OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **WHISKEY SCHAT'S,** **dba Whiskey Creek**	OTA Case No.: 241218152 CDTFA Case ID: 4-779-815

OPINION

Representing the Parties:

For Appellant: Marianne Schat, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Whiskey Schat's, doing business as Whiskey Creek, (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying in part appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on March 14, 2023.[1] The NOD is for tax of $539,235, plus applicable interest, and a 40 percent penalty of $203,144[2] for the period July 1, 2019, through June 30, 2022 (liability period).

After the issuance of the NOD, CDTFA prepared a reaudit that reduced the determined tax and penalty. In preparation for this appeal, CDTFA performed a second reaudit, which reduced the tax liability to $384,073 and the penalty to $144,406.80.

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

[1] The NOD was timely issued because on August 2, 2022, appellant signed a waiver of the otherwise applicable three-year statute of limitations for the period July 1, 2019, through December 31, 2019, which allowed CDTFA until April 30, 2023, to issue an NOD. (See R&TC, §§ 6487(a), 6488.)

[2] CDTFA imposed a 40 percent penalty of $203,144.80 for sales tax reimbursement that was knowingly collected but not remitted timely in accordance with R&TC section 6597 for the liability period.

ISSUES

1. Whether additional adjustments to the measures of tax are warranted.
2. Whether CDTFA properly imposed the 40 percent penalty; if so, whether relief of the penalty is warranted.

FACTUAL FINDINGS

1. Appellant, a corporation, operated a restaurant located in Bishop, California. CDTFA issued appellant a seller's permit with an effective start date of April 15, 2016. CDTFA previously audited appellant for the period April 15, 2016, through December 31, 2018.
2. During the liability period, appellant filed sales and use tax returns reporting gross sales of $2,077,328 and claiming deductions for exempt sales of food products of $145,140, which resulted in reported taxable sales of $1,932,188. Appellant also reported purchases subject to use tax of $327. In total, appellant reported taxable transactions of $1,932,515 ($1,932,188 + $327).
3. For the liability period, CDTFA completed an audit and two reaudits.[3]
4. Appellant did not provide a complete set of books and records for the audit. Instead, appellant provided point of sale (POS) system sales data for October 1, 2020, through June 30, 2022, and POS cash and credit card sales summary reports (POS sales summary) for July 3, 2020, through June 30, 2022.[4] However, appellant did not provide source documents for CDTFA to verify the information recorded in the various POS reports. CDTFA also obtained: appellant's federal income tax returns for 2019 and 2020; and Form 1099-K data for the period January 1, 2019, through December 31, 2021.[5]
5. Upon audit, CDTFA asserted a liability based on six audit items: unreported taxable sales based on a comparison of appellant's federal income tax returns to appellant's

[3] CDTFA completed the second reaudit after appellant filed its appeal with OTA. The second reaudit is based on two audit items and is discussed below. OTA includes a brief description of the original audit and first reaudit to the extent that they are related to any remaining issue.

[4] The audit workpapers also indicate that appellant provided a single entry set of books and records. There is little specificity as to what appellant included with these records. However, CDTFA concluded that they were not supported by source documentation and appeared to be kept separate from the POS system sales data.

[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 data includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

sales and use tax returns measuring $1,703,451; unreported taxable sales based on a ratio of credit card sales measuring $2,151,426; purchases of fixtures and equipment subject to use tax based on a review of appellant's federal income tax returns measuring $18,876; additional taxable sales based on POS system sales data measuring $2,292,811; disallowed claimed deductions for the sale of nontaxable food products measuring $145,140; and disallowed other income reported on appellant's federal income tax returns but not reported on appellant's sales and use tax returns measuring $209,706.

6. On March 14, 2023, CDTFA issued the aforementioned NOD with a tax liability of $539,235.
7. In the NOD, CDTFA also imposed a 40 percent penalty of $203,144.80 for failing to remit sales tax reimbursement that appellant knowingly collected, based on the following:
    a. During the audit, CDTFA scheduled appellant's POS system sales data for the fourth quarter of 2020 (4Q20) through 2Q22 and found that appellant recorded the collection of sales tax reimbursement totaling $332,265. CDTFA noted that appellant did not collect sales tax reimbursement on 2 percent of its recorded sales. Thus, CDTFA concluded that appellant collected sales tax reimbursement on 98 percent of its sales.
    b. To calculate the penalty, CDTFA scheduled appellant's audited total sales excluding tip (ex-tip) for each quarter of the liability period. CDTFA reduced audited sales by 2 percent to arrive at adjusted audited sales where sales tax was collected. CDTFA then applied the sales tax rate to compute audited sales tax reimbursement collected of $670,033 for the liability period.
    c. CDTFA compared audited sales tax reimbursement collected to the amount that appellant reported during the liability period of $162,171 and found unremitted sales tax reimbursement of $507,862 for the liability period. Appellant's quarterly unremitted sales tax reimbursement was greater than $1,000 per month and greater than 5 percent of the total liability per quarter. Therefore, CDTFA calculated a penalty of $203,144.80 (40 percent of the unpaid sales tax reimbursement collected).
8. Appellant filed a petition for redetermination disputing the NOD.
9. During CDTFA's internal appeal process, CDTFA determined that adjustments were warranted to the measure of unreported taxable sales based on a ratio of credit card

sales. CDTFA performed a reaudit, which reduced the taxable measure from $6,521,541 to $4,972,817. CDTFA also reduced the 40 percent penalty for failing to remit knowingly collected sales tax reimbursement for 3Q19 through 1Q22 to $145,234.40.[6] CDTFA issued a decision ordering the liability to be redetermined based on the first reaudit. Otherwise, CDTFA denied appellant's petition for redetermination.

10. Appellant timely appealed to OTA.

11. During these appeals proceedings, CDTFA completed a second reaudit, which further reduced the taxable measure.

12. For the second reaudit, CDTFA compared the gross receipts reported on appellant's federal income tax returns for 2019 through 2021 to the gross receipts, excluding tax, that appellant reported on its sales and use tax returns.[7] The amounts reported on appellant's federal income tax returns exceeded appellant's sales and use tax returns by $1,416,749 for 2019, $1,027,471 for 2020, and $1,885,157 for 2021.

13. CDTFA used appellant's federal income tax returns and appellant's Form 1099-K data to apportion the gross receipts reported on appellant's federal income tax returns to each quarter of the period 3Q19 to 4Q21. CDTFA scheduled the credit card sales reported on appellant's 1099-K forms to calculate a ratio of quarterly credit card sales to annual credit card sales for each quarter, which CDTFA then applied to the gross receipts reported on appellant's federal income tax returns to compute quarterly federal income tax return sales. This resulted in total sales reported on appellant's federal income tax returns of $4,936,573 for the period 3Q19 through 4Q21.

14. On its federal income tax returns, appellant reported "other income" of $206,675 in 2019, $106,367 in 2020, and $186,614 in 2021. CDTFA determined that appellant's "other income" should be included in the taxable measure because appellant did not provide documentation showing otherwise. Thus, CDTFA applied the quarterly credit card sales to annual credit card sales ratios (discussed above) to appellant's other income to calculate quarterly other income of $410,434 for the period 3Q19 through 4Q21.

15. Appellant's federal income tax return for the 2022 tax year was not available during the second reaudit. Therefore, CDTFA accepted the sales that appellant reported in

[6] CDTFA concluded that the unremitted tax for 2Q22 did not meet the thresholds for imposing the penalty in that quarter.

[7] CDTFA obtained appellant's federal income tax return for 2021, which was unavailable prior to the second reaudit.

appellant’s POS sales summary of $578,018 for 1Q22 and $712,334 for 2Q22, or $1,290,351 combined (rounded).[8]

16. CDTFA computed appellant’s projected “other income” for 1Q22 through 2Q22 based on the increase in sales that appellant recorded from the corresponding quarter in the prior year. CDTFA compared the sales recorded in appellant’s POS sales summary for 1Q22 to the sales that appellant recorded for 1Q21 and found a growth rate of 70.57 percent. CDTFA applied that rate to the audited “other income” for 1Q21 of $25,202 to project “other income” of $42,987. CDTFA followed the same process to calculate a growth rate of .54 percent from 1Q22 to 2Q22. CDTFA applied the growth rate to appellant’s quarterly “other income of $54.601 to calculate other income for 2Q22 of $54,893.

17. In total, CDTFA calculated total sales included in appellant’s federal income tax returns and POS summaries of $6,735,239 ($4,936,573 + $1,290,351 + $410,434 + $97,880). CDTFA subtracted sales tax reported on appellant’s sales and use tax returns to compute audited taxable sales of $6,573,044, which when compared to reported taxable sales reveals unreported taxable sales of $4,640,529.

18. On April 3, 2022, CDTFA issued an audit report based on two audit items, including: unreported taxable sales based on appellant’s federal income tax returns and POS summaries of $4,640,529; and unreported purchases of fixture and equipment subject to use tax of $18,876. The results of the second reaudit further reduced the taxable measure from $4,972,817 to $4,659,405.

19. CDTFA also reduced the 40 percent penalty for failure to remit sales tax reimbursement. To compute the revised penalty, CDTFA first calculated the sales tax reimbursement collected by reducing audited total sales (ex-tip) of $6,573,044 by appellant’s claimed nontaxable sales of food of $145,140 and 2 percent to account for sales in which appellant did not collect sales tax reimbursement. This resulted in adjusted audited taxable sales of $6,299,533 for the liability period. After applying the sales tax rate to each quarter, CDTFA computed audited sales tax reimbursement collected of $522,151 for the audit period, which when compared to the amount of sales tax reported results in unremitted sales tax reimbursement of $361,017. Appellant’s unremitted sales tax reimbursement was greater than $1,000 per month and greater than 5 percent of the

[8] For 1Q22, the sales recorded in appellant’s POS summary exceeded the taxable sales that appellant reported in its sales and use tax returns of $165,161 by $412,857 ($578,018 - $165,161). For 2Q22, the sales recorded in appellant’s POS summary exceeded the taxable sales that appellant reported in its sales and use tax return of $672,185 by $40,149 ($712,334 - $672,185).

total amount of tax collected for the period 3Q19 through 1Q22. Therefore, CDTFA applied a 40 percent penalty of $144,406.80 for the period 3Q19 through 1Q22.

DISCUSSION

Issue 1: Whether additional adjustments to the measures of tax are warranted.

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*.)

Upon audit, appellant did not provide a complete set of books and records. Initially, CDTFA compared appellant's federal income tax returns to appellant's sales and use tax returns for the 2019 and 2020 tax years and found differences that could not be explained. For example: appellant reported sales on its federal income tax returns that were not included on its sales and use tax returns; appellant reported "other income" on its federal income tax returns but did not provide documentation to support that this other income was anything but additional taxable sales; and appellant reported purchases of fixtures and equipment on its federal income tax returns but failed to provide documentation that it had paid tax on these purchases. Similarly, the second reaudit revealed differences between the amounts that appellant had recorded in its federal income tax returns and POS sales summaries and the amounts reported on appellant's sales and use tax returns. Based on these differences, it was reasonable for CDTFA to conclude that appellant underreported the taxable transactions on its sales and use tax returns.

As relevant here, the amount remaining in dispute is based on the second reaudit. For the second reaudit, CDTFA compared appellant's federal income tax returns to appellant's sales and use tax returns for the period 2019 through 2021 and found discrepancies that could not be explained. However, the liability period does not include all of 2019 and appellant did not provide source documents from which its taxable sales could be verified. Thus, it was appropriate to use an indirect approach to calculate the taxable measure. (See *Appeal of Amaya*, 2021-OTA-328P.)

To calculate the taxable measure, CDTFA used appellant's Form 1099-K data for each quarter to calculate a ratio of quarterly credit card sales to annual credit card sales. CDTFA then applied the quarterly ratios to the gross receipts reported on appellant's federal income tax returns to calculate audited taxable sales for each quarter of the period 3Q19 through 4Q21. For the remaining quarters (1Q22 and 2Q22), CDTFA used both a direct method and indirect method to calculate the taxable measure. First, CDTFA calculated unreported taxable sales based solely on a comparison of the sales recorded in appellant's POS sales summaries. Then, CDTFA calculated projected "other income" based on the business's growth as recorded in the POS sales summaries. Considering the absence of books and records, and the discrepancies that could not be explained, it was reasonable and rational for CDTFA to use appellant's own records (i.e., Form 1099-K data, federal income tax returns, and POS data) to project appellant's audited taxable sales. Accordingly, the burden shifts to appellant to show that a reduction to the taxable measure is warranted. (See *Appeal of Talavera*, *supra.*)

On appeal, appellant argues that the taxable measure should be reduced. Appellant contends that during the audit it provided "actual POS records," which were ignored by CDTFA. However, appellant has not provided any further explanation or evidence to support this contention. For example, appellant has not provided the POS records that were purportedly ignored. By comparison, the record reflects that CDTFA reviewed the available POS information and found substantial differences. As relevant here, CDTFA found that the sales recorded in appellant's POS summaries exceeded the taxable sales reported in appellant's sales and use tax returns by $412,841 for 1Q22 and $40,149 for 2Q22.[9] To date, appellant has not provided any explanation for these differences. Appellant also has not provided any evidence to show that CDTFA's calculations for 1Q22 and 2Q22 are incorrect.

Similarly, appellant has not provided any evidence to explain the differences between gross receipts that it reported on its federal income tax returns and the taxable sales that it

[9] See footnote 8.

reported on its sales and use tax returns. Appellant's unsupported assertions are not sufficient to meet its burden of proof. (See *Appeal of Talavera*, *supra.*) As such, OTA finds no basis to reduce the taxable measure.

<u>Issue 2: Whether CDTFA correctly imposed the 40 percent penalty; if so, whether relief of the penalty is warranted.</u>

For determinations made before January 1, 2025, any person who knowingly collects sales tax reimbursement and fails to timely remit that tax reimbursement to CDTFA is liable for a penalty of 40 percent of the amount not timely remitted. (Former R&TC, § 6597(a)(1) [amended by Stats. 2024, ch. 499, eff. Jan 1, 2025].) The penalty does not apply if the person's liability for unremitted sales tax reimbursement averages $1,000 or less per month or does not exceed 5 percent of the total amount of the tax liability for which the sales tax reimbursement was collected for the period in which the tax was due, whichever is greater. (Former R&TC, § 6597(a)(2)(A).)[10]

The 40 percent penalty may be relieved if a person's failure to make a timely remittance of sales tax reimbursement was due to reasonable cause or circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. (R&TC, § 6597(a)(2)(B).) Reasonable cause or circumstances beyond the person's control includes, but is not limited to, any of the following:

(1) The occurrence of a death or serious illness of the person or the person's next of kin;
(2) A state of emergency declared by the governor;
(3) A natural disaster or other catastrophe directly affecting the person's business operations;
(4) CDTFA's failure to send returns or other information to the correct address of record;
(5) The failure to make a timely remittance occurred only once over a three-year period, or once during the period in which the person was engaged in business, whichever period is shorter; or
(6) The person voluntarily corrected errors in remitting sales tax reimbursement that were made in previous reporting periods and remitted payment of the liability

[10] The amendments updated the thresholds in this section, effective January 1, 2025, to $1,500 or less per month and 25 percent of the total tax liability, respectively. Appellant's underpayment of collected sales tax reimbursement also exceeds the updated thresholds.

owed as a result of those discrepancies. (See R&TC, § 6597(b)(1)(A)-(F) [summarized above].)

Appellant bears the burden of establishing by a preponderance of evidence that relief of the penalty is warranted. (Cal. Code Regs., tit. 18, § 30219(a) & (b) [placing the burden of proof on the appellant as to all issues of fact].)

Here, CDTFA reviewed appellant's POS system sales data and found that appellant recorded the collection of sales tax reimbursement totaling $332,265 for 4Q20 through 2Q22 but only reported and remitted $125,790 for the same periods. Accordingly, CDTFA concluded that appellant knowingly collected and failed to remit the sales tax.

The second reaudit, which is based on a combination of appellant's federal income tax returns and POS summaries, resulted in unreported taxable sales of $6,735,239 and unremitted sales tax reimbursement of $361,017. However, OTA notes that the measure of unreported taxable sales includes "other income" reported on appellant's federal income tax returns of $410,434 for the period 3Q19 through 4Q21 and projected "other income" of $97,880 for the period 1Q22 through 2Q22. It is unclear whether this income is included in appellant's POS system sales data. Further, OTA finds no evidence that appellant collected sales tax reimbursement on its "other income." Therefore, the audited sales tax reimbursement collected must be reduced to exclude amounts derived from appellant's audited "other income" in calculating the penalty.

On appeal, appellant has not provided any explanation for the differences between the sales tax reimbursement recorded in its POS system sales data and the amounts reported on its sales and use tax returns. Appellant also does not provide any facts or circumstances showing that its failure to make a timely remittance of sales tax reimbursement was due to reasonable cause or circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. Therefore, with the exception of the adjustments discussed herein, relief of the 40 percent penalty is not warranted.

HOLDING

1. Additional adjustments to the measure of tax are not warranted.
2. Reduce the 40 percent penalty to exclude amounts for sales tax reimbursement collected on "other income." Otherwise, CDTFA properly imposed the 40 percent penalty and relief of the penalty is not warranted.

DISPOSITION

Recalculate the 40 percent penalty in accordance with this Opinion. Redetermine the taxable measure in accordance with the second reaudit. Otherwise, CDTFA's action denying appellant's petition for redetermination is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Steven Kim
Administrative Law Judge

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Kim Wilson
Hearing Officer

Date Issued: 6/4/2026