2026-OTA-315
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **SABSV INC.,** **dba Anand Bhavan**	OTA Case No. 21088505 CDTFA Case IDs: 345-115; 2-173-198

OPINION

Representing the Parties:

For Appellant: Gerald J. Donnini II, Attorney
Ravi Kumaraswany, Owner
Sridhar Panchumarthi, CPA

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

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, SABSV Inc. (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's petitions for redetermination of the Notices of Determination (NODs). The first NOD was issued on April 30, 2018, for tax of $104,031.88, plus applicable interest, for the period October 1, 2014, through September 30, 2017 (first liability period).[2] The second NOD was issued on June 9, 2020, for tax of $36,161, plus applicable interest, for the period October 1, 2017, through September 30, 2019 (second liability period).

In its subsequent reaudit of the second liability period, as explained below, respondent concedes to reducing the determined taxable measure from $401,791 to $256,602, which will result in reductions to the tax.

[1] The State Board of Equalization (board) formerly administered sales and use taxes. On July 1, 2017, administrative functions of the board relevant to this case transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events occurring before July 1, 2017, "respondent" refers to the board.

[2] The NOD was timely issued because on February 5, 2018, appellant signed the most recent in a series of waivers of the otherwise applicable three-year statute of limitations for the period October 1, 2014, through June 30, 2015, which allowed respondent until October 31, 2018, to issue an NOD. (R&TC, §§ 6487(a), 6488.)

The Office of Tax Appeals (OTA) panel, comprised of Hearing Officer Kim Wilson, Administrative Law Judge Keith T. Long, and Administrative Law Judge Josh Aldrich, held an oral hearing for this matter in Cerritos, California, on June 17, 2025. At the conclusion of the hearing, the record was closed and this matter was submitted for an Opinion.

ISSUES

1. Whether adjustments are warranted to the measure of unreported taxable sales for the first liability period.
2. Whether further adjustments are warranted to the measure of unreported taxable sales for the second liability period.

FACTUAL FINDINGS

1. Appellant, a corporation, operated two restaurants during the liability periods a franchise Anand Bhavan selling Indian-style food, which had a maximum capacity of 78 individuals, and a franchise Papa Murphy's[3] selling cold ready-to-bake pizza to-go (July 11, 2017, through October 15, 2018). Both restaurants were located in Sunnyvale, California.
2. Papa Murphy's sales were deemed nontaxable sales of cold food to-go. Appellant netted these sales from gross sales. These sales are not included in the audit or this appeal and thus are not in dispute. Accordingly, all further use of appellant exclusively refers to Anand Bhavan unless otherwise noted.
3. Appellant was issued its seller's permit with an effective start date of October 1, 2014, and the permit was closed out with an effective end date of September 30, 2019.
4. Appellant was audited for October 1, 2014, through September 30, 2017 (first liability period), and October 1, 2017, through September 30, 2019 (second liability period). On appeal, OTA consolidated appellant's cases.

First Liability Period

5. For the first liability period, appellant reported on its sales and use tax returns (SUTRs) total sales of $2,030,682, claiming no deductions, resulting in reported taxable sales of

---

[3] Papa Murphy's sales were deemed nontaxable sales of cold food to-go. Appellant netted these sales from gross sales. These sales are not included in the audit or this appeal and thus are not in dispute.

the same amount. Appellant reports on a cash basis/single entry system. Appellant prepared its SUTRs and provided monthly sales records to an accountant to prepare its federal income tax returns (FITRs).

6. Initially, appellant did not provide any books and records for the audit. As a preliminary examination, respondent decided to perform an observation test to assess the adequacy of sales reported on appellant's SUTRs; September 28, 2017, and January 24, 2018, were selected and the stated objective was a preliminary examination.

7. Respondent performed a site test at Anand Bhavan on Thursday, September 28, 2017 (site test 1). Respondent observed lunch from 11:00 a.m. to 2:00 p.m., and dinner from 5:00 p.m. to 8:00 p.m., and also noted that appellant operated until 10:00 p.m. on the weekdays and 10:30 p.m. on the weekends. Respondent observed that "lunch time was quite busy, due to the High-Tech companies in the nearby area, dinner time seems to be slower." Respondent obtained sales records for the entire date, which were used in its analysis. Based on the records and the site test, respondent noted that only 66.47 percent of the sales tax reimbursement was properly collected on appellant's sales. Respondent noted that appellant was incorrectly categorizing some taxable sales as nontaxable. Based on the site test observations, respondent concluded the 80-80 rule was applicable to appellant's sales, and thus all sales of its were subject to sales tax.[4]

8. Respondent obtained Form 1099-K[5] data from the IRS for October 1, 2014, through December 31, 2016. Respondent noted that credit card sales alone exceeded taxable sales reported on the SUTRs for that period and concluded that additional testing was needed to verify reported taxable sales.

9. Appellant subsequently provided FITRs for partial year 2014 (October 1, 2014, through December 31, 2014), 2015, and 2016; a sales summary for the third quarter of 2017 (3Q17); partial 1099-Ks, and bank statements for January 1, 2017, through

[4] The general rule is that a sale of cold food to-go is exempt from tax. (Cal. Code Regs., tit. 18, § 1603(c)(1)(B).) However, there is a special 80-80 rule under which a sale of cold food to-go in a form suitable for consumption on the retailer's premises (e.g., a cold sandwich) is subject to tax. This rule applies when more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of the retailer's sales of food are otherwise subject to tax. (R&TC, § 6359(d)(6); Cal. Code Regs. tit. 18, § 1603(c)(1)(A), (c)(3).)

[5] 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.

September 30, 2017. Appellant did not provide the monthly sales reports used to prepare the SUTRs or source documentation such as cash register tapes or merchandise purchase invoices for the first liability period.

10. Respondent compared total sales reported on the SUTRs for 4Q14, 2015, and 2016 to the corresponding gross receipts (excluding sales tax reimbursement) reported on the FITRs. Gross receipts exceeded total sales by \$111,461 for partial year 2014; \$455,498 for 2015; \$359,741 for 2016; or \$926,700 for the three periods combined. Appellant stated that the differences were due to nontaxable sales but did not provide supporting documentation.

11. Respondent then compared gross receipts to the corresponding cost of goods sold (COGS) reported on the FITRs and computed book markups of 269.47 percent for partial year 2014; 264.09 percent for 2015; 290.02 percent for 2016; or 275.26 percent combined.[6] Based on its experience in audits of similar businesses in appellant's area, respondent considered the FITR book markups to be adequate for appellant's business. However, due to the incomplete books and records, and large unexplained differences, respondent decided to perform another site observation test day.

12. In preparation for the second site test, respondent met with appellant. Appellant indicated that it changed point-of-sale (POS)[7] systems from Aldelo to Clover in July 2017. Respondent also requested: the names of the claimed non-taxable items, credit card sales or merchant statements for the first liability period, and POS monthly reports for the audit period. Respondent also provided further explanation of the 80-80 rule.

13. Respondent performed a second site test on Wednesday, January 24, 2018 (site test 2). Appellant provided the cash register z-tape for that day. Respondent noted minor differences between the cash register z-tape and the amounts it compiled from its

---

[6] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is \$0.70 and it charges customers \$1.00, the markup is \$0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.42857). A "book markup" (sometimes referred to as an "achieved markup") is one that is calculated from the retailer's records. Markup and gross profit margin are different. The gross profit is the sales price minus the cost. The formula for determining the gross profit margin is profit amount ÷ sales price. In the above example, the gross profit margin is 30 percent (0.30 ÷ 1.00 = 0.30).

[7] A POS system typically included 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 included breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable.

observation. Respondent concluded the sales recorded on the cash register z-tape were reliable and computed a credit-card-sales ratio of 94.32 percent and a credit card tip ratio of 9.07 percent based on the cash register z-tape amounts; the credit-card-sales ratio was higher than expected for appellant's business.

14. Based on the second site test, respondent again concluded that the 80-80 rule applied and thus all sales were taxable. Respondent multiplied total sales (excluding sales tax reimbursement and tips) of $2,377.04 by the sales tax rate of 9 percent and computed sales tax due of $213.44 (rounded). Respondent divided sales tax reimbursement collected of $158.20 by sales tax due and computed the ratio of sales tax charged to sales tax due of 74.12 percent ($158.20 ÷ $213.44).[8] Like the first site test, respondent noted that appellant was incorrectly categorizing some sales as nontaxable and that under the 80-80 rule, all sales were subject to sales tax.

15. Respondent estimated taxable sales using the credit-card-sales ratio method; it compiled credit card sales of $3,307,501 (including tax and tips) from the 1099-K data for October 1, 2014, through December 31, 2016, and the bank statements for January 1, 2017, through September 30, 2017. Appellant provided documentation that credit card bank deposits included credit card sales of $25,805 relating to nontaxable sales for Papa Murphy's for July 1, 2017, through September 30, 2017; thus, respondent computed credit card sales of $3,281,696 ($3,307,501 - $25,805) for the first liability period at Anand Bhavan.

16. Respondent divided credit card sales by 1 plus the credit card tip ratio of 9.07 percent and computed credit card sales, excluding credit card tips, of $3,008,868 for the first liability period. For each quarterly period, respondent divided credit card sales, excluding credit card tips, by 1 plus the applicable sales tax rate to compute credit card sales, excluding sales tax reimbursement and tips, of $2,766,264 for the first liability period.[9] Respondent then divided credit card sales, excluding sales tax reimbursement and tips, by the credit-card-sales ratio of 94.32 percent to compute taxable sales of $2,932,817 (rounded) for the

[8] These dollar amounts were compiled from the site observation test and not the cash register z-tapes. The differences are immaterial.

[9] Because appellant did not charge sales tax reimbursement on all sales, this computation overstates sales tax reimbursement included in credit card sales.

first liability period. As a reasonableness test, respondent decided to compute audited taxable sales using FITRs as an alternate method.

17. Respondent divided gross receipts reported on the FITRs by 1 plus the applicable sales tax rate to compute gross receipts, excluding sales tax reimbursement, of $2,438,043 for partial year 2014, 2015, and 2016, combined.[10] Using the credit-card-sales ratio method, respondent compared taxable sales of $2,231,683 for 4Q14, 2015, and 2016, to the corresponding FITR gross receipts (excluding sales tax reimbursement); respondent found that FITR gross receipts (excluding sales tax reimbursement) exceeded taxable sales by $206,360 for the three periods combined. Respondent found that gross receipts appellant reported on its FITRs were reasonable in comparison to the credit-card-sales ratio method and since the FITR book markups were adequate, concluded gross receipts were the best evidence of appellant's sales.

18. Respondent subtracted sales tax reported on the SUTRs from the corresponding gross receipts to compute gross receipts, excluding sales tax reimbursement, of $2,512,604 for partial year 2014, 2015, and 2016, combined. Upon comparison to reported taxable sales of $1,585,904 for the same period, respondent computed unreported taxable sales of $926,700 for that period and an error ratio[11] of 58.43 percent ($926,700 ÷ $1,585,904).

19. Respondent applied the error ratio of 58.43 percent to taxable sales of $444,778 reported on the SUTRs for 1Q17, through 3Q17, and computed unreported taxable sales of $259,900 (rounded). In total, respondent calculated unreported taxable sales of $1,186,600 ($926,700 + $259,900) for the first liability period.

20. Respondent issued the NOD for first liability period to appellant on April 30, 2018, based on the above-mentioned audit, with a tax liability of $104,031.88, plus applicable interest. Respondent concluded that imposition of the negligence penalty was not warranted because of the following: this was appellant's first audit; appellant purchased additional sales tax tools (e.g., the new POS system); and appellant made improvements to keep track of the sales tax reporting.

21. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.

---

[10] Because appellant did not charge sales tax reimbursement on all sales, this computation overstates sales tax reimbursement included in credit card sales.

[11] That is, the "error ratio" is the percentage of unreported taxable sales to reported taxable sales.

22. Respondent held an appeals conference with appellant, and subsequently issued a Decision on July 6, 2021, denying the petition.
23. Appellant timely appealed to OTA.
24. In its opening brief dated December 28, 2021, respondent states that in preparation of its response, it prepared an analysis using gross receipts from appellant's 2017 FITR which was not available at the time of the audit and although appellant was unable to provide documentation for bulk/frozen food sales, respondent concluded an allowance to sales was warranted beginning mid-May 2017. Using the 2017 FITR, respondent computed gross receipts for 1Q17, through 3Q17. Respondent deducted claimed sales tax reimbursement included in reported total sales and then, in consideration of nontaxable bulk/frozen food sales, respondent made a 5 percent allowance in 2Q17 and 10 percent allowance in 3Q17 which in total resulted in increasing the taxable measure to $1,194,048. Therefore, respondent recommends no adjustments for the first liability period.

Second Liability Period

25. For the second liability period, appellant reported on its SUTRs total sales of $1,349,137, claiming deductions for an unknown "other" amount of $1,351, resulting in reported taxable sales of $1,347,786.[12] Appellant also reported $18,750 for sales of fixtures and equipment upon close of the business, resulting in total taxable measure of $1,366,536. Appellant asserted that the sales for Papa Murphy's were reported on the seller's permit of a related entity but did not provide supporting documentation.
26. For audit, appellant provided FITRs for 2017 and 2018; income statements for 2018 and January 1, 2019, through September 30, 2019; a food sales general ledger account summary for January 1, 2018, through June 30, 2019; and bank statements for the second liability period. Appellant did not provide the monthly sales reports used to prepare the SUTRs or source documentation such as cash register tapes or merchandise purchase invoices for the second liability period.

[12] After the notification of audit and prior to the completion of the audit fieldwork, appellant provided informational "amended" SUTRs for the second liability period. Total sales were increased to $2,071,793 and deductions totaling $725,082 were claimed resulting in a taxable measure of $1,365,461 for the second liability period which was less than the taxable measure reported of $1,366,536.

27. Respondent compared total sales reported on the SUTRs for 2017 and 2018, to the corresponding gross receipts (excluding sales tax reimbursement) reported on the FITRs and found that gross receipts exceeded total sales by $408,864 for 2017, $421,081 for 2018, or $829,945 combined. Appellant asserted the differences were related to nontaxable sales/income. Respondent compared taxable sales reported on the SUTRs to the corresponding COGS reported on the FITRs and computed SUTR book markups of 111.49 percent for 2017, 136.93 percent for 2018, and 124.40 percent for both periods combined.

28. Based on its experience in audits of similar businesses in appellant's area as well as the markups established in the immediately preceding prior audit, respondent considered the SUTR book markups to be inadequate for appellant's business. Respondent compared gross receipts to the corresponding COGS reported on the FITRs and computed FITR book markups of 263.45 percent for 2017, 291.87 percent for 2018, or 277.87 percent combined. Respondent considered the FITR book markups to be adequate for appellant's business. Respondent was unable to verify COGS because appellant did not provide purchase journals or merchandise purchase invoices. Due to the incomplete books and records, and large unsupported differences, respondent concluded that additional testing was needed to verify reported taxable sales.

29. Using the bank statements appellant provided, respondent compiled bank deposits from sales proceeds of $1,937,020 for the second liability period.[13] Upon comparison to taxable sales, including reported sales tax, of $1,472,127 reported on the SUTRs, respondent computed a difference of $464,893 for the second liability period. Respondent concluded this was evidence that reported taxable sales were understated and that additional testing was warranted.

30. Respondent obtained 1099-K data for the second liability period, and compiled credit card sales of $1,888,534. Respondent divided credit card sales by 1 plus the credit card tip ratio of 9.07 percent computed in the audit of first liability period and computed credit card sales, excluding credit card tips, of $1,718,566 for the second liability period. For

[13] Bank deposits are not gross receipts. (R&TC, § 6012(a).) However, where a retailer is engaged in the business of making retail sales of tangible personal property, the retailer's bank deposits, net of deposits from non-sale or nontaxable transactions, are evidence of gross receipts from the retail sale of tangible personal property, which evidence respondent can use to determine audited taxable sales when sales cannot be accurately established using a direct approach because of a lack of adequate records.

each quarterly period, respondent divided credit card sales, excluding credit card tips, by 1 plus the applicable sales tax rate to compute credit card sales, excluding sales tax reimbursement and tips, of $1,576,666 for the second liability period.[14] Upon comparison to taxable sales of $1,349,137 reported on the SUTRs, respondent computed a difference of $227,529 for the second liability period. Respondent concluded this was further evidence that reported taxable sales were understated. Based on the available records for the second liability period, respondent calculated audited taxable sales as follows.

31. Using bank statements for 4Q17, respondent compiled non-cash deposits (credit card deposits and sales deposits from food delivery services such as Uber Eats, Eat24, and Grubhub) of $289,426. Respondent computed a ratio of non-cash deposits to total sales deposited of 93.74 percent per the food sales general ledger account summary for January 1, 2018, through June 30, 2019. Respondent divided non-cash deposits for 4Q17 by the 93.74 percent ratio to compute total sales of $308,766.

32. Respondent concluded that gross receipts of $1,220,489 per the 2018 FITR (agrees with income statement) and total sales of $586,874 per the income statements for 1Q19 through 3Q19 were reasonable. In total, respondent computed total sales of $2,116,129 ($308,766 + $1,220,489 + $586,874) for the second liability period.

33. Using bank statements, respondent compiled cash reward deposits of $5,280 and other non-sales deposits of $30,274 for 1Q8, through 3Q19.

34. Appellant identified $35,196 it asserted were sales for resale for January 1, 2018, through September 30, 2019. Appellant did not provide resale certificates; however, based on information from respondent's taxpayer information system,[15] respondent accepted that the customer had purchased food from appellant for resale.

35. From total sales of $2,116,129 for the second liability period, respondent subtracted cash rewards deposits, sales for resale, other non-sales deposits, deposits related to the sale of the business, and tips (as reported on appellant's amended returns) to compute taxable sales (including sales tax reimbursement) of $1,907,039 ($2,116,129 - $5,280 - $35,196 -

---

[14] Because appellant did not charge sales tax reimbursement on all sales, this computation overstates sales tax reimbursement included in credit card sales.

[15] OTA makes the reasonable inference from the names of the purchasers that these sales were made to other food retailers.

$30,274 - $10,223 - $128,107). Respondent divided taxable sales (including sales tax reimbursement) of $1,907,039 by 1 plus the sales tax rate of 9 percent to compute taxable sales of $1,749,577 for the second liability period. Upon comparison to taxable sales of $1,347,786 reported on the SUTRs for the second liability period, respondent computed unreported taxable sales of $401,791 for that period.

36. Appellant asserted that it had nontaxable sales of frozen food and the amounts are claimed on the amended SUTRs. Respondent noted that three frozen food items were added to the menu after a representative from respondent's Statewide Compliance and Outreach Program (SCOP)[16] had visited the business on Wednesday, May 10, 2017. The May 10, 2017 SCOP report (SCOP report) includes the kind of food items available for sale. None of the food items observed were cold food "to-go". The SCOP report indicates that rent is between $8,000-$8,800 per month.[17]

37. Appellant was unable to provide documentation to support sales of frozen food during the second liability period, and thus respondent could not determine the amount of nontaxable sales of frozen food.

38. Respondent issued the NOD for the second liability period to appellant on June 9, 2020, based on the audit, with a tax liability of $36,161 plus applicable interest.

39. Appellant filed a timely petition for redetermination protesting the NOD in its entirety.

40. Respondent held an appeals conference with appellant, and subsequently issued a Decision on July 6, 2021, denying the petition.

41. Appellant timely appealed to OTA.

42. In its opening brief dated December 28, 2021, respondent states that in preparation of its response, it noted an additional sale for resale of $6,000.[18] Because appellant did not charge sales tax on all sales, respondent deducted sales tax reported ($122,990) on the respective SUTRs and then made a 10 percent allowance for nontaxable bulk/frozen food

[16] SCOP is respondent's program that focuses on identifying and registering businesses who are actively selling tangible personal property in California without a seller's permit. In general, the purpose of SCOP is to advise business owners about when they need a seller's permit and how to report and remit their taxes and fees due.

[17] According to the SCOP report, the rent percentage using FITRs gross receipts is approximately 15 percent compared to SUTRs which is approximately 25-30 percent.

[18] To the benefit of appellant, respondent allowed an additional $6,000 adjustment that was not warranted. Respondent is not asserting an increase based on the additional adjustment. Thus, OTA need not address it further.

sales ($177,805). These adjustments resulted in decreasing audited taxable sales to $1,600,244 for the second liability period. Upon comparison to reported taxable sales of $1,347,786, respondent computed unreported taxable sales of $252,458 for the second liability period and error ratios of 26.43 percent for 4Q17 and 27.80 percent for 2018. Because reported taxable sales exceeded audited taxable sales for January 1, 2019, through September 30, 2019, respondent concluded that reported taxable sales were reasonable for that period.

43. Respondent applied the error ratios to taxable sales reported on the corresponding SUTRs for October 1, 2017, through December 30, 2018, and computed unreported taxable sales of $256,602. Thus, respondent prepared a reaudit report dated December 2, 2021, recommending a decrease in the determined taxable measure by $145,189 from $401,791 to $256,602, which remains in dispute.

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).) Such records include but are not limited to: (A) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (B) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (C) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).)

If 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.) 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*.) To satisfy its burden of proof, a taxpayer must prove both: (1) that the tax assessment is incorrect; and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

In general, sales of food are exempt from tax. (R&TC, § 6359.) However, certain sales of food are excluded from the exemption (and are thus subject to tax). As relevant here, sales of food are subject to tax if the food is sold for consumption at facilities provided by the retailer or if the food is sold as hot prepared food products (R&TC, § 6359(d)(2), (d)(7)).

When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359(d)(6).) When a retailer's sales fit within this provision, known as the "80-80 rule," the retailer may avoid its application by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. Tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises. (R&TC, § 6359(f); Cal. Code Regs. tit. 18, § 1603(c)(1)(A).)

Regarding the first liability period, appellant did not initially provide respondent with records for examination. Accordingly, respondent conducted site test 1, which showed that appellant was not accurately recording or collecting sales tax reimbursement (i.e., only 66.47 percent of sales tax reimbursement was properly collected for that day) and based on respondent's observation, the 80-80 rule was applicable to appellant. Respondent then obtained Form 1099-K data for the majority of the liability period, which showed that credit card sales exceeded reported taxable sales ($3,307,501 compared to $2,030,682). Appellant then provided additional, but incomplete records.[19] Respondent's review of the FITRs, when compared to the SUTRs for the same period, showed large discrepancies totaling $926,700 for the period 4Q14 through 2016. Respondent conducted site test 2, which showed the following: appellant was not accurately recording or collecting sales tax reimbursement on 74.12 percent of its sales; 94.32 percent of appellant's sales were transacted through credit cards; the credit card tip ratio

[19] See Factual Finding 9, above.

was 9.07 percent; and respondent once again concluded that the 80-80 rule was applicable to appellant based on the results of respondent's observation.

Respondent then compared gross receipts with COGS, as reported on appellant's FITRs, to calculate appellant's markup. Respondent concluded that the markup of 275.26 percent was reasonable for appellant's business. Respondent then conducted a credit-card-sales ratio analysis. After excluding sales tax, excluding tips, and applying the credit-card-sales ratio established in site test 2, the credit-card-sales ratio analysis showed $2,932,817 in total sales. As a reasonableness test, respondent computed audited total sales based on gross receipts reported on appellant's FITRs. For the period 3Q14 through 4Q16, the audited total sales based on the FITR were $206,360 higher than audited total sales based on the credit-card-sales ratio analysis. Respondent then used reported gross receipts for 4Q14, 2015, and 2016, combined, to compute an error ratio of 58.43 percent (unreported taxable sales of $926,700 ÷ reported taxable sales of $1,585,904), which respondent then applied to the remaining portion of the liability period (i.e., 1Q17-3Q17).

Based on the foregoing, OTA finds that respondent correctly concluded that the books and records appellant provided for audit were incomplete or otherwise unreliable, and respondent could not use the provided records to verify reported taxable sales with a direct audit.[20] When, as is the case here, respondent cannot compute taxable sales from appellant's records, it is appropriate to use an indirect audit approach (i.e. the FITR analysis) to calculate the taxable measure. (See *Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.) In sum, the evidence shows that respondent's use of appellant's reported gross receipts in an indirect audit was reasonable and rational. Thus, for the first liability period the burden of proof shifts to appellant to show that the tax assessment is incorrect; and the proper amount of tax.

With respect to the second liability period, appellant provided more documents than in the first liability period; however, appellant did not provide monthly sales reports, merchandise purchase invoices, or source documentation such as cash register receipts. Similarly, respondent was unable to verify sales reported on appellant's SUTRs for the liability periods using a direct audit method. Respondent's preliminary analysis found large unsupported differences between

[20] A direct audit method is one that enables respondent to verify taxable sales directly from the taxpayer's business records. Generally, a direct audit involves a simple tabulation of taxable sales evidenced by source documents, such as sales invoices, cash register tapes, or verifiable POS data. A direct audit approach based on complete and accurate business records is generally the most accurate.

reported total sales and reported gross receipts. Respondent made adjustments for frozen food sales of 10 percent, cash rewards, sales for resales, non-sales deposits, tips, and sales tax. OTA finds that respondent was rational to question reported sales and use indirect audit methods to compute appellant's sales. Respondent's use of a combination of appellant's own FITRs, income statements, and bank statements in the second liability period to establish appellant's sales are recognized and standard accounting procedures. (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 determinations were reasonable and rational. Therefore, for the second liability period, the burden of proof shifts to appellant to show that the tax assessment is incorrect; and the proper amount of tax.

<u>Site test 1 & 2</u>

Site test observations were performed on September 28, 2017, and January 24, 2018. OTA notes that that September 28, 2017, and January 24, 2018, were selected for the site test days and that the objective of the test was a preliminary examination.

Appellant contends that respondent ignored its two site observations without merit. Appellant asserts that respondent dismissed the two site test days without explanation as to the rationale or argument as to why the site tests should be disregarded. Appellant disagrees with respondent's conclusion that the observation test was not properly conducted. Appellant argues that the credit-card-sales ratio method is a credible method from respondent's audit manual used to project sales. Referencing copies of auditor's email/comments, appellant contends respondent's auditor advocated for using the credit-card-sales ratio method but it was rejected by the audit supervisor who decided to use the FITRs because that resulted in the highest liability. Appellant argues that respondent should have performed a third site test for its observation test.

In response, respondent states that the observation test "verified that the total sales recorded on the FITRs were correct," and thus additional site observation days "were not necessary as the recorded FITR sales were deemed acceptable." Respondent's Audit Manual section 0401.05[21] states that a primary purpose of respondent's audit program is to provide

[21] Respondent's Audit Manual "is an advisory publication providing direction to [Respondent's] staff administering the Sales and Use Tax Law and Regulations." (Respondent's Audit Manual.) Respondent's Audit Manual has not been adopted pursuant to a formal rulemaking process. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) While respondent's Audit Manual may provide guidance to OTA, it does not constitute binding legal authority. (*Appeal of Amaya*, 2021-OTA-328P.)

reasonable assurance that taxpayers pay neither more nor less than required by law. Therefore, respondent may change its audit methodology during the course of the audit if it determines that more accurate information is available, or it finds that its previous conclusions are incorrect. (See R&TC, § 6481; Respondent's Audit Manual § 0401.14.) While respondent presented preliminary findings based on the observation test to appellant, those preliminary findings did not preclude respondent from coming to a different conclusion (e.g., based on the FITR analysis). OTA notes that prior to site test 1, respondent had very little information upon which it could conduct its examination. Subsequently, respondent independently obtained more records and appellant provided records.

While the credit-card-sales ratio method is a recognized indirect audit method utilized by respondent, in this case, respondent found that the credit-card-sales ratio of 94.32 percent was higher than anticipated, based on its experience, and concluded gross receipts reported on the FITRs were more reliable. Appellant's allegations regarding the alleged disagreement between respondent's auditor and audit supervisor are unpersuasive. Respondent has broad authority to use any and all information, as well as the discretion to elect the appropriate audit method based on the available information. (R&TC, § 6481.) Here, the available information materially changed during the audit (e.g., virtually no records prior to obtaining 1099-K data, FITRs etc.), and OTA finds that respondent's decision to disregard the observation test and use another recognized and standard indirect audit method, i.e. analysis of appellant's FITRs, was reasonable. Accordingly, appellant's argument that respondent's audit methodology, the FITR analysis, should be abandoned is unpersuasive. Further, respondent's decision not to perform a third site test is not a basis for adjustment.

Cold Food "To-Go" and the 80-80 Rule

The retailer may avoid the application of the 80-80 rule by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. Tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises. (R&TC, § 6359(f); Cal. Code Regs. tit. 18, § 1603(c)(1)(A).) Any seller meeting the criteria of the 80-80 rule and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made. (R&TC, § 6359(f); Cal. Code Regs. tit. 18, § 1603(c)(3).)

Appellant argues it sold nontaxable frozen food during both liability periods and that respondent erroneously concluded that the 80-80 rule applies. Appellant asserts that the observation test showed exempt cold food sales were 33.53 percent on September 28, 2017, 25.88 percent on January 24, 2018, or 29.71 percent combined. Appellant submitted its own calculation of taxable sales in which it computed 29.71 percent of sales were nontaxable cold food sales for the entire first liability period which resulted in a credit measure for the first liability period. Appellant argues that respondent erroneously concluded that appellant met the provisions of the 80-80 rule. In support, appellant provided purchase invoices for aluminum food containers, which appellant argues were for its exempt cold food "to-go" sales. Appellant also provided frozen food coupons and flyers, a screen shot from a Google search showing its menu, a letter from a former employee, a monthly sales report for 3Q17 and 4Q17, testimony of the owner, as well as testimony of the appellant's CPA.

Respondent concluded, based on the two site observations, a review of the menu, and information from Yelp.com, that appellant's sales during the liability periods met the requirements of the 80-80 rule. Respondent notes that appellant claimed no exempt sales of food (i.e., cold food "to-go") on its SUTRs and did not provide POS sales reports or source documentation such as cash register receipts to support its sales of cold food to-go. Therefore, respondent concluded that all of appellant's sales were subject to tax under the 80-80 rule. Respondent argues that appellant provided a self-constructed spreadsheet without source documentation, which is insufficient to meet appellant's burden. Respondent also argues that appellant only added three frozen food items to the menu shortly after SCOP visited on May 10, 2017, which is towards the end of the first liability period. Further, for the first liability period, respondent argues that it reviewed images posted on Yelp by appellant's customers and that none of the photos contain images of frozen food "to-go," and similarly the menu posted on Yelp does not include any frozen food items. Respondent conceded that appellant made sales of frozen food, and respondent states that it has made an applicable adjustment.[22]

OTA examined the evidence pertaining to the site tests, and notes that respondent identified sales where sales tax reimbursement was not charged or the proper amount was not charged but did not notate whether the sale was for cold food "to-go." Respondent also did not identify any sales of frozen food not for immediate consumption. Respondent asserts that

[22] See Factual Findings 24 and 42.

appellant did not charge tax reimbursement on items that should have been taxed; thus, although appellant only charged tax on 66.47 percent for site test 1 and 74.12 percent for site test 2 of sales during the observation tests, respondent concluded that the actual amount of taxable sales exceeded 80 percent of appellant's sales. Here, appellant has not provided source documentation to support it did not meet the criteria of the 80-80 rule but relies on respondent's observation test. However, OTA finds the observation test does not establish that 29.71 percent was for nontaxable cold food and frozen food; rather, the test shows only that appellant did not charge or collect tax on those sales. Appellant simply misconstrues the site test results. Accordingly, OTA finds that appellant's assertions are unpersuasive and finds that appellant's sales were subject to the 80-80 rule.

Even if appellant were not subject to the 80-80 rule, it would be subject to the same 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).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.) Appellant failed to maintain and provide verifiable documentation supporting its sales of cold food "to-go" and frozen food not for immediate consumption on the premises. Exemptions from tax are strictly construed against the taxpayer who has the burden of proving that the statutory requirements have been satisfied. (*H. J. Heinz Co. v. State Bd. of Equalization*, (1962) 209 Cal.App.2d 1, 4.)

Regarding appellant's testimony, statement of a former employee, copies of discounts, and unsupported self-constructed schedules, OTA finds that appellant's evidence is insufficient to conclude that appellant sold frozen food "to-go" throughout the first liability period. Appellant's evidence, when considered with the conflicting contemporaneous evidence in the record, is not entitled to more weight. For example, appellant argues that nothing material changed between the two liability periods and testified that it began selling frozen food in 2014. However, the audit workpapers show that appellant changed its POS system in July 2017; made improvements to keep track of the sales tax reporting; and changed its menu to include three frozen food items after the SCOP visit. Therefore, appellant's evidence in support does not meet appellant's burden to prove entitlement to the exemption. With respect to appellant's argument that its purchases of aluminum containers support an adjustment, it is just as probable that aluminum containers could have been used for food that is excluded from the exemption (i.e., hot food "to-go"), which is insufficient to meet appellant's burden.

In sum, in the absence of verifiable supporting evidence, OTA finds no further adjustment for frozen food is warranted to the measure of unreported taxable sales established in the audit of the first liability period and reaudit of the second liability period.

Adjustments for Tips and Sales Tax

Appellant contends that tips and sales tax in the first liability period were not properly deducted in computing audited taxable sales while they were excluded in the second liability period. Appellant asserts that if an allowance for cold food "to-go" is not made, unreported taxable sales should be assumed to be sales tax included and sales tax should be computed as in the second liability period by dividing by 1 plus the sales tax rate. Appellant asserts that tips should be allowed based on the observation test at 9.07 percent.

Respondent reduced gross receipts by sales tax reimbursement appellant reported on its SUTRs. As OTA has previously concluded, appellant has not provided documentation to support nontaxable sales of cold food. Appellant's failure to collect sales tax reimbursement is not a basis to regard those sales as sales tax included. Accordingly, OTA rejects appellant's contention that all gross receipts should be assumed to include sales tax reimbursement.

Appellant has not provided documentation to support tips but relies on respondent's observation test for the 9.07 percent credit card tip ratio. Appellant has not provided documentation to support the reported gross receipts and whether the reported amounts include tips. If tips were included, the 9.07 percent credit card tip ratio would be applied only to credit card sales and not gross receipts attributable to cash sales. Accordingly, OTA finds no basis to recommend adjustment for this argument.

Appellant contends that respondent's Appeals Bureau representative had preconceived notions on how Indian restaurants do not have cold food sales and did not provide a fair and impartial review of the facts. Appellant's appeals are now before OTA. OTA is an independent and impartial appeals body. In general, OTA has jurisdiction to hear and decide an appeal that has been timely submitted pursuant to an Appeals Bureau decision that is adverse to the taxpayer, in whole or in part. (Cal. Code Regs., tit. 18, § 30103(b)(1).) As stated above, OTA found that respondent has met its initial burden of showing that its determination was reasonable and rational. Therefore, appellant must show that there are errors in the audit. Accordingly, OTA declines to further discuss the alleged bias inferred from Appeals Bureau representative's comments.

In summary, OTA finds that respondent computed audited taxable sales based on the best available evidence. Appellant has not identified any errors in respondent's computation of audited taxable sales or provided new documentation or other evidence in support of its contentions from which a more accurate determination could be made. As appellant bears the burden of proof in these cases, OTA must conclude that no further adjustments are warranted.

HOLDINGS

1. Adjustments are not warranted to the measure of unreported taxable sales for the first liability period.
2. Further adjustments are not warranted to the measure of unreported taxable sales for the second liability period.

DISPOSITION

Respondent's action in reducing the determined taxable measure by $145,189 from $401,791 to $256,602 in the second liability period but otherwise denying the petitions is sustained.

DocuSigned by:
Josh Aldrich
48745BB806914B4...
Josh Aldrich
Administrative Law Judge

We concur:

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

Signed by:
Kim Wilson
4E8E740EDB984CD...
Kim Wilson
Hearing Officer

Date Issued: 9/23/2025