OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeals of: **STAR OF INDIA, LLC** **dba Holiday Inn Bar and Lounge**	OTA Case Nos.: 18083610, 21088499 CDTFA Case IDs: 627341, 80-114

OPINION

Representing the Parties:

For Appellant:	Kai Mickey, Representative
For Respondent:	Nalan Samarawickrema, Hearing Representative Jason Parker, Chief of Headquarters Ops. Stephen Smith, Attorney
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Star of India, LLC (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)[1] partially denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on July 11, 2012. The NOD is for tax of $149,528, plus applicable interest, a negligence penalty of $11,270.78, and a penalty of $14,728.22 for failure to remit sales tax collected for the period April 1, 2008, through March 31, 2011 (First Liability Period). In its subsequent decision, explained below, respondent made no adjustment to the tax liability, replaced the penalty for failure to remit sales tax collected with a negligence penalty, which increased the negligence penalty by $3,682.02 to $14,952, and denied the remainder of the petitioned amount.

[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 respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "respondent" shall refer to the board.

Appellant also appeals a separate decision issued by respondent denying appellant's administrative protest of an NOD issued on January 28, 2016.[2] The NOD is for tax of $131,595.52, plus applicable interest, and a negligence penalty of $13,159.55 for the period October 1, 2012, through September 30, 2015 (Second Liability Period). Pursuant to R&TC section 6565, an additional 10 percent penalty of $13,159.55 was added to the NOD for appellant's failure to timely pay the NOD before it became final (finality penalty). In a subsequent decision, respondent prepared a reaudit that reduced the taxable measure by $466,261 from $1,759,490 to $1,293,229.

Office of Tax Appeals (OTA) Panel Members Natasha Ralston, Keith T. Long, and Kim Wilson held an oral hearing for this matter in Sacramento, California, on May 20, 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, (Regulation) section 30209(b).

ISSUES

1. Whether appellant has shown that adjustments are warranted to the audited understatements of reported taxable sales.
2. Whether the understatements were the result of negligence.
3. Whether the finality penalty for the second liability period should be relieved.

FACTUAL FINDINGS

First Liability Period:

1. Appellant operated a restaurant with a bar, which is located inside a Holiday Inn hotel in Chico, California. Appellant does not operate the hotel; however, V. Sharma was an officer of both appellant and the hotel.
2. During the First Liability Period, appellant reported total sales of $1,445,068, claimed deductions for exempt sales of food products totaling $1,139,188,[3] and reported taxable sales of $305,880.

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[2] Under regulations promulgated by respondent, if a taxpayer files a petition for redetermination after the 30-day period authorized in R&TC section 6561 expires, respondent may accept it as an administrative (i.e., late) protest; however, such an appeal does not qualify as a valid petition for redetermination. (Cal. Code Regs, tit. 18, § 35019.)

[3] The total of $1,139,188 includes $663,104 erroneously claimed as "other" deductions on returns and constitutes approximately 79 percent of appellant's sales.

3. Appellant did not provide a complete set of books and records for the audit. Instead, appellant provided profit and loss statements (P&Ls), a sales and use tax return (SUTR) worksheet for the second quarter of 2008 (2Q08), an incomplete set of daily sales sheets, some monthly sales summaries, and merchandise purchase invoices for 2009. Respondent requested but did not receive federal income tax returns (FITRs) from appellant.

4. In its preliminary review, respondent noted that reported taxable sales were substantially less than the recorded costs of goods sold (COGS) recorded on P&Ls for the period 2Q08, through 4Q10, and it computed a negative achieved markup of -46.27 percent. Respondent expected a markup of at least 250 percent for this business.

5. Respondent reviewed the available records and established six categories of understatements that totaled $1,908,447. The six categories are as follows: 1) Unreported taxable sales of breakfast for the liability period; 2) Unreported taxable sales based on an analysis of sales tax accrued (2Q08 through 2Q09); 3) Unreported taxable restaurant sales based on an analysis of recorded restaurant sales (2Q08 through 2Q09); 4) Unrecorded taxable banquet sales (4Q08 through 2Q09); 5) Unrecorded taxable bar and restaurant sales (4Q08 and 2Q09); and 6) Understated taxable sales computed using an error ratio (3Q09 through 1Q11).

6. <u>Unreported taxable sales of breakfast</u>: Hotel guests received breakfast coupons that could be redeemed in the restaurant operated by appellant. Appellant recorded the number of coupons redeemed, and the hotel reimbursed appellant $7.95 for each coupon. Appellant included these receipts from the hotel in its recorded exempt sales of food. Appellant provided monthly sales summaries for 30 months of the audit period. Respondent used the summaries to compile a total of 61,031 breakfast coupons redeemed for those 30 months. Using the information for the 30 months, respondent computed a monthly average of 2,034 coupons redeemed, which it used to establish breakfast sales for the six months for which sales summaries had not been provided, for a total number of coupons of 73,235. Respondent multiplied the number of coupons received by $7.95 to establish unreported taxable sales of breakfast of $582,215.

7. <u>Unreported taxable sales based on an analysis of sales tax accrued (April 1, 2008, through June 30, 2009)</u>: Respondent performed an analysis of sales tax accrued using appellant's monthly sales summaries for the period 2Q08, through 2Q09, and the daily

sales sheets for the period 2Q08, through 2Q09,[4] to compile sales tax reimbursement collected by appellant of $42,497 ($19,159 for the restaurant and $23,338 for the bar). Respondent added this amount and the sales tax reimbursement of $5,907 that appellant had collected for banquet sales for 2Q08 and 3Q08 to compute total sales tax reimbursement of $48,404 collected for the period 2Q08, through 2Q09. Respondent divided the sales tax reimbursement collected by quarter, by the applicable sales tax rate to compute taxable sales of $652,501 for that period, which exceeded reported taxable sales of $155,492 by $497,009.

8. Unreported taxable restaurant sales based on an analysis of recorded restaurant sales (April 1, 2008, through June 30, 2009): Respondent compiled sales tax reimbursement related to restaurant sales of $19,159, which represented taxable restaurant sales of $257,199. Using sales amounts recorded on the same daily sales sheets and monthly sales summaries, respondent compiled total restaurant sales of $292,102, excluding sales tax reimbursement for the period 2Q08, through 2Q09. Respondent concluded that the difference of $34,903 ($292,102 - $257,199) represented additional taxable sales.

9. Unrecorded taxable banquet sales (October 1, 2008, through June 30, 2009): Respondent found that appellant had collected sales tax reimbursement of $5,907 for banquet sales for 2Q08 and 3Q08 but had not recorded banquet sales for the remainder of the audit period. Respondent concluded that appellant had made banquet sales throughout the audit period. Therefore, respondent divided the average amount of sales tax reimbursement per quarter of $2,954 ($5,907 ÷ 2) by the sales tax rate of 7.25 percent to establish average quarterly taxable banquet sales of $40,745. Respondent then multiplied that figure by three quarters to establish unreported banquet sales of $122,235 for 4Q08 through 2Q09.

10. Unrecorded taxable bar and restaurant sales (4Q08 and 2Q09): Respondent scheduled appellant's recorded bar and restaurant sales from its daily sales sheets for the period 2Q08 through 2Q09. Respondent noted that there were daily sales sheets missing for 4Q08 and 2Q09. For 4Q08, respondent noted seven daily sales sheets missing for the restaurant. Respondent used a daily average of restaurant sales of $671 to compute unrecorded restaurant sales of $4,697. Respondent noted that 11 daily sales sheets

[4] Respondent did not use the monthly sales summaries for this period because it found that the sales recorded in the daily sales sheets exceeded the sales amounts recorded in the monthly sales summaries.

were missing for the bar for 4Q08. Respondent used a daily average of bar sales of $872 to compute unrecorded bar sales of $9,592 ($872 x 11).

11. For 2Q09, respondent noted six daily sales sheets missing for the restaurant. Respondent used a daily average of restaurant sales of $656 to compute unrecorded restaurant sales of $3,936. For the bar, respondent noted three missing daily sales sheets. Respondent used a daily average of bar sales of $603 to compute unrecorded bar sales of $1,809.
12. For 4Q08 and 2Q09, respondent established unrecorded restaurant and bar sales of $20,034.
13. Understated taxable sales computed using an error ratio (July 1, 2009, through March 31, 2011): Respondent computed the unreported taxable sales of breakfast for the entire audit period. The total of the remaining audit items discussed above, $674,181,[5] represents the understatement established by respondent, other than breakfast sales, for the period 2Q08, through 2Q09. Respondent compared that amount to reported taxable sales of $155,492 for the same period to compute an error ratio of 433.58 percent (rounded). Respondent applied that percentage to reported taxable sales of $150,388 to compute an understatement of $652,051 (rounded) for the period 3Q09 through 1Q11.
14. On July 11, 2012, respondent issued an NOD for tax of $149,528, a negligence penalty of $11,270.78 and a 40 percent penalty of $14,728.22 for failure to remit sales tax collected.
15. On July 30, 2012, appellant filed a timely petition for redetermination.
16. On August 6, 2014, respondent issued a decision in which it replaced the 40 percent penalty for failure to remit sales tax collected with a negligence penalty and made no adjustments to the understatements of reported taxable sales.
17. This timely appeal followed.

Second Liability Period:

18. Appellant reported total sales on its sales and use tax returns of $695,287; claimed deductions of $25,014 for exempt sales of food products and $15,836 for sales tax reimbursement included in total sales; and reported taxable sales of $654,437.

[5] The $674,181 consists of $497,009 for unreported taxable sales based on an analysis of sales tax accrued, $34,903 based on an analysis of recorded restaurant sales, $122,235 for unrecorded taxable banquet sales, and $20,034 for unrecorded taxable bar and restaurant sales based on missing daily sales sheets.

19. For audit, appellant did not provide a complete set of books and records. Instead, appellant provided the following: a FITR for 2013; P&Ls for 2012, 2013, and 2014; sales journals for 1Q13 through 3Q15; guest checks for September 2015; and food and beverage coupons for September 2015. Appellant did not provide the bank statements or food costing sheets that respondent requested. Further, appellant did not provide source documents of sales for 35 of the 36 months in the audit period.
20. Respondent calculated appellant's sales using multiple methods: a comparison of recorded sales to reported sales; the markup method; and a projection of sales using information from the prior audit.
21. Appellant did not file a timely petition for redetermination within the 30-day time period specified in R&TC section 6561. Thus, the NOD became final on February 28, 2016. Therefore, respondent added a mandatory 10 percent finality penalty in the amount of $13,159.55, to the NOD pursuant to R&TC section 6565.
22. On March 14, 2016,[6] appellant filed a protest of the NOD which respondent accepted as an administrative protest.
23. Appellant declined to sign a waiver to extend the statute of limitations, therefore, respondent issued an NOD to appellant on January 28, 2016, based on preliminary audit work. The NOD was for tax of $131,595.82, plus interest. Respondent also added a 10-percent penalty for negligence of $13,159.55.
24. Appellant did not file a timely petition for redetermination within the 30-day time period specified in R&TC section 6561. Thus, the NOD became final on February 28, 2016. Therefore, respondent added a mandatory 10 percent finality penalty in the amount of $13,159.55, to the NOD pursuant to R&TC section 6565.
25. On March 14, 2016,[7] appellant filed a protest of the NOD which respondent accepted as an administrative protest.

[6] Appellant's petition for redetermination is dated February 8, 2016, but the document was not received by respondent until March 14, 2016. Appellant stated in a cover-letter in May 2016 that the petition had been mailed February 15, 2016, and it provided a post office receipt. However, the post office receipt appears to be for a 1.6 ounce package sent to Ogden, Utah, and a 3.4 ounce package sent to Sacramento, California, rather than a single sheet of paper mailed to Sacramento. Appellant has not referred to that evidence of mailing in its appeal before OTA, and it will not be addressed herein.

[7] Appellant's petition for redetermination is dated February 8, 2016, but the document was not received by respondent until March 14, 2016. Appellant stated in a cover-letter in May 2016 that the petition had been mailed February 15, 2016, and it provided a post office receipt However, the post office receipt appears to be for a 1.6 ounce package sent to Ogden, Utah, and a 3.4 ounce package sent to Sacramento, California, rather than a single sheet of paper mailed to Sacramento. Appellant has not referred to that evidence of mailing in its appeal before OTA, and it will not be addressed herein.

26. For the period 1Q13 through 3Q15, respondent used appellant's sales journals to compile recorded alcohol sales of $258,161 and recorded food sales of $492,058. Respondent then calculated mandatory service charges as follows. Using guest checks for September 2015 as a test period, respondent calculated that mandatory service charges represented 13.52 percent of recorded tips. Respondent applied the 13.52 percent ratio to tips recorded in the sales journal to compute mandatory service charges of $10,705 for the period 1Q13, through 3Q15. Respondent then added the mandatory service charges of $10,705 to the recorded alcohol sales of $258,161 and recorded food sales of $492,058 to compute recorded taxable sales of $760,925 (rounded) for the period 1Q13 through 3Q15.[8] Respondent compared recorded taxable sales of $760,925 for the period 1Q13 through 3Q15, to reported taxable sales for the same period to compute the difference between recorded and reported taxable sales of $205,156 for the period January 1, 2013, through September 30, 2015.

27. Since appellant did not provide a sales journal for 4Q12, respondent computed a difference for that period as follows. Respondent computed a quarterly average of $18,651, by dividing the understatement of $205,156 by 11 quarters. Respondent considered this to be to be a projected difference between recorded and reported taxable sales for 4Q12.

28. Respondent noted that on a quarterly basis, recorded taxable sales during the Second Liability Period were less than 10 percent of the recorded taxable sales for the First Liability Period. Appellant did not provide what respondent considered a satisfactory reason for the decline in recorded sales from the First Liability Period to the Second Liability Period. Respondent concluded that substantial amounts of sales in the Second Liability Period had not been recorded. Respondent computed additional taxable sales based on the difference between recorded taxable sales in the First Liability Period and recorded taxable sales in the Second Liability Period. Using amounts of recorded sales from the First Liability Period for the six-month period 2Q08 through 3Q08, respondent calculated alcohol sales of $1,825 per quarter, taxable food sales of $11,669 per quarter, and taxable banquet service charges of $29,460 per quarter. Respondent compared recorded alcohol sales of $1,825 per quarter from the First Liability Period to recorded alcohol sales of $78 per quarter in the Second Liability

[8] Respondent characterizes this amount as "recorded" taxable sales even though the $10,705 amount for service charges is not a recorded amount but is instead a calculated amount.

Period to compute a quarterly difference of $1,747. Respondent compared recorded food sales of $11,669 per quarter from the First Liability Period to recorded food sales of $751 per quarter in the Second Liability Period to compute a quarterly difference of $10,917. Respondent compared recorded banquet service charges of $29,460 per quarter from the First Liability Period to recorded banquet service charges of $168 per quarter in the Second Liability Period to compute a quarterly difference of $29,291.

29. Respondent compared the monthly average number of recorded breakfast coupons redeemed in the First Liability Period of 2,034 to the monthly average number of recorded breakfast coupons redeemed in the Second Liability Period of 565 to compute unrecorded breakfast coupons of 1,470 per month. To establish quarterly unrecorded sales related to the coupons of $39,634.00,[9] respondent used a value of $9.00 (rounded) per coupon.[10]

30. Respondent added the four differences together to compute unrecorded taxable sales of $81,589 per quarter ($1,747 + $10,917 + $29,291 + $39,634). Respondent multiplied the $81,589 quarterly amount by 12 quarters to compute unrecorded taxable breakfast and banquet sales based on a comparison of taxable sales recorded in the First Liability Period and taxable sales recorded in the Second Liability Period of $979,068.[11]

31. Respondent performed a markup analysis.[12] For the years 2013 and 2014, respondent added reported taxable sales and the portions of the previously computed unreported sales applicable to those years to compute audited taxable sales of alcohol and food for those two years. Specifically, respondent computed audited taxable sales of alcohol of $123,278 for 2013 and $83,939 for 2014; it computed audited taxable sales of food of $382,451 for 2013 and $368,723 for 2014. Respondent compared audited taxable sales to audited COGS for each category to compute markups of 47.97 percent for alcohol and 153.35 percent for food, for 2013 and 2014, combined. Respondent found the

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[9] 2034 – 565 is 1,469. It is not clear why respondent used 1,470 missing coupons. However, using 1,469 per month x 3 x $8.99, OTA computes unrecorded sale of $39,619.00. OTA finds that the minimal difference of $15.00 to be immaterial.

[10] According to respondent, appellant had informed the auditor at the beginning of the audit that the value of each coupon was $8.99.

[11] There is an immaterial $6 rounding difference in this calculation.

[12] "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 $.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 (.30 ÷ .70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

153.35 percent markup for food acceptable but found the 47.97 percent markup for alcohol far below the expected markup of at least 250 percent. Thus, respondent concluded that it was necessary to compute alcohol sales using the markup method.

32. Respondent performed a short shelf test[13] which resulted in a markup for alcohol of 269 percent. . . Respondent established alcohol purchases for 2013 using the 2013 FITR and established alcohol purchases for 2014 using information from the First Liability Period. Respondent scheduled food and alcohol purchases from the First Liability Period for the period 2Q08 through 4Q09. Respondent calculated that alcohol purchases of $137,962 for the period 2Q08 through 4Q09, represented an annual average of $78,835. Respondent calculated that alcohol represented 31.26 percent of total merchandise purchases for the period 2Q08 through 4Q09. Respondent computed the percentage of alcohol purchases from the First Liability Period and applied the percentage to total purchases recorded from the P&L statements. Respondent then computed a percentage of alcohol purchases of 31.26 percent and applied it to purchases recorded in the P&L statement. Thus, respondent computed alcohol purchases of: $64,066 for 2013 and $78,830 for 2014. Respondent reduced audited alcohol purchases of $64,066 for 2013 and $78,830 for 2014 by two percent for pilferage to compute the audited cost of alcohol sold of $62,785 for 2013 and $77,254 for 2014.[14] Respondent applied the audited markup factor of 3.692 (the markup of 269.20 percent plus 100 percent) to the audited cost of alcohol sold to compute audited alcohol sales of $231,803 for 2013 and $285,220 for 2014. From these amounts, respondent subtracted alcohol sales recorded in appellant's sales journals and unreported alcohol sales that were included in the $979,068 measure of tax, to compute unreported alcohol sales using the markup method of $108,525 for 2013 and $201,281 for 2014. Respondent computed error ratios of 88.03 percent for 2013 and 239.79 percent for 2014.

33. Respondent applied the error ratio of 88.03 percent to computed taxable alcohol sales for the period 4Q12 through 4Q13, and the error ratio of 239.79 percent to computed taxable alcohol sales for the period 1Q14 through 1Q15, to compute unreported taxable

[13] A shelf test is a comparison of known costs and associated selling prices used to compute markups. In general, a shelf test is conducted using purchases for a full purchasing cycle. For a short shelf test, fewer purchases are used.

[14] An allowance for self-consumption was not made because appellant stated that there was no self-consumption of alcohol.

alcohol sales established using the markup method of $509,047 (as compared to the $556,616 understatement computed based on preliminary audit results).

34. The total measure of tax respondent computed in the original audit was $1,711,922.

35. On January 10, 2020, appellant's prior representative sent an email to respondent stating that the hotel reimbursed appellant for the value of the breakfast coupons.

36. On May 4, 2020, respondent issued a Decision ordering a reaudit to make two adjustments. First, with regard to the $979,068 measure of tax for unrecorded taxable sales based on a comparison of taxable sales recorded in the First Liability Period and taxable sales recorded in the Second Liability Period, respondent's decision determined that the unrecorded service charges should be computed at 20.27 percent of the unrecorded alcohol and food sales (rather than using the amount of $29,291 per quarter). Second, with regard to the alcohol markup computation, respondent determined that alcohol purchases for 2014 should be the same amount as alcohol purchases for 2013 (rather than using information from the First Liability Period to establish alcohol purchases for 2014). Respondent otherwise denied the administrative protest.

37. Respondent prepared a reaudit in accordance with the Decision. In the reaudit, respondent applied a ratio of 20.302 percent[15] to unrecorded food and alcohol sales to compute unrecorded service fees of $2,571 per quarter (as compared to the $29,291 quarterly amount calculated in the original audit). Respondent added quarterly unrecorded alcohol sales of $1,747, quarterly unrecorded food sales of $10,917, quarterly unrecorded service fees of $2,571, and quarterly unrecorded breakfast sales from coupons of $39,634 to compute unrecorded taxable sales of $54,869 per quarter. Respondent multiplied $54,869 by 12 quarters to compute $658,428 for unrecorded taxable sales based on a comparison of taxable sales recorded in the First Audit and taxable sales recorded in the Second Audit (as compared to the $979,074 amount computed in the original audit).

38. In the markup calculations, respondent changed the amount of alcohol purchases for 2014 to equal the amount for 2013, which reduced the error ratio for 2014 from

[15] In the Decision, the 20.27 percent ratio was calculated by first adding quarterly recorded alcohol sales in the Second Audit of $77.87 to average quarterly recorded food sales in the Second Audit of $751.20 to compute a total of $829.07. Then the amount of quarterly recorded service fees for the Second Audit of $168.32 was divided by the $829.07 to compute the 20.27 percent ratio. However, the audit comments on Schedule R2 12F-1 explain that, when respondent recomputed the percentage, using the procedure ordered in the Decision and detailed figures from the original audit, it computed 20.302 percent, rather than 20.27 percent.

239.79 percent to 176.16 percent, and in turn reduced the measure of tax for unreported alcohol sales established using the markup method from $509,047 to $410,995. The deficiency measures of $205,155 for unreported taxable sales for the period 1Q13 through 3Q15, based on a comparison of recorded taxable sales to reported taxable sales; and $18,651 for unreported taxable sales for 4Q12, based on a projection from the period 1Q13, through 3Q15, were unchanged in the reaudit. Thus, the total deficiency measure in the reaudit is $1,293,229.

39. Appellant filed a timely request for reconsideration of the decision reached by respondent in its Decision.

40. On July 22, 2021, respondent issued a Supplemental Decision, in which it ordered that the deficiency measure be reduced to $1,293,229 as computed in the reaudit, and that the administrative protest be otherwise denied.

41. Appellant filed the instant appeal with OTA.

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*.)

Issue 1: Whether adjustments are warranted to the audited understatements of reported taxable sales.

It shall be presumed that property, the gross receipts of which are subject to sales tax, is sold at a price which includes sales tax reimbursement if the retailer posts or provides one of the following notices: 1) All prices of taxable items include sales tax reimbursement computed to the nearest mill; 2) The price of this item includes sales tax reimbursement computed to the nearest mill. (Cal. Code Regs, tit. 18, § 1700(a)(2)(C).)

Although gross receipts from the sale of "food products" are generally exempt from the sales tax, sales of hot food and sales of food served in a restaurant are subject to tax. (R&TC, § 6359(a), (d)(1), (d)(2), and (d)(7).)

First Liability Period:

For the First Liability Period, appellant provided incomplete records. Appellant asserts that it provided 12 boxes of records to respondent at the time of the audit, but those records are no longer available. In addition, it claimed almost 79 percent of its sales as exempt sales of food. Since sales of cold food to go do not generally represent the majority of a hotel restaurant's sales, respondent considered the high percentage of claimed exempt sales to be an indication that reported taxable sales were understated. In the absence of complete records, respondent used indirect audit methods to establish the understatements, which are discussed below. Thus, OTA finds that respondent has established that its determination was reasonable and rational. Accordingly, appellant has the burden to establish that adjustments are warranted.

Unreported taxable sales of breakfast ($582,215)

In its opening brief, appellant contends that the $7.95 received from the hotel for each breakfast included sales tax reimbursement. Appellant has provided no evidence that its contract with the hotel contained a notice explaining that the $7.95 included sales tax reimbursement. Accordingly, OTA finds there is no basis for concluding that the $7.95 is a tax-included amount.

Appellant also asserts that the numbers of coupons shown on its monthly sales summaries were unreliable and that appellant did not receive payment for all the breakfasts that are represented by the numbers of coupons listed in its records. Appellant further argues that, since respondent has described its records as unreliable, it should not utilize the listed numbers of coupons as evidence of the number of breakfasts sold during the audit period. Appellant states that the numbers of coupons recorded in its records for nine months appear incorrect and should be disregarded. Appellant then provides a computation of quarterly averages of redeemed coupons, which it suggests should be substituted for the numbers of coupons in its records. In other words, appellant argues that its records should be disregarded, and a lower number of coupons should be computed and used to establish the audited amount of unreported taxable breakfast sales.

Respondent responds that appellant has not provided any documentation to show that the recorded numbers of vouchers were incorrect or that another figure is more accurate.

OTA finds that the numbers of coupons redeemed, recorded in appellant's records contemporaneously with the breakfasts served to hotel guests, are the best evidence of the number of coupons for which appellant received reimbursement by the hotel. OTA is not persuaded by appellant's argument that the characteristics of the some of the numbers indicate that the numbers are invalid. Appellant has not provided evidence of errors in the counts of redeemed coupons, and there is no basis to disregard the numbers recorded in appellant's records for 30 of the 36 months of the audit period. Furthermore, it was reasonable for respondent to use the numbers for those 30 months to compute an average number of coupons redeemed to apply to the remaining six months of the audit period. Accordingly, no adjustment to the audited amount of unreported taxable sales of breakfast is warranted.

As a separate argument, appellant states in its opening brief, "The CDTFA [respondent] deemed that petitioner claimed taxable sales of breakfast as exempt sales. With that conclusion, taxable sales of breakfast are already included in CDTFA's [respondent's] calculation's [sic] of $582,215 of unreported taxable sales of breakfast." This argument is not clear because respondent did not establish an audit item to disallow exempt sales. Instead, respondent used various audit approaches to establish the amount of audited taxable sales. Accordingly, it is irrelevant whether the unreported sales of breakfast were not reported on returns or were included in claimed exempt sales.

Appellant appears to be arguing that there is some sort of duplication between the unreported taxable sales of breakfast and the other audit items. In its response brief, respondent states that appellant has not provided any documentation of duplication in the audit items, and OTA agrees. OTA rejects the argument regarding duplication of audit items because, as explained below, the other understatements of unreported taxable sales for periods through June 30, 2009, were computed using appellant's own records of its taxable sales, which were the best evidence available.

Unreported taxable sales based on an analysis of sales tax accrued for April 1, 2008, through June 30, 2009 ($497,009)

Appellant argues, with respect to the recorded amounts of sales tax reimbursement, that its records are not reliable. To support its argument, appellant has listed the sales for various days in April and May 2009. For four of those days, April 11, 12, and 24, and May 10,[16] the amounts of recorded sales are $1,077, $3,380, $1,245, and $5,306, respectively. Those amounts are significantly higher than the sales recorded on the other seven days listed by appellant, which range from $220 to $711. Appellant asserts that it would be impossible to staff a restaurant if there were such a broad variance in the sales volume and concludes, on that basis, that the sales records must be incorrect.

Appellant further asserts that because respondent determined that the amounts that it calculated from the daily sales summaries exceeded the amounts it calculated from the monthly summaries, respondent disregarded the monthly summaries for 1Q09 through 1Q11 and created a projection based on the results of the 2Q08 through the 2Q09. Appellant asserts that this was incorrect and that respondent should have computed the amount of the understatement for 1Q08 through 2Q09 using the monthly sales summaries. Appellant asserts that this would have led to a more accurate result and a lower percentage of error.

Respondent responds that unreported taxable restaurant sales were established by comparing recorded sales tax reimbursement to reported sales tax. Respondent asserts that appellant has not documented errors in its recorded sales tax reimbursement or explained why those recorded amounts should be disregarded.

This audit item, computed by establishing taxable sales from the amount of sales tax reimbursement collected,[17] represents the majority of the audited difference between recorded and reported taxable transactions ($497,009). Appellant has not provided evidence of errors or explained why its recorded amounts of sales tax reimbursement would be overstated.

OTA is not persuaded by appellant's assertion that its sales records should be disregarded because the recorded sales are materially greater on some days. The daily sales sheets represent the best, most reliable evidence of the actual sales for each day since they were prepared contemporaneously with the sales. To the extent that the monthly sales

[16] OTA notes that these days are a Saturday, Easter Sunday, Friday, and Sunday, respectively, which are all days when a hotel restaurant would be expected to have more patrons.

[17] As explained in the discussion of the next audit item, respondent also established recorded but unreported restaurant sales of $34,903, using a comparison of recorded restaurant sales and the amount of sales established using the sales tax reimbursement reconciliation.

summaries are supported by the daily sales sheets (for the period 2Q08, through 3Q08), the monthly sales summaries are equally reliable. Accordingly, there is no basis to disregard the amounts of taxable sales established by compiling the sales tax reimbursement from these records and using those amounts to compute appellant's taxable sales. Thus, no adjustment is warranted.

Unreported taxable restaurant sales based on an analysis of recorded restaurant sales for April 1, 2008, through June 30, 2009 ($34,903)

In its opening brief, appellant argues that these unreported taxable sales are also included in the unreported taxable sales of breakfast. Appellant has provided no evidence to show that breakfast sales were included in the sales recorded on its daily sales sheets or monthly sales summaries. Further, there is no similarity between the amount of the understatement established here of $34,903 and the amount of taxable breakfast sales established for the same period of $312,202.[18] There does not appear to be a logical relationship between those two figures, and it is implausible that appellant would record $34,903 of breakfast sales in its daily sales sheets and monthly summaries and not record the remaining $277,299. Accordingly, there is no convincing evidence of a duplication between the audited amount of unreported taxable sales of breakfast and this difference between recorded restaurant sales and the amount of taxable restaurant sales computed using the amount of recorded sales tax reimbursement. Accordingly, no adjustment is warranted to this audit item.

Unrecorded taxable banquet sales for October 1, 2008, through June 30, 2009 ($122,235)

In its opening brief, appellant asserts that banquet sales are not consistent, regular sales. Appellant also states that a banquet sale is often simply the rental of the banquet room for meetings, with no sales of food or beverages. Appellant asserts that there were no banquet sales of food or beverages after September 30, 2008.

Respondent found that appellant had collected sales tax reimbursement of $5,907 for banquet sales for 2Q08 and 3Q08 but had not recorded banquet sales for the remainder of the audit period. Respondent concluded that appellant had made banquet sales throughout the audit period. It divided the average amount of sales tax reimbursement per quarter of $2,954 ($5,907 ÷ 2) by the sales tax rate of 7.25 percent to establish average quarterly taxable banquet sales of $40,745. It used that figure for 4Q08, 1Q09, and 2Q09 to establish unreported banquet sales of $122,235.

[18] This amount of breakfast sales is compiled from audit workpaper Schedule 12A, for the period 2Q08 through 2Q09 ($102,968, $55,730, $48,510, $40,266, and $64,728).

While banquet sales are not consistent, regular sales, it is highly implausible that appellant's banquet sales would average over $40,000 for the first two quarters of its operation of the business and that it would not have a single banquet sale after those two quarters. It is also unlikely that banquet sales by a restaurant routinely represent merely the rental of the room. While that could occur, it is more likely than not that a restaurant would provide some sort of refreshments when organizations schedule meetings in the banquet room.

Thus, OTA finds that it was reasonable for respondent to conclude that appellant continued to make banquet sales after September 30, 2008, and that respondent used the only available information to compute the average quarterly amount of banquet sales. Accordingly, no adjustment is warranted to the audited amount of banquet sales for 4Q08, 1Q09, and 2Q09.

Unrecorded taxable bar and restaurant sales for 4Q08 and 2Q09 ($20,034)

Appellant has provided no documentation, such as sales and use tax return worksheets, to show that reported total sales included the sales for these days. For the majority of the days in 4Q08, 1Q09 and 2Q09, appellant's records included daily sales sheets for the restaurant and for the bar. Appellant has offered no explanation for the absence of several daily sales sheets for certain days in 4Q08 and 2Q09. Accordingly, it was reasonable for respondent to conclude that there were unrecorded sales on the days for which the daily sales sheets were missing. Respondent used the best available information, the sales recorded for the remainder of each quarter, to establish an average amount of daily sales which it used to establish audited unrecorded restaurant and bar sales for 4Q08 and 2Q09. Therefore, no adjustment is warranted to this audit item.

Understated taxable sales computed using an error ratio for 3Q09 – 1Q11 ($652,051)

Appellant's argument regarding this audit item is predicated on its arguments regarding the remaining audit items, wherein it asserts that the amount of unreported breakfast sales should be significantly reduced and the remaining audit items should be reduced to zero. On that basis, appellant argues that there is no understatement for the period 2Q08 through 2Q09 from which to compute an error ratio to be applied to reported amounts for the period 3Q09 through 1Q11.

For the reasons explained above, no adjustments are warranted to the understatements for the period 2Q08 through 2Q09. Further, it was appropriate for respondent to use its findings for that period of five calendar quarters to compute a percentage of error to apply to the remainder of the audit period. Thus, no adjustment is warranted to the understatement for the period 3Q09 through 1Q11.

Summary – Audited understatements of reported taxable sales

In its reply to respondent's opening brief, appellant reiterates the argument in its opening brief, stating that, since respondent has found its records unreliable, "CDTFA [respondent] should be required to rely totally on taxpayer's records or accept their finding which substantiates . . . that taxpayer's records are unreliable." In other words, appellant argues that respondent should accept their records or disregard all of appellant's records.

As noted above, it is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability. Further, when respondent is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.)

Since appellant did not fulfill its responsibility to maintain adequate and accurate records from which the correct tax liability could be determined, respondent relied on all information available to it, which included appellant's records. Due to appellant's failure to maintain and provide adequate records, respondent found it necessary to rely on alternative audit methods. In this case, respondent has used the audited taxable sales and the cost of goods sold recorded on P&Ls to compute markups of 320 percent for food sales and 219 percent for bar sales for the period 2Q08 through 4Q08, and 224 percent for food sales and 223 percent for bar sales for the period 1Q09 through 2Q09. Respondent has stated that, based on its audit experience, it would expect an achieved markup of at least 250 percent for this business. Accordingly, the markups computed using audited sales and recorded COGS are evidence that the audit findings are reasonable and do not result in an excessive amount of audited taxable sales. This analysis offers additional support for OTA's conclusion that no adjustments are warranted to any of the understatements of reported tax.

Second Liability Period:

As observed by respondent, the taxable sales recorded in appellant's sales journals for the second audit period were less than 10 percent of the amounts of recorded sales during the prior audit period. There is no evidence that appellant's business operations changed significantly after the first audit, and appellant has not provided a satisfactory explanation for the dramatic decline in recorded sales. Thus, OTA finds that it was reasonable for respondent to use recorded amounts from the First audit in the current audit calculations. Appellant did not provide source documents of sales (such as guest checks and cash register tapes), for 35 of the 36 months in the audit period (guest checks were provided for only September 2015). Source documents for purchases were not provided for the 33-month period October 1, 2012, through June 30, 2015. Thus, OTA finds that appellant's books and records were incomplete and inadequate for sales and use tax purposes, and that it was appropriate for respondent to use an indirect audit method (the markup method) to calculate sales. The markup method is a standard and accepted audit method. (See, *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 612-613.) Thus, OTA finds that respondent has met its initial burden to show that its determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

Appellant contends that it did not make enough merchandise purchases to support the amounts of taxable sales computed in the reaudit. Appellant further disputes respondent's assertion that appellant originally stated a value of $8.99 for the coupons for the current audit period. Appellant also asserts that the auditor arbitrarily decided that appellant's recorded amount of breakfast coupons of 18,639 in volume, was insufficient. Appellant asserts respondent used an estimated quarterly amount of coupons based on the first audit. Appellant argues that respondent has accepted appellant's records for some calculations but not for others. Appellant argues that this is inconsistent. Appellant asserts that respondent should accept the recorded amount of coupons of 18,639. With regard to the value of the coupons, appellant asserts that respondent should value the coupons at $3.49, rather than $8.99. Appellant further argues that appellant was never reimbursed by the hotel for the value of the coupons, so no sale actually occurred. Appellant asserts that should OTA determine that a sale occurred, appellant would be entitled to a bad debt deduction. In support of its contention that appellant did not receive payment from the hotel for the coupons, appellant provides affidavits from three individuals: A. Bocast, appellant's office manager, V. Sharma, owner of the hotel, and A. Bashir, general manager of the hotel.

Appellant's arguments do not affect the calculations of the measures of tax of $205,155 for unreported taxable sales for the period 1Q13 through 3Q15, based on a comparison of recorded taxable sales to reported taxable sales; and $18,651 for unreported taxable sales for the period 3Q12, through 4Q12, based on a projection from the period 1Q13 through 3Q15. These arguments only affect the calculations of the $410,995 measure of tax for unreported alcohol sales computed using the markup method, and the $658,428 measure of tax based on a comparison of recorded taxable sales in the First Liability Period and recorded taxable sales in the Second Liability Period.

Regarding appellant's assertion that it did not make enough purchases to support the audited sales, merchandise purchases reported on appellant's own 2013 FITR were used to calculate audited taxable sales. Appellant has neither shown errors in the amount of merchandise purchases reported on the 2013 FITR nor provided any reliable documentation to refute those reported purchases. As stated above, purchase invoices were not provided for the 33-month period 4Q12 through 2Q15, and the purchase invoices provided for 3Q15 were found to be incomplete. OTA rejects the purchases recorded in the profit and loss statements provided by appellant because: 1) those profit and loss statements appear to be for the Holiday Inn hotel, not appellant's business, and 2) the purchase amounts recorded on the profit and loss statements are not supported by complete source documents. Consequently, appellant has not shown that the amount of merchandise purchases reported on its 2013 FITR are excessive, or that it otherwise did not make enough merchandise purchases to support the amounts of taxable sales computed in the reaudit.

As previously stated, amounts paid by a third party to a retailer to reimburse the retailer for the value of the coupons redeemed by the retailer's customers are included in the retailer's gross receipts. (Cal. Code Regs, tit. 18, § 1671.1(b)(5).) In the First Liability Period, respondent found that appellant received $7.95 from the hotel for each breakfast coupon redeemed by appellant's customers. According to respondent, at the beginning of the Second Liability Period, appellant stated it received $8.99 from the hotel for each breakfast coupon redeemed during the Second Liability Period by appellant's customers. Thus, it was reasonable for respondent to value the redeemed breakfast coupons at $8.99 each in the Second Liability Period. Therefore, the burden of proof shifts to appellant to support a lower amount. Appellant should be able to provide a contract(s) between it and the hotel detailing the amount that appellant would receive from the hotel for each redeemed breakfast coupon during the Second Liability Period. Appellant has provided no such contract or any other documentation to support that it received $3.49, or any other amount less than $8.99, from the hotel for each redeemed breakfast coupon. Therefore, OTA rejects appellant's contention regarding the value of the breakfast coupons.

Further, while appellant asserts that the hotel did not reimburse appellant for the breakfast coupons, this is directly disputed by appellant's previous representative who stated in a January 10, 2020 email to respondent that the hotel reimbursed appellant for the value of the breakfast coupons. Appellant provided three affidavits which all state that appellant did not receive reimbursement from the hotel for the breakfast coupons for multiple years. None of the three affidavits explain why appellant would continue to accept the coupons from the hotel if appellant was not receiving reimbursement for them. OTA finds it strains credulity to believe that appellant would continue to accept breakfast coupons from the hotel for multiple years without reimbursement. Further, V. Sharma was an officer in both appellant and the hotel and as such was in a position to assist appellant in getting reimbursement from the hotel. Thus, OTA finds that appellant's affidavits are not credible and as such gives little weight to the affidavits. (See Cal. Code Regs, tit. 18, § 30214 (f)(4). Therefore, OTA concludes that appellant failed to establish that an adjustment is warranted for claimed unreimbursed coupons.

Appellant provided a schedule which appellant contends respondent did not have at the time of the audit. Appellant asserts that $204,947 that respondent calculated as purchases subject to the markup calculation for the 2013 year erroneously included labor costs consisting of wages of $69,876 and that the correct amount of purchases was $135,071. Appellant calculated that 66 percent of the purchases subject to the markup calculation erroneously consisted of wages. Appellant further contends that because respondent estimated purchases for the 2014 tax year based on purchases from the 2013 year, the purchases for 2014 also erroneously included labor costs. Appellant contends that based on the COGS that appellant reported on its 2014 FITRs, the correct amount of purchases was not $190,366. Appellant further asserts that it is likely that 66 percent of the amount of purchases appellant reported in 2014 also consisted of wages. Thus, appellant asserts that the amount of purchases for 2014 should be reduced from $190,366 to $125,642. Appellant further asserts that using these "corrected" amounts of purchases will reduce the percentages of error from 88.03 to 23.92 for 4Q 12 and 2013, from 239.79 to 69.3 for 2014, and from 239.79 to 42.30 for 2015. Appellant asserts that using these figures will result in the understated taxable sales based on markup being reduced by $285,233.

Respondent asserts that because appellant failed to provide purchase invoices to support the reported COGS on the FITRs, respondent is unable to verify the reported information. Respondent asserts that the COGS calculated in the First Liability Period were significantly higher than the COGS calculated in the Second Liability Period. Despite this discrepancy, respondent asserts that it utilized the reported COGS for 2014 rather than estimating the amount based on the 2013 COGS. Respondent asserts that had it estimated the purchases based on the purchases reflected on appellant's First Liability Period to determine alcohol sales for the Second Liability Period, then the unrecorded alcohol sales would increase by around $167,000 from around $411,000 to $578,000.

Here appellant has failed to provide purchase information to support its reported COGS. Thus, there is no way to verify what information was included in the reported COGS. As such, no adjustments are warranted.

Appellant also asserts that the differences between recorded and reported taxable sales should be $37,590 because respondent erroneously included $167,565 in coupons that the audit treats as being recorded. Appellant asserts that respondent erroneously included the monetary value of the breakfast coupons, based on volume in the amount of total food sales. Appellant asserts that appellant did not record any sale amount related to the breakfast coupons but did record the volume of the coupons. Appellant asserts that using a value of $8.99, respondent calculated an amount of $167,565 for sales related to breakfast coupons, which appellant states respondent erroneously included in total recorded food sales of $492,058. Appellant states that the breakfast coupons were never redeemed. Therefore the $167,565 should be removed from the total recorded food sales of $492,058. Appellant also states that that amount of breakfast coupons, also, were erroneously included in total recorded taxable alcohol and food sales of $760,925. Appellant asserts that respondent compared the audited amount of taxable food sales of $760,925 to the taxable measure reported on appellant's SUTRs and calculated a difference of $205,155. Appellant asserts that the $205,155 figure erroneously includes $167,565 in breakfast coupons. Thus, appellant asserts that the correct difference of recorded versus reported sales should be $37,590 ($205,155 - $167,565).

As noted above, OTA finds appellant's argument that it did not receive reimbursement for the breakfast coupons from the hotel is not credible. Therefore, no adjustments are warranted.

Appellant asserts that when calculating the amount of recorded breakfast coupon food sales, respondent used a quarterly average calculated from records for 1Q13 to 3Q15, and applied it to 4Q12 because the records for 4Q12 were unavailable. Appellant asserts that the quarterly average that respondent calculated of $18,651, was erroneous because it was based on respondent's incorrect calculation of recorded versus reported taxable sales. Appellant asserts that had respondent used what respondent consider to be the corrected amount of recorded versus reported taxable sales of $37,590, then respondent would have calculated a quarterly average of $3,417, rather than $18,651.

For the reasons stated above, OTA finds that appellant has failed to prove facts from which a more accurate determination can be made, and on that basis, OTA concludes that additional reductions to the measure of unreported taxable sales are not warranted.

Issue 2: Whether the understatements were the result of negligence.

First Liability Period:

R&TC, section 6484 provides that 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.

Taxpayers are required to maintain and make available for examination on request by respondent, 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 sales and use tax returns. (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).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal. Code Regs, tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to determinations associated with the first audit of a taxpayer. However, a negligence penalty should be upheld in a first audit if the understatement cannot be attributed to a bona fide and reasonable belief that the bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A); also see *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167Cal App.2d 318, 321-324.)

Respondent imposed the negligence penalty in this matter because of the large understatement in relation to the reported measure of tax. Appellant disputes the negligence penalty on the basis that appellant had not been audited previously.

Appellant also argues that the audited understatement should be reduced from $1,908,447 to $392,185, thus asserting that the understatement is not nearly as large as respondent has determined and does not represent negligence. Since no adjustments are warranted to any of the audit items, OTA rejects appellant's assertion that the understatement determined by respondent should be reduced. Therefore, this argument will not be addressed further.

Appellant also asserts that this was appellant's first audit and that the bulk of the understatement was due to a misunderstanding of the law and not negligence. Appellant also asserts that appellant provided respondent with numerous records consisting of 12 boxes of records.

Respondent noted in the Decision that the understatement of $1,908,447 represented 624 percent (rounded) of reported taxable sales of $305,880. This exceptionally large error rate is evidence of negligence. Moreover, appellant failed to provide source documents, such as guest checks, to support amounts recorded in the daily sales sheets, and it claimed 79 percent of its reported total sales as exempt ($1,139,188 ÷ $1,445,068) without providing any documentation of exempt sales or even a plausible explanation of why it believed the vast majority of its sales were not subject to sales tax. The incomplete records and the failure to provide documentation to support claimed deductions is additional evidence of negligence.

However, strongest evidence of negligence is appellant's failure to report $497,009 of sales tax for which it had collected reimbursement for the period April 1, 2008, through June 30, 2009. Any retailer, even one with limited experience, would report sales tax for which it has collected sales tax reimbursement, particularly when such tax reimbursement is clearly recorded in its records. Accordingly, appellant's failure to report almost half a million dollars of sales tax for which it collected reimbursement cannot be attributed to a bona fide and reasonable belief that its bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A); also see *Independent Iron Works, Inc. v. State Bd. Of Equalization* (1959) 167Cal App.2d 318, 321-324.) Therefore, OTA finds that the negligence penalty was properly applied even though this was the first audit of appellant's business.

<u>Second Liability Period:</u>

In this case, respondent states that it imposed the negligence penalty provided by R&TC section 6484 because appellant did not maintain adequate books and records, and because errors that occurred in the prior audit were repeated in the current audit. Appellant disputes the negligence penalty but has provided no specific basis.

The total understatement computed in the reaudit of $1,293,229 represents an error ratio of 197.61 percent when compared to reported taxable sales of $654,437 ($1,293,229 ÷

$654,437). The amount of the understatement and the large error ratio are evidence of negligence.

Appellant did not provide source documents for sales (such as guest checks and cash register tapes), for 35 of the 36 months in the audit period (guest checks were provided for only September 2015). Source documents for purchases were not provided for the 33-month period October 1, 2012, through June 30, 2015. After being previously audited, appellant should have known of its obligation to maintain and submit for audit source documents of sales and purchases. OTA finds that the absence of source documents to be evidence of negligence in recordkeeping.

Appellant asserts that the bulk of the liability is based on the breakfast coupons. Appellant asserts that as discussed above, the markup and the difference between recorded and reported taxable sales should be reduced to negligible amounts based on appellant's calculations. Appellant asserts that based on its argument that the breakfast coupons are not taxable, the liability should be greatly reduced, and that there were not similar errors in the second audit as in the first audit.

Appellant failed to report taxable sales of $194,451 that were recorded in its own sales journals. Appellant is knowledgeable regarding the sales recorded in its records, and appellant should have been able to report all the taxable sales that were recorded in its sales journals. Appellant has not provided a non-negligent explanation for failing to report all the amounts of taxable sales recorded in its own records. Appellant's failure to report substantial amounts of taxable sales that were recorded in its sales journals is strong evidence of negligence.

Appellant was previously audited for the period April 1, 2008, through March 31, 2011, resulting in a deficiency measure of $1,908,447. A negligence penalty was added to the prior audit because appellant failed to provide source documents to support the amounts recorded in the sales sheets and claimed 79 percent of its reported total sales as exempt, without providing any supporting documentation. Appellant repeated the error of underreporting its taxable sales in the current audit and also repeated the error of not maintaining complete source documents. OTA finds that the repeated errors are evidence of negligence. Further, OTA has concluded that the breakfast coupons are taxable and thus the difference between recorded and reported taxable sales is significant. OTA has found that no further adjustments are warranted to the audited understatement. As such, the negligence penalty was properly applied.

Issue 3. Whether appellant has established reasonable cause for relief of the finality penalty for the second liability period.

R&TC code section 6565 provides that an NOD is due and payable at the time the NOD becomes final. Section 6565 also provides that a 10 percent finality penalty will be added to the NOD if the NOD is not paid when due and payable. In the second audit, the NOD became final on February 28, 2016, and since appellant had not paid any portion of the tax liability prior to that date, a finality penalty in the amount of $13,159.55 was added to the NOD (the amount of the finality penalty was subsequently reduced in accordance with the reaudit).

Under the provisions of R&TC section 6592, a taxpayer may be relieved of the finality penalty if the taxpayer's failure to timely pay the NOD or file a timely petition was due to reasonable cause and circumstances beyond the taxpayer's control and occurred notwithstanding the exercise of ordinary care and absence of willful neglect. A taxpayer seeking relief of a finality penalty must submit a statement signed under penalty of perjury setting forth the facts on which the request for relief is based. (R&TC, § 6592(b).)

On September 5, 2019, appellant submitted to respondent an executed form CDTFA-735, *Request for Relief from Penalty, Collection Cost Recovery Fee, and/or Interest*, signed under penalty of perjury, explaining its basis for requesting relief of the finality penalty. On that form, appellant states that it exercised ordinary care with reporting sales and there is an absence of willful neglect. However, appellant offered no explanation for its failure to file a petition for redetermination in a timely manner or to timely pay at least the undisputed portion of the audit liability.[19] Therefore, OTA finds that appellant has not established reasonable cause, and that there is no basis for relief of the finality penalty.

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[19] The portions of the audit liability that have not been specifically disputed are the deficiency measures of $205,155 for unreported taxable sales for the period January 1, 2013, through September 30, 2015, based on a comparison of recorded taxable sales to reported taxable sales; and $18,651 for unreported taxable sales for 4Q12, based on a projection from the period January 1, 2013, through September 30, 2015.

HOLDINGS

1. Appellant has not shown that adjustments are warranted to any of the understatements of reported taxable sales.
2. The understatements were the result of negligence, and the negligence penalty was properly applied.
3. Appellant has not established reasonable cause for relief of the finality penalty for the second liability period.

DISPOSITION

Respondent's actions are sustained.

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

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DC88A60D8C3E442...

Keith T. Long
Administrative Law Judge

Signed by:
Kim Wilson
4E8E740EDB984CD...

Kim Wilson
Hearing Officer

Date Issued: 8/26/2025