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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **K. NILTASUWAN &** **N. PATRATHIRANOND** **dba Jumbo Bowl Cafe**	OTA Case No. 19074969 CDTFA Account No. 100-934531 CDTFA Case ID 980538

OPINION

Representing the Parties:

For Appellant: Vernon Oates, CPA

For Respondent: Kevin C. Hanks,
Chief, Headquarters Operations Bureau

For Office of Tax Appeals: Deborah Cumins,
Business Tax Specialist III

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, K. Niltasuwan and N. Patrathiranond dba Jumbo Bowl Cafe (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) in response to appellant's timely petition for redetermination of a Notice of Determination (NOD) which assessed a liability of $42,805.01 of additional tax and applicable interest, for the period April 1, 2013, through March 31, 2016. In its subsequent decision, CDTFA reduced the assessed tax liability from $42,805.01 to $40,512.00[1] and denied the remainder of the petitioned amount.

Appellant waived its right to an oral hearing; therefore, the matter is being decided based on the written record.

[1] $40,512 is an estimated amount of tax, computed by CDTFA.

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ISSUE

Whether appellant has shown that additional adjustments are warranted to the audited understatement of reported taxable sales.

FACTUAL FINDINGS

1. Appellant is a partnership that operated a restaurant in Riverside, serving Thai-style cuisine, from July 1, 2007, through January 28, 2018, when the business was discontinued without a successor. The restaurant was primarily a dine-in restaurant, although its website also stated it offered free delivery and catering.
2. During the audit period, appellant reported total sales of $712,945, claimed deductions of $52,810 for sales tax reimbursement included, and reported taxable sales of $660,135.
3. Appellant provided no records for audit.
4. In the absence of records, CDTFA utilized the credit card ratio projection of sales audit method to establish audited sales.
5. CDTFA made several unsuccessful attempts to contact the business. Appellant's representative signed a Power of Attorney on March 9, 2016. Otherwise, neither appellant nor its representatives responded to CDTFA from February 12, 2016, through May 24, 2016, when the representative agreed to fax documents to the auditor. As a result of appellant's failure to cooperate with the audit process, CDTFA did not have the opportunity to arrange a time to observe the restaurant.
6. Since CDTFA was unable to observe the restaurant's operations and compute a ratio of credit card sales to total sales (credit card ratio), it used the credit card ratios from the audits of ten similar restaurants in Riverside to compute an average of 55.37 percent.
7. CDTFA's Data Analysis Section obtained credit card transaction data for appellant (forms 1099-K[2]) for the period April 2013 through December 2014. CDTFA compiled total credit card deposits of $423,367 for that period.

[2] Form 1099-K is used to report a taxpayer's income received from electronic or online payment services (e.g., credit cards, debit cards, PayPal, etc.). It is filed with the Internal Revenue Service by credit card processing companies for tax administration purposes.

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8. In the first reaudit, which was issued to correct a computation error in the audit, CDTFA divided $423,367 by 55.37 percent[3] to compute audited taxable sales of $764,669 (rounded). It compared that figure to reported taxable sales of $432,378 (for the period April 2013 through December 2014) to compute and understatement of $332,291. It computed a percentage of error of 76.85 percent ($332,291 ÷ $432,378), which it applied to reported taxable sales for the remainder of the audit period to compute an understatement of $175,036. Thus, the understatement in the first reaudit was $507,327 ($332,291 + $175,306).

9. After the appeals conference, appellant retained a new representative, who provided a hand-written sales journal, 1099-K forms, and bank statements for the audit period. Appellant asserted that the amounts deposited in the bank represented all of its sales, and it computed an understatement of reported taxable sales of $34,319.

10. After the appeals conference, CDTFA obtained the forms 1099-K for the first quarter 2015. Using the same procedure used in the first reaudit, CDTFA computed an understatement of $375,249 for the period April 1, 2013, through March 31, 2015, and a percentage of error of 76.71 percent, which it applied to reported taxable sales for the remainder of the audit period to compute an understatement of $131,149. Thus, the total understatement was reduced to $506,398 ($375,249 + $131,149).

11. On May 29, 2019, CDTFA issued a Decision, in which it reduced the audited understatement of reported taxable sales to $506,398 and otherwise denied the petition.

12. This timely appeal followed.

DISCUSSION

The California sales tax is imposed on a retailer's retail sales in this state of tangible personal property, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

[3] According to CDTFA's Decision (footnote 4), the credit card ratio in each of the ten audits was computed using credit card sales, including sales tax reimbursement and tips, and total sales (cash sales plus credit card sales), excluding sales tax reimbursement and tips. Therefore, when credit card deposits are divided by the average credit card ratio of 55.37 percent, the result is audited taxable sales, net of sales tax reimbursement and tips.

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When 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. (See *Schuman Aviation Co. Ltd. v. U.S.* (2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) 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. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *ibid*; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

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

When more than 80 percent of a retailer's gross receipts are from sales of food products, and over 80 percent of its retail sales of food are subject to tax, then cold food sold in a form suitable for consumption on the retailer's premises is subject to tax even if it is purchased "to go." (R&TC, § 6359(d)(6).) When a retailer's sales fit within this provision, known as the "80/80 rule," the retailer may avoid its application by keeping a separate accounting of its sales to-go of cold food in a form suitable for consumption on the retailer's premises. (R&TC, § 6359(f); Cal. Code Regs., tit. 18, § 1603(c)(1)(A).)

In this case, CDTFA concluded, based on a visit to the restaurant and a review of the menu, that appellant's sales met the requirements of the 80/80 rule. Therefore, CDTFA concluded that all of appellant's sales were subject to tax. Appellant has not protested CDTFA's finding that the 80/80 rule is applicable, and appellant claimed no exempt sales of food on its sales and use tax returns. Accordingly, we find it is undisputed that all of appellant's sales are subject to tax.

Appellant provided no records for audit, although it provided a few records after the appeals conference, as discussed further below. In addition, during the first several months that the audit was in process, appellant and its representative did not respond to CDTFA's attempts to

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contact them. Considering the complete absence of records, we find it was appropriate for CDTFA to use alternate audit methods. We further find that the projection of a credit card sales ratio was appropriate, since the amount of credit card receipts is readily verifiable.[4] Therefore, we find CDTFA has shown that its determination is reasonable and rational, and appellant has the burden to establish that further adjustments are warranted.

In its July 31, 2019 brief, appellant disputes the 55.37-percent credit card ratio, asserting that the ratio tends to be in the range of 60-75 percent.

We first reiterate that appellant provided no records for audit. After the appeals conference, it provided a hand-written sales journal and bank statements for the audit period. To explain the absence of other records, appellant states in its June 27, 2019 Request for Appeal that the partner responsible for financial matters has disappeared and has taken all the financial records. Regardless, as explained previously, in the absence of complete records, 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.)

For this audit, CDTFA utilized credit card ratio projection of sales as the audit method. It used the known amounts of credit card receipts, developed from forms 1099-K filed with the Internal Revenue Service by the credit card processing companies, for two of the three years of the audit period. As noted previously, CDTFA was unable, due to appellant's lack of cooperation, to conduct observation tests to compute a representative credit card ratio. Therefore, CDTFA used an average of credit card ratios developed in audits of ten similar restaurants in Riverside.

Given that appellant declined to cooperate with the audit process, its complaints about how CDTFA used alternative methods to establish a credit card ratio are entirely unpersuasive. As noted above, appellant's unsupported assertion that the credit card ratio is incorrect does not satisfy appellant's burden of proof. (See *Riley B's, Inc. v. State Bd. of Equalization, supra*; see also *Appeal of Magidow, supra*.)

In its July 31, 2019 brief, appellant also argued that the bank deposits shown on the available bank statements are an accurate representation of its sales. In its October 11, 2019 brief, CDTFA responded with a comparison of known credit card receipts and total deposits

[4] The amount of credit card receipts can be established using Forms 1099-K, which are filed with the Internal Revenue Service by the credit card processing companies, an objective source.

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shown on the bank statements for the period April 1, 2013, through December 31, 2014. CDTFA observed that the credit card deposits of $69,536 for the second quarter 2013 were $5,440 greater than the amount deposited for that quarter, $64,096, as shown on the bank statement provided by appellant. CDTFA offered this comparison as evidence that appellant likely maintained another bank account for which it has not provided bank statements. CDTFA noted, further, that it has no means to verify if all cash receipts were deposited in the bank. In that regard, for the remainder of the seven quarters, CDTFA computed that the percentages of credit card receipts to total deposits range from 71 percent to 94 percent (rounded), with six of the seven percentages in excess of 80 percent. CDTFA states that those percentages are much higher than expected, based on its experience auditing similar restaurants, and notes that the percentages are also significantly higher than the percentages estimated by appellant in its opening brief (60-75 percent). In other words, CDTFA's position is that there were cash receipts that were not deposited.

We are not persuaded that the amounts deposited in the bank represent appellant's total sales. Appellant has not provided complete records that could be used to evaluate that assertion. Although appellant provided a hand-written sales journal, it provided no source documents related to sales (cash register z-tapes or sales tickets). Also, appellant has provided no summary records of purchases and no purchase invoices. Appellant has not even provided federal income tax returns. Since the available records are extraordinarily limited, there is no information available to evaluate whether the amounts deposited in the bank represent all of appellant's sales, including all of its cash sales.

Moreover, for the reasons identified by CDTFA, we find it more likely than not that the amounts deposited in the bank did not include all of appellant's cash receipts. On this issue, we note that CDTFA used credit card ratios from audits of ten similar businesses to compute an average credit card ratio of 55.37 percent. Eight of the ten ratios were less than 65 percent, and the two highest percentages were 81 percent and 88 percent (rounded).[5] We find the percentages of credit card receipts to total sales reflected by appellant's bank accounts (with six of the seven percentages greater than 80 percent) to be strong evidence that the amounts deposited in appellant's bank accounts did not include all of its cash receipts.

[5] The ten ratios (rounded) were 34, 38, 48, 48, 49, 50, 54, 63, 81, and 88 percent.

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Moreover, for the ten credit card ratios used to compute the average of 55.37, we note that five were in the range of 48-54 percent. We therefore find that CDTFA's decision to use the average credit card ratio of 55.37 percent in its audit computations was reasonable. Appellant has provided no convincing evidence to show otherwise.

On a related matter, appellant stated in its July 31, 2019 brief that it ran on a cash-only basis for the period September 2015 through March 2016. Appellant notes that the amounts deposited in the bank declined during that period and posits that the decline is evidence of a high percentage of credit card sales prior to September 2015. However, CDTFA provided evidence that appellant may have more than one bank account (as noted above, appellant's credit card receipts for the second quarter 2013 exceeded the total amount deposited in the bank for that quarter by $5,440). If appellant did have more than one bank account, then the available bank statements are not definitive evidence that it was not accepting credit cards during the stated period. Since CDTFA obtained 1099-K forms only for the period April 1, 2013, through March 31, 2015, we have no evidence that such forms were not available for the period September 2015 through March 2016. Further, we note that CDTFA provided several versions of appellant's website, dated December 22, 2013, February 7, 2014, January 9, 2016, January 12, 2016, and March 14, 2016, all of which state that the restaurant accepted credit cards, offering evidence that appellant accepted credit cards throughout the audit period.

There is conflicting evidence as to whether or not appellant accepted credit cards during the period September 2015 through March 2016. However, we find that the decrease in bank deposits during that seven-month period is not persuasive evidence that most of appellant's sales were credit card sales prior to September 2015, as appellant suggests. Another viable possibility, if appellant did actually convert to cash-only, is that the bank deposits after August 2015 did not include all the restaurant's cash receipts.

Accordingly, we conclude that CDTFA's determination is reasonable and rational, and appellant has failed to provide evidence from which a more accurate determination may be made.

HOLDING

Appellant has not shown that additional adjustments are warranted to the audited understatement of reported taxable sales.

DISPOSITION

We sustain CDTFA's decision to reduce the audited understatement of reported taxable sales from $535,062 to $506,398 and to otherwise deny the petition.

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Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

We concur:

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