

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

BEFORE THE OFFICE OF TAX APPEALS
ANDREW KWEE, PANEL LEAD
DOUG BRAMHALL AND LINDA CHENG, PANEL MEMBERS

In the Matter of)
)
SKU TRADING, INC.)
)
Appellant,)
)
) No. 18011260
Office of Tax Appeals)
State of California)
Respondent)
)
_____)

TRANSCRIPT OF PROCEEDINGS
Van Nuys, California
Monday, October 22, 2018

Reported by:
SUSAN GALLAGHER
Hearing Reporter

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

BEFORE THE OFFICE OF TAX APPEALS
ANDREW KWEE, PANEL LEAD
DOUG BRAMHALL AND LINDA CHENG, PANEL MEMBERS

In the Matter of)
)
SKU TRADING, INC.)
)
)
Appellant,)
)
) No. 18011260
Office of Tax Appeals)
State of California)
Respondent)
)
_____)

TRANSCRIPT OF PROCEEDINGS, taken at
California State Building Offices, Van Nuys
6150 Van Nuys Boulevard, Van Nuys,
California, Monday, October 22, 2018, commencing at
3:35 p.m. and concluding at 4:47 p.m. on Monday,
October 23, 2018, heard basically
ANDREW KWEE, PANEL LEAD,
LINDA CHENG, PANEL MEMBER
DOUG BRAMHALL, PANEL MEMBER

Reported by SUSAN GALLAGHER.

Reported by:
SUSAN GALLAGHER
Hearing Reporter

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

APPEARANCES:

FOR THE DEPARTMENT OF
TAX AND FEE
ADMINISTRATION:

BY: CIRO IMMORDINO
LEGAL DIVISION
450 N Street, MIC:82
PO BOX 942879
Sacramento, California 94279-0082

FOR THE APPELLANT:

JANE KIM
JANE KIM & CO.
Certified Public Accountant
1737 5th Avenue
Los Angeles, California, 90019

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

I N D E X

| | | |
|------------|--------|-------|
| Witnesses: | Direct | Cross |
| /// | | |

E X H I B I T S

| | |
|----------------|-------------|
| MARKED FOR | RECEIVED |
| IDENTIFICATION | IN EVIDENCE |

APPELLANT'S

Exhibits 1 through 20 5

DEPARTMENT'S

Exhibits A through R 6

Exhibit S 9

1 Van Nuys, California, Monday, October 22, 2018

3:35 p.m.

2
3 JUDGE KWEE: We're opening the record in the matter of SKU
4 Trading, Inc., before the Office of Tax Appeals, OTA Case
5 No. 18011260. Today's date is Monday, October 22nd, 2018, and
6 the time is approximately 3:35 p.m. This hearing is being
7 conducted in Van Nuys, California.

8 For the record, will both parties please state their name and who
9 they represent, starting with the Franchise Tax Board.

10 MR. IMMORDINO: Ciro Immordino and David Gemmingen, and we
11 represent the Franchise Tax Board.

12 MS. KIM: Jane Kim. I represent SKU Trading, Inc.

13 THE COURT: Okay. Today's hearing is being heard by a panel
14 of three administrative law judges. My name is Andrew Kwee. I
15 will be the lead judge. Judge Bramhall and Judge Cheng are the
16 other members of this panel.

17 The exhibit index that you have in front of you are
18 identified as Exhibits 1 through 19 for the appellant and A
19 through R for FTB. In addition, we have documents submitted by
20 the taxpayer with Exhibits 1 through 6, and I'm just going to
21 refer to this exhibit -- exhibits submitted on the day of the
22 hearing, and I'm going to allow Exhibit 20 on the exhibit index.
23 Is that okay with both parties? Okay. And I'm marking these for
24 identification. I'm not admitting anything at this point.

25 (Appellant's Exhibits 1 through 20 marked for

1 identification.)

2 (Department's Exhibits A through R marked for
3 identification.)

4 Does FTB have -- I'll start with the taxpayer. Does the
5 taxpayer have any objections to any of the exhibits listed on the
6 exhibit index?

7 MS. KIM: Yes. There is some documents still by summary,
8 the No. 12, Item No. 12 and 13, which is not related. And same
9 as part of Item Number 6, it's about 2013. And it was probably
10 transmitted by the error, so the 2013 commission shouldn't be
11 included in there.

12 JUDGE KWEE: Oh. So these are the documents -- exhibits
13 that you submitted to the Office of Tax Appeals and the dates
14 there for 12 and 13, and that was the printout date on the top
15 corner. That wasn't the date that it applied to.

16 MS. KIM: Okay.

17 JUDGE KWEE: But then for No. 6, the income statement, I
18 believe that was for Exhibit -- that was for 2013. Did you want
19 to strike the income statement?

20 MS. KIM: Income statement, yes. That's part of the 2013,
21 yes, that had been struck by -- Item No. 6.

22 THE COURT: Okay. So we'll strike.

23 MR. IMMORDINO: No, if I -- Exhibit Number 6, I believe on
24 the taxpayer's created a financial statement. In 2013 they
25 created what was purportedly financial statements for 2007, but

1 they forgot to update their software date to put in 2007. So we,
2 the appellant offered these for the 2007 taxpayer financial
3 statements, and she just forgot to update the tax year. So these
4 reflect what the taxpayer's now put forth as the financial
5 information for 2007.

6 JUDGE KWEE: Okay. Well, these are Ms. Kim's exhibits; so
7 I'm just going to turn it back to her.

8 Would you like Exhibit 6 admitted for year 2013 with -- is
9 this documentation that you wanted admitted for -- to show what
10 the 2007 tax year?

11 MS. KIM: It should be -- yeah, it should be taken out
12 because there's a replace -- there is other documents there, the
13 same documents, so yeah, 2013, I don't know. I don't even
14 remember what happened back then but it shouldn't be in there.
15 It should have been just for 2007.

16 JUDGE KWEE: Okay. So these are the taxpayer's exhibits
17 they have right now. So I'm going to strike out the items
18 selected as 2013. If the Franchise Tax Board wanted to admit new
19 evidence, you could submit these as your exhibits if --

20 MR. IMMORDINO: Well, yeah, to the extent that they were
21 discussing the briefing, I would like them kept in the record. I
22 think they are part of the discussion, and they are necessary to
23 fully understand this appeal.

24 JUDGE KWEE: Okay. I'm going to list the -- I'm sorry?

25 MR. IMMORDINO: Could I just have a moment please?

1 JUDGE KWEE: Okay. That's fine.

2 Okay. So would you still like to admit this as their
3 Exhibit for 2013 documents?

4 JUDGE BRAMHALL: Can I get a clarification? When you say
5 2013, they're talking about Documents No. 12 and 13?

6 JUDGE KWEE: I'm talking about the Exhibit -- Exhibit 6, the
7 part for the income statement for part of 2013 and -- for part of
8 2013.

9 MR. GEMMINGEN: I'm sorry. So we haven't addressed 12 and
10 13 yet, which he attributes to 2013.

11 JUDGE KWEE: No, no, no. 12 and 13 was just the date, not
12 the actual --

13 MR. IMMORDINO: You know, before we move to admit this as
14 FTB's exhibits, our first, you know, kind of preliminary step,
15 though -- that is that we object in general to all of the
16 appellant's financial records submitted because the briefing
17 shows, number one, a lot of these are not actual business
18 records. They're summaries of business records, and they're
19 inconsistent with each other.

20 So as a general item, we object to all of those as evidence
21 in this appeal, but if you keep them in, then we prefer to keep
22 in Exhibit No. 6 as FTD's exhibit, if that makes sense.

23 JUDGE KWEE: Okay. So we'll get to the second objection
24 next. But in the event we keep this in, I'm going to mark this
25 for identification as Exhibit S, the Franchise Tax Board, and

1 that's the documents labeled for 2013 from exhibits -- taxpayer
2 Exhibit 6. Okay.

3 (Department's Exhibit S.)

4 So Ms. Kim, the taxpayer -- I'm sorry, the Franchise Tax
5 Board has raised an objection to the exhibits that you submitted
6 on the basis of, I think, credibility?

7 MR. GEMMINGEN: Your Honor, we feel that there's no
8 foundation as well as these are not business records, and so they
9 do not pass for hearsay.

10 JUDGE KWEE: Would you like to respond to the objection?

11 MS. KIM: Yes. I think I need to explain a little bit about
12 the background and his story of this account and corporation.
13 They incorporated in 2003. And the first of three years the
14 return was prepared by me and then they switched to the other
15 CPA. And 2006 and '7 was prepared by other CPAs. And when I
16 took it over, the audit, I asked for the documentation from the
17 previous accountant within a letter.

18 JUDGE KWEE: Okay. So I was just referring to the
19 objection, so you can provide the background information during
20 your presentation, but with respect to the FTB's objection, my
21 inclination is inconsistent with the OTA rule for tax appeals
22 that we have submitted with the OAL a couple weeks ago to admit
23 all evidence with the exception of objections for relevance or
24 privilege.

25 I understand the concerns that you have regarding the

1 foundation for the documentation, and the panel will consider all
2 evidence submitted by both parties and give it the proper weight
3 it deserves. But the documents submitted by the taxpayer, they
4 do appear relevant in as far as to what they purport to offer, so
5 I'm going to admit it on that basis.

6 During your presentation you can address and point out
7 concerns that you have and state it on the record why you don't
8 believe that we should give it as much weight, for example, as
9 the documentation. So I will be overruling that objection.

10 And your objection on No. 6 was addressed by moving that
11 down to a different exhibit for FTB at this point.

12 Do -- are there any other objections to the exhibits?

13 MR. IMMORDINO: So the new exhibits we object to since we
14 haven't had the ability to -- to look at those.

15 JUDGE KWEE: Okay. I understand that point. And these,
16 since they are new documents, my inclination is -- here is to let
17 the taxpayer address these during the presentation and to hold
18 the record open for 30 days and let the Franchise Tax Board
19 submit a follow-up briefing to address any concerns that they
20 have or any contentions that they have with regard to the
21 taxpayer's newest exhibit.

22 How does that sound with the Franchise Tax Board?

23 MR. IMMORDINO: You know, we've -- this has been going on
24 for nine years now where we gave additional documents and we gave
25 them additional briefings. We prefer to end it here.

1 JUDGE KWEE: Okay. I believe this panel would like to hear
2 what the taxpayer has to say about the documentation, and I
3 believe it would be fair also because I believe it would be fair
4 to allow the Franchise Tax Board an opportunity to address the
5 document. So what I will be doing is I'll be having all the
6 exhibits marked on the index in addition to Exhibit 20 for the
7 appellant, which is the exhibit binder submitted today in
8 addition to Exhibit S for the Franchise Tax Board, which is the
9 2013 documents from Exhibit 6.

10 So in total we have Exhibits 1 through 20 for Appellant and
11 Exhibits A through S for the Franchise Tax Board in which we are
12 admitting over two objections. And the Franchise Tax Board will
13 have -- we're going to hold the record open for 30 days after
14 today's hearing and the Franchise Tax Board will have 30 days to
15 submit any reply or response that it has to the exhibits
16 submitted by the taxpayer today.

17 JUDGE BRAMHALL: And may I just -- point of clarification,
18 30 days to provide a brief, but we may need to leave it open for
19 the taxpayer to have a final reply.

20 JUDGE KWEE: Yes. So depending on what the Franchise Tax
21 Board provides in its reply brief, we may allow the taxpayer to
22 provide an additional response, but we'll reserve in that right.
23 We're not going to offer it at this point, but I'm going to
24 determine what is submitted by FTB before determining if there's
25 going to be an additional 60-day period.

1 JUDGE BRAMHALL: And I would just like to caution you that
2 you had an opportunity to attend the prehearing conference at
3 which time you could have provided this kind of information, and
4 then we would have all had it all in advance. So if you're
5 involved in appeals before us again, I urge you to take advantage
6 of those prehearing conferences and not surprise the other side
7 with documents provided at the last minute.

8 That is not conducive to determine -- the proper
9 determination of the current amount of tax, and that's what we're
10 here to resolve. Okay.

11 MS. KIM: Yes, Your Honor.

12 JUDGE KWEE: Okay. Thank you for that. So the exhibits are
13 admitted into evidence, and the issue that's going to be heard
14 today is whether Appellant has established that it reported on
15 that accrual basis and therefore, FTB proposed assessment to
16 account for a change in accounting method.

17 So since there are just representatives today, I'm not going
18 to swear in anyone. I will just turn it over at this point to
19 the taxpayer to start her opening presentation, and that will be
20 ten minutes. So you may proceed when you are ready.

21 MS. KIM: Yes. The issue here is very clear, whether that
22 taxes or this income and expenses had been reported on an accrual
23 or a cash basis. And on tax return by the error, it was marked
24 as cash basis. From the beginning they usually return the for
25 2003 was marked as cash basis on accountant's reporting. But

1 actually, it was reported on an accrual basis. Because if you're
2 looking at the returns, it has accounts receivable, accounts
3 payable on balance sheets.

4 Clearly, I have to say that, again, there is clearly there's
5 checkmark error. And in 2000 -- SO I just have to explain a
6 little bit about the document -- confusion of the documentations,
7 and as I said earlier, the CPA could prepare the 2006 and '7
8 returns. It was not me. It was somebody else, and it handed
9 down to me. And I request a general ledger from the accountant
10 who prepared the 2006 and '7 return, and he said he had a problem
11 with the computer. So he wasn't able to generate the general
12 ledger.

13 But he -- the taxpayer had a copy of financial statements,
14 and also taxpayer maintained the books on QuickBooks, and
15 obviously inhouse computer -- the accountant, is not very
16 competent to prepare for financial statement, but I was able to
17 get all the documents from the QuickBooks all the year 2006 and
18 '7, especially 2007, which is in question.

19 And based on the QuickBooks data, I generate the general
20 ledger, and I generate the general ledger in two sets. And if
21 you -- the one that I presented today is the one that basically
22 based on the QuickBooks printout, based on like the QuickBooks
23 printout that's Exhibit No. 4 and 5, and also sales of -- and No.
24 12 and 13 is based on those -- the printouts from the QuickBooks.

25 And then also there's a financial statement and general

1 ledger was prepared earlier. It was presented in Exhibit No.,
2 probably No. 15, and that was -- I prepared the general ledger
3 pretty much the same information, but we processed all the checks
4 into our computer. So the number that is -- the numbers are all
5 same, but it looks a little bit different. So that's my little
6 bit of a background.

7 I explained why we have two sets of general ledgers, the
8 numbers are all the same. And also our sources are all the same
9 sources, which the QuickBooks data from the clients. So if
10 you're looking at the Exhibit No. -- No. 4 and 5, this is a base
11 for and to prepare the general ledger and financial statement and
12 also the tax return, I believe, which I included on the new
13 documentation that's Exhibit No. 20 -- actually Exhibit No. 6 of
14 20.

15 But actually, the bottom line is whether the tax -- tax
16 return was prepared based on accrual basis or cash basis. So
17 even the 2003 was prepared on accrual basis with having the
18 accounts receivable payable inventory, and you just cannot adjust
19 the one year backing up -- backing up as a cash basis accounting.
20 When you have all buildup the income expenses up to -- from the
21 beginning to 2006 and you just -- I don't think there's any way
22 that you can just adjust the one year based on the error was made
23 on the return by this check mark.

24 And also if you really converting to the return by the cash
25 basis, actually there's -- their loss. So it's very simple error

1 that made on the return, checkmark error, and I explained to the
2 Franchise Tax Board many, many times, and they wouldn't listen,
3 and they insist all the documents, you know, which I had to
4 generate the general ledger somehow because they need to have the
5 general ledger, even though the financial statements and tax
6 returns clearly indicating the return was prepared on accrual
7 basis.

8 JUDGE KWEE: Does that conclude your presentation, Ms. Kim?

9 MS. KIM: Yes.

10 JUDGE KWEE: Okay. So I have a quick question or two. I
11 was wondering if you could clarify or explain why the gross
12 receipt recorded on the federal income tax and state income tax
13 return for '07 doesn't reconcile with the general ledger. I
14 believe it was off by about, was it 50,000 or 45,000, that there
15 was a difference between gross receipts on the tax return versus
16 what was listed on the general ledger. I was just wondering if
17 you can explain that.

18 MS. KIM: Hold on. 2006 and --

19 JUDGE KWEE: 2007 I believe --

20 MS. KIM: 2007?

21 JUDGE KWEE: On the federal and state returns the gross
22 receipts are listed as 10.25 million and the general ledger, it
23 was listed an at 10.28 million.

24 MS. KIM: Okay. One second. General ledger I presented on
25 the new exhibit is the 2 -- 10.257024.

1 JUDGE KWEE: Okay. So I guess that was one of the other
2 things that you have a couple copies of the general ledger?

3 MS. KIM: Yes.

4 JUDGE KWEE: So I guess I'm -- so what you're asking is to
5 look at the one -- the most recent copy because I believe in the
6 prior general ledger, there was a different figure report.

7 MS. KIM: Let me look at the previous general ledger. I
8 have a copy.

9 JUDGE KWEE: Okay.

10 MS. KIM: The exhibit that they gave to me today and handed
11 has a sales figure 10,257,024.

12 JUDGE BRAMHALL: That's what the return shows.

13 JUDGE KWEE: Okay. I was also just curious because you
14 mentioned that this was a check-the-box error going back to 2003,
15 and I'm -- I guess just wondering if you could help me understand
16 how this happened. How does it happen that that same error
17 occurs for every year? It is, like, how does this as a
18 practicing -- practicing CPA?

19 MS. KIM: As a CPA I can say that, you know, because when
20 use the same program, all the previous year information just turn
21 it over, carry over to the current year, and we cannot pay really
22 good attention to what's in there. It can happen repeatedly.

23 JUDGE KWEE: Okay. Thank you.

24 Does the panel have any other questions before I move to the
25 FTB?

1 JUDGE BRAMHALL: This is an education, okay? Educate me,
2 please. When you look at a tax return, you look at the
3 computation of income and you look at a balance sheet on the tax
4 return.

5 MS. KIM: Yes.

6 JUDGE BRAMHALL: What on that return -- you said you look at
7 the return and you can see that it is accrual basis. What
8 entries show you -- and FTB you can respond too -- what entries
9 show you whether it's accrual or cash?

10 MS. KIM: If the account -- the sales that it recorded as it
11 incurred based on the invoices or if the cash basis means by the
12 collection. So if you're looking at the general ledger, we have
13 sales in general that was supported by the invoice. That's what
14 recorded as the sales.

15 JUDGE BRAMHALL: So 10,000,257 or 10,984,000, okay. So a
16 cash basis taxpayer would show that as the gross receipt?

17 MS. KIM: No. That gross bank deposit statement. The sales
18 can be bank deposit for the period of time. So if you're looking
19 at my general ledger or either if you're looking at the Exhibit
20 No. 20, I believe it's on No. 5, Exhibit 5 of 20, it has a
21 transaction report. So if your looking at that --

22 JUDGE BRAMHALL: It was what? I'm sorry, I missed it.

23 MS. KIM: Transaction.

24 JUDGE BRAMHALL: Okay. All right.

25 MS. KIM: It has -- if you're looking at the transaction

1 number, Reference No. 11, sales was recorded and accounts
2 receivable was recorded the same time, which means this was
3 accrual-base accounting. If it's the cash-base accounting, that
4 sales recorded, then other side of the debit should be cash in
5 bank.

6 JUDGE BRAMHALL: Cash in bank.

7 MS. KIM: So I hope that answers your question.

8 JUDGE KWEE: Does the appellant taxpayer, do they still have
9 the source documents to back this up, the invoices and the fees?

10 MS. KIM: Yes. On QuickBooks. Yeah. Yeah.

11 JUDGE KWEE: Okay. I'm going -- at this point I'm going to
12 let the franchise --

13 MR. IMMORDINO: Did you want me to respond to that question
14 too?

15 JUDGE BRAMHALL: Yeah.

16 MR. IMMORDINO: So the number one indicator on a tax return,
17 whether they reported on the cash or the accrual basis, is
18 whether they checked the mark, whether they checked the box, cash
19 or accrual. And then, in addition, what the appellant is talking
20 about is look at the balance sheet and look in what's reported
21 there, you know, you can find that on either of the two methods.
22 And the only way -- you know, once they raise the question of
23 whether they reported on the cash or the accrual, the only way to
24 figure out for sure what method they reported on is to look at
25 the underlying accounting records and then look in at the general

1 ledger, you know, and then looking at potentially some source
2 documents from the general ledger, we can figure out whether they
3 did report on accrual or cash.

4 And that's the issue in this whole appeal of that. At audit
5 we asked them, please provide us the copy of the general ledgers
6 so we can determine if, in fact, you reported the accrual method.

7 JUDGE KWEE: Okay.

8 JUDGE BRAMHALL: And then that might lead to other questions
9 as well if this is the underlying invoices, which would
10 demonstrate whether the amount of invoices reflect the amount --
11 and you can look at the payment terms of the invoices as well as
12 to say whether they had a 90-day payment. And so if you look at
13 the end-of-the-year invoices that might have a payment go over to
14 the following year.

15 And if those invoices were booked in the year that the sale
16 was recorded, then that would demonstrate the accrual method if
17 the payment was not made until the following year under the
18 payment terms. So you'd look to see the matched invoices and the
19 payment terms for the contract of sale to how the receipts are
20 reported on the return.

21 JUDGE KWEE: All right. For the Franchise Tax Board, I'm
22 just curious because on their state return they filled out a
23 Schedule L reporting accounts payable and accounts receivable.
24 And I'm wondering would they have been required to fill that
25 schedule out on the cash basis?

1 MR. IMMORDINO: They would not have been required, however,
2 you know, sometimes you see that on tax -- on a cash basis.
3 Importantly, when a company records its books, whether you are a
4 cash or accrual basis, you know, you are going to keep track of
5 the accounts receivable or accounts payable. It's just when you
6 print out your profit and loss or figuring out your tax
7 liability, it's which method.

8 Oftentimes software lets you print out on either the accrual
9 method or the cash method, but a company's going to have accounts
10 receivable. A company's going to have accounts payable. Because
11 these are real business operations. A company has to know who
12 has been sold a good but hasn't yet paid that in accounts
13 receivable. A company's going to have to know when they've
14 incurred an expense. You know, if they have a rent bill but they
15 haven't yet paid it, that's accounts payable.

16 So those accounts exist on both cash and accrual, and they
17 don't give you clear guidance whether on the tax return or not
18 whether the taxpayer reported under the accrual method or the
19 cash method, which, again, is why this entire appeal now, this
20 entire appeal is about whether the appellant provided the FTB
21 with any substantiation which led us to -- which gave us the
22 ability to determine which method they had reported under.

23 MS. KIM: Can I add something to that opinion? If it's an
24 accrual basis, if you're a cash basis, you're not supposed to
25 have any accounts payable nor the accounts receivable. And if

1 you are truly an accrual basis, then there's the change in
2 accounts receivable and accounts payable from the payments --
3 time to time, which means beginning balance and ending balance is
4 different.

5 If it's a cash basis for the certain period of time, if they
6 maintain the one cash basis one year, means there is no changes
7 in accounts receivable and accounts payable. If the sales is
8 recorded, based on cash and receipts means sales is going to be
9 increased by the cash receipt, right? Nothing going to make any
10 impact on accounts receivable. So there shouldn't be any changes
11 in accounts receivable.

12 And accounts payable, same thing. If the expenses are
13 recorded as they pay, then when you make that expense, it was
14 deducted from the cash, so it wouldn't make any impact on the
15 accounts payable. So there shouldn't be any changes from the
16 beginning balance and ending balance of accounts receivable and
17 accounts payable.

18 MR. IMMORDINO: Thank you. You know, in the normal course
19 of a business when you sell a good and you a sell it on account,
20 you have an account receivable, and so this is the normal
21 business function. And so that's -- you know, you are going to
22 have a change in accounts receivable based on when you made a
23 sale and you have not yet been paid.

24 And so as I said before, a lot of software lets you print on
25 either the accrual method or the cash method because you can

1 choose either one, and based on the way it was entered in the
2 system, you can tell, you know, was it received cash? Then if
3 you put in the cash method it would show income. If it was an
4 account or a sale on an account then that would result in cash
5 until the -- or I'm sorry.

6 If there's a sale on account, then under the accrual method
7 that would -- where you print under the accrual method, that
8 would show up as income. But if you print under the cash method
9 it wouldn't show up as income until the -- the account payable
10 was paid. And so under both systems, you can have these
11 accounts, whether it's a function of what accounts you have to
12 have in order to operate a business.

13 MS. KIM: Well, let me add one more thing to there.
14 According to the accounting principals in IRS, if we have
15 inventory, then we're not supposed to maintain the books on a
16 cash basis anyway.

17 JUDGE BRAMHALL: Are you referring that you reported
18 inventory on your return?

19 MS. KIM: Yes. So I had a beginning and ending inventory.
20 Because this is fabric company, trading, a wholesaler, and
21 there -- the terms of collection is more than 90 days.

22 JUDGE KWEE: And so the Franchise Tax Board had indicated
23 certain types of documentation that it would have wanted to see
24 in order to substantiate the position, and I'm wondering if
25 why -- and I don't think that was the types of documents that

1 were listed here, I am just one wondering why you haven't
2 provided that type of documentation that FTB wanted to support
3 your appeal.

4 MS. KIM: Well, first of all, they request the financial
5 statements and general ledger, which was provided. You know, I
6 mean, even though I didn't have it, somehow I had to come up with
7 is. And now they are saying they want to see the collection
8 history. That never requested by the Franchise Tax Board before.
9 And I could have printed out -- QuickBooks has -- it's over 10
10 million sales company, so there's no way that I can print out all
11 the accounts receivable history, but I could send them some
12 samples and send it to them, but we never been requested by the
13 Franchise Tax Board.

14 And I never thought of it as the -- printed them as a
15 documentation they requested because I always think it's a simple
16 matter. It's just a checkmark error, and it's so obviously on
17 the return was reported on accrual basis, having the inventory,
18 accounts receivable, accounts payables, and the type of industry,
19 type of the business it's in, it's just -- there is no cash on
20 that return. And if I just prepared based on a accrual basis.

21 MR. IMMORDINO: So we -- about what was requested, we --
22 back in 2009 within one year when they filed their tax return,
23 when we were asking for the financial statements and the general
24 ledger, we got a complete copy of the financial statements. The
25 original financial statements were prepared by a CPA, Donald Chen

1 (phonetic), and we never got a complete copy of those. We got
2 the copy without the auditor's compilation report.

3 And we asked for the -- this -- we continued to ask for the
4 compilation report. It was never provided. Finally around 2013,
5 2014, the appellant created a new set of financial statements
6 which is the one -- which the appellant moved to exclude, which
7 had the year 2013 listed.

8 And so -- and those financial statements were not prepared
9 the same way that the other CPA's financial statements were
10 prepared, the contemporaneous financial statements. They were
11 prepared in a different manner. And so that's the financial
12 statement issue. The other issue, the general ledger was also
13 asked for in the beginning, and as we said in the briefing, we've
14 never received a copy of the general ledger.

15 We've received several summary versions which are
16 contradictory to each other. And again, this appeal, the
17 question of what's on the tax return, based on the tax return,
18 what's clear is you don't know how they report it. It's not
19 clear if they report it on a cash basis or an accrual basis. And
20 the burden's on the taxpayer to establish that they report it on
21 the accrual basis.

22 We asked for a copy of the general ledger within one year of
23 when the tax return was filed. This is the document which they
24 would have had readily available, they could have provided us. I
25 know the appellant mentioned the size of documents and how many

1 pages there are. You know, we audit the largest companies in the
2 world, and we have -- you know, we're able to get copies of their
3 general ledgers. This is information which is commonly provided
4 to the tax authorities, and it was what's necessary here for us
5 to understand if they reported under the accrual or the cash
6 basis, and it simply wasn't provided.

7 JUDGE KWEE: Okay. Thank you. I'm going to let you do your
8 opening presentation.

9 MR. IMMORDINO: You know, I've -- some of what I covered is
10 in here. I've already covered. Maybe I'll try and do an
11 abbreviated version a little bit. Also I thought I was going to
12 do my closing before questions, I guess that's why I'm just
13 confused a little bit here. So I'll just try to incorporate the
14 two. So please forgive, you know, if it's a little bit choppy.

15 JUDGE BRAMHALL: So are we today. And believe me, this is
16 an educational experience because I can't tell either, and I need
17 your help telling me how to tell, not your answer, but tell me
18 how to tell, so. And that -- and that's caused some choppiness
19 and I apologize for that.

20 MR. IMMORDINO: Thank you very much, and that's what this
21 covers. So, you know, to start off, the issue in this appeal is
22 whether the appellant met its burden of proving that it reported
23 income expenses on the accrual method of accounting. You know,
24 the taxpayer has a burden, and they need to show they reported it
25 that way. The appellant's 2006 and 2007 tax returns claim that

1 it used the cash basis of accounting; however, based on the
2 appellant's gross receipts under Revenue Taxation Code 24654,
3 which incorporates 448, the appellants were required to report
4 under the accrual method, and this is because they had more than
5 \$5 million of average gross receipts.

6 And the appellant can see it was required to report under
7 the accrual method of accounting. So the appellant argued that
8 it actually did report under the accrual method of accounting.
9 So based on the appellant's assertion, the Franchise Tax Board
10 requested that the appellant provide information which would
11 allow us to verify if the appellant reported under the accrual
12 method of accounting.

13 Since the audit began nine years ago, this information has
14 been requested over 24 times, but the appellant has never
15 provided the requested information. Further, the information
16 that Appellant did provide does not support that the appellant
17 reported under the accrual method of accounting.

18 To give context, when a taxpayer reports his income, it
19 generally uses the cash method of accounting or the accrual
20 method of accounting. The cash method of accounting calculates
21 income based on whether taxpayer received or paid cash. So
22 recognizing income and expenses followed the payment of cash.

23 The accrual method of accounting calculates income based on
24 when revenue is earned and expenses are incurred despite when
25 payment actually occurs. For example, say a sale occurs toward

1 the end of the year but the customer does not pay the invoice
2 until the next year. Under the accrual method, the taxpayer will
3 recognize income in the year of sale. This is when the income is
4 earned. But under the cash method, the taxpayer will not
5 recognize the income until the customer pays the bill, which
6 happens in the second year.

7 Beginning in 2009, just one year after the appellant filed
8 his tax return, the Franchise Tax Board began asking the
9 appellant for information that would allow the Franchise Tax
10 Board to determine whether the appellant had reported under the
11 cash method or the accrual method. Since the appellant had just
12 recently filed his tax return, this information should have been
13 readily available. Exhibit R details 19 requests that FTB made
14 for substantiation which the appellant failed to provide.

15 Similarly, when this appeal began six year ago in 2012, your
16 predecessor, the Board of Equalization, repeatedly requested the
17 appellant provide substantiating evidence, with the appellant
18 continuing to not provide this evidence. The result of that, the
19 BOE would not let the appeal go to oral hearing.

20 For example, in a December 16, 2013, letter requesting
21 additional information, the BOE stated, "The Franchise Tax Board
22 has requested documents from Appellant that it should hold in the
23 normal course of its business operation. Nonetheless, Appellant
24 has failed to comply with these requests."

25 What the Franchise Tax Board had thought was simple, records

1 for Appellant which confirm, i.e., trace and prove, the amount
2 that Appellant has claimed as revenue and expenses on income tax
3 returns. The BOE letter further stated that based on the
4 documentation currently in the record, Appellant has submitted
5 virtually no documentation that would lead to a productive
6 hearing before the Board of Equalization to resolve this appeal.
7 The Board of Equalization sent similar letters in both December
8 of 2014 and May of 2017.

9 While the Appellant's provided virtually no documentation
10 for 2006, I briefly want to go over the incomplete and limited
11 documents that Appellant did provide regarding 2007. In general,
12 the appellant did not provide original accounting records. And
13 what may be original records are incomplete, not consistent with
14 the appellant's tax return, or contradict themselves.

15 Perhaps the most important accounting record in this appeal
16 is the general ledger. An accurate and complete general ledger
17 is important because the general ledger records each transaction
18 a business enters into, and it records these transactions as they
19 occur. Each recorded entry then ties the underlying documents
20 such as the sale of invoice or a bill.

21 So if a sale occurs, then a sale entry will show up on the
22 general ledger, and that entry will tie to a specific invoice.
23 So an auditor would be able to see the sale recorded on the
24 general ledger and then verify the sale by looking at the sale's
25 invoice. And to go back to your question, this is how it's

1 verified that the accrual method was used.

2 To determine whether the cash or accrual method of
3 accounting was used, one of the things an auditor would do is
4 look to an invoice or a bill where payment was not immediately
5 made and determine whether the taxpayer followed the cash method
6 or accrual method of recognizing income and expenses.

7 Essentially, the general ledger can be viewed as a start of
8 a conversation. Based on what constitutes a general ledger,
9 they've been asked for information to substantiate the taxpayer's
10 assertions are correct. Since the appellant never produced the
11 necessary documents, the FTB was never able to even begin this
12 conversation. It's notable the reported excerpts from the
13 general ledger the appellant provided do not reconcile to the
14 numbers on Appellant's tax return, so even these excerpts are
15 contrary to Appellant's position.

16 I'd like to go over a couple examples at this time. If you
17 don't mind pulling up the exhibit excerpts I provided.

18 So if you go to my example one on page 1, I want to go to
19 the point that Appellant has never provided an original general
20 ledger, and the summary version contradict each other.

21 So if you turn to page 3, skip page 2 and go to page three,
22 page 3, the highlighted portion shows what the Appellants
23 reported in 2017 as the account balance for income tax payable.
24 It shows 34,500. Now if you go to page 4, you'll see that same
25 account, Account No. 235, income tax payable, has a zero balance.

1 This is the general ledger provided in 2014.

2 It's interesting that the exhibit the appellant brought
3 today, Exhibit Number 20, if you go to Exhibit 4, when you go
4 over the income tax payable account, you'll see that the
5 appellant has gone back to the version they had in 2013. So if
6 2013 has a zero balance, 2017 had a 34,500 balance, and the
7 version today goes back to having the zero balance. This is one
8 example of many where the summary general ledgers are
9 inconsistent with each other.

10 Earlier the appellant noted that she summarized the general
11 ledger, but she had the account balances the same. And this is
12 not the case. Throughout the general ledger, the account
13 balances, the different account names, different account amounts,
14 there are material and substantial differences between the
15 accounts in the different versions of the general ledger
16 presented. And I guess this is very important to note that this
17 was one the reasons why we need to see the actual original
18 general ledger. Only by looking at the original general ledger
19 can we have a starting point to figure out if the taxpayer
20 reported on the accrual or cash basis of accounting.

21 And, now, another major issue that the appellant has in this
22 appeal, which has already been touched on today, is that the
23 appellant's sales journals do not reconcile with the sales
24 reported on the appellant's tax return. It's important to note
25 that the sales journals provided by Appellant are excerpts from

1 the general ledger, and so there's initially a credibility issue
2 as to whether they're accurate.

3 But just getting past all that, I want to turn to my example
4 number two, page number 5. And if you go to the next page, page
5 number 6, and this is an excerpt from the 2017 -- the documents
6 provided by the appellant in 2017, and they're provided to show a
7 reconciliation between the sales journals and the number reported
8 on the tax return.

9 If you see that highlighted number, there's a sales discount
10 which the appellant uses to reconcile the two numbers, and
11 there's also a unknown adjustment. But that sales discount,
12 24,558, and the unknown adjustments lead to gross receipts of
13 \$10,257,024. And if you then turn to page 7, you'll see that
14 same figure, 10,257,024 at the top of the profit loss statement.

15 Next they take that same sales discount and they apply it
16 again. It's not possible to apply a sale discount -- the same
17 sale discount twice to the same sales. This is an impossibility.
18 Again, the taxpayer's reconciliation serves to bridge the sales
19 journal and the amount on the tax return reported on the tax
20 return in a way which is just not possible. You can't take the
21 same sale discount twice.

22 It's not possible for company books to have transactions
23 recorded at two different amounts. And we're clear on this
24 appeal that we have never received true copies of the company
25 books, only altered versions.

1 I'll just conclude my opening statement, you know, to show
2 you that it's the appellant's burden to establish that it
3 reported on the accrual method. It's had ample opportunity, and
4 it's failed to provide these documents.

5 The one thing I do want to run through, too, is part of
6 this -- is a discussion of -- of a misunderstanding of what's
7 required. I note during -- inside the FTB's Exhibit R, there are
8 many instances where the appellant notes that it hadn't received
9 the information that the FTB purportedly had sent to it or it had
10 misunderstood that information.

11 There's many instances where we were told that we were going
12 to get information that was never provided. Before the Board of
13 Equalization this submission came up over and over. There were
14 many extensions, many instances where briefs were not filed, and
15 eventually the Board of Equalization's attorney would call the
16 appellant and tell her, please provide this. But still
17 information was not provided.

18 And I think that's important to note in this case is that
19 there's a pattern of where these opportunities to provide
20 information were not taken advantage of, and this is the
21 situation we're in right now. I think it's very important to
22 note we don't know how the appellant reported because the
23 appellant never gave us the key documentation, which they had
24 access to, to show us how they reported their income expenses.

25 Thank you.

1 JUDGE KWEE: So I just have one question. I'm wondering if
2 there has been any federal action on this or is this only picked
3 up by the State?

4 MR. IMMORDINO: There's been no federal action. The federal
5 tax returns also indicate that they were reported on the cash
6 basis, but it appears the IRS has not audited the issue.

7 JUDGE KWEE: Are there any more questions from the panel
8 before we go to the closing arguments?

9 JUDGE CHENG: No.

10 JUDGE BRAMHALL: No.

11 THE COURT: Okay. At this point I would like to turn it
12 over to Ms. Kim for the appellant to make any final closing
13 arguments that she would like at this point.

14 MS. KIM: Yes, yes. Burden of proof is on the taxpayers to
15 prove there was reported and reported on an accrual basis. It's
16 very clearly stated on the financial statement that was on the
17 tax return has accounts receivable, payable, and inventory.
18 That's more than enough to prove there was a reported accrual
19 basis.

20 Just remember, we're not talking about the numbers, amount.
21 Question is, the return was prepared in the accrual basis or cash
22 basis. And just by looking at the return itself, clearly
23 indicated that it was just check-marked error, was reported and
24 prepared by accrual basis. Also, by having an inventory it's
25 clearly indicating this is required by the law to report it on

1 accrual basis.

2 And as I -- if want to add something into it, as I mentioned
3 earlier, it was a turn it over from other accountant. So I don't
4 know how long it been dragging before I put my hands on it. And
5 when I put my hands on it, then previous accountants say that
6 there's no general ledger. So I told you that we had to make a
7 general ledger.

8 And the general, it comes from nowhere. It came from the
9 QuickBooks, which was maintained by the taxpayer, and the number
10 cannot -- just juggling along, it's in there. So it's clearly
11 indicating that all the documents and all the data had been
12 inputted correctly, reported, and prepared on accrual basis.

13 Thank you.

14 JUDGE KWEE: Thank you.

15 Would the Franchise Tax Board like to make any closing
16 remarks?

17 MR. IMMORDINO: I will, first of all, you know, note that
18 the Exhibit F of Appellant's -- or Exhibit F of the Franchise Tax
19 Board's exhibits, Exhibit F was a letter from the Franchise Tax
20 Board to Mrs. Kim dated August 7th, 2009. So I'm not sure what
21 period of time she is talking about when it went from another
22 accountant to her, but in the beginning of this audit when the
23 documents were readily available, she was the person who was
24 representing the taxpayer. And so I'm not -- you know, I'm not
25 sure at what point, you know, or what this period of time is when

1 the records were changing CPAs.

2 Going to my closing arguments --

3 JUDGE BRAMHALL: I'd like to make one comment, too, is that
4 she mentioned that we're not talking about the numbers amount,
5 but actually, the numbers do provide the verification as to what
6 methodology was used to prepare the return. So the numbers are
7 relevant in this, and we unfortunately left the documents to
8 verify it. The invoices and numbers was reflected as in sales.

9 MR. IMMORDINO: That's right, yeah. The appellant also
10 mentions the financial statements. I think it's, again,
11 important to note that we never got a complete copy of the
12 financial statements. Instead of providing us the financial
13 statements which we asked for repeatedly, eventually around 2013
14 the appellant provided new financial statements which were
15 inconsistent with the original CPA's financial statements. And
16 so again, these inconsistent versions just highlight the need to
17 look at the general ledger and the documentation which, you know,
18 which the FTB asked for within one year when the tax return was
19 filed.

20 JUDGE BRAMHALL: What does a compilation report provide as
21 supplemental to the financial statements?

22 MR. IMMORDINO: You know, it's -- it generally tells the
23 information about, you know, how the taxpayer got the info or how
24 the CPA got the information, how they provided --

25 The compilation report generally tells, you know, the

1 information that the CPA received and how they provided the
2 compilation. The compilation is not an audit. It's a lower
3 level where the information is provided to the CPA who then takes
4 that information and provides financial statements. Again,
5 the --

6 JUDGE BRAMHALL: Okay. Thank you.

7 MS. KIM: Can I add something to that? Because compilation
8 is not required to prepare the tax return.

9 JUDGE BRAMHALL: I understand, but it was asked for and I
10 wanted to know what was being asked for.

11 Thank you.

12 MR. IMMORDINO: So in my closing argument, I want to point
13 out that, you know, over nine years and two dozen times the
14 appellant was asked for information which was consistently not
15 provided.

16 I'm going to try and put this -- have a short version to the
17 synopsis, go over a few things we may have gone over with the
18 deal. Again, these documents were asked for. Just one year
19 after the taxpayer filed their tax return they were readily
20 available, and they were not provided to the Franchise Tax Board.

21 The summary's documents are not business records. They are
22 summary documents, and they're clearly flawed as we've pointed
23 out repeatedly in the briefs. Yeah. It's clear that the
24 Franchise Tax Board has never received true copies of the company
25 books, only altered versions. And it begs the question that if

1 the accounting documents need to be altered to support the
2 appellant's position, then it should be inferred that the
3 original documents do not support the appellant's position.

4 The appellant has been unwilling to provide original
5 accounting documents which would allow the Franchise Tax Board to
6 determine if the appellant had indeed reported on the accrual
7 method of accounting. The appellants asked for accounting
8 documents. And for the past nine years has failed to provide
9 them. The law requires that the appellant's unwillingness to
10 provide such documents be construed that these documents would be
11 unfavorable to the appellant's position.

12 In conclusion, if the appellant's burden to establish that
13 it reported on the accrual method, it has not provided documents
14 to meet its burden. It provided virtually no documents for 2006
15 despite being asked many times. And, in fact, the documents the
16 appellant has provided do not support they reported on the
17 accrual method of accounting.

18 Thank you very much for your time, and we respectfully
19 request that you sustain the Franchise Tax Board's assessment.

20 JUDGE BRAMHALL: One question. The documents that are new
21 today, and I'm not asking you to evaluate fully, but according to
22 what you've been presenting, these documents would not support
23 the taxpayer view either; is that correct?

24 MR. IMMORDINO: That's correct. Most of these documents are
25 similar to documents that have already been provided, I think,

1 with the exception -- and, you know, please forgive me if I make
2 an error -- but I think with the exception of number --

3 MR. GEMMINGEN: I'd just restate the question that these
4 documents would not support the taxpayer's position they filed
5 under the accrual method.

6 JUDGE BRAMHALL: Your view.

7 MR. GEMMINGEN: -- argue with that. Yes.

8 MR. IMMORDINO: With the exception of document -- of Exhibit
9 No. 6, there's some new information, but again, this is just the
10 same summary information that we've been provided many times.
11 And like I pointed out earlier, some of the information provided
12 here includes the same errors like the income tax payable. They
13 add one version in 2013, one version in 2017, and now the
14 documents here go back to the version in 2013. It's clear that
15 these documents are not the source business documents, you know,
16 especially the general ledgers between the --

17 JUDGE BRAMHALL: Okay. Thank you.

18 JUDGE KWEE: We're going to have a brief five-minute break
19 before we finish up with this here. So we'll be back in five
20 minutes. Thank you.

21 (Recess)

22 JUDGE KWEE: Okay. We're ready to resume here. As it was
23 mentioned earlier, we do prefer the parties are able to review
24 all the evidence before the hearing as opposed to having to hold
25 the record open to allow additional time. Because there was a

1 surprise, and the Franchise Tax Board have the opportunity to
2 have 30 days to comment on our response -- responds to the
3 exhibits that were provided on the day of the hearing.

4 That being said, if the Franchise Tax Board does not want to
5 provide a response and wants to waive a response, that's their
6 right also. So at this point I would just like to offer FTB that
7 opportunity if they want to state their position now with respect
8 to the exhibits or to reserve that for the response period.

9 MR. IMMORDINO: Well, I think I'd be comfortable saying that
10 the exhibits provided in here are the same -- you know, are
11 similar versions of the other exhibits that had been provided,
12 and they would be flawed for the same reasons. I think we've
13 talked about some of them today. So I think I'll be comfortable
14 with that being our response to those exhibits, and we can waive
15 the period to address them.

16 JUDGE KWEE: Okay. Thank you. The 30-day period is waived.
17 I believe we are ready to close the record unless the panel has
18 any further questions? No? Okay.

19 The case is now closed. Today's date is October 22nd, 2018.
20 Thank you, everyone, for coming in today. The judges will meet
21 and decide your case later on, and we will send you the written
22 opinion in approximately 100 days, or within 100 days. Today's
23 hearing as well of SKU Trading, Inc., is now closed, and we will
24 take -- and we're done for the day. Thank you.

25 (Hearing concluded at 4:47 p.m.)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

REPORTER'S CERTIFICATION

I, the undersigned, a Hearing Reporter for the State of California, do hereby certify:

That the foregoing proceedings were taken before me at the time and place herein set forth; that any witnesses in the foregoing proceedings, prior to testifying, were duly sworn; that a record of the proceedings was made by me using machine shorthand, which was thereafter transcribed under my direction; that the foregoing transcript is a true record of the testimony given.

Further, that if the foregoing pertains to the original transcript of a deposition in a federal case, before completion of the proceedings, review of the transcript [] was [] was not requested.

I further certify I am neither financially interested in the action nor a relative or employee of any attorney or party to this action.

IN WITNESS WHEREOF, I have this date subscribed my name.

Dated: November 19, 2018

