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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **ALWAYS AN ADVENTURE, INC.,** **dba Cheers Bar, West Sacramento**	OTA Case No.: 250522025 CDTFA Case ID: 4-861-714

OPINION

Representing the Parties:

For Appellant: Brian Coggins, Representative

For Respondent: Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Mia Marasigan, Business Taxes Specialist

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Always an Adventure, Inc., dba Cheers Bar, West Sacramento (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 April 10, 2023. The NOD is for tax of $29,998, plus applicable interest, a 40 percent penalty of $7,711.93 pursuant to R&TC section 6597 for sales tax reimbursement that was knowingly collected but not remitted, and a negligence penalty of $1,071.83, for the period July 1, 2019, through June 30, 2022 (liability period).[1]

Pursuant to the Decision, CDTFA performed a reaudit on February 20, 2025, which reduced the determined tax and deleted the penalties. While preparing for this appeal, CDTFA performed a second reaudit, which further reduced the tax to $22,056.

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 September 12, 2022, appellant signed a waiver of the otherwise applicable three-year statute of limitations, which allowed CDTFA until April 30, 2023, to issue a determination for the period July 1, 2019, through December 31, 2019. (See R&TC, §§ 6487(a), 6488.)

ISSUE

Whether further reductions to the measure of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, a California corporation, operated a bar in West Sacramento, California, since October 2014 selling food and alcoholic beverages. This was appellant's first audit.
2. On the quarterly sales and use tax returns (SUTRs) for the liability period, appellant reported total sales of $395,991 and claimed the following deductions: $10,212 for exempt sales of food products, and $25,616 for sales tax reimbursement included in total sales. In total, appellant claimed deductions of $35,828, which resulted in reported taxable sales of $360,163 for the liability period. Appellant stated that it used point-of-sale (POS) reports to prepare the SUTRs.
3. Upon audit, appellant provided the following records: federal income tax returns (FITRs) for 2019 and 2020; bank statements and POS reports for April 1, 2019, through December 31, 2019, and January 1, 2021, through June 30, 2022; detailed daily POS reports for December 5, 2022, through December 19, 2022; a signed Form CDTFA-1311-B[2] (Bar Fact Sheet); profit and loss statements (P&Ls) for July 1, 2019, through December 31, 2019, and January 1, 2021, through June 30, 2022; and balance sheets. In addition, CDTFA obtained Form 1099-K data[3] for the period July 1, 2019, through December 31, 2020, through its own internal means. CDTFA found appellant's books and records were incomplete and inadequate for sales and use tax purposes. Appellant did not provide P&Ls for 2020, POS reports for 2020, bank statements for 2020, a complete set of merchandise purchase invoices, sales receipts, or SUTR worksheets.
4. CDTFA found gross receipts reported on appellant's FITRs exceeded reported sales on the SUTRs by $12,309 for 2019 and $15,285 for 2020. Further, CDTFA noted bank

[2] Form CDTFA-1311-B, Bar Fact Sheet, is used to assist the audit staff and taxpayers in documenting the essential information needed to perform a bar audit, such as the pour size and glass sizes (including changes during entertainment, "happy hour," and special events), drink prices, estimated percentage of sale by category (i.e., mixed drinks, cocktails, or "on-the-rocks"), theft (pilferage), and self-consumption. (CDTFA Audit Manual § 0802.15.) CDTFA's Audit Manual is an advisory publication providing direction to CDTFA staff administering the Sales and Use Tax Law and regulations. While CDTFA's Audit Manual may provide guidance to OTA, it does not constitute binding legal authority. (*Appeal of Micelle Laboratories, Inc.,* 2020-OTA-290P.)

[3] Form 1099-K is an IRS form titled, "Payment Card and Third Party Network Transactions," which shows the monthly and annual amounts paid to a merchant by a bank, credit card company, or third party network, during a given time period. Form 1099-K includes payments made by any electronic means, including, but not limited to, credit cards, debit cards, and PayPal.

deposits exceeded total sales recorded on the 2019, 2021, and 2022 P&Ls and on the POS reports for the third quarter of 2019 (3Q19), 4Q19, 2021, 1Q22, and 2Q22, combined. CDTFA also noted sales tax reimbursement recorded on the P&Ls was understated. As a result, CDTFA determined that it could not rely on appellant's recorded sales.

5. Based on gross receipts and cost of goods sold (COGS) reported on the FITRs, CDTFA calculated appellant's book markup[4] factors as 1.87 for 2019 and 1.76 for 2020. CDTFA considered those markup factors too low for the type and location of appellant's business. CDTFA conducted a preliminary shelf test[5] to calculate a markup factor of 4.07 (307 percent markup), which CDTFA believed was more reasonable. Based on this and the unexplained discrepancies, CDTFA concluded that an indirect audit method would be necessary to verify appellant's taxable sales.

6. CDTFA used appellant's bank statements to compute audited taxable sales of $256,271 (audited bank deposits of $525,573 – reported taxable sales $269,302) for 4Q19, 1Q21-2Q21, 4Q21, 1Q22, and 2Q22.[6] CDTFA used an average error ratio of 53 percent[7] to compute unreported taxable sales of $25,167[8] (reported taxable sales of $47,486 × 53 percent) for 3Q21.[9]

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[4] "Markup" is the amount added to the cost of a good to arrive at its retail selling price. For example, if the retailer's cost is $10 and it charges customers $15, the markup is $5. The markup percentage is calculated by dividing the markup amount by cost. In this example, the markup percentage is 50 percent ($5 ÷ $10 = 0.50). "Book markup" refers to the taxpayers costs reflected in their books and records compared to reported sales. "Markup factor" refers to the markup percentage plus 1. In this example, the markup factor is 1.5. Markup and margin are different; margin is calculated as a percentage of the selling price rather than of the cost. In this example, while the markup is $5 and the markup percentage is 50 percent, the margin is only 33 percent (($15 - $10) ÷ $15). (See CDTFA Audit Manual § 407.10.)

[5] A shelf test is an accounting comparison of known costs and associated selling prices used to compute markups.

[6] CDTFA compiled the cash deposits (including sales tax reimbursement) of $379,327 and the credit card deposits of $219,677 for a total of $559,004. CDTFA then divided the total deposits of $559,004 by one plus the sales tax rate of 8.25 percent to compute audited taxable deposits of $553,353 (excluding sales tax reimbursement) for 3Q19 through 4Q19, 2021, and 1Q22 through 2Q22.

[7] CDTFA computed 53 percent [(109 percent for 4Q21 + 27 percent for 1Q22 + 22 percent for 2Q22) ÷ 3].

[8] This Opinion rounds amounts to the nearest dollar, which may cause immaterial differences in some totals.

[9] CDTFA computed a credit of $19,708 (audited taxable bank deposits of $27,778 – reported taxable sales of $47,486) for 3Q21. Therefore, unreported taxable sales were computed based on an average error ratio of 53 percent.

7. CDTFA used appellant's 1099-K data to compile credit card receipts (including sales tax reimbursement) of $49,879 for 2020 and then multiplied the credit card receipts by the cash to credit card ratio of 173 percent[10] to compute audited cash sales (including sales tax reimbursement) of $86,128. CDTFA adjusted the audited sales (including sales tax reimbursement) of $136,007 ($49,879 + $86,128) for sales tax reimbursement at a rate of 8.25 percent to compute audited taxable sales of $125,642 and unreported taxable sales of $82,267 ($125,642 – reported taxable sales of $43,375) for 2020.
8. In total, CDTFA computed unreported taxable sales of $363,607 ($256,273 + $82,267 + $25,068) based on analysis of available bank statements and Form 1099-K data for the liability period.
9. On April 10, 2023, CDTFA issued the NOD for tax of $29,998 (based on a total deficiency measure of $363,607), plus applicable interest, a 40 percent failure to remit sales tax reimbursement penalty of $7,711.93, and a 10 percent negligence penalty of $1,071.83, for the liability period.
10. Appellant timely filed a petition for redetermination disputing the NOD in its entirety.
11. CDTFA held an appeals conference with appellant, and thereafter appellant submitted additional records. In support of its contention that bank deposits included non-sales deposits, appellant provided a detailed spreadsheet with corresponding check deposits, Form W-2G,[11] Certain Gambling Winnings, obtained from the IRS and a log of deposits made for gaming income, detailed deposits spreadsheet, and daily POS reports for the liability period. CDTFA reviewed the documentation and found it incomplete.
12. CDTFA concluded that it appeared that the bank deposit analysis did not account for all cash sales and decided to perform a reaudit using the markup method to compute unreported taxable sales. CDTFA also decided to establish a separate measure for unreported cost of self-consumed taxable merchandise because it concluded that the unreported taxable sales established based on the markup method was more representative.

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[10] CDTFA used the bank statements to compute a cash to credit card ratio of 173 percent (cash deposits of $379,327 ÷ credit card deposits of $219,677).

[11] Form W-2G, (Certain Gambling Winnings) is used to report gambling winnings and any federal income tax withheld on those winnings. The requirements for reporting and withholding depend on the following: 1) the type of gambling, 2) the amount of the gambling winnings, and 3) generally, the ratio of the winnings to the wager.

13. On October 25, 2024, CDTFA issued a Decision ordering a reaudit using the markup method to compute unreported taxable sales. Specifically, CDTFA adjusted COGS by a 2 percent allowance for self-consumption and a 2 percent allowance for pilferage. Afterwards, CDTFA computed audited taxable sales using the 4.07 markup factor derived from a shelf test performed during the audit. In the Decision, CDTFA also concluded that the 10 percent negligence penalty should be deleted in its entirety, and the 40 percent unremitted sales tax reimbursement collected penalty should be deleted for three of the five quarters that the penalty was imposed. Otherwise, CDTFA denied the petition for redetermination.
14. CDTFA prepared a reaudit that reduced unreported taxable sales of $363,607 to $318,106 and also established a separate measure for the unreported cost of self-consumed taxable merchandise of $3,468 subject to use tax. The reaudit also deleted both the 10 percent negligence penalty and the 40 percent unremitted sales tax reimbursement collected penalty for the entire liability period.
15. In a letter dated April 8, 2025, CDTFA notified appellant that the liability had been adjusted in accordance with the Decision.
16. Appellant timely appealed to OTA.
17. In preparation for this appeal, CDTFA determined that a second reaudit should be conducted to address appellant's disagreement with the markup method results.
18. In its opening brief to OTA, appellant contends that COGS recorded on the P&Ls and 2020 FITR included non-alcoholic beverage merchandise purchases.
19. In response, CDTFA concedes that the COGS included purchases unrelated to alcoholic beverages including soda that were used as mixers in drinks, and food such as bar snacks, and performed a second reaudit using the markup method to adjust for purchases unrelated to alcoholic beverages.
20. In this second reaudit, CDTFA used the shelf test for alcoholic beverages performed during the audit, which compared purchase prices for products shown in available merchandise purchase invoices[12] with the associated selling prices appellant provided, and selling prices found on the POS reports and the Bar Fact Sheet; based on those amounts, CDTFA computed markup factors of 2.44 for draft beer, 3.95 for domestic

[12] According to the Form CDTFA-945, Receipt of Books and Records of Account, dated September 30, 2022, appellant provided merchandise purchase invoices for September 2019, April 2021, and April 2022.

bottle and can beer, 4.32 for premium bottle and can beer, 4.34 for call liquor, 4.18 for well liquor, 4.55 for cocktails and 0.74 for wine.

21. Using the sales ratios for drink type that appellant provided, and the above-mentioned average markup factors, CDTFA computed an overall weighted average markup factor of 4.07 (307 percent markup) for taxable alcoholic beverages.

22. CDTFA compiled the merchandise purchases of $140,287 from the P&Ls for 3Q19, through 4Q19, 2021, and 1Q22, through 2Q22, combined, and merchandise purchases of $33,236 from the 2020 FITR. Next, CDTFA used appellant's records to compute adjustments for soda purchases of $3,768, food purchases of $14,461 for 3Q19, through 4Q19, 2021, and 1Q22, through 2Q22, combined, food purchases of $3,426 and soda purchases of $894 for 2020, resulting in audited alcoholic beverage merchandise purchases of $150,975.

23. By multiplying the audited alcoholic beverage merchandise purchases of $150,975 by 2 percent, CDTFA computed self-consumption of $3,019. Next, CDTFA subtracted the self-consumption amount of $3,019 from audited alcoholic beverage merchandise purchases of $150,975 and multiplied by 2 percent to compute a pilferage allowance of $2,959.

24. CDTFA subtracted the $3,019 for self-consumption and $2,959 for pilferage to compute audited alcoholic beverage merchandise purchases totaling $144,997, and applied the markup factor of 4.07 to compute audited taxable alcoholic beverage sales of $590,134 for the liability period.

25. CDTFA computed audited taxable food sales by compiling the food purchases of $14,461 and an estimated $3,426 in taxable food purchases (based on merchandise purchases from the 2020 FITR) for a total of $17,887 for the liability period.

26. Using the 2 percent estimates for self-consumption and pilferage, CDTFA computed self-consumption of $358 and pilferage of $358 for audited food purchases, and then subtracted the self-consumption and pilferage to compute audited cost of food sold of $17,171. Moreover, CDTFA conceded the markup on food was 100 percent. Therefore, CDTFA applied the estimated markup factor of 2.00 (1 + the estimated audited markup of 100 percent) to compute audited taxable food sales of $34,344 for the liability period.

27. CDTFA added the audited taxable food sales of $34,344 to audited alcoholic beverage sales of $590,134 to compute total audited taxable sales of $624,478 for the liability period.

28. CDTFA subtracted reported taxable sales of $360,163 to compute unreported taxable sales of $264,315 for the liability period, which remains in dispute. CDTFA also reduced from $3,468 to $3,020 the unreported taxable cost of self-consumed taxable merchandise subject to use tax; appellant did not dispute this audit item, and thus OTA does not discuss it further.

DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

A taxpayer is required to maintain and make available for examination on request by CDTFA all records necessary to verify the accuracy of any return filed, or, if no return has been filed, to ascertain and determine the amount required to be paid. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (1) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules of working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, 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, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, appellant provided inadequate books and records and failed to provide a complete set of original source documents. Specifically, appellant did not provide a complete set of merchandise purchase invoices, sales receipts, and SUTR worksheets, and also did not provide

P&Ls for 2020, POS reports for 2020, or bank statements for 2020. CDTFA found gross receipts reported on the FITRs exceeded reported taxable sales on the SUTRs for 2019 and 2020, the bank deposits exceeded sales recorded on the P&Ls and the POS reports, and the sales tax reimbursement recorded on the P&Ls were understated. Further, CDTFA compared the recorded merchandise purchases to the gross receipts in the FITRs, which resulted in lower than expected markup factors for 2019 and 2020 for appellant's type of business. Based on the foregoing, CDTFA believed that taxable sales were understated. Given these circumstances, OTA finds that CDTFA had sufficient reason to question the reliability of appellant's recorded and reported taxable sales, and it was reasonable for CDTFA to compute appellant's taxable sales using an indirect method. It is up to CDTFA's discretion on what it believes is the most accurate way to audit a taxpayer's business. CDTFA initially used an analysis of appellant's bank deposits and credit card sales data but concluded that the markup method produced a more representative result. The markup method is a recognized and accepted accounting procedure to determine audited sales. (*Appeal of Amaya*, 2021-OTA-328P.) Accordingly, CDTFA has met its initial burden to show that its determination was reasonable and rational, and the burden of proof shifts to appellant to show that adjustments are warranted.

Appellant contends that CDTFA disregarded the POS reports, reports from the POS system's representative, and the Forms W-2G, and states that its business bank account included deposits from gambling winnings and consulting income. Appellant argues that CDTFA relied solely on the bank statements for income and disregarded all other documentation showing the sources of appellant's income. Further, appellant asserts that CDTFA's use of the markup method based on COGS from the P&Ls and FITRs to compute unreported taxable sales was erroneous because the COGS includes merchandise purchases unrelated to alcoholic beverages.

Here, appellant has not identified any errors in CDTFA's computations of unreported taxable sales or provided any new records or evidence to support appellant's contentions from which a more accurate determination could be made. Regarding the bank deposits that appellant alleges are from gambling winnings and consulting income, the original audit did rely on appellant's bank deposits; however, in the reaudits CDTFA switched to the markup method to compute the measure of unreported taxable sales. As a result, whether bank deposits included gambling and consulting income would not affect the determination of tax at issue here. To the extent that appellant is asserting that CDTFA should have accepted appellant's POS reports and other records as accurate, above OTA concluded that CDTFA had sufficient reason to question the reliability of appellant's recorded and reported taxable sales. CDTFA is

not required to accept a taxpayer's books and records as conclusive evidence of what they purport to represent, even if the books and records are in agreement with each other and with SUTRs. (See *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 615.)

Regarding appellant's contention that the COGS includes merchandise purchases unrelated to alcoholic beverages, CDTFA's second reaudit made adjustments to remove appellant's soda and food purchases from the COGS that the markup was applied to.[13] Thus, CDTFA's calculation of unreported sales accounted for those purchases unrelated to alcoholic beverages.

Given all of the above, OTA concludes appellant has not established that any further adjustments are warranted.

HOLDING

Further reductions to the measure of unreported taxable sales are not warranted.

DISPOSITION

Reduce the tax to $22,056 as CDTFA concedes on appeal; otherwise, sustain CDTFA's actions of deleting the penalties and denying the petition for redetermination.

Signed by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

Signed by:
Josh Lambert
CB1E7DA37831416...
Josh Lambert
Administrative Law Judge

Signed by:
Greg Turner
1B8E50433E1D4D5...
Greg Turner
Administrative Law Judge

Date Issued: 6/22/2026

[13] In addition, CDTFA made additional allowances for self-consumption and pilferage; appellant has not indicated that there are additional adjustments that should be made with respect to these purchases.