OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:

24 CARROTS SPECIAL EVENTS, INC.

OTA Case No.: 240817036
CDTFA Case ID: 3-530-533

OPINION

Representing the Parties:

For Appellant: Mardiros H. Dakessian, Attorney
Benjamin K. Lee, Attorney
Alma Martinez, Representative

For Respondent: Jennifer Barry, Attorney
Jarrett Noble, Attorney
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For Office of Tax Appeals: Corin Saxton, Attorney

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, 24 Carrots Special Events, Inc. (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 January 28, 2022, for the period October 1, 2013, through September 30, 2021 (liability period).[1] The NOD is for tax of $1,855,621, plus applicable interest, and penalties totaling $185,562.08. The penalties consist of a failure-to-file penalty of $167,334.87 for fourth quarter of 2013 (4Q13) through 4Q20 and a negligence penalty of $18,227.21 for 1Q21 through 3Q21.

Office of Tax Appeals (OTA) Panel Members Andrew Wong, Steven Kim, and Kim Wilson 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, (Regulation) section 30209(b).

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

ISSUES

1. Whether appellant is a retailer who made taxable sales during the liability period.
2. Whether CDTFA timely issued the NOD.[2]
3. Whether the failure-to-file penalty should be relieved.
4. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant is a California corporation located in Costa Mesa, California.
2. In conjunction with a related business entity, 24 Carrots, LLC, appellant is engaged in business to provide food and beverage, venue rental, equipment rental, and event-related services for events such as weddings, showers, and graduation parties.[3] Customers purchased food and beverage from 24 Carrots, LLC, and appellant provided venue leases, equipment rental, and service staff.
3. 24 Carrots, LLC was organized in 2004, and appellant incorporated in 2009. Prior to appellant's incorporation, 24 Carrots, LLC provided its customers with a full complement of event-related goods and services under a single contract. Appellant was organized in 2009 following a telephone conversation wherein CDTFA informed 24 Carrots, LLC that charges for venue and equipment rentals and service charges would be nontaxable if provided by a third party separate from 24 Carrots, LLC.
4. On June 18, 2010, 24 Carrots, LLC's consultant sent an email requesting that CDTFA confirm the accuracy of the oral advice CDTFA provided over the telephone. In his email, the consultant did not identify appellant.
5. In an email response sent on July 14, 2010, CDTFA provided general advice that if one business entity made retail sales and a second separate business entity provided nontaxable services, then the services provided by the second business entity would not be taxable as a part of the sale of the tangible personal property by the first business

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[2] During a pre-hearing conference with the parties, OTA framed this issue as what was the applicable statute of limitations for CDTFA's determination (i.e., three years or eight years). OTA addresses this question below in the context of whether CDTFA timely issued the NOD to appellant with respect to 4Q13 through 3Q18. Appellant does not dispute that CDTFA timely issued the NOD with respect to 4Q18 through 3Q21.

[3] 24 Carrots, LLC and appellant are commonly owned. 24 Carrots, LLC is also located in Costa Mesa, California.

entity;[4] however, if a single business entity provided the services and tangible personal property, the entire charge would be taxable.[5] CDTFA's email also clarified that equipment rentals are also not necessarily nontaxable.

6. Appellant did not apply for a seller's permit because appellant believed, based on the advice from CDTFA, that it was not in the business of selling tangible personal property.
7. It was not until CDTFA audited 24 Carrots, LLC that CDTFA discovered appellant's business and advised appellant to file an application for a seller's permit.
8. In 1Q21, appellant applied for a seller's permit, and CDTFA opened a seller's permit for appellant with an effective start date of October 13, 2009. Appellant began filing sales and use tax returns starting with 1Q21.
9. Regarding operations, 24 Carrots, LLC prepared the food for the events at a commissary kitchen in Costa Mesa. Appellant's employees picked up the food and delivered it to a venue leased by appellant. At the venue, appellant's staff of chefs, servers, and bartenders served the food and beverage to the event's attendees.
10. Event customers entered separate contracts with appellant and 24 Carrots, LLC. Appellant and 24 Carrots, LLC issued separate invoices for their charges.
11. Appellant issued "Staffing & Rental Services" invoices, which included charges for various food-related serving fees as well as venue-related fees.
    a. The food-related serving fees included charges for chef and bartender services, fees for food servers, food delivery fees, food-related set up and pick-up services, kitchen fees, and related mandatory gratuities (collectively, food-serving fees).
    b. The venue-related fees included the following: equipment rental charges; venue charges; venue setup and installation charges; parking fees; cleaning fees; security guard fees, administrative fees, equipment damage waiver fees; and lead server fees (collectively, venue-related fees).

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[4] Specifically, CDTFA wrote, "Your client wishes to set up two separate companies to handle the catering services now provided by a single company. One of the proposed new companies would provide the food and beverage for the event and the other proposed company would provide the venue location, staffing, and rentals…. You are proposing that the second company's services would not be taxable as they are not related to the sale of the food and beverage." Subsequently, CDTFA advised, "Assuming the companies are operating as bona fide separate legal entities then the contract for the separately stated [']non-taxable' services offered by the new company would not be subject to tax."

[5] Relief based on written advice, pursuant to R&TC section 6596, is not applicable or at issue because the incoming request did not identify the person requesting advice and, as such, CDTFA's July 14, 2010 response specifically stated that it does not qualify for relief pursuant to R&TC section 6596.

12. 24 Carrots, LLC issued "Catering & Bar Services" invoices, which included, in pertinent part, charges for the food, meals, and beverages. The invoices issued by 24 Carrots, LLC are not at issue in this appeal.
13. Upon audit, appellant did not provide any books or records. Instead, CDTFA used sales summaries, sales invoices, and event contracts obtained during CDTFA's audit of 24 Carrots, LLC.
14. CDTFA determined that sales tax applied to appellant's food-serving fees, but the venue-related fees were nontaxable and allowed a deduction for them. As appellant reported zero taxable sales for the liability period, CDTFA identified a deficiency measure for unreported taxable sales of $23,435,417 for the liability period.
15. Overall, CDTFA determined that 37.49 percent of appellant's charges were taxable as related to the sale of food and beverages. CDTFA's audit methodology is not in dispute.
16. Despite multiple requests from CDTFA during the audit, appellant declined to file sales and use tax returns for the period 4Q13 to 4Q20. According to a CDTFA-836-A (*Report of Discussion of Audit Findings*) dated January 27, 2022, appellant declined to file returns and refused to "self-assess" because it was contesting the statute of limitations and filing returns would undercut its argument against the statute: "[Appellant's representative during the audit] stated that they would not file returns based on CDTFA treating the audit as a combined audit between both entities, and[,] based on statute of limitations, self-assessing would hinder their argument."
17. On January 28, 2022, CDTFA issued the NOD to appellant.
18. Appellant filed a timely petition for redetermination as well as a request for penalty relief, both of which CDTFA denied.
19. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant is a retailer who made taxable sales during the liability period.

California imposes upon all retailers a sales tax measured by the retailer's gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) "Gross receipts" mean the total amount of the sale price of the retail sales of retailers, valued in money, and includes any services that are a part of the sale. (R&TC, § 6012(a), (b).) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, it is presumed 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 tax returns or the amount of tax required to be paid to the state by any person, CDTFA may compute and determine the amount required to be paid on the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) If any person fails to make a return, CDTFA will estimate that person's gross receipts. (R&TC, § 6511.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Las Playas #10*, 2021-OTA-204P.) If CDTFA's determination is not reasonable or rational, then the determination should be rejected. (*Appeal of Landeros*, 2024-OTA-655P.) If CDTFA's determination is reasonable and rational, then the determination is presumed correct, and the burden of overcoming this presumption is on the taxpayer. (*Ibid*.)

Generally, the appellant bears the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) That is, a taxpayer must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Las Playas #10, Inc.*, *supra*.) To satisfy its burden of proof, a taxpayer must prove both that the tax assessment is incorrect and what the proper amount of tax should be. (*Appeal of AMG Care Collective*, *supra*.)

Did appellant make taxable "sales"?

"Sale" means and includes any transfer of title or possession, exchange or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. (R&TC, § 6006(a).) "Sale" also means and includes the fabricating of tangible personal property for a consideration for consumers who furnish, directly or indirectly, the materials used in the fabricating. (R&TC, § 6006(b).) Further, "sale" means and includes the furnishing, preparing, or serving for a consideration of food, meals, or drinks. (R&TC, § 6006(d).)

Here, it is undisputed that appellant served food, meals, and drinks, and charged its customers for that service. A separate legal entity related to appellant invoiced appellant's customers for the food, meals, and drinks that appellant served, and appellant separately invoiced its customers an additional charge for serving the food, meals, and drinks to the guests. In other words, appellant seeks to delineate the charge for the food, meals, and drinks from the charge for serving the food, meals, and drinks in order to separate (or "unbundle") taxable components (i.e., the food, meals, and drinks) from allegedly nontaxable components (i.e., the serving of the food, meals, and drinks).

During the audit, CDTFA asserted taxes on appellant's charges for serving the food, meals, and drinks directly to the event guests. Because appellant was engaged in the business of serving for a consideration food, meals, or drinks, appellant made a "sale" within the meaning of R&TC section 6006(d), and its gross receipts from such sales are taxable, absent an exemption or exclusion. Aside from appellant's argument that its service of food, meals, and drinks does not qualify as "sales," no applicable exemption or exclusion is at issue in this appeal. Therefore, tax applies to appellant's food-serving fees. Although the forgoing is dispositive, this Opinion will address the respective arguments raised by the parties.[6]

CDTFA asserts that appellant's charges for preparing and serving food and beverages are subject to sales tax because R&TC section 6006(d) defines a "sale" to include the furnishing, preparing, or serving for a consideration of food, meals, or drinks. CDTFA also cites Sales and Use Tax Annotations (annotation) 295.0120 (8/4/67) and 550.0809 (9/14/93).[7]

In response, appellant raises a statutory construction argument, asserting that CDTFA's interpretation of R&TC section 6006(d) disregards legislative intent and fails to accord with the purpose of the statute. Specifically, appellant argues that CDTFA's interpretation of R&TC section 6006(d) results in the application of sales tax to service transactions that do not involve the transfer of tangible personal property. Appellant asserts that CDTFA's position is therefore contrary to California Supreme Court precedent and California Court of Appeal precedent, which has repeatedly held that sales tax only applies to transactions that involve the sale of tangible

[6] To the extent an argument or item is not specifically addressed herein, OTA evaluated it and considered it to be without merit, repetitive, and/or duplicative of argument or items already addressed.

[7] Annotations are summaries of the conclusions reached in selected legal rulings by respondent. (Cal. Code Regs., tit. 18, § 35101(a)(1).) Annotations do not embellish or interpret the legal rulings which they summarize and do not have the force and effect of law. (*Ibid*.) Annotation 295.0120 states that opening and serving customer-furnished champagne constitutes a sale, and charges for this are includible in taxable gross receipts. Annotation 550.0809 states that cutting and serving a customer-furnished wedding cake constitutes a sale by a country club, and charges for cutting and serving are considered taxable gross receipts pursuant to R&TC sections 6006(d) and 6012.

personal property.[8] Additionally, appellant asserts that CDTFA's position is contrary to Regulation section 1501, which stands for the principle that a service is only taxable if bundled with the transfer of tangible personal property.

Appellant argues that the Legislature's purpose in enacting the language now codified as R&TC section 6006(d) was merely to specify that sales of meals for on-premises consumption (i.e., sales by restaurants) were transfers of tangible personal property subject to tax, and that the Legislature did not intend to impose sales tax on serving meals. In support of this argument, appellant notes that Section 3 of the Retail Sales Act of 1933, which introduced California's sales tax, originally defined the term "sale" as follows:

> "Sale" means any transfer, exchange or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property, for a consideration, and includes the furnishing, preparing or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing, or serving such tangible personal property.

Appellant notes that, as originally enacted, the definition of "sale" was not separated into distinct subdivisions. Instead, the language that ultimately resulted in R&TC section 6006(a) and the language that would evolve into R&TC section 6006(d) were placed together in Section 3 of the Retail Sales Act of 1933. Appellant argues that this integrated structure indicates that R&TC section 6006(d) should be read in conjunction with section 6006(a).

Appellant also notes that, in the Retail Sales Act of 1933, the Legislature placed the word "means" immediately prior to language regarding the transfer of tangible personal property (i.e., the language that is now R&TC section 6006(a)), and appellant argues that this placement shows that the Legislature wanted this language to function as the primary definition of the term "sale." Furthermore, appellant argues that the Legislature's use of the phrase "and includes" prior to language concerning the serving of food (i.e., the language that is now R&TC section 6006(d)) indicates the Legislature only intended this language to clarify that sales of food constitute a type of transfer of tangible personal property that satisfies this primary definition.

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[8] Appellant cites to *Dell, Inc. v. Superior Court* (2008) 159 Cal.App.4th 911, 924 (services are only taxable in a bundled transaction); *Preston v. State Bd. of Equalization* (2001) 25 Cal.4th 197, 208 (sales tax provisions only apply to tangible personal property); *Navistar International Transportation Corp. v. State Bd. of Equalization* (1994) 8 Cal.4th 868, 874 (California law imposes tax on the retail sale of tangible personal property but not on the sale of intangible personal property or on the performance of services); and *Loeffler v. Target Corp.* (2014) 58 Cal.4th 1081, 1104 (retail sellers are subject to a tax on their gross receipts derived from retail sales of tangible personal property).

Appellant asserts that this interpretation is consistent with the history of the Retail Sales Act of 1933, as evidenced by an article in an August 1933 publication by the California State Chamber of Commerce stating that sales "of meals by hotels, restaurants and other eating places . . . are sales of tangible personal property." Additionally, appellant argues that the language that would evolve into R&TC section 6006(d) was included in Section 2 of the Retail Sales Act of 1933 in response to a California Supreme Court decision, *City and County of San Francisco v. Larsen* (1913) 165 Cal. 179, which held that a restaurant is not in the business of selling goods. Appellant reasons that the Legislature hoped to prevent restaurants from using this holding as a means of avoiding sales tax liability, and, to that end, included in the definition of "sale" the language that would eventually evolve into R&TC section 6006(d).

Additionally, appellant asserts that CDTFA's position is predicated on the notion that subdivisions (a) and (d) of R&TC section 6006 contain separate and independent definitions of the term "sale" and that, under such an interpretation of R&TC section 6006(d), the service of a meal for consideration would constitute a sale even if there is no transfer of tangible personal property, as required by R&TC section 6006(a). Appellant contends that this position is precluded by the California Supreme Court's interpretation of R&TC section 6006 in *Select Base Materials, Inc. v. Board of Equalization* (1959) 51 Cal.2d 640 (*Select Base*). Appellant notes that, in *Select Base*, the California Supreme Court stated that R&TC section 6006(a) sets forth the principal, basic definition of the term "sale," and that the subdivisions that follow R&TC section 6006(a) are further refinements of this definition.

Appellant also relies on *GMRI, Inc. v. California Department of Tax and Fee Administration* (2018) 21 Cal.App.5th 111 (*GMRI*), a California Court of Appeal case which upheld the validity of Regulation section 1603(g) and which sustained CDTFA's determination that mandatory gratuities are included in taxable gross receipts. Appellant argues that, in *GMRI*, the court's analysis of R&TC sections 6012 and 6006(d) demonstrates that not all charges for the service of meals are taxable.

Lastly, appellant cites to the "backup letters" to four Sales and Use Tax Annotations,[9] which state that the sales of services are not taxable unless a part of the sale of tangible personal property.[10] Appellant also argues that CDTFA's reliance on annotations 295.0120 and 550.0809 is misplaced. With respect to annotation 295.0120, appellant argues that the facts of

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[9] The legal ruling on which an annotation is based is typically referred to as a backup letter or ruling. (See *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 4.)

[10] Appellant cites to the backup letters to annotations 515.0001.900 (2/26/97), 515.0005.470 (10/16/91), 515.0014 (10/9/92), and 550.0827(11/28/95).

this annotation are distinguishable because it concerned a restaurant that sold a corkage service as well as a meal. Regarding annotation 550.0809, appellant argues that it is unclear whether the country club in this annotation sold meals in addition to its sales of cake-cutting services, in which case appellant asserts that, like annotation 295.0120, the facts of this annotation are distinguishable from the facts of this appeal. Furthermore, appellant argues that if the country club did not sell meals, annotation 550.0809 should not be given any weight because it is contrary to the concept that services may only be taxed when included in bundled transactions.

Regarding appellant's statutory construction argument, there is no need to resort to the canons of construction or extrinsic aids to interpretation if the plain language of a statute is clear and unambiguous. (*Butts v. Board of Trustees of California State University* (2014) 225 Cal.App.4th 825, 838.) Where no ambiguity exists and the text of the statute provides a clear answer, it is presumed the Legislature meant what it said and the plain language of the statute governs. (See *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, 519.) If a statute is found to be ambiguous in its terms (i.e., patent ambiguity) or effect (i.e., latent ambiguity), an analysis of legislative history may help determine the appropriate application of the statute. (*Appeal of NASSCO Holdings, Inc.* (2010-SBE-001) 2010 WL 5626976.)

Here, it is well-established and beyond reasonable dispute that in general sales tax applies to transactions involving the sale of tangible personal property and that a service is taxable when it is included as a part of a sale of tangible personal property. However, it is appellant's argument that this principle cannot be reconciled with the plain language of R&TC section 6006(d), which states that a "sale" means and includes the furnishing, preparing, or serving for a consideration of food, meals, or drinks. Therefore, appellant argues that R&TC section 6006(d) contains a latent ambiguity that necessitates an examination of the statute's legislative history. This argument, however, overlooks the similarities between subdivisions (b) and (d) of R&TC section 6006. Subdivision (b) states that a "sale" means and includes fabricating tangible personal property for a consideration for consumers who furnish the materials for fabrication. Thus, the definition of "sale" in R&TC section 6006 includes two types of transactions (fabrication labor in R&TC section 6006(b) and furnishing, preparing, or serving food in R&TC section 6006(d)) whereby, from a practical standpoint, the retailer merely performs a service with respect to property provided by a third party.

Given that R&TC section 6006(b)'s definition of "sale" also includes transactions where the retailer similarly did not provide tangible personal property, appellant's argument—that R&TC section 6006(d) was the indeliberate result of imprecise revisions to the statute—seems highly unlikely. Rather, by explicitly extending the definition of "sale" to include "borderline" service transactions (see 9 Witkin, Summary of Cal. Law (11th ed. 2025) Tax, § 359.), the Legislature appears to have deemed the transformative effects these services have on property to be tantamount to a transfer of tangible personal property.[11] Therefore, OTA finds that R&TC section 6006(d) is not ambiguous, and, consequently, there is no need to examine the legislative history of R&TC section 6006(d). Instead, OTA finds that the plain language of R&TC section 6006(d) is controlling, and this finding is supported by the California Supreme Court's acknowledgment that the furnishing, preparing, or serving for a consideration of food, meals, or drinks is a specific transaction included in the definition of "sale" pursuant to R&TC section 6006(d). (See *Loeffler v. Target Corp*. (2014) 58 Cal.4th 1081, 1143, fn. 6.)

Based on the above, OTA finds that appellant's arguments regarding the statute's legislative history are unavailing. Appellant emphasizes that, as originally enacted, the definition of "sale" was not separated into distinct subdivisions, and appellant asserts that the original, integrated structure indicates that the Legislature intended the language that ultimately resulted in R&TC section 6006(d) to be read in conjunction with the language that ultimately resulted in R&TC section 6006(a). However, the fact that the Legislature's revisions to R&TC section 6006 organized the definitive transactions into separate subdivisions indicates that the Legislature intended the requirements of each subdivision to operate independently. Absent from these revisions is any conjunctive language tending to suggest that R&TC section 6006 subdivisions (b) through (g) are dependent on subdivision (a), and, while appellant asserts that the original structure of the statute shows a legislative intent to combine the requirements of subdivisions (b) and (a), the compartmentalized revisions to R&TC section 6006 suggest otherwise.

With respect to appellant's assertion that, when first enacted, the language now codified as R&TC section 6006(d) was only intended to include restaurant sales for on-premises consumption, this assertion fails to account for the fact that the original language would also have taxed the transactions at issue. Specifically, the original language of R&TC section 6006 provides that a sale "includes the furnishing, preparing or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing, or serving such tangible personal property." There is no requirement in this original language that the person serving the food also furnish the food. To the contrary, the statutory language says

[11] While this may seem like a relatively artificial concept, such is the nature of California sales tax law, which is shaped by its own provisions and definitions, and where these are unclear, by applying its own perceived policies and concepts. (See *King v. State Bd. of Equalization*, (1972) 22 Cal.App.3d 1006, 1010-1011.)

tax applies to furnishing "or" serving. In addition, the food is served on premises provided by appellant. Thus, even under the narrower, original language of the Retail Sales Act of 1933, tax would have applied to these transactions, as it does today.

Appellant's argument is essentially that, with respect to sales of food, although the language of the statute was substantially revised and reorganized, its purpose remained the same. This argument, however, seems unlikely given that the statute was expanded to include in the definition of "sale" several types of transactions not included in the original enactment. In other words, contrary to appellant's arguments, the Legislature expanded the scope of the statute in the intervening years. For example, appellant acknowledges that the statute was amended in 1939 to delete language requiring consumption of the food on the premises of the person furnishing it, and appellant notes that CDTFA's Biennial Report at the time of this amendment stated that the purpose of this amendment was "to include positively in the measure of the tax such transactions as the furnishing and serving of meals by caterers . . . ."

Thus, Regulation section 1603(i)(3) states that tax applies to the entire charge made by a caterer for serving meals, food, and drinks, and for the labor of serving the meals, whether performed by the caterer, the caterer's employees, or subcontractors. Given that Regulation section 1603(i) further defines caterers as service providers,[12] and states that "tax applies to charges made by caterers even though the food is not provided by the caterer," it appears that the Legislature intended its amendments to R&TC section 6006 to include food service transactions where the server did not provide the food. Thus, while appellant's arguments illuminate the origins of R&TC section 6006, this historical context does not diminish the fact that R&TC section 6006 has long been interpreted by Regulation section 1603, and likely was intended by the Legislature, to reach the type of transactions precisely at issue in this appeal.[13]

Turning to appellant's case law arguments, in the *GMRI* case, a California Court of Appeal addressed a restaurant's argument that Regulation 1603(g)—which excludes optional tips from taxable gross receipts—is invalid because it conflicts with R&TC section 6012. Appellant emphasizes that, in *GMRI*, the court recognized that not all payments for food service are taxable, and appellant interprets this holding to imply that food service payments are only

[12] The term "caterer" means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer. (Cal. Code Regs., tit. 18, § 1603(i)(1).)

[13] The parties agree that appellant does not qualify as a "caterer" under Regulation section 1603(i); however, this does not disqualify appellant from making sales under R&TC section 6006(d) when it served for a consideration food, meals, or drinks.

taxable when bundled with charges for the sale of food.[14] This interpretation, however, is not reflective of the court's analysis, which ultimately concerned the type of compensation (i.e., tips, gratuities, and service charges) at issue in that appeal, not the nature of the service provided.

An understanding of the court's reasoning in the *GMRI* case is aided by an understanding of Regulation section 1603(g)'s basis for excluding optional tips from taxable gross receipts. Regulation 1603(g) states that optional tips are not subject to tax and that mandatory tips are included in taxable gross receipts. This exclusion, however, does not stem from the nature of the service to which the tips relate: after all, a single food service transaction can involve both mandatory and optional tips, which may be paid as compensation for the exact same service.[15] Instead, optional tips are nontaxable because a sale requires consideration (see R&TC section 6006(a)-(g)), and optional tips are nonobligatory payments that do not constitute consideration. As a result, optional tips are not included in the total amount of the sale. And this principle is embodied in the court's statement that "the total amount of the sale is the total amount due on the bill . . . ." (*GMRI*, *supra*, 21 Cal.App.5th 111, 125.) Thus, contrary to appellant's assertion, this case does not stand for the proposition that R&TC section 6006(d) excludes the type of food services at issue here; instead, the case merely holds that Regulation section 1603(g) properly excludes from taxable gross receipts gratuitous (optional) compensation for services included in R&TC section 6006(d). Therefore, the holding in the *GMRI* case is not instructive here, and appellant's reliance on this opinion is unavailing.

Appellant also relies on the California Supreme Court's decision in *Select Base* for the proposition that R&TC section 6006(a) sets forth the principal, basic definition of the term "sale," and that the subdivisions that follow R&TC section 6006(a) are further refinements of this definition. The legal nuances of this case are complicated. The *Select Base* case concerned the application of sales tax to transportation charges made by a granite retailer during the period May 1, 1951, through September 30, 1953. (*Select Base*, *supra*, 51 Cal.2d 640, 642.) At that time, R&TC section 6012 excluded from gross receipts separately stated transportation charges

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[14] Specifically, appellant relies on the court's statement that "[t]he Legislature did not define the circumstances under which services are considered 'part of the sale' (i.e., part of the furnishing, preparing, or serving for a consideration of food, meals, or drinks) within the meaning of section 6012." (*GMRI*, *supra*, 21 Cal.App.5th 111, 124.)

[15] For example, in the *GMRI* case, while the court found that mandatory tips are taxable, the court held that optional tips—which were paid for the same service—are not taxable when added to the mandatory amounts. (*GMRI*, *supra*, 21 Cal.App.5th 111, 125.)

"if the transportation occurs after the sale of the property is made to the purchaser."[16] (See *Meyer v. State Bd. of Equalization* (1954) 42 Cal.2d. 376, 398, fn. 1.) Accordingly, the principal issue in *Select Base* was whether the transportation occurred before or after the sale, which, of course, required the court to determine when the sale occurred. (See *Select Base*, *supra*, 51 Cal.2d at p. 644.) CDTFA argued that this determination was governed by R&TC section 6006(a)'s definition of "sale" (i.e., transfer of title of tangible personal property for consideration) and that, because the retailer was obligated to deliver the granite to the customers' locations, the sale occurred upon delivery.[17] (See *ibid.*)

The retailer in the *Select Base* case argued that, rather than relying on R&TC section 6006(a), the court should look to R&TC section 6006(b). (See *Select Base*, *supra*, 51 Cal.2d 640, 646.) As discussed above, R&TC section 6006(b) currently concerns fabrication labor; however, at the time of the *Select Base* decision, R&TC section 6006(b) defined "sale" to include any withdrawal of tangible personal property for delivery in this state for the purpose of transfer of title.[18] Thus, the retailer in *Select Base* argued that the sale occurred upon the granite's withdrawal from the mines. (See *ibid*.)

The court in *Select Base* stated that R&TC section 6006(b) was obviously created for the purpose of applying sales tax to retail transactions in which property was shipped to federal territories within the state where sales tax would not otherwise apply. (*Select Base*, *supra*, 51 Cal.2d at p. 646.) The court in *Select Base* noted that, only a year after its enactment in 1939, a 1940 federal law (4 U.S.C.A. § 105) rendered this provision obsolete by granting

[16] The requirement that transportation occurs after the sale of property is made now only applies when transportation is made by the facilities of the retailer or the property is sold for a delivered price. (R&TC section 6012(c)(7).)

[17] RT&C section 6006(a) provides that a sale takes place upon passage of title, but the Sales and Use Tax Law does not specify when title passes. Courts have consistently used section 2401 of the California Uniform Commercial Code (following its adoption in 1963) to determine when title passes between sellers and buyers. (*City of South San Francisco v. Board of Equalization* (2014) 232 Cal. App.4th 707, 728.) And this section states that title passes at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. Because the *Select Base* case preceded the California Uniform Commercial Code's adoption in 1963, a determination of when title to the granite passed was governed by California Civil Code section 1739, which set forth that title passes upon delivery. (See *Select Base*, *supra*, 51 Cal.2d 640, 644.)

[18] Specifically, the definition of "sale" in R&TC section 6006(b) included any withdrawal, except a withdrawal pursuant to a transaction in foreign or interstate commerce, of tangible personal property from the place where it is located for delivery to a point in this State for the purpose of the transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of the property for a consideration. (*Select Base Materials, Inc. v. Board of Equalization* (1958) 329 P.2d 65, 67.)

California authority to levy sales taxes in any federal area; however, this former version of R&TC section 6006(b) remained in effect until September 15, 1953 (i.e., during the time of the transactions at issue in *Select Base*).[19] (*Ibid*.)

The court in *Select Base* held that the retailer's interpretation of R&TC section 6006(b) would render meaningless those portions of R&TC sections 6011 and 6012 that distinguish between transportation costs made before the sale and those made after. (See *Select Base*, *supra*, 51 Cal.2d 640, 646-647.) Thus, the court found that R&TC section 6006(b) should be confined to its limited purpose of allowing the state to tax the sale of tangible personal property delivered to federal areas within California. (*Id*. at 647.) Consequently, the court in *Select Base* found that R&TC section 6006(a) applied to a determination of when the sale occurred. (*Ibid*.)

Appellant relies on language in the *Select Base* decision stating that R&TC section 6006(a) sets forth the principal, basic definition of the term "sale," and that the subdivisions that follow R&TC section 6006(a) are further refinements of this definition. (See *Select Base*, *supra*, 51 Cal.2d at pp. 645-646.) However, nothing in this decision suggests that these "refinements" are interdependent. Instead, the court in *Select Base* stated that the subdivisions following R&TC section 6006(a) set forth "other specific transactions which would be taxable." (*Id.* at 646.) Contrary to appellant's implication, the *Select Base* decision did not involve a reconciliation of the subdivisions of R&TC section 6006, but instead concerned an inquiry into which subdivision of RT&C section 6006 applied to the transactions at issue there. And, after inventing a qualifying clause the court believed to be reflective of the statute's legislative intent, the court in *Select Base* found R&TC section 6006(b) to be inapplicable.

Ironically, appellant's position requires OTA to read a limiting provision into R&TC section 6006(d) much like the court in *Select Base* did with R&TC section 6006(b) when the court sided with CDTFA. However, the *Select Base* decision was primarily influenced by unique circumstances that are not present here, such as the court's explicit concern that the subdivision conflicted with other statutes, and the court's implicit frustration over the subdivision's obsolescence. The court in *Select Base* was also swayed by CDTFA's contemporaneous administrative construction (see *Select Base*, *supra*, 51 Cal.2d 640, 647), yet this factor also runs counter to appellant's position as the annotations relevant to R&TC section 6006(d) plainly contradict appellant's interpretation of this subdivision. Therefore, while the *Select Base* decision is, by and large, factually distinguishable from this appeal, it is similar in the sense that

[19] The court in *Select Base* surmised that the California Legislature refrained from repealing the former version of R&TC section 6006(b) out of concern that the federal law might be repealed. (*Select Base*, *supra*, 51 Cal.2d 640, 646.)

appellant's position, much like that of the retailer in *Select Base*, is diminished by adverse administrative guidance.

And although appellant asserts that annotations 295.0120 and 550.0809 are distinguishable on the basis that the retailers sold (or might have sold) meals, there is no indication in these annotations that the guidance provided was influenced by such facts. The annotations CDTFA relies on are simple, straightforward, and entirely unamenable to the interpretation appellant submits. Additionally, the backup letters appellant relies on are unpersuasive because they are unrelated to R&TC section 6006(d) and thus not on point.

Considering the foregoing, OTA finds appellant's serving for a consideration of food, meals, or drinks constitutes "sales" pursuant to R&TC section 6006(d).

Is appellant a "retailer"?

"Retailer" includes every seller who makes any retail sale or sales of tangible personal property. (R&TC, § 6015(a)(1).)[20] "Seller" includes every person engaged in the business of selling tangible personal property. (R&TC, § 6014.) "Retail sale" means a sale for a purpose other than resale in the regular course of business in the form of tangible personal property. (R&TC, § 6007.) "Tangible personal property" means personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. (R&TC, § 6016.)

On appeal, appellant argues that it is neither a "retailer" nor a "seller" because it sells services, not tangible personal property. In response, CDTFA asserts that appellant is a "retailer" because it is a seller who made retail sales of tangible personal property during the liability period. Although appellant may not qualify as a "retailer" under R&TC section 6015(a)(1) because it is not literally selling tangible personal property, there is another definition of "retailer" in R&TC section 6015(a)(2) that does not require the sale of tangible personal property.

"Retailer" also includes every person engaged in the business of making sales for storage, use, or other consumption. (R&TC, § 6015(a)(2).) "Person" includes any individual, firm, partnership, limited liability company, or corporation. (R&TC, § 6005.) "Business" includes any activity engaged in by any person with the object of gain, benefit, or advantage, either direct or indirect. (R&TC, § 6013.) "Sale" means and includes the furnishing, preparing, or serving for a consideration of food, meals, or drinks. (R&TC, § 6006(d).)

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[20] As relevant here, "retailer" further includes every corporation making more than two retail sales of tangible personal property during any 12-month period. (R&TC, § 6019.)

Here, appellant is a corporation, which is a "person," and it is undisputed that it is engaged in a "business." Appellant's business is serving food, meals, and drinks in exchange for monetary consideration, which, as OTA concluded above, qualifies as a "sale" under R&TC section 6006(d). And appellant was making sales by serving food, meals, and drinks to event guests for their literal consumption (i.e., eating and drinking). Accordingly, OTA concludes that appellant certainly qualifies as a "retailer" under R&TC section 6015(a)(2). Thus, appellant is a retailer.

Conclusion

Based on the preceding analyses, OTA concludes that appellant is a retailer who made taxable sales during the liability period.

Issue 2: Whether CDTFA timely issued the NOD.

As relevant here, a three-year statute of limitations from the last day of the calendar month following a quarterly reporting period (quarters) applies to determinations issued for quarters for which returns were filed, and an eight-year statute of limitations from the last day of the calendar month following a quarter applies to quarters for which no return was filed. (R&TC § 6487(a).)

For the liability period at issue, appellant did not file returns for 4Q13 through 4Q20 but did so for 1Q21 through 3Q21. For the period for which no returns were filed (4Q13 through 4Q20), the last day CDTFA could issue an NOD was January 31, 2022 (i.e. eight years after January 31, 2014, the last day of the calendar month following 4Q13). For the period for which returns were filed (1Q21 through 3Q21), the last day CDTFA could issue an NOD was April 30, 2024 (i.e., three years after April 30, 2021, the last day of the calendar month following 1Q21). Here, CDTFA issued the NOD for the entire liability period of 4Q13 through 3Q21 on January 27, 2022, which is before both January 31, 2022, and April 30, 2024. Therefore, CDTFA timely issued the NOD to appellant for the entire liability period.

On appeal, appellant argues that only a three-year statute of limitations applies to the period for which no returns were filed (4Q13 through 4Q20). Specifically, appellant argues that CDTFA's conclusion that appellant's sale of services was taxable under R&TC section 6006(d) must mean that CDTFA disregarded appellant's separate existence from 24 Carrots, LLC, the business entity making taxable sales of food, meals, or drinks. In that case, a three-year statute of limitations must apply to the period 4Q13 through 4Q20 because 24 Carrots, LLC (and by extension appellant, the business entity being disregarded) filed returns for that period. And if that were true, then the earliest quarter for which CDTFA's January 27, 2022 NOD would be timely issued and valid would be 4Q18, not 4Q13.[21] Thus, according to appellant, CDTFA's January 27, 2022 NOD is valid only for the period 4Q18 through 3Q21, not the entire liability period of 4Q13 through 3Q21.

However, the two things that appellant suggests are contradictory can be (and are) true at the same time: (1) appellant and 24 Carrots, LLC are in fact two separate business entities (undisputed by the parties); and (2) appellant's service of food, meals, and drinks for a consideration are taxable "sales" under R&TC section 6006(d) (as OTA explained in the analysis of Issue 1 of this Opinion). These two truths lead to a third: because appellant did not file its own returns for the period 4Q13 through 4Q20, when it was making taxable sales, an eight-year statute of limitations for issuing an NOD applies to that period pursuant to R&TC section 6487(a). Accordingly, the eight-year statute of limitations applies to 4Q13 through 4Q20, and thus CDTFA timely issued the January 27, 2022 NOD for that period as well as the encompassing liability period.

Issue 3: Whether the failure-to-file penalty should be relieved.

CDTFA added a 10 percent failure-to-file penalty of $167,334.87 pursuant to R&TC section 6511 for appellant's failure to file returns for the period 4Q13 through 4Q20.[22]

If a person fails to make a return, CDTFA shall make an estimate of the tax required to be paid to the state, adding to the sum determined a penalty equal to 10 percent thereof (commonly known as a failure-to-file penalty). (R&TC, § 6511.) Relief of the failure-to-file penalty may be granted where the failure to file the return was due to reasonable cause and circumstances beyond the taxpayer's control and occurred notwithstanding the taxpayer's exercise of ordinary care and in the absence of willful neglect. (R&TC, § 6592(a)(1).) A person seeking to be relieved of the failure-to-file penalty must file with CDTFA a statement under penalty of perjury setting forth the facts upon which the person bases the claim for relief. (R&TC, § 6592(b).)

On May 2, 2024, appellant submitted such a request for relief to CDTFA. Appellant requests relief of the failure-to-file penalty because 24 Carrots, LLC sought, obtained, and appellant relied upon, written advice from CDTFA. Appellant purports that CDTFA's advice affirmed that taxable and nontaxable components of a sale could be "unbundled" and then

[21] Pursuant to appellant's argument, for 4Q13, CDTFA would have had to issue an NOD by January 31, 2017.

[22] The failure-to-file penalty is separate from a 10-percent penalty for failure to timely file a return (a.k.a., a late-filing penalty), which R&TC section 6591 authorizes but is not at issue here.

separately sold by two business entities. Appellant argues that 24 Carrots, LLC's efforts to seek advice from CDTFA constituted the exercise of ordinary care and the absence of willful neglect, appellant's reliance on that advice was reasonable, and CDTFA's disavowal of that advice was beyond 24 Carrots, LLC and appellant's control.

As a preliminary matter, OTA notes that the language of R&TC section 6592(a)(1) lays out four separate requirements for relief: the failure to file returns (1) was due to reasonable cause; (2) was due to circumstances beyond the taxpayer's control; (3) occurred notwithstanding the exercise of ordinary care; and (4) occurred in the absence of willful neglect. (Cf. *First American Commercial Real Estate Services, Inc. v. County of San Diego* (2011) 196 Cal.App.4th 218, 225 (examining whether there was reasonable cause to abate a late payment penalty under R&TC section 4985.2.) If any of these requirements are missing, then the taxpayer is not entitled to relief of the failure-to-file penalty. (See *ibid*.)

Here, 24 Carrots, LLC exercised ordinary care in seeking CDTFA's advice. CDTFA's advice arrived via a July 14, 2010 email in response to an email inquiry from appellant's representative that did not mention appellant. In that response, CDTFA advised that charges for food services (i.e., servers, bartenders, chefs, etc.) would be nontaxable if billed by a business entity separate from the business entity that sells food and beverage. It is evident that appellant was incorporated in response to this advice and appellant's reporting practices were informed by it. Thus, OTA finds that appellant's failure to file returns for 4Q13 to 4Q20 was due to reasonable cause, namely reliance on CDTFA's general advice. For the same reason, OTA also finds that appellant's continued refusal to file returns during the audit, when CDTFA apprised appellant of its filing obligations and made multiple requests to file, was not due to willful neglect. Thus, appellant failure to file returns was due to reasonable cause and occurred notwithstanding appellant's exercise of ordinary care and in the absence of willful neglect.

However, appellant's failure to file returns was not due to circumstances beyond its control. Rather, appellant deliberately chose not to file returns for 4Q13 to 4Q20, believing that filing would undercut a statute of limitations argument it was asserting during the audit; appellant's choice resulted in the failure-to-file penalty. Appellant's view that CDTFA's disavowal of the general advice provided in the July 14, 2010 email constituted a circumstance beyond appellant's control misses the mark because CDTFA's disavowal, while outside of appellant's control, did not prevent appellant from filing its returns upon CDTFA's request during the audit. Because appellant's failure to file returns for 4Q13 to 4Q20 was by choice and not due to circumstances beyond its control, relief of the failure-to-file penalty is not warranted pursuant to R&TC section 6592(a)(1).

Issue 4: Whether appellant was negligent.

CDTFA added a negligence penalty of $18,227.21 for the period 1Q21 through 3Q21. According to CDTFA's decision, it did so for three reasons: (1) for 1Q21 through 3Q21, appellant reported total sales of $3,437,271 but taxable sales of $0; (2) upon audit, appellant did not provide any documents for the liability period; and (3) CDTFA determined that, for the liability period, appellant did not report taxable sales of $23,435,417, which CDTFA found "significant."

If any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the tax specified in the determination shall be added to the deficiency determination. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Appeal of HM Carpet Inc.*, 2025-OTA-595P.)

A taxpayer shall maintain and make available for examination on request by CDTFA, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return. (R&TC, §§ 7053 7054; Cal. Code Regs, tit. 18, § 1698(b).) All records required to be retained under this regulation must be preserved for a period of not less than four years. (Cal. Code Regs, tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties or other appropriate administrative action. (Cal. Code Regs, tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practice were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs, tit. 18, § 1703(c)(3)(A); see also *Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-324.) A negligence penalty is justified where a prior audit notified taxpayer of reporting errors that taxpayer ignored and continued to commit, and that were again disclosed in a subsequent audit. (*Independent Iron Works, Inc. v. State Bd. of Equalization*, *supra*, 167 Cal.App.2d at p. 323.) Additionally, numerous unreported transactions that were not caused by, or related to, a taxpayer's accounting system constitute evidence of the taxpayer's negligence. (*Ibid*.)

On appeal, appellant argues that the negligence penalty should be removed because its tax deficiency was based on a reasonable, good-faith interpretation of the law and because appellant's reporting practices were adopted in accordance with written guidance from CDTFA.

In response, CDTFA argues that the negligence penalty should be upheld because the amount of underreporting constitutes evidence of negligence and because appellant did not provide documents for review during the liability period.

Here, although appellant did not provide books and records upon audit, appellant's related business entity (24 Carrots, LLC) provided sales summaries, sales invoices, and event contracts that allowed CDTFA to identify appellant's taxable sales. Thus, in this instance, the insufficiency of appellant's records does not constitute compelling evidence of negligence for a first-time audit due to the likelihood that appellant believed that the related entity's maintenance of sale records was sufficient for bookkeeping purposes. As for CDTFA's July 14, 2010 email, CDTFA summarized a clear understanding of the question that was at the center of this appeal and advised that charges for food services (i.e., servers, bartenders, chefs, etc.) would be nontaxable if billed by a business entity separate from the business entity selling food and beverage.[23] Clearly, appellant was formed in response to this advice and appellant's reporting practices were informed by it. Consequently, OTA finds the evidence fails to show that appellant's reporting errors cannot be attributed to a good faith and reasonable belief that its reporting practices complied with the requirements of the Sales and Use Tax Law. Therefore, OTA finds appellant was not negligent, and the negligence penalty was improperly imposed.

[23] See footnote 4.

HOLDINGS

1. Appellant is a retailer who made taxable sales during the liability period.
2. CDTFA timely issued the NOD for the entire liability period because an eight-year statute of limitations applies to 4Q13 through 3Q18 and appellant does not dispute the NOD's timeliness with respect to 4Q18 through 3Q21.
3. Relief of the failure-to-file penalty is not warranted.
4. Appellant was not negligent, and the negligence penalty was improperly imposed.

DISPOSITION

CDTFA's action is modified to remove the negligence penalty. Otherwise, CDTFA's action denying the petition for redetermination is sustained.

DocuSigned by:
Phyllis Mallard
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For
Andrew Wong
Administrative Law Judge

I concur:

DocuSigned by:
Steven Kim
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Steven Kim
Administrative Law Judge

K. WILSON, Hearing Officer, concurring in part and dissenting in part:

I concur with the majority that 24 Carrots Special Events, Inc. (appellant) is a retailer who made taxable sales during the period October 1, 2013, through September 30, 2021 (liability period) and respondent California Department of Tax and Fee Administration (CDTFA) timely issued a January 28, 2022 Notice of Determination for the liability period. I also concur that relief of the failure-to-file penalty is not warranted but differ from some of the majority's analysis. I also dissent on the analysis and abatement of the negligence penalty.

Failure to File Penalty

If a person fails to make a return, CDTFA shall make an estimate of the tax required to be paid to the state, adding to the sum determined a penalty equal to 10 percent thereof (commonly known as a failure-to-file penalty). (Revenue and Tax Code [R&TC], § 6511.) Relief of the failure-to-file penalty may be granted where the failure to file the return was due to reasonable cause and circumstances beyond the taxpayer's control and occurred notwithstanding the taxpayer's exercise of ordinary care and in the absence of willful neglect. (R&TC, § 6592(a)(1).) A person seeking to be relieved of the failure-to-file penalty must file with CDTFA a statement under penalty of perjury setting forth the facts upon which the person bases the claim for relief. (R&TC, § 6592(b).)

As a preliminary matter, OTA notes that the language of R&TC section 6592(a)(1) lays out four separate requirements for relief: the failure to file returns (1) was due to reasonable cause; (2) was due to circumstances beyond the taxpayer's control; (3) occurred notwithstanding the exercise of ordinary care; and (4) occurred in the absence of willful neglect. (Cf. *First American Commercial Real Estate Services, Inc. v. County of San Diego* (2011) 196 Cal.App.4th 218, 225 (examining whether there was reasonable cause to abate a late payment penalty.) If any of these requirements are missing, then the taxpayer is not entitled to relief of the failure-to-file penalty. (See *ibid*.)

Here, a representative of 24 Carrots, LLC, an entity related to appellant, anonymously inquired with CDTFA via email about a proposed scenario. In the email, the representative anonymously described 24 Carrots LLC's business as a full-service event planning company offering full-service catering, full-service event rentals, the leasing of a venue, and full-service staffing (i.e., servers, bartenders, chefs, etc.). The representative explained that his client wanted to open another business that would sell non-taxable items, while his client continued selling the taxable items:

> For example, my client has a customer that has a $4,000 contract. $2,000 of that contract is for food and beverage service and is placed on one contract through

> one of the companies. Another $2,000 will go towards the venue fee, the staffing and the rentals which will go on a completely separate contract through a completely separate company alleviating the customer from having to pay sales taxes on those items and only pay sales tax on the food and beverage contract.

I do not agree with the majority's analysis that CDTFA advised that charges for food services (i.e., servers, bartenders, chefs, etc.) would be nontaxable if billed by a business entity separate from the business entity that sells food and beverage. In the July 14, 2010 email (general information letter), CDTFA provided in relevant part, California Code of Regulations, title 18, (Regulation) section 1603 (*Taxable Sales of Food Products*), explaining that tax applies to the entire charge made by caterers for serving meals, food or drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals and for the labor of serving meals, whether performed by the caterer, the caterer's employees or subcontractors. (Cal. Code Regs., tit. 18, § 1603(i)(3)(A).) Tax applies to charges made by the caterer for preparing and serving meals and drinks even though the food is not provided by the caterers. The letter states, "You are proposing that the second company's services would not be taxable as they are not related to the sale of the food and beverage." The letter explains how the two businesses would need to be separate:

The companies would need to have separate contracts and invoices for their clients for the goods and services offered by each company…. Each company would need to offer their services to the general public independently of one another. Assuming the companies are operating as bona fide separate legal entities then the contract for the separately stated 'non-taxable' services offered by the new company would not be subject to tax.

Reading the letter in its entirety, CDTFA informed that food and beverage services would be taxable, unless the second company's services were not related to the sale of the food and beverage. In accordance with Regulation section 1603, tax applies to charges made by the caterer for preparing and serving meals and drinks even though the food is not provided by the caterers. Despite the general information letter, appellant and 24 Carrots, LLC structured their businesses inconsistent with the information provided. While it was proposed that members of 24 Carrots, LLC open another business that would sell the non-taxable items, while 24 Carrots, LLC continued selling the taxable items. Here, however, the new business (i.e., appellant) continued to sell taxable items that include food and beverage service. Therefore, appellant could not rely on the letter since the companies deviated from the proposed separate entity functions. Further, the general information letter expressly includes language that the information may not be relied upon for purposes of R&TC section 6596. Had the founding members of appellant wished to rely upon binding advice, the representative or appellant's founding members should have requested an advice letter consistent with R&TC section 6596.

I agree with the majority's conclusion that appellant's failure to file returns was not due to circumstances beyond its control. Rather, appellant deliberately chose not to file returns for fourth quarter 2013 (4Q13) to 4Q20, believing that filing would undercut a statute of limitations argument it was asserting during the audit. Appellant's view that CDTFA's disavowal of the general information provided in the July 14, 2010 email constituted a circumstance beyond appellant's control misses the mark because CDTFA's disavowal, while outside of appellant's control, did not prevent appellant from filing its returns. Because appellant's failure to file returns for 4Q13 to 4Q20 was by choice and not due to circumstances beyond its control, relief of the failure-to-file penalty is not warranted pursuant to R&TC section 6592(a)(1).

<u>Negligence Penalty</u>

If any part of a deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Negligence is generally defined as failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Warner v. Santa Catalina Island Co*. (1955) 44 Cal.2d 310, 317; see also *People v. Superior Court (Sokolich)* (2016) 248 Cal.App.4th 434, 447.)

Taxpayers are required to maintain and make available for examination on request by CDTFA 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 sale and use tax return. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) 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 will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence or intentional disregard should not be added to deficiency determinations associated with the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Taxpayers are charged with knowledge of the law, and ignorance of the law is no defense for failing to comply with statutory requirements. (See *Appeal of GEF Operating, Inc.*, 2020-OTA-057P.)

On appeal, appellant argues that the negligence penalty should be removed because its tax deficiency was based on a reasonable, good-faith interpretation of the law and because appellant's reporting practices were adopted in accordance with written guidance from CDTFA.

CDTFA added the negligence penalty on the sales and use tax returns that appellant filed for 1Q21 through 3Q21 because appellant reported zero taxable sales when unreported taxable sales were excessive ($2,319,744), and appellant did not provide all records necessary for the audit.

The majority finds that appellant was not negligent and that the negligence penalty was improperly imposed. However, I respectfully disagree with the majority's analysis that since CDTFA was able to obtain the records from 24 Carrots, LLC and that CDTFA's general information letter provided guidance are reasonable bases to remove the negligence penalty. CDTFA's use of the records obtained from 24 Carrots, LLC does not obviate appellant's obligation to maintain and make records available. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) On September 29, 2021, appellant was notified of the audit and requested to make available books and records necessary for the audit. Since appellant did not provide the records requested, CDTFA had to use other means of obtaining the necessary records for the audit. CDTFA was able to obtain sales summaries, sales invoices, and event contracts from the related entity, 24 Carrots, LLC, but had to request income tax returns from the IRS for years 2013 through 2019. In addition, 24 Carrots, LLC was formed in 2004, and appellant was incorporated in 2009; approximately nine years and four years prior to the liability period respectively. Further, appellant was formed and operated by experienced businesspersons operating in the same or similar retail space. Therefore, I find appellant was negligent in maintaining and making records available.

Regarding the general information letter, CDTFA advised that food and beverage services would be taxable, unless the second company's services were not related to the sale of the food and beverage. CDTFA provided the relevant law, Regulation section 1603, and provided general information based on the proposed hypothetical in which the second company's (appellant's) services would not be taxable as they are not related to the sale of the food and beverage. Appellant made an incorrect assumption that food and beverage services would be nontaxable despite being provided with the relevant law section. For 1Q21 through 3Q21, appellant reported gross receipts and reported zero taxable sales based on this incorrect assumption. Despite this being appellant's first audit, the substantial underreporting of taxable sales, the deviation from the general information letter, and the prior business experience in the same retail space, demonstrate negligence. Based on the foregoing, I find appellant did not have a good faith and reasonable belief that its bookkeeping and reporting practices substantially complied with the requirements of the Sales and Use Tax Law and authorized regulations. For these reasons, I find that the negligence penalty was properly imposed and appellant was negligent.

Signed by:
Kim Wilson
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Kim Wilson
Hearing Officer

Date Issued: 6/10/2026