OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **KIM BROTHERS WORLD WIDE, dba The Blue Door Bar**	OTA Case No.: 241218331 CDTFA Case ID: 5-067-541

OPINION

Representing the Parties:

For Appellant: Marc Brandeis, CPA
James Kim, President

For Respondent: Jason Parker, Chief of Headquarters Ops.
Christopher Brooks, Attorney
Nalan Samarawickrema, Hearing Representative

K. WILSON, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Kim Brothers World Wide, dba The Blue Door Bar (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on July 12, 2023.[1] The NOD is for tax of $33,054, plus applicable interest, and a penalty of $3,305.38 for the period April 1, 2019, through March 31, 2022 (liability period).

Office of Tax Appeals (OTA) Panel Members Kim Wilson, L. Katrine Shelton, and Steven Kim held an oral hearing for this matter in Cerritos, California on March 10, 2026. At the conclusion of the oral hearing, the record was closed and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, section 30209(b).

[1] The NOD was timely issued because on October 31, 2022, appellant signed the most recent in a series of wavier of the otherwise applicable three-year statute of limitations, which allowed CDTFA until July 31, 2023, to issue an NOD for the period from April 1, 2019, through March 31, 2020. (R&TC, §§ 6487(a), 6488.)

ISSUE[2]

Whether further adjustments to the reaudited measure of taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a California corporation, operates a dive bar located in Fullerton, California, serving distilled spirits, beer, and carbonated beverages and selling apparel merchandise. Appellant does not sell food. Additionally, appellant is a California lottery ticket retailer. Appellant holds an active seller's permit with an effective start date of July 10, 2015.
2. For the liability period, appellant reported total taxable sales of $1,934,221, with no claimed deduction.
3. Upon audit, appellant provided federal income tax returns (FITRs) for 2019 and 2020; Forms 1099-K[3] and bank statements for 2019, 2020, and 2021; sales and use tax returns (SUTRs) and point-of-sale (POS)[4] reports for the liability period; and purchase invoices for March 2022.
4. CDTFA obtained appellant's 2021 FITR from Franchise Tax Board; POS data from the POS system provider, Clover, for 2019 through 2021; and purchase invoices from appellant's alcohol vendors for the liability period.
5. Using the purchases reported on appellant's FITRs[5] and the taxable sales reported on appellant's SUTRs, CDTFA calculated an average book markup[6] of 218.68 percent for

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[2] CDTFA removed the negligence penalty; thus, it is no longer at issue.

[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 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] A point-of-sale system typically includes one or more terminals, which are the modern equivalent of a cash register. Depending on the equipment and software, POS systems can generate reports that summarize sales activity for the period of time selected by the operator. These reports can include breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable.

[5] In calculating the adjusted merchandise purchases, CDTFA reduced the amount reported on FITRs as the cost of goods sold by a five percent allowance for consumable supplies, a two percent allowance for self-consumption, and an additional two percent allowance for pilferage.

[6] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. The formula for determining the markup percentage is markup amount ÷ cost. A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records.

2019 through 2021,[7] which was below CDTFA's expected markup of 280 to 340 percent for the industry. In addition, CDTFA determined, by comparing Clover provided transaction data with appellant's POS transaction data, that certain transactions had been removed from appellant's POS system. Thus, CDTFA concluded that it could not verify appellant's reported sales tax amounts through a direct audit method.

6. CDTFA computed unreported cost of purchases subject to use tax of $11,988 for self-consumption for the liability period.
7. CDTFA used the information from the vendor surveys to calculate individual weighted average markups of 180.42 percent for draft beer, 354.55 percent for canned and bottled beer, 346.72 percent for liquor, and an overall weighted markup of 297.20 percent. The overall weighted markup of 297.20 percent was based on a shelf test that CDTFA performed using appellant's information from the test period of March 1, 2022, through March 7, 2022.
8. CDTFA calculated audited taxable sales of $2,276,198 for 2019 through 2021 by applying the markup factor of 397.20 percent (100 + 297.20) to purchases from the FITRs adjusted for self-consumption and pilferage of $573,061. After comparing audited taxable sales with reported taxable sales, CDTFA determined a taxable sales difference of $398,296 for 2019 through 2021.
9. CDTFA calculated a percentage of error for each year: 22.00 percent for 2019, 41.40 percent for 2020, 13.59 percent for 2021, and a combined average 21.21 percent. For 2Q20, CDTFA used recorded taxable sales based on POS data, plus items removed, to arrive at recorded taxable sales including removed items of $7,351 since appellant did not report any sales for this quarter. CDTFA then applied the percentages to reported taxable sales on a quarterly basis for all quarters to arrive at additional taxable sales based on markup of cost of $399,169.[8]
10. CDTFA determined that appellant had failed to report district tax for 3Q21 and assessed $239,098 to Orange County Transit Authority at a rate of one half of one percent.
11. CDTFA assessed the amount of the adjustments for these three audit errors: additional taxable sales based on markup of cost (including 2Q20 estimate) of $399,169; self-

[7] CDTFA found book markups of 225.59 percent for 2019, 180.91 percent for 2020, and 249.67 percent for 2021.

[8] The additional taxable sales based on markup of cost of $399,169 includes $7,351 sales from 2Q20 plus the other quarters sales based on the percentages of error of $391,818.

consumption of purchases subject to use tax of $11,998; and unreported district tax of $239,098. CDTFA also imposed a 10 percent negligence penalty.[9]

12. On July 12, 2023, CDTFA issued the instant NOD to appellant. Appellant timely filed a petition for redetermination disputing the NOD.
13. CDTFA performed a reaudit based on purchase invoices and a list of purchases provided by appellant, adjusting purchases for supplies by 10.40 percent. The adjustment to purchases also resulted in a corresponding reduction to self-consumption of purchases subject to use tax. In total, CDTFA reduced the unreported taxable sales from $399,169 to $174,727 and self-consumption of purchases subject to use tax from $11,988 to $11,305. CDTFA also removed the negligence penalty.
14. Based on a February 22, 2024 discussion with appellant, CDTFA prepared a second reaudit which reduced unreported taxable sales from $174,727 to $170,002 to adjust for additional supplies found in purchases as well as a delivery charge of $5 per invoice. In addition, pilferage was increased to three percent for 2020 in consideration of COVID-19 state mandated closure.[10]
15. Appellant continued to disagree with the reaudit results insisting that a higher spoilage percentage was warranted as well as adjustments to purchases for supplies. CDTFA issued a Decision on August 6, 2024, ordering a third reaudit to be performed.
16. On October 25, 2024, CDTFA issued its third reaudit results, increasing the Red Bull pour size to 4.2 ounces for Jäger Bomb cocktails, increasing the average selling price for hats to $18 and excluding sales tax, adjusting the sales segregation based on appellant's information, and removing the unreported taxable sales for 2Q20 for the COVID-19 pandemic. Overall, CDTFA reduced the overall weighted markup percentage from 297.20 to an audited markup of 271.84 percent and the unreported taxable measure from $170,002 to $79,025, which adjusted only 1Q20, 3Q20, and 4Q20, but made no adjustments to the unreported district measure for 3Q21 or self-consumption of purchases subject to use tax.
17. This timely appeal followed.

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[9] Appellant conceded the unreported district tax of $1,195 for 3Q21 on May 3, 2024. Hence, this audit item is no longer in dispute and OTA will not further address it.

[10] The COVID-19 pandemic for this audit covers periods of March 2020 through the end of the liability period. Businesses such as restaurants and bars were allowed to reopen in June 2020 with restrictions that limited capacity.

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 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, CDTFA's preliminary analysis disclosed a low average book markup of 218.68 percent which was below CDTFA's expected markup of 280 to 340 percent for the industry.[11] In addition, CDTFA determined that transactions had been removed from the POS system. CDTFA found the low markup and deleted transactions were indications that reported sales were understated. Thus, OTA finds that it was reasonable for CDTFA to question reported taxable sales and use an indirect audit method. The markup method is a recognized and accepted accounting procedure. (*Appeal of Amaya*, 2021-OTA-328P.) Accordingly, OTA finds that CDTFA's use of the markup audit method was appropriate. Therefore, OTA concludes that CDTFA has met its minimal initial burden to show that its determination is reasonable and rational, and accordingly, the burden shifts to appellant to show errors in the audit.

[11] CDTFA's expected markup of 280 to 340 percent is based on data from similar businesses showing audited markups of 340.90 percent from a business located in Fullerton, 280.75 percent from a business in Santa Ana, and 305.95 percent from a business in Huntington Beach. Additionally, the markups reflected are the other businesses' audited markups, not actual markups. The expected markups are, therefore, not without doubt. However, CDTFA's use of the expected markups was limited to its preliminary analysis and the expected markups did not impact the assessment.

Appellant argued at the hearing that the books and records were accurate and should have been accepted on face value since items removed or missing from the POS system were voided transactions. Additionally, appellant argues that the taxable measure based on the markup of cost is overstated because CDTFA did not consider "the significant spoilage and waste of perishable resale inventory during the pandemic period."

CDTFA is not required to accept the taxpayer's books and records as conclusive evidence of what they purport to represent, even when the books and records are in agreement with each other and with SUTRs. (*Appeal of Amaya*, *supra*.) R&TC section 6481 establishes the broad power of CDTFA to determine a taxpayer's liability. Here, appellant provides no specifics for its claim of "significant spoilage and waste of perishable resale inventory," i.e., which quarters, which inventory items, or amount of spoilage. Nor does appellant offer any evidence, such as pictures of spoiled items or a completed form CDTFA-775 Approval Request and Declaration of Destruction for Spoiled Beer or Wine, to support its argument that CDTFA's allowance of three percent pilferage is insufficient.

Furthermore, per CDTFA's Decision, the third reaudit accepted appellant's claim of zero sales for 2Q20 due to the COVID shutdown, despite POS data showing $6,849 in sales (inclusive of sales tax). More importantly, appellant reported $55,092 and $151,396 in total sales for 3Q20 and 4Q20 (and close to $1 million in 2021), respectively, without claiming any deductions during the audit period. Moreover, given that appellant once again reported sales starting in 3Q20, it is hard to imagine how significant the spoilage and waste would have been due to the COVID-19 shutdown. In other words, the amount of spoilage appellant sustained during the brief shutdown would have been limited in scope and time, one purchasing cycle, given appellant was open for business immediately after the shutdown ended. Nevertheless, absent any evidentiary support for its claim, appellant has not met its burden of showing that further adjustments are warranted to the reaudited measure of taxable sales.

HOLDING

No further adjustments to the reaudited measure of taxable sales are warranted.

DISPOSITION

CDTFA's action allowing adjustments[12] as shown in the third reaudit but otherwise denying appellant's petition for redetermination is sustained.

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

We concur:

Signed by:
L. Katrine Shelton
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L. Katrine Shelton
Administrative Law Judge

DocuSigned by:
Steven Kim
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Steven Kim
Administrative Law Judge

Date Issued: 5/8/2026

[12] The adjustments made in the third reaudit are shown in factual finding 16.