTFA's use of an indirect audit method was reasonable and rational. OTA further finds that the bank deposit analysis method was an appropriate approach for this audit. Accordingly, OTA finds that CDTFA has shown that its determination is reasonable and rational; thus, the burden of proof shifts to appellant to establish a more accurate taxable measure.

Appellant contends that the lottery sales should not be counted as taxable gross receipts. Appellant submitted a report from the California Lottery, which lists appellant's yearly lottery sales for 2019 through 2022.

CDTFA found that the lottery report had previously been submitted and reviewed and found that the bank deposits scheduled in the audit for both taxable and nontaxable items did not include lottery sales. CDTFA found that for 2019 and 2020 the lottery sales exceeded bank deposits by $123,521 ($450,190 - $326,669) and $116,427 ($430,502 - $314,075), respectively. CDTFA properly segregated the bank deposits as taxable and nontaxable and did not find evidence of lottery sales included in the bank statements provided by appellant. CDTFA concluded that appellant must have had a separate bank account for his lottery sales. CDTFA determined that the bank deposit analysis was the appropriate methodology based on the available records. Since appellant did not provide reliable sales receipts, CDTFA used an average taxable sales ratio from three similar businesses in appellant's area. Appellant does not dispute the use of the taxable sales ratio.

OTA reviewed the reaudit and did not find any calculation errors or flaws in the audit methodology used by CDTFA. OTA concludes that CDTFA used the best available evidence to determine appellant's deficiency measure. Thus, OTA finds that the audit findings are reasonable and that further adjustments are not warranted.

Issue 2: Whether the negligence penalty was properly imposed.

R&TC section 6484 provides that, if any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. 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.) Generally, a negligence penalty should not be added to deficiency determinations made in the first audit of a taxpayer. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) However, if the evidence establishes that any bookkeeping and reporting errors cannot reasonably 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, the negligence penalty, even for a first-time audit, should be upheld. (Ibid.)

A taxpayer shall 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 sales and use tax return. (R&TC, §§ 7053 7054; Cal. Code Regs, tit. 18, § 1698(b).) All records required to be retained under this regulation must be preserved for a period of not less than four years. (Cal. Code Regs, tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties or other appropriate administrative action. (Cal. Code Regs, tit. 18, § 1698(k).)

Appellant submitted a medical note dated July 18, 2023, describing appellant's medical condition. Appellant did not provide an explanation for his submission, but out of an abundance of caution, OTA will presume that appellant is making a reasonable cause argument regarding the negligence penalty.

CDTFA imposed the negligence penalty because appellant failed to keep and maintain books and records for the business. Appellant only provided one month of sales receipts, FITRs, and bank statements. CDTFA found the sales receipts unreliable because of possible ring-up errors. CDTFA had to use an alternative audit methodology to determine appellant's taxable sales. The high error ratio calculated was 259.24 percent when comparing unreported taxable sales with reported taxable sales, which is also evidence of negligence. OTA finds that CDTFA properly imposed the negligence penalty for the above reasons. Appellant's reasonable cause argument lacks substance, in that, OTA does not find that a medical condition that occurred after the liability period, prevented appellant from maintaining records necessary to support his reported sales.

HOLDINGS

1. Further adjustments are not warranted to the audit liability.
2. Appellant was negligent.

DISPOSITION

CDTFA's action in reducing the determined measure of tax from $582,418 to $513,084 and excess tax from $8,070 to $7,378 but otherwise denying the petition is sustained.

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

We concur:

Signed by:
Natasha Ralston
25F8FE08FF56478...
Natasha Ralston
Administrative Law Judge

DocuSigned by:
K Long
DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

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