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**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of:<br>**VAPEFORIC, LLC** | OTA Case No.: 240215500<br>CDTFA Case ID: 4-550-118 |

## OPINION

Representing the Parties:

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| For Appellant: | Roger Wang, CPA |
| For Respondent: | Ravinder Sharma, Hearing Representative<br>Chad Bacchus, Attorney<br>Jason Parker, Chief of Headquarters Ops. |
| For Office of Tax Appeals: | Crystal Spratley,<br>Business Taxes Specialist III |

G. TURNER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Vapeforic, LLC (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 9, 2023.[1] The NOD is for tax of $28,643, plus applicable interest, for the period January 1, 2019, through December 31, 2021 (liability period).

Office of Tax Appeals (OTA) Panel Members Natasha Ralston, Suzanne B. Brown, and Greg Turner held a Virtual oral hearing for this matter on April 23, 2026. At the conclusion of the oral hearing, the record was closed, and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, section 30209(b).

### ISSUE

Whether adjustments to the amount of unreported taxable sales are warranted.

[1] CDTFA timely issued the NOD because appellant waived the otherwise applicable three-year statute of limitations by signing a waiver on February 21, 2022, which gave CDTFA until April 30, 2023, to issue the NOD for the period January 1, 2019, through December 31, 2019. (R&TC, §§ 6487(a), 6488.)

## FACTUAL FINDINGS

1. Appellant, a limited liability company (LLC), operated as a licensed cigarette and tobacco products retailer located in Anaheim, California, during the liability period. Appellant sold vape juice,[2] vaping hardware, disposable vapes, and vape parts.
2. Appellant opened its seller's permit effective February 12, 2018.
3. For the liability period, appellant reported the following on its sales and use tax returns (SUTRs): total sales of $861,759; deductions of $3,014 for interstate and foreign commerce; and taxable sales of $858,745. The SUTRs were prepared using appellant's point-of-sale (POS) data.
4. For audit, appellant provided the following books and records: federal income tax returns (FITRs) for 2019 and 2020; POS data for 2019, 2020, and 2021; interstate commerce invoices covering the periods of first quarter 2019 (1Q19) and 2Q19; copies of sales receipts/customer receipts for June 13, 2022; and purchase invoices for May 2022 and June 2022.
5. CDTFA reviewed claimed deductions for interstate and foreign commerce and the sales invoices for these sales provided by appellant and determined $1,287 of the claimed deductions were not supported and therefore were disallowed.
6. CDTFA compared gross receipts reported on the FITRs filed for 2019 and 2020 to the corresponding total sales reported on the SUTRs. CDTFA noted differences that appeared to be immaterial, more than likely attributable to timing issues, and did not investigate them further. CDTFA also noted the lack of deduction for any salaries and wages and the reported ordinary business loss.
7. CDTFA reviewed the documents appellant provided and computed a markup[3] using cost of goods sold (COGS) from the FITRs and the total sales (ex-tax[4]) from the SUTRs to arrive at 38.97 percent for 2019, 20.82 percent for 2020, and an overall markup of

[2] Vape juice, also known as e-juice or e-liquid, is a liquid used in electronic cigarettes (e-cigarettes) and other vaping devices. When heated, it creates an aerosol that users inhale. (Cal. Code Regs., tit. 18, § 4076(a)(3).)

[3] "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). Markup and margin are different but often confused. 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 AM § 407.10.)

[4] As used in this Opinion, "ex-tax" refers to sales excluding sales tax reimbursement.

28.11 percent. CDTFA concluded these markups were inconsistent and lower than it expected for the location and industry. Appellant did not provide purchase invoices and CDTFA was not able to verify the completeness of the COGS. CDTFA determined based on the foregoing that further analysis was warranted.

8. CDTFA reviewed the POS data provided for the liability period and compared the recorded taxable sales in the amount of $860,247 to reported taxable sales on the SUTRs of $858,745 and noted an immaterial difference of -$1,502.

9. CDTFA reviewed the POS data provided for the liability period and compared the recorded sales tax in the amount of $66,675 to reported sales tax on the SUTRs of $66,553 and noted an immaterial difference of -$122.

10. CDTFA determined the credit card ratio was 92 percent, meaning 92 percent of appellant's sales reported by its POS system were made via credit card, which CDTFA determined was not typical of vape shops in the City of Anaheim. Credit card sales reported were compared to data on appellant's Form 1099-Ks (1099-K data) and differences deemed immaterial .[5]

11. CDTFA identified three businesses that it considered similar to appellant; those businesses had audited markup percentages of 99.17 percent, 94.59 percent, and 104.06 percent with an average markup of 99.27 percent. CDTFA determined that the markups calculated for appellant of 38.97 percent, 20.82 percent, and an overall markup of 28.11 percent were much lower than that of the other businesses.[6] CDTFA determined that further testing was warranted.

12. CDTFA conducted a full day observation test on June 13, 2022, from 11 a.m. to 7 p.m. CDTFA collected sales receipts from the observation test and scheduled the selling price per item, as well as the sales price less any discount given per item.

13. CDTFA conducted a short shelf test[7] based on the observation day sales prices, using the discounted sales prices, and the purchase invoices obtained from one of appellant's

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

[6] The record provides no additional details about the businesses identified as "similar" to appellant. For example, no information is provided regarding the audit periods at issue, the types and mix of sales transactions, the locations of the business, or other facts that might validate the asserted similarity to appellant's business and specifically its products sold.

[7] A shelf test is a comparison of known costs and associated selling prices used to compute markups.

vendors to determine the cost per unit.[8] CDTFA calculated an average markup for the items of 84.54 percent. CDTFA noted that the 84.54 percent markup calculated per the short shelf test was significantly higher than the 28.11 percent reported average markup calculated.

14. CDTFA used the COGS from the FITRs[9] less 1 percent attributable to shrinkage[10] to arrive at $140,549 for 2019, $209,330 for 2020, and an overall total of $349,879. CDTFA then applied the markup of 84.54 percent to arrive at audited total sales of $259,369 for 2019, $386,298 for 2020, and overall combined audited total sales of $645,667. CDTFA then subtracted claimed interstate commerce sales[11] of $3,014 for 2019 to arrive at total audited taxable sales of $256,355 for 2019, $386,298 for 2020 and combined total audited taxable sales of $642,653. CDTFA subtracted reported taxable sales of $194,286 for 2019 and $255,474 for 2020, resulting in differences of $62,069 for 2019, $130,824 for 2020, and a total difference of $192,893. CDTFA calculated percentages of error (POEs)[12] of 31.95 percent for 2019, 51.21 percent for 2020, and total combined POE of 42.89 percent.
15. CDTFA applied the POEs to the reported taxable sales of each corresponding period (31.95 percent to 2019, 51.21 percent to 2020, and the overall POE of 42.89 percent was applied to 2021), to arrive at unreported taxable sales of $368,317 for the liability period.
16. CDTFA issued a timely NOD on January 9, 2023, for the liability period, with a tax liability of $28,643, plus applicable interest.
17. Appellant filed a timely petition for redetermination, by correspondence dated February 3, 2023.

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[8] Appellant did not provide CDTFA with purchase invoices of items appellant sold on the observation day. Consequently, CDTFA relied on purchase invoices it obtained from appellant's vendors.

[9] Appellant did not provide purchase invoices for review, and therefore, CDTFA used COGS information from appellant's FITRs.

[10] Shrinkage: an allowance made for pilferage, spoilage, theft, natural disasters and fire losses. When shrinkage is present, an amount of up to 1 percent of the cost of these items may be allowed. When the taxpayer claims shrinkage of more than 1 percent, they must substantiate the amount. (CDTFA AM § 407.10.)

[11] Interstate commerce sales were only claimed in 1Q19 and 2Q19; none were claimed in the rest of the liability period.

[12] Percentage of error calculation is the percentage of unreported taxable sales to reported taxable sales.

18. On September 20, 2023, CDTFA's Appeals Bureau held an appeals conference and subsequently issued a decision on January 29, 2024, making no adjustments to the determination and denying the petition.
19. This timely appeal to OTA followed.

## 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).)

Taxpayers are required to maintain and make available for examination on request by CDTFA, or its authorized representative, 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 returns. (R&TC, §§ 7053, 7054; B&PC, § 22974; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).)

CDTFA is authorized to verify the accuracy of any return made. (R&TC, § 7054.) If CDTFA is not satisfied with the return or amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid based on facts contained in the returns or upon the basis of any information in its possession or that may come into its possession. (R&TC, §§ 6481, 6511; *Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Amaya,* 2021-OTA-328P.) 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*.) To satisfy its burden of proof, a taxpayer must not only prove that CDTFA's determination is incorrect but produce evidence

from which a proper tax determination can be made. (*Paine v State Bd. of Equalization* (1982) 137 Cal.App.2d 438, 442.) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Here, while appellant supplied records supporting its reported sales, including POS records (2019 through 2021), FITRs (2019 and 2020), 1099-K data, and bank deposits, all of which were found to contain immaterial differences, appellant failed to provide purchase invoices. CDTFA compared COGS reported on appellant's FITRs to reported sales and calculated an overall markup of 28 percent for 2019 and 2020, which CDTFA considered low for the type and location of appellant's business. In addition, appellant's high percentage of credit card sales and lack of employee-related expenses on its FITRs led CDTFA to question reported sales and use an indirect audit method to validate reported sales.

CDTFA scheduled and conducted an observation day where its auditor purchased a number of items that were subsequently matched to POS records; however, appellant did not supply purchase invoices for the goods purchased. CDTFA, therefore, acquired purchase information from appellant's vendors. Comparing actual purchases with appellant's vendor data for cost produced an overall markup percentage for the purchases of 85.54 percent, which is significantly higher than the markup derived by comparing appellant's reported sales with reported COGS.

From this observed markup percentage, and after assuming a shrinkage of 1 percent and interstate commerce sales of $3,014, CDTFA calculated audited total sales for 2019 and 2020, and commensurate error rates (an average error rate was used for 2021). Applying the error rates for each year to corresponding reported sales, CDTFA determined total unreported sales of $368,317.[13] Establishing an expected markup percentage to validate reported sales, or in the absence of reliable records to estimate actual sales, is a recognized audit method. (See *Maganini v. Quinn* (1950) 99 Cal.App.2d 1; CDTFA's Audit Manual (AM) §§ 0802.05, 0802.70.)[14] The markup method relies on the basic economic principle that goods are purchased at cost and resold at a markup. To the extent a markup percentage can be predictably estimated, it becomes an independent estimate of sales that does not depend on the

[13] Although CDTFA determined to disallow claimed interstate commerce sales of $1,287, CDTFA chose not to assert the increase here except as a potential offset to adjustments ordered by OTA.

[14] CDTFA's Audit Manual does not provide binding legal authority; however, OTA may look to it for guidance. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

taxpayer's actual sales records. (*Maganini, supra*, at p. 5.) Based on the record, OTA finds that it was not unreasonable for CDTFA to question appellant's reported sales nor use an indirect audit method to compute appellant's total actual sales. Accordingly, OTA finds that CDTFA has met its initial burden and it is appellant's obligation to show errors in the audit and to establish sufficient evidence from which a proper tax determination can be made.

Appellant's principal challenge to CDTFA's determination is that except for missing purchase invoices, appellant's records are complete and were made available for inspection. Specifically, appellant argues that its POS system recorded all sales of both credit card and cash transactions, which validated reported total sales. Because the POS system reports were substantiated by third-party records such as 1099-K data and bank statements, appellant contends that its reported total sales should be respected. Appellant asserts that only by ignoring those records and treating appellant's business as an all-cash business can CDTFA's determination be sustained. Appellant also challenges CDTFA's reliance on transactions outside the audit period to substantiate CDTFA's markup methodology and comparing appellant's business to much larger businesses that make their own vape juices. Appellant also claims error in CDTFA's refusal to recognize appellant's unusual volume of defective merchandise that was either exchanged, returned, or unsold. Appellant argues that when properly accounted for, even using CDTFA's methodology, the determination of unreported taxable sales should be adjusted from $368,317 to $37,432. Finally, appellant argues that even if the markup method is utilized, it should be restricted to estimating cash sales, because credit card sales were validated by 1099-K data.

Although appellant asserts that its POS system reflects all of its sales, both credit card and cash transactions, and on that basis it should be the sole source of CDTFA's determination of taxable sales. However, it is precisely that assertion that CDTFA's audit challenges: whether appellant's total actual sales are reflected in the POS records and in the SUTRs. One would expect that a properly constructed markup percentage derived from appellant's purchase invoices would roughly approximate total sales reported by the POS system and reflected on the SUTRs. The fact that reported total sales were substantially lower than sales estimated by CDTFA using a markup suggests that either the markup method was improperly implemented or total sales were not accurately reported.

Appellant challenges CDTFA's markup method as erroneous because the method relies on cost of sales outside the audit period. While the criticism is well taken, even assuming the challenge was sufficient to rebut CDTFA's presumption of correctness, more information would be necessary for appellant to carry its ultimate burden of proof. Appellant neither produces

records of purchases made during the audit period nor explains why the products sold on the observation day do not fairly reflect the type, mix, or average markup of products sold during the audit period. CDTFA resorted to the best available alternative; and appellant must not simply show CDTFA's error but present sufficient evidence upon which a proper tax determination can be made. (*People v. Schwartz* (1947) 31 Cal.2d 59, 64.) Consequently, OTA has no basis upon which to support any specific adjustment to the determination based on the identified weakness of CDTFA's methodology.

Appellant's attack on CDTFA's comparison of appellant's markup percentages to those of "similar businesses" is also a valid criticism. Beyond CDTFA's assertion that the three businesses identified for comparison were similar and what their markups were, OTA has little in the record to evaluate what, if anything, those businesses and their alleged markups indicate about appellant's reported total sales. Nevertheless, CDTFA presents the evidence only as a barometer. Even assuming the vagaries and uniqueness of appellant's business relative to those identified, CDTFA's observation day markup analysis tends to look more like these businesses than appellant's markup from reported COGS and total sales, presenting legitimate questions as to the veracity of appellant's reported total sales.

Appellant argued that its low markup is justified because appellant offers discounts to customers and allows for exchanges of defective products that its suppliers do not give it credit for, effectively lowering its profit margins. However, CDTFA's observation day purchases reflected discounts given. While appellant submitted photos and inventory lists of purportedly defective or damaged merchandise, neither the photos nor the lists established that the merchandise was actually defective or damaged. Moreover, appellant failed to provide specific information tying the goods shown by photographic evidence to purchases made, sales made to customers which were returned or exchanged, or damaged goods held in inventory during the audit period. Appellant should have some business records to document the return of defective merchandise for refund or exchange, but none were provided. Appellant also failed to explain why any unsold defective and damaged goods were not included in ending inventory or were erroneously included in COGS. Both naturally account for such returns, exchanges, and damage. While CDTFA's standard spillage allowance of just 1 percent might be legitimately questioned, without some substantiation of commensurate value associated with the identified defective merchandise, and explanation of appellant's lack of accounting for it, OTA has no basis to make an adjustment.

Finally, appellant argues that even if CDTFA's markup method is sustained, it should be restricted to adjusting cash sales as credit card sales were completely accounted for and

validated by 1099-K data. What appellant's argument fails to appreciate, however, is that the markup method is agnostic to the method of payment. Whether by barter, cash, credit card, debit card, or cryptocurrency, the markup method estimates total sales by estimating an average markup from cost. Total credit card sales alone indicate nothing about cash, or other transactional methods. The markup method exists precisely to test the completeness of *total* sales. Consequently, while credit card sales might be entirely accounted for, standing alone, they reveal only a component part of *total* actual sales.

Appellant has not identified any errors in CDTFA's computation of taxable sales. While appellant has raised several shortcomings in CDTFA's methodological approach, appellant has failed to provide sufficient documentation or other evidence of actual errors from which a proper tax determination can be made. As appellant bears the burden of proof in this case, OTA concludes that no further adjustments are warranted.

## HOLDING

Appellant has not shown that additional adjustments to unreported taxable sales are warranted.

## DISPOSITION

CDTFA's actions, in denying the appeal, are sustained.

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

We concur:

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

Signed by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

Date Issued: 7/22/2026