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HEARING
OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Business
Tax Appeals Hearing of:
GOLDEN 7 LIQUOR & DELI, INC., OTA Case No. 18032427
Appellant.
_____ /

REPORTER'S TRANSCRIPT OF PROCEEDINGS

WEDNESDAY, MARCH 27, 2019

9:00 A.M.

OFFICE OF TAX APPEALS
400 R STREET
SACRAMENTO, CALIFORNIA

Reported by AMY E. PERRY, CSR No. 11880

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APPEARANCES

Panel Lead:

MICHAEL GEARY, ADMINISTRATIVE LAW JUDGE
STATE OF CALIFORNIA
OFFICE OF TAX APPEALS
400 R Street
Sacramento, California 95811

Panel Members:

JOHN JOHNSON, ADMINISTRATIVE LAW JUDGE
TOMMY LEUNG, ADMINISTRATIVE LAW JUDGE

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Administration
KEVIN C. HANKS, CHIEF
California Department of Tax and Fee
Administration
PAMELA BERGIN, TAX COUNSEL
California Department of Tax and Fee
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Also Present:

CRISTINA RUBALCAVA, SUPERVISOR
OFFICE OF TAX APPEALS
FOUNDATION SUPPORT

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I N D E X

EXAMINATIONS

APPELLANT'S WITNESSES PAGE

YARED FELEKE

Direct Examination by Ms. Saechao	16
Examination by ALJ Geary	30
Cross-Examination by Mr. Lambert	46
Examination by ALJ Geary	47
Examination by ALJ Leung	52

AZEB SERTSU

Direct Examination by Ms. Saechao	36
Cross-Examination by Mr. Lambert	43

EXHIBITS

APPELLANT'S EXHIBITS PAGE

Exhibits 1-2 admitted into evidence	9
-------------------------------------	---

DEPARTMENT'S EXHIBITS

Exhibits A-L admitted into evidence	10
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(Exhibits premarked, described
and retained by Administrative
Law Judge.)

1 WEDNESDAY, MARCH 27, 2019 - 9:00 A.M.

2

3 MS. RUBALCAVA: Our first case this morning
4 is Golden 7 Liquor and Deli, Inc., Case No. 18032427.

5 ALJ GEARY: Good morning, ladies and
6 gentlemen. Welcome to the Office of Tax Appeals, our
7 Sacramento hearing room. My name is Michael Geary. I
8 will be lead judge this morning on this matter, and I
9 am joined on the dais by my co-judges, Tommy Leung and
10 John Johnson.

11 While I am lead this morning, I will be doing
12 most of the introductory comments. My co-judges are
13 absolutely equal participants in the deliberations and
14 we will decide the issues presented together.

15 Our court reporter, Ms. Perry, our
16 stenographer, Ms. Perry, is using her equipment to
17 take down everything that's being said. And to help
18 us make a clear record and one which, if read, would
19 be easy to understand, I'm going to ask you to follow
20 a few basic rules:

21 Always speak clearly and slowly. Do not
22 speak when someone else is speaking. If you have two
23 people talking at once, it's difficult for Ms. Perry
24 to accurately report both speakers. And do not engage
25 in discussions at the table with your representatives

1 or among each other because she will try to hear and
2 take down what is being said, as is her job. If you
3 wish to talk to your representative or among
4 yourselves, it's best to ask for a recess and do that
5 off the record.

6 Can I ask who is appearing for the parties
7 beginning with the appellant, please.

8 MS. SAECHAO: Framta Saechao for the
9 appellants, Mr. Yared Feleke and Ms. Azeb Sertsu are
10 also present.

11 ALJ GEARY: Thank you. And who is appearing
12 for the Department of Tax and Fee Administration?

13 MR. LAMBERT: Scott Lambert. To my left is
14 Kevin Hanks, and to his left is Pam Bergin.

15 ALJ GEARY: All right. Good morning,
16 everybody. I want to mention that the Office of Tax
17 Appeals is an independent agency. We're not part of
18 CDTFA or the other tax agency that appears before us.
19 We're here today to hear the arguments of the people
20 and to take evidence from the parties, and ultimately
21 to deliberate and address the issues that the parties
22 present to us for determination.

23 I have a brief summary of the relevant facts
24 that I believe from my review of the file. I will ask
25 each of you when I've completed reading the summary to

1 indicate whether I've misstated anything.

2 The appellant operated a liquor store and
3 deli in San Francisco selling beer, wine, cigarettes,
4 soda, some exempt food products, some taxable sundry
5 items and lottery.

6 The department audited Appellant for the
7 period July 1, 2009 through June 30, 2012 and found
8 taxable merchandise purchases for the audit period.
9 That, in the department's mind, exceeded reported
10 taxable sales for the audit period.

11 The department decided to compute Appellant's
12 taxable sales using the markup method, ultimately
13 calculating a weighted markup for taxable merchandise
14 of 28.73 percent, and computed unreported taxable
15 sales for the audit period of \$597,347.

16 The department also computed a separate
17 measure of tax of \$29,725 for unreported cost of
18 self-consumed merchandise, and a separate credit
19 measure of \$10,639 for unclaimed credits for tax
20 purchases, tax paid purchases resold. And it's our
21 understanding the appellant does not dispute either of
22 these last two items.

23 Ms. Saechao, have I correctly stated the
24 background facts and what is in dispute today?

25 MS. SAECHAO: Yes, you have. Thank you.

1 ALJ GEARY: Mr. Lambert?

2 MR. LAMBERT: Yes.

3 ALJ GEARY: Thank you. Based on my review,
4 it appears that Appellant argues that the audited
5 markup which is based on the August 2012 shelf test
6 should not be applied to the entire three-year audit
7 period. Appellant states that it is in direct
8 competition with numerous vendors in the area where
9 this store is located, and in order to stay
10 competitive, Appellant offers deals resulting in lower
11 markups.

12 Appellant further argues that during the
13 audit period, the business was slow and profit margins
14 were slim. Appellant states that during the audit
15 period, the economy was in recession, resulting in a
16 markup lower than that determined by the department.
17 And finally, Appellant states that the audited markup
18 does not account for inflation.

19 Ms. Saechao, have I correctly summarized what
20 the appellant's arguments are?

21 MS. SAECHAO: Yes.

22 ALJ GEARY: Is there any of those arguments
23 that I've made that you do not intend to pursue in
24 this hearing?

25 MS. SAECHAO: No.

1 ALJ GEARY: The parties agree that the sole
2 issue to be addressed at this hearing is whether
3 Appellant is entitled to a further reduction to the
4 measure of unreported taxable sales. And I say
5 further because there have been other reductions since
6 the original audit.

7 I believe there was a re-audit and revised
8 audit resulting in some reductions, the evidence that
9 has been proposed, the documentary evidence that has
10 been proposed so far.

11 Appellant has offered two exhibits which have
12 been marked 1 and 2 for identification. The first is
13 a seven-page -- seven pages that Appellant describes
14 as a map. It appears to be two maps and the names of
15 various businesses located near Appellant's store with
16 information concerning distances of those businesses
17 from Appellant's store.

18 And the second is 94 pages, which Appellant
19 describes as its taxable purchases, history and
20 analysis.

21 Ms. Saechao, have I correctly identified your
22 exhibits?

23 MS. SAECHAO: Yes.

24 ALJ GEARY: Does the department have any
25 objection to the admission of the appellant's

1 exhibits?

2 MR. LAMBERT: We do not. I would state for
3 clarification in your earlier statement that the shelf
4 test was in September of 2012 instead of August of
5 2012.

6 ALJ GEARY: Thank you. Mr. Lambert, I have
7 should have asked you that, and thank you for
8 clarifying.

9 So no objection to the two exhibits; right?

10 MR. LAMBERT: No.

11 ALJ GEARY: Those two exhibits are admitted.
12 (Appellant's Exhibits 1-2
13 admitted into evidence.)

14 ALJ GEARY: Ms. Saechao, did you bring any
15 other documents that you wish to have admitted?

16 MS. SAECHAO: No.

17 ALJ GEARY: Thank you. The department has
18 offered Exhibits marked A through L for
19 identification. I'm not going to describe every
20 exhibit. Ms. Saechao has received, I believe has
21 received copies of the exhibits and the department's
22 index for the total of 238 pages.

23 Ms. Saechao, do you have any objection to the
24 admission of the department's exhibits?

25 MS. SAECHAO: No, we do not.

1 ALJ GEARY: Thank you. Those exhibits are
2 admitted.

3 (Department's Exhibits A-L
4 admitted into evidence.)

5 ALJ GEARY: Mr. Lambert, does the department
6 have any new exhibits today it wishes to offer?

7 MR. LAMBERT: We do not.

8 ALJ GEARY: As indicated in the pre-hearing
9 conference, Appellant will be allowed to give a brief
10 opening statement, not to exceed ten minutes to
11 outline the evidence but not to make any arguments.

12 Ms. Saechao, you're not required to give an
13 opening statement, but if you wish to, we will allow
14 it. If you give an opening statement, I will also
15 allow the department to give a brief opening
16 statement. Again, it's not for the purposes of
17 stating your arguments, but only for the purposes of
18 outlining the evidence.

19 Assuming that the opening statements are
20 either waived or given, we'll begin with our
21 testimonial phase. Ms. Saechao has two witnesses that
22 she's disclosed that she wishes to call, and I believe
23 those are the two people who are with her today; is
24 that correct?

25 MS. SAECHAO: Yes.

1 ALJ GEARY: When it's time to call those
2 witnesses, I've indicated to you before we went on the
3 record you are free to either have them sit in the
4 witness box, which is some distance away from counsel
5 table and also not covered by one of the cameras we
6 use for live streaming.

7 You may also have them sit next to you to
8 give their testimony. They will be close to you that
9 way. They will be on camera that way for our
10 streaming, and you'll simply need to put your
11 microphone somewhere between you so they can pick up
12 both voices. I'll let you decide how you wish to
13 proceed in that regard.

14 Once we complete the testimony, and I should
15 mention, each witness that you examine, of course, the
16 department would have an opportunity to examine and
17 the judges on the panel would also have an opportunity
18 to examine.

19 Also, the judges can ask questions of the
20 parties at any time. They may ask questions about
21 their arguments or about testimony that somebody has
22 given or about their exhibits.

23 At the conclusion of the evidentiary phase of
24 the hearing, Appellant will be allowed to give the
25 first argument which will be 15 minutes in length or

1 less. I'm not going to hold you to exactly
2 15 minutes. I tried to keep it within a reasonable
3 period of time, and we talked at the pre-hearing
4 conference, and I think we agreed 15 minutes would be
5 adequate.

6 After that, the department will be allowed
7 15 minutes for its argument. And following that,
8 Appellant will have roughly a five-minute rebuttal if
9 you choose to take that opportunity.

10 Any questions about the process of this
11 hearing? Seeing none and hearing none, we'll move on.

12 Ms. Saechao, do you wish to give an opening
13 statement?

14 MS. SAECHAO: Yes.

15 ALJ GEARY: Okay. You can remain seated, you
16 can stand, you can do whatever you're comfortable
17 doing. And remember that the opening statement is to
18 outline the evidence, not to include your argument.
19 Okay?

20 MS. SAECHAO: Thank you.

21 ALJ GEARY: You bet. You can begin.

22 MS. SAECHAO: Good morning, Judges. My name
23 is Framta Saechao. I'm representing the appellants,
24 Golden 7 Liquor and Deli, Inc., a partnership owned by
25 Mr. Yared Feleke and Ms. Azeb Sertsu. Both Mr. Feleke

1 and Ms. Sertsu are here today to testify about the
2 operations and sales for the audit period of July 1,
3 2009 through June 30, 2012.

4 We are here today to contest the department's
5 findings of additional taxable sales in the amount of
6 \$597,347. In reaching its findings, the department
7 examined taxable purchases made by Golden 7 in August
8 of 2012, and compared the purchase prices to the
9 selling prices via a shelf test in September of 2012.
10 Initially, this yielded a weighted markup rate of
11 34.78 percent.

12 At the conclusion of the appeals conference
13 held in this matter, the department recommended the
14 markup rate be reduced to 28.73 percent based on
15 various other factors such as cigarette purchases that
16 were unrepresentative in the weighted markup.

17 Mr. Feleke will testify as to why the
18 department's methodology is an unreliable method to
19 audit sales through the market. Mr. Feleke's
20 testimony will highlight why a fixed markup
21 methodology is unrealistic as to the actual sales at
22 Golden 7. He will testify about the economic downturn
23 during the audit period, the numerous competitors in
24 their immediate vicinity, and the promotional sales
25 Golden 7 was forced to undertake to stay in the

1 market.

2 Ms. Sertsu will further expound as to why the
3 department's collected audit methodology does not work
4 for Golden 7. Again, the department examined one
5 month's purchases and compared those to the sales of
6 another month, which was both periods after the audit
7 period.

8 Ms. Sertsu conducted her own analysis
9 employing the department's selected methodology but
10 using actual purchases for the entire audit period,
11 the relevant time period. She will testify how even
12 employing the department's methodology but using the
13 actual purchases yielded a measure of less than the
14 department's, therefore, making the methodology
15 unreliable. That's it.

16 ALJ GEARY: Thank you. Department, you can
17 give an opening statement now if you'd like, you can
18 reserve and give an opening statement before you
19 present your case, or you can waive.

20 MR. LAMBERT: I'll just give a brief opening
21 statement.

22 ALJ GEARY: Go ahead.

23 MR. LAMBERT: Essentially, in this particular
24 case, it was established that the reported taxable
25 sales were less than the taxable purchases; therefore,

1 our established audit procedures or one of our
2 established audit procedures is they use the markup
3 test to establish the liability, which we did in this
4 case, to determine the amount of taxable sales.

5 ALJ GEARY: Thank you. Ms. Saechao, who
6 would you like to call first?

7 MS. SAECHAO: The appellants will call Yared
8 Feleke first.

9 ALJ GEARY: All right. Ms. Perry, did you
10 get the spelling of both witnesses' names?

11 THE COURT REPORTER: No.

12 ALJ GEARY: Would you give the full spelling
13 of both witnesses' names? You can do it when you are
14 ready to examine, and you are now.

15 Sir, would you state your full name and spell
16 both your first and last names for the court reporter?

17 THE WITNESS: Thank you. My name is Yared
18 Feleke, Y-A-R-E-D, last name, F-E-L-E-K-E.

19 ALJ GEARY: Thank you, Mr. -- pronounce it
20 for me, again, your last name?

21 THE WITNESS: Feleke.

22 ALJ GEARY: -- Feleke. Would you please
23 stand and raise your right hand. I'm going to
24 administer an oath or affirmation to you.

25 Do you solemnly swear or affirm that the

1 testimony you're about to give in this proceeding will
2 be the truth, the whole truth and nothing but the
3 truth?

4 THE WITNESS: I do.

5 ALJ GEARY: Thank you. You may sit. And
6 Ms. Saechao, you can proceed.

7 MS. SAECHAO: Thank you.

8 **YARED FELEKE**

9 called as a witness, being first duly sworn, testified
10 as follows:

11 DIRECT EXAMINATION

12 BY MS. SAECHAO:

13 Q Good morning, Mr. Feleke.

14 A Good morning.

15 Q You and your wife Azeb Sertsu are the owner
16 of Golden 7 Liquor and Deli, Inc., is that correct?

17 A Yes, we are.

18 Q When did you and your wife acquire ownership
19 of Golden 7?

20 A In 2003, which we fully started picking up
21 [unintelligible].

22 Q How would you describe the business of Golden
23 7 when you initially acquired the store?

24 A Thank you for this opportunity. Golden 7,
25 when I took over, almost shut down the door the end of

1 the year which is December 31st. So I assume that's
2 the store, which is American dream, that was my dream
3 to start from zero. The inventory was between 6 to 8
4 thousand dollars inventory. So by working 19 hours
5 every day, seven days a week, I built it up what it is
6 right now, which is impossible before every other
7 years, it was ownership change.

8 Now I'm there the last 16 years, which is to
9 compete, which is 50 yard and then 100 yard next to
10 right and left and then Safeway. I tried to use
11 different kind of sales to compete with strangers by
12 selling wine by small margin. We used to sell like
13 30, 40 cases making like 15 percent.

14 To me, I tried to make it destination because
15 I'm between the stores. I can't -- people pass by
16 come to my store. I build it from zero what it is
17 right now.

18 Q Thank you for your response.

19 A Thank you.

20 Q My question was at the beginning of your
21 acquisition, how was business sales, was it good, bad?

22 A It was almost zero. Like I said, when I took
23 over, it was the sale like \$200, it was so hard and
24 nobody wanted to take that store, so I built it little
25 by little.

1 Q Thank you. So is your testimony that you
2 worked for the store personally?

3 A Yes.

4 Q During the audit period, July 1, 2009 through
5 June 30, 2012, did you work at the store?

6 A Yes.

7 Q And what were the store hours for you?

8 A Those days, between 7:00 to 2:00 a.m.

9 Q And what hours did you work?

10 A First, I was working -- I'm sorry. I was
11 working when I start, 19 hours. Was so hard. And
12 then I start building and I start hiring people. From
13 zero, now I have six employees which is that's why I
14 started.

15 Q What types of products did you sell at the
16 store?

17 A We sell too much, everything in grocery
18 stores.

19 Q Earlier Judge Geary provided a list, liquor,
20 beer, wine cigarettes?

21 A Sandwich.

22 Q Some food items, lottery?

23 A Yes.

24 Q And some sundry items.

25 Would that be a comprehensive list of the

1 things that you sold at the store?

2 A Yes.

3 Q Who was responsible for purchasing the goods
4 for the store?

5 A That was me.

6 Q Did you order the goods?

7 A Yes. All the sales people count on our
8 order, yes.

9 Q And how often were purchases ordered?

10 A Every week.

11 Q Did that vary over the time period, it vary
12 by month or year? How many purchases you would make?

13 A Yes. Sometimes beer this week and then wine
14 this week, and then the next week is going to be
15 liquor. It was going to be different kind of
16 purchase.

17 Q Were there months when you would purchase
18 more goods than other months?

19 A Yes. I can tell you like between -- after
20 November to April, that's the slow time, less
21 purchased. And then after April to October, that's a
22 little bit the peak time.

23 Q Would you agree then that August is one of
24 your peak times?

25 A Yes. Definitely, yes.

1 Q So do you agree that it's better to consider
2 the actual purchases rather than a one-month purchase?

3 A Yes, because in one month, you can buy One
4 Opus wine. When you see the percentage, I sell One
5 Opus wine here, then you can sell \$100,000 cigarette.
6 When you put together which was one months, the markup
7 goes up because you only see the one months.

8 But when you see the whole three years,
9 \$500,000 cigarettes, the market then becomes more.
10 But what you see for one month, the markup, when you
11 put everything together become 34 percent, 35 percent.
12 That's why I want less the cigarette, 500,000 less
13 [unintelligible] beer's separate, liquor separate.

14 ALJ GEARY: Let me offer a suggestion. You
15 estimated 30 minutes per witness. If you try to just
16 answer the question that's asked, your responses will
17 be shorter, but it will also let your representative
18 lead you through the examination that she wants to do.

19 The other thing is you mentioned Opus One, is
20 that a wine?

21 THE WITNESS: Yes, sir.

22 ALJ GEARY: Thank you. Go ahead.

23 BY MS. SAECHAO:

24 Q Thank you. Who was responsible for
25 determining the selling price for the goods of the

1 store?

2 A That would be me.

3 Q How did you determine the selling price of
4 the goods?

5 A Because every week, Monday through Friday it
6 was different. Monday, Tuesday, Wednesdays can be
7 slow. So to bring the customers, I have to lower the
8 price. Every week it change. That's why I have to be
9 there to change it. Peak time has to be like instead
10 of cigarette 10 percent, become 17 percent. I have to
11 fluctuate the price. I have to work with the other
12 stores, what they do.

13 Q Thank you. So are you saying that you would
14 look at the prices on a weekly basis?

15 A Yes, I do.

16 Q And you would make adjustments weekly?

17 A Yes, I do.

18 Q Did this apply to all the products?

19 A Most of the products, yes.

20 Q Were there any products where you didn't
21 adjust it weekly?

22 A With some products, I don't purchase every
23 week. Yes. I don't adjust it.

24 Q What types of products would those be?

25 A Let's say you might not sell it too much

1 every day, you buy, like I say, certain items, like I
2 mentioned Opus wine, we get like two, three bottles.
3 That, I may see the whole year sit on the shelf.

4 Q So you said that you would have to review it
5 weekly to set the price?

6 A Yes.

7 Q What types of things did you take into
8 consideration in whether you would reuse or increase a
9 price?

10 A To bring the customer, usually the majority
11 buyers, let's say cigarette, what kind of cigarette
12 they buy. To come to me from passing those stores, it
13 has to be per done the other stores.

14 Q So you would look at other competitors?

15 A Yes. Yes.

16 Q So who were your main competitors?

17 A Number one is like I'm 940, there is a store
18 900, and then the other corner 1000-something, there's
19 another liquor store. The biggest one was Trader
20 Joe's and then Safeway.

21 Q You mentioned there was a store at 900
22 Columbus?

23 A Columbus.

24 Q And you're at 940?

25 A Yes.

1 Q What's the store at 900 Columbus?
2 A They sell beer, wine, groceries.
3 Q What's their name?
4 A North Beach Food Mart.
5 Q Do they sell the same products that you sold?
6 A Yes.
7 Q You mentioned another store at the 1000
8 block?
9 A 1026, yes. Right.
10 Q Do you remember the name of that store?
11 A Huh-uh.
12 Q What kind of products did they sell?
13 A They sold everything, liquors, wine,
14 everything I have.
15 Q So the same products?
16 A The same products, yes.
17 Q And how far is Trader Joe's from your store
18 location?
19 A It's about two blocks down.
20 Q And what products did Trader Joe's sell that
21 was in competition with your store?
22 A Most of them wine, I tried to bring customers
23 wine and beer. Those two things competitive.
24 Q Okay. So you said before that you were
25 trying to attract customers with wine?

1 A Yes.

2 Q Can you just explain why you tried to attract
3 the customers with the wine?

4 A Because the location I am, if I tried to
5 compete with the food, there's Safeway, all those
6 things. They're not going to come to me. They know I
7 can't compete with them.

8 Q So if I'm understanding you correctly, you're
9 saying that you can't compete as to the other
10 products?

11 A Yes.

12 Q Such as food?

13 A Yes.

14 Q But you thought that you could compete at
15 least with wine?

16 A Wine, yes. Yes.

17 Q So were there any deals or promotions that
18 you would have with respect to wine in order to be
19 competitive with these other stores?

20 A Yes.

21 Q Can you tell us about some of those
22 promotions you did?

23 A Promotion, I tried to compete, you know,
24 because you guys remember two-buck Chuck, I tried to
25 make my own two-buck Chuck. I paid -- I buy 1.50, we

1 sell 1.99 in those days. Those, I used to sell 30,
2 40 cases a month. So that's why I tried to bring more
3 customers to our store. That's why little by little,
4 tried to do it in -- tried to -- like cigarette, I
5 can't compete with Walgreens. To make it competitive
6 with Walgreens, I have to lower the price.

7 Q Were there any other types of promotions or
8 deals that you recall having with respect to beer or
9 liquor during this time period to remain competitive
10 for the competition?

11 A I'll give you an example. Take your -- this
12 is American dream. I focus Budweiser. By selling
13 Budweiser the cheapest in town, I have the highest
14 sale Budweiser, which is I lowered the percentage like
15 15, 16 percent. For me, I tried to make it a volume
16 instead of saying one can beer, that's why I tried to
17 be competitive in the sale of those.

18 Q I'm sorry, just trying to understand.
19 So you would sell it by the can or you would
20 sell it with the reduced price?

21 A Reduced price, yes.

22 Q And how much would you reduce the price by?

23 A Like I said, other competitors, they go like
24 20 percent, I go 15 percent.

25 Q I see.

1 A Yes.

2 Q So you're saying you would mark it up 15
3 percent?

4 A Yes, or 20 percent if that's what they do,
5 yes.

6 Q Okay. Thank you. Earlier I asked you how
7 business was when you first acquired the store. So I
8 wanted to ask you how business was during the audit
9 period. This is from 2009 to 2012.

10 Did you notice any difference year to year in
11 terms of sales during that audit period?

12 A Yes, because in those days, there was a
13 recession time. North Beach right now is most stores
14 are shutting down. It's like 2008, 2009. If you pass
15 by North Beach, it's because of the cost of running
16 business. The overhead's getting higher and higher.

17 Those days, there was a recession time. Most
18 people, they're moving out from that area. My
19 customers, residents is not passing by, so it affects
20 so much. I tried to stay just barely, I'm using my
21 credit line those days. Even still now.

22 Q Just between 2009, 2010, '11, and '12, did
23 the sales fluctuate year to year?

24 A It does. It does. Yes. Months to months,
25 even week to week, it fluctuates. Yes.

1 Q Let me just be more specific then.

2 How were the sales of let's say 2009, 2010,
3 how did that time period compare to 2012, end of the
4 audit period?

5 A End of audit period, almost we get out of the
6 recession time. We start civilizing the business,
7 so-called become normal.

8 Q I want to show you the Exhibit 1 that was
9 referenced earlier.

10 A Yes.

11 Q So have you seen this map before?

12 A This map is like full map, yes.

13 Q Right.

14 A Yes.

15 Q And I just want to point out that there's
16 some stars on the map.

17 A Yes.

18 Q Are you able to locate your store location on
19 the map?

20 A Yes. Yes.

21 Q Okay. So the stars on the map there, they've
22 been identified as other local markets that sell
23 liquor, wine and deli items, so close to your store.

24 A Yes.

25 Q If you can take a minute to just review the

1 exhibit. I want you to see if those competitors that
2 you earlier testified about, the one on 900 Columbus
3 and 1000 Columbus are on the map?

4 A Yes. Right here, yes. Rose market, yes.

5 Q Rose market?

6 A Rose [unintelligible] yes.

7 Q Was that the market that was at 1000?

8 A 1000, yes.

9 Q That you were talking about?

10 A Yes.

11 Q Do you see Trader Joe's on the map?

12 A Trader Joe's, yeah, across the street from
13 Safeway right here. Yes.

14 Q Okay. So Safeway was also -- is also nearby?

15 A Was nearby, yes. Yes.

16 Q And how far is Safeway from your store?

17 A It's about two blocks down.

18 Q Sorry.

19 A I'm sorry.

20 Q I'd like you just to look through the pages
21 and see if there are any store locations that are not
22 on the map that you believe were competitors during
23 the audit period.

24 A On the curve which is the high competitors,
25 they are part of North Beach. We are were not North

1 Beach on the map, we're Russian Hills, almost nowhere
2 down the -- after the North Beach. North Beach is
3 like the Coit Tower liquor.

4 Q So Coit Liquor is on the map?

5 A Yes. Yes.

6 Q Would you just do me a favor and look through
7 the exhibit and see if there are any competitors that
8 were present during the audit period that aren't
9 listed on the map? There's -- it's several pages.

10 ALJ GEARY: If you look at the pages
11 following the map, there's a list of stores.

12 THE WITNESS: Okay. I can see Coit Liquor,
13 the Warf Liquor, Safeway, North Side,
14 [unintelligible], North Beach Food Mart
15 [unintelligible] --

16 (Clarification by Reporter.)

17 ALJ GEARY: Speak into the microphone.

18 THE WITNESS. Okay. I'm sorry. North Beach
19 Food Mart, Trader Joe's, Safeway.

20 BY MS. SAECHAO:

21 Q So are there any markets that are not on the
22 list that did exist during the audit period that you
23 consider competitors?

24 A No. I don't remember now. It's pretty much
25 this is [inaudible] --

1 Q Were there Walgreens in the neighborhood at
2 the time of the audit period --

3 A Yes.

4 Q -- that are no longer on the map?

5 A Yes.

6 Q How many Walgreens were there?

7 A There were -- there were, beside Safeway,
8 there's one Walgreens. There was three of them but
9 one of them shut down now. It's closed.

10 Q What kind of products did Walgreens sell that
11 you considered to be in competition with you?

12 A In those days it was cigarettes. Walgreens
13 was the cheapest cigarettes in the area. So for us,
14 like I said, to bring people in the store, I have to
15 make cheaper cigarettes.

16 MS. SAECHAO: Okay. Thank you. I have no
17 further questions.

18 ALJ GEARY: Does the department have any
19 questions for this witness?

20 MR. LAMBERT: No, we don't.

21 ALJ GEARY: I might have some questions.
22 Bear with me a moment.

23 EXAMINATION

24 BY ALJ GEARY:

25 Q The list that you just reviewed that has

1 markets, possible competitors of your store, did you
2 see any on that list that were not there during the
3 audit period?

4 A The only one's North Side Rose, it was
5 different name. Now this is a new name, yeah.

6 Q All the rest of those listed were your
7 competition during the audit period?

8 A Yes.

9 Q Do you have any documents that would reflect
10 what your actual markup was on various products during
11 the audit period?

12 A To be honest with you, in those days, we were
13 kind of still new in the business. I know this is big
14 mistake. When I get to the business, I should know
15 the error. We didn't prepare to document because it
16 goes day by day. I don't have the actual data.

17 Q Was the competition for business more
18 intense, less intense, or the same during the audit
19 period as it was in September of 2013 when the
20 department did its shelf test?

21 A It was still competition.

22 Q Was it as competitive as it was --

23 A Yes.

24 Q -- during the audit period?

25 A Yes. Yes.

1 Q You described a little bit while Ms. Saechao
2 was examining you about how recession affected sales.
3 And I just want to make sure there were --

4 One of part of your testimony is that there
5 were fewer sales during the recessionary times?

6 A Fewer sales. To make it bigger, I tried to
7 go with the volume by lowering my markup.

8 Q So were there more sales but with less of a
9 profit?

10 A It's not more sales. The sales too much,
11 almost the same, but I tried to make it to level, I
12 have to lower the markups. I tried to go with the
13 volume. If I put little bit higher with competition I
14 have, it would be lower.

15 MS. SAECHAO: If I may clarify something?

16 ALJ GEARY: Sure.

17 MS. SAECHAO: By sales, he means the total
18 amount of money taken.

19 ALJ GEARY: No. Actually, the number of
20 sales. I meant the number of sales. In other words,
21 the purchases remained basically constant but you
22 charged less for your products, is that what you're
23 telling us?

24 THE WITNESS: Pretty much the same. Yes.
25 Yes.

1 MS. SAECHAO: Sorry. My misunderstanding.

2 BY ALJ GEARY:

3 Q That's fine. Was your business audited by
4 the department, was this the only audit of your
5 business by the department, the one that we're here to
6 talk about?

7 A No. There's another one after this one.

8 Q But none before?

9 A None before.

10 Q When you did your, I don't know what you did,
11 secret shopper, how did you determine what others'
12 markups were, like what your competitors' markups
13 were?

14 A To be honest with you, the customer will tell
15 you when they come, the cigarettes, oh, so-and-so this
16 much. So I'll always go with the customers, what they
17 want. So just every day it's a challenge, who does
18 what.

19 Like I said, when I took over, it was almost
20 empty. I'm learning the business, too, so I have to
21 listen to my customers. My customers' my biggest
22 asset to run the business. So I listened to them and
23 it's just, to make it, Golden 7 is like a committee
24 for me. I trust them. They trust me. They know the
25 lowest price they can get, the best anywhere they can

1 get. That's why they pass all the stores to come to
2 Golden 7.

3 Q So your customers might report to you, hey, I
4 can buy this product for 50 cents less down the
5 street, and you might lower the price to match or beat
6 that price that your competitor's offering?

7 A Most of the time, yes. Then sometimes I go
8 myself, like Safeway, Trader Joe's, I go myself and
9 select items. I see the price and then I try to
10 manage it.

11 ALJ GEARY: Okay. Thank you. Those are all
12 the questions I have. I'll ask my co-panelists if
13 they have any questions.

14 Judge Leung, do you have anything?

15 ALJ LEUNG: I do, but I want to wait until
16 the other witness testifies. She might answer my
17 questions.

18 ALJ GEARY: Okay. All right. Department,
19 anything come up during my questioning that makes you
20 want to ask a question?

21 MR. LAMBERT: No.

22 ALJ GEARY: Ms. Saechao, did you have any
23 follow-up before we switch witnesses?

24 MS. SAECHAO: No.

25 ALJ GEARY: All right. Thank you. If you

1 wouldn't mind changing seats so we can examine the
2 next witness, I'd appreciate that. Sit up close to
3 the microphone so they will be able to hear you,
4 everyone can hear you. And actually, we'll need to
5 keep the microphone somewhere in the middle since
6 Ms. Saechao is speaking also.

7 The first thing I need you to do is state
8 your full name and spell your first and last names.

9 THE WITNESS: Azeb Sertsu, first name
10 A-Z-E-B, last name S-E-R-T-S-U.

11 ALJ GEARY: You speak kind of softly so I
12 want to ask you to --

13 THE WITNESS: Coming over from cold.

14 ALJ GEARY: -- raise your voice really loud
15 when you speak so the microphone picks it up.

16 Ms. Saechao, you can begin your questions.
17 Excuse me. I didn't swear the witness. If you
18 wouldn't mind standing up. If you'd raise your right
19 hand, please.

20 Do you solemnly swear or affirm the testimony
21 you're about to give in this proceeding will be the
22 truth, the whole truth, and nothing but the truth?

23 THE WITNESS: Correct.

24 ALJ GEARY: Thank you. You may sit. Go
25 ahead, Ms. Saechao.

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AZEB SERTSU

called as a witness, being first duly sworn, testified
as follows:

DIRECT EXAMINATION

BY MS. SAECHAO:

Q Good morning, Ms. Sertsu.

A Good morning.

Q You and your husband, Mr. Feleke, are the
owners of Golden 7; correct?

A Correct.

Q Did you work at the store during the audit
period?

A Not physically, but yeah, I do. I do the
bookkeeping.

Q You did the bookkeeping for the store?

A Yes.

Q Were you the only one that did the
bookkeeping for the store?

A Correct.

Q How often did you work on the bookkeeping?

A A couple days [sic] [inaudible] --

Q Okay. Thank you. Did you prepare the sales
tax for the store?

A Correct.

Q And how did you go about preparing the sales

1 tax returns?

2 A So I put it on an Excel worksheet, I look at
3 the Z-tape for each night that when they close for
4 each night, they will have the total sale, and then it
5 will have the sales tax that was collected. It will
6 show on the tape. So I will -- on one column showing
7 the total sale, and then one column showing the actual
8 sales tax that's collected.

9 So I keep the record that way. And then that
10 will be the total at the end of the prepayment and
11 then the actual average in three months.

12 Q Thank you. The department asserts that
13 Golden 7 had additional taxable sales during this
14 audit period of approximately \$597,000.

15 Does that seem like a possibility for you?

16 A No.

17 Q And would you have noticed an additional
18 \$597,000 in sales?

19 A Absolutely.

20 Q Since this audit, have you made any changes
21 to the sales and accounting system that is used by
22 Golden 7?

23 A Yes, we did.

24 Q What kinds of changes did you make?

25 A After this audit, we purchased a POS system

1 that actually connects to track each sale by category,
2 and it will also segregate that total audit resale and
3 the cash out. And also gives you a summary report and
4 pretty much [inaudible] --

5 (Clarification by Reporter.)

6 THE WITNESS: Pretty much the PO system.

7 BY MS. SAECHAO:

8 Q So then you rely on the what the POS system
9 report shows in order to prepare the sales tax return;
10 is that correct?

11 A That's correct.

12 Q I want to show you Appellant Exhibit 2.
13 This is a document that you created; is that
14 correct?

15 A Yes.

16 Q Can you explain how you created this
17 document?

18 A So after the audit finding is the total
19 possible sale was based on the actual of one-month
20 sample that the department did, and that they get
21 estimated, and they come up with 1.9 million of total
22 taxable sale.

23 Then I -- so the only way to demonstrate that
24 amount is incorrect, so I went back to all of our
25 vendors and requested all of our total purchases for

1 the audit period.

2 So these are the listed 14 vendors, and they
3 were able to provide the figures, total actual
4 purchases which they were transmitted, each one of
5 them by email, sending some of them, they emailed it
6 out for me.

7 So I got all this information and put it on
8 the worksheet. So the first column that shows to the
9 total purchase from July 2009 to 6/30/2012. And the
10 next column that shows is the actual 4-percent
11 consumption that the department -- reduced amount, and
12 come up with the next column, the adjusted purchase.

13 So the markup range that we see in here
14 instead of doing a weighted average, what I was trying
15 to do is by line item. For example, if we look at the
16 first one, this is soda, doing the markup, the range
17 between 15 to 20.

18 So instead of doing a weighted average for
19 all the products, we are saying it would be more
20 appropriate and goes with our practice of how we're
21 selling doing the weighted average line by line item
22 which is by each product.

23 So this column that shows the markup range is
24 not showing the range. So we're saying that, for
25 example, for the soda, it's 15 to 20 percent. And

1 that would be the weighted average. So the highest
2 markup would be the 20. So we took the highest markup
3 in order to demonstrate this worksheet.

4 So that gives the next column is the markup.
5 The purchase plus the markup. So the total sale with
6 the markup, we come up with an actual which is
7 100 percent true purchase sale plus the markup, we
8 come up with 1.7 million.

9 Q Thank you. To be clear, you are applying the
10 department's methodology of a markup audit, but using
11 the actual purchases of Golden 7; is that correct?

12 A Yes. Using the actual purchase of Golden 7,
13 using the department method, but not overall weighted
14 average, but using the weighted average by line item,
15 that's the difference.

16 Q And you did not --

17 Golden 7 did not actually employ this markup
18 rate in its selling price; is that correct?

19 A Yes.

20 Q Does the total sale with markups column
21 totalling 1.727267 include or take into account your
22 ending inventory?

23 A No. We're just demonstrating, trying to show
24 that, you know, at the beginning, just the 1.9, it
25 really doesn't [inaudible] that's what we actually

1 purchased. For 2012, our ending inventory was
2 somewhere 200,000 ending inventory was in the store.

3 Q Thank you. Did you ever do any purchasing of
4 goods?

5 A No.

6 Q Did you ever set the prices of goods to the
7 store?

8 A No.

9 Q Would you agree with your husband's testimony
10 about the main competitors in the local area as to who
11 they were?

12 A Yes.

13 Q And do you recall any types of promotions or
14 deals on the products at the time of the audit period,
15 do you recall any of those deals?

16 A Not really, no [inaudible] --

17 (Clarification by Reporter.)

18 THE WITNESS: I really wouldn't know. I do
19 only the numbers together.

20 BY MS. SAECHAO:

21 Q Are there other reasons -- well, what are
22 some of the reasons why a markup rate employed by --
23 like the one employed by the department, why would
24 that not work at Golden 7?

25 A The markup, well, I mean, you're not selling

1 your product by weighted average. Someone walks in,
2 I'm not going to do a weighted average to sell it to
3 someone else in any of the product. So we're selling
4 it based on an actual -- I think we should be treated
5 within an actual total what we sold and should be by
6 an actual line item.

7 The reason that the line items is very
8 crucial is it's almost 35 percent of our purchase is
9 in the total sale, is 35 percent is cigarette. And
10 obviously, cigarette is in the lowest markup range.
11 So if you're taking the weighted average and
12 multiplying 30, 35 percent of your total sale, it
13 really is not going to be a fair line item. So that's
14 the most important thing we were trying to do across.

15 Q Was Golden 7 audited again after this audit?

16 A Yes.

17 Q And what was the outcome of that audit?

18 A They are -- we are on the stage of trying to
19 examine some of the data's they did. I would not
20 agree with the markup in the same situations. And in
21 addition to not only the markup, only we are
22 contesting to say how the data is being downloaded and
23 how the data is being taken from the cash register.
24 And the way we're presenting the purchase price, it's
25 incorrect.

1 So that's being reexamined and we're in the
2 stage of the department's coming back to rerun those
3 reports again, and then revalidating that number to
4 make sure the price is the correct list.

5 Q Did they employ a markup audit methodology
6 again?

7 A Yes.

8 Q Were the findings similar to the findings of
9 this audit?

10 A As a matter of fact, it's exactly the same
11 amount.

12 Q Do you have an understanding of how they
13 reached that markup rate?

14 A Same method.

15 Q And you're currently in appeals for that
16 audit; is that right?

17 A Yes.

18 MS. SAECHAO: I have no further questions.

19 ALJ GEARY: Thank you. Does the department
20 have questions for the witness?

21 CROSS-EXAMINATION

22 BY MR. LAMBERT:

23 Q I do have one question in regards to their
24 Exhibit 2, page 1 under Markup Range.

25 My question would be how did you come up with

1 that range of markups? How was that calculated?

2 A The markup range is we're trying to look at
3 what's the lowest that we have sold this product and
4 then what's the highest we sold this product. And
5 we're just trying to get the range. If I mark this
6 over 15 percent and if my competitor is going to
7 20 percent, maybe I would raise it to 17. By looking
8 at that, that's the range that we come up.

9 Q So as an example for 7UP, if you sold it for
10 \$1, what would the cost and markup be on that item?

11 A Well, in this case, to demonstrate, we did
12 use the highest markup, and then we can go ahead by
13 the 20 percent. So the 1.727 million, that came up
14 with the column that we used with that highest markup.
15 So this column is just to demonstrate the range.

16 Q I understand that.

17 What I'm trying to get at is if you sold
18 something for \$1, what would the cost and the profit
19 be on that item, let's say for 7UP?

20 A How much do you [inaudible] --

21 ALJ GEARY: You have to be careful because we
22 can't pick that up. If you don't know the answer, you
23 can say you don't know. Do you understand the
24 question?

25 THE WITNESS: Yeah. I understand but I don't

1 know what would be the purchasing price, so that's
2 what I was trying to ask my husband.

3 ALJ GEARY: We can't do that when he's
4 sitting over there. We wouldn't be able to hear what
5 he has to say. If your husband would be able to
6 answer that question, perhaps when you're through, we
7 can have him re-take the chair and ask him that
8 question.

9 THE WITNESS: Okay.

10 MS. SAECHAO: Well, I'll just object to the
11 extent that the question would ask the witness to
12 speculate as to the purchase price. I mean, I
13 understand that's probably what he wants the witness
14 to do.

15 ALJ GEARY: Well, I'm not sure what he wants
16 to do. Why don't we just -- did you have any other
17 questions for this witness?

18 MR. LAMBERT: No.

19 ALJ GEARY: Do you want to ask that question
20 to the first witness?

21 MR. LAMBERT: Yes.

22 ALJ GEARY: All right. If he doesn't know
23 the answer, all he'll have to do is indicate he does
24 not know. If you wouldn't mind changing seats once
25 more.

1 THE WITNESS: Sure.

2 ALJ GEARY: You're still under oath.

3 THE WITNESS: Yes.

4 ALJ GEARY: Just a reminder. Mr. Lambert, go
5 ahead.

6 **YARED FELEKE**

7 re-called as a witness, still under oath, testified as
8 follows:

9 CROSS-EXAMINATION

10 BY MR. LAMBERT:

11 Q Well, in this particular, I'm just wondering
12 how they calculated the markup. So if he could just
13 give an example of any item, how it was calculated and
14 the range?

15 ALJ GEARY: You want to know, for example,
16 how they calculated a 15 to 20-percent markup on 7UP
17 soda?

18 MR. LAMBERT: Yes.

19 ALJ GEARY: All right. Can you answer that
20 question, sir?

21 THE WITNESS: Yes. Most of the time when
22 accounts and sale, all of us will know when it goes to
23 the store, they target 99 cents. So the stores, we
24 couldn't do anything about it which is that's
25 promotion when you say \$1. Our purchase can be 81

1 cents. That's promoting the customer to come into the
2 store.

3 Usually, if you calculate our sodas, the
4 lowest, the three years, if you calculate, it's not
5 more than \$10,000 soda. We sell more water than
6 anything in the store than the soda. Soda, we don't
7 even sell [unintelligible] \$4,000.

8 ALJ GEARY: Did that answer your question,
9 Mr. Lambert?

10 MR. LAMBERT: I'm not exactly sure. I don't
11 think so. But I'm just trying to figure out exactly
12 how, if they sold something for a dollar, what the
13 cost would be of that particular item.

14 So in other words, I'm trying to see how they
15 calculated the markup.

16 EXAMINATION

17 BY ALJ GEARY:

18 Q Do you understand, sir? If you just take a
19 product --

20 A Okay.

21 Q -- and you sold that product, let's say it's
22 a soda product, and you sold that product for a
23 dollar, how did you or how did the other witness
24 calculate a 15 to 20-percent markup with what was used
25 to sell that product for a dollar?

1 A Okay. What we do is we [inaudible] the
2 invoice. When we see the invoice, there is a price.
3 There's a CRV. So we calculated, let's say we
4 purchased 65 cents. We add up our markup and then put
5 it in the system. That's how we do it. So it goes
6 invoice by invoice. Can change every week, every two
7 weeks.

8 Q Did you do that to determine the markup range
9 that is listed for the 14 different types of products
10 listed on this Exhibit 1, is that how you determined
11 the markup in each instance?

12 A Like I said, we -- I look at the invoice,
13 each items. And then we change it daily or weekly.
14 And depend if they change the price, we change it,
15 too. So if you see like magazine, magazine is already
16 price tag, there's nothing you can do. If it says
17 2.99, it's 2.99. That's the markup. You can see it's
18 21 percent. There's nothing the store, they can do.

19 But other items, when they come, they give us
20 invoice. We see the purchasing price, then it will
21 put our markup.

22 Q Let me try to rephrase my question. There
23 are 14 different products listed on the schedule, and
24 they have a markup range and a highest markup, and the
25 other witness testified that she used the highest

1 markup for each of those ranges.

2 But what I'm wondering, and perhaps this is
3 what Mr. Lambert was asking, is are these based on an
4 analysis of actual records from the audit period that
5 showed the cost of the item and also showed you what
6 you sold that item for?

7 A Like I said, we go by the invoice. I'm not
8 sure if I understood very well. Every week when the
9 merchandise comes, I take the invoice, each company,
10 the 14 companies, they don't come same day. Three of
11 them come Monday, three of them Tuesday. So I look
12 out and I see the price if it's changed. I'll adjust
13 it.

14 And then to compete with the other stores, I
15 try to manage which ones, let's say if we don't sell
16 [unintelligible] cigarettes, we can't even sell one
17 carton a year, that can be 17 percent. But let's say
18 Newport. Newport, we sell more now because if we
19 don't sell menthol cigarettes, our cigarette sale's
20 down by 30 percent.

21 So we look, our customers, like I say I
22 mentioned earlier, we go by our customers. The
23 customers tell us, to bring those customers in the
24 stores so we have to manage the price list. Like I
25 said, Walgreens [unintelligible] sellers, the corner

1 store [unintelligible] how much they sell it, so all
2 consideration, I change it every week.

3 Q I think you're misunderstanding my question.
4 I am simply trying to find out the basis, the factual
5 basis for the document that you are looking at.

6 A Yeah.

7 Q For example, I'm looking at the source
8 information from 7UP Bottling Company of San
9 Francisco. And it indicates invoice numbers, account
10 number which is the same, account name which is the
11 same, date of invoice, and then total invoice amount.
12 It does not say how many products were sold. And it
13 does not tell us what you sold that product for in
14 2009, for example.

15 How did you know that? How did you know to
16 determine what your actual markup was? How did you
17 know what you sold the products for?

18 A Okay. Most of -- there's a range always
19 because when I receive items, those suggestion price
20 always comes. So we look at the suggestion price, so,
21 and then we try to learn our customers, which ones
22 more sell the items. Which one bring the customers in
23 the store.

24 So when it says 7UP soda, 10,900, that's our
25 purchase. That's our purchase. And then there's a

1 range. All this for liquor, all of them, they have a
2 range. If I put the highest price, nobody's going to
3 come, like I said. To compete, I have to move the
4 range.

5 Q Let me just interrupt.

6 Is the ranges that are reflected in this
7 document the same ranges that you would use today?

8 A I do. Yes, I do.

9 Q And they're the same ranges you used in 2009?

10 A Now, the cost of living is little bit higher.
11 I can't do 10 percent because 2009, the range was
12 \$4,000. Now it's \$7,000. My employees, they work
13 minimum wage is \$12. Now I pay \$20 an hour. So I
14 have to adjust those circumstances. So 2009, it's
15 like 10 percent, can be now 15 percent. So I tried to
16 adjust with the living standard.

17 Q Okay.

18 A Yes.

19 Q So the numbers that you have reflected here
20 are a range that you've applied consistently while you
21 go in the business, but you might be more toward the
22 higher part of that range now than you were in 2009 or
23 2010 or 2011?

24 A Now, yes. I can tell you cigarettes 2009,
25 cigarettes was 30 bucks. Now it's \$90, my purchase.

1 So the purchase will be a little bit higher.

2 Q But you did not look at actual documents that
3 showed you what -- that told you what you specifically
4 sold these products for in 2009, did you?

5 A In those days, we don't have the POS system.
6 The new one does, yes. The new one shows you how much
7 we sold, liquor, wine, all those goes with the system.

8 ALJ GEARY: Okay. Thank you.

9 THE WITNESS: Thank you.

10 ALJ GEARY: Mr. Lambert, any questions?

11 MR. LAMBERT: No further questions.

12 ALJ GEARY: Judges, do you have any questions
13 for this witness?

14 EXAMINATION

15 BY ALJ LEUNG:

16 Q I do. I'm curious about the inventory
17 purchase and sale turnaround times. The department
18 indicated that they took the purchases from August of
19 2012 and applied markups as of September 2012, so a
20 one-month difference.

21 In your store's history, how long do your
22 products stay on the shelf? Is one month shelf life
23 too long, too short, or does that depend on the type
24 of products we mentioned, like wine will stay on the
25 shelf for a much longer time than obviously things

1 that are more perishable like dairy products.

2 So could you sort of explain whether a
3 one-month differential between purchasing and selling
4 is an average or is it not average, or what not?

5 A Yes. Those are chargeable items, chips,
6 sandwich, milk, chocolates, this is weekly basis.
7 This is just a week. But wine, some wines stay
8 three years, four years. But like I said, I tried to
9 focus the majority sale, I'm going with the volume.

10 Beer. There's a beer that doesn't sell at
11 all, might buy once a month. But most of the beers
12 comes every week, rotate. I try to make it more
13 volume sales. That's why I tried to put the markup
14 lower. But items comes every week.

15 Q Okay. They come every week, things like beer
16 are sold that same week?

17 A It's the same week, yes. Beer, wine, liquor,
18 chips, all those, water, they come every week, yes.

19 ALJ LEUNG: Okay. Thank you.

20 ALJ GEARY: I want to make sure that the
21 judges also don't have any questions from the witness
22 who's not in front of the microphone right now, for
23 either witness, no other questions? I have no other
24 questions. Department?

25 MR. LAMBERT: No questions.

1 ALJ GEARY: All right. Ms. Saechao, any
2 follow-up for your witnesses?

3 MS. SAECHAO: No.

4 ALJ GEARY: All right. This completes the
5 evidentiary phase of the hearing. It's now time for
6 the closing arguments. As I indicated, Ms. Saechao,
7 you'll have a 15-minute first closing.

8 Mr. Lambert or whoever is giving the argument
9 will have 15 minutes, and then Ms. Saechao, you'll
10 have a five-minute opportunity if you want for
11 rebuttal.

12 Are you ready to give your closing?

13 MS. SAECHAO: Yes.

14 ALJ GEARY: Ms. Court Reporter, are you doing
15 okay? All right. You can begin, Ms. Saechao.

16 MS. SAECHAO: Thank you. The audit markup
17 methodology should not be applied to Golden 7 for the
18 reasons that were reiterated by Mr. Feleke and
19 Ms. Sertsu. At the time of the audit, there was a
20 recession beginning portion of the audit that forced
21 Mr. Sertsu -- or sorry, Mr. Feleke to make various
22 changes to the markups and price to stay competitive.

23 Mr. Feleke also testified as to the numerous
24 competitors in the area, almost all of which existed
25 at the time of the audit -- I'm sorry. He indicated

1 in the -- by referring to the map, Exhibit 1, that all
2 competitors were in existence at the time of the
3 audit.

4 He also testified that it was impossible to
5 keep prices at a fixed markup rate. He had to adjust
6 weekly in order to move the products. Because of the
7 unique circumstances of the location and direct
8 competition, the fixed markup rate was just not
9 something the Golden 7 could employ.

10 Ms. Sertsu testified that she used the actual
11 purchase invoices and the markup proposed by the
12 department to determine what proposed additional sales
13 might be. In her analysis, the potential additional
14 sales were less than that proposed by the department.

15 And in this case, the department should not
16 have made a finding that the records were inadequate.
17 Golden 7 provided federal income tax returns, sales
18 journals, bank statements, bills, the Z-tapes and
19 various financial statements.

20 You have heard testimony from Mr. Feleke and
21 Ms. Sertsu as to why their prices were lower and why
22 the adjustment should be -- or why the department's
23 adjustment is incorrect.

24 Because the method cannot be applied, markup
25 method cannot be applied to Golden 7 and because

1 Ms. Sertsu's analysis has showed that it's flawed, the
2 proposed measure should not be applied to Golden 7.

3 Since this audit, Golden 7 has undertaken
4 considerable steps to ensure accurate -- department
5 adequate accounting and reporting. They installed a
6 POS system, and I believe they've run through the POS
7 system with department representatives.

8 However, the department is yet again seeking
9 to apply the same methodology to another three-year
10 period. The taxpayers have testified that, you know,
11 they would have noticed such an increase or additional
12 sales to the tune of \$597,000.

13 Essentially, the department's proposed
14 measure represents 80 percent of their total reported
15 taxable sales for this three-year period. It is
16 unreasonable and unfathomable that taxpayers would
17 have sold that much more product, and it's not
18 traceable anywhere.

19 The department acknowledges that they
20 reviewed their financial statements by including bank
21 statements, and they did not notice anything of
22 notable difference. Therefore, the proposed measure
23 in the department's findings are wrong.

24 For these reasons, we ask that the panel find
25 for the appellants and that the proposed assessments

1 be dismissed.

2 As an alternative, Ms. Sertsu's measure or
3 analysis has yielded a measure that is less than the
4 department's proposed measure by using actual purchase
5 invoices. She does not take into account inventory,
6 however.

7 If the panel should find that the -- against
8 the appellants that no measure should be applied, we
9 would ask the panel at least consider this alternative
10 measure that has been illustrated by Ms. Sertsu's
11 analysis with the caveat that the ending inventory
12 should be taken into account. Thank you.

13 ALJ GEARY: Thank you. And Mr. Lambert, will
14 you be giving the closing for the department?

15 MR. LAMBERT: I will.

16 ALJ GEARY: You may proceed.

17 MR. LAMBERT: Thank you. In this particular
18 case, the calculation was made, or there was a
19 comparison between the reported taxable sales and the
20 taxable purchases that were reported. So if you refer
21 to Exhibit E, page 34, what you'll see on this
22 particular page is that there was a calculation as to
23 the book markup. And the overall markup is
24 40.64 percent. So, and that's in Column F. And there
25 would be some adjustments for that for inventory.

1 But essentially, the overall markup which is
2 the markup of both taxable and nontaxable is
3 significantly more than the taxable audit percentage
4 of just over 28 percent.

5 So the issue here is not whether we're coming
6 up with additional sales or we're coming up with this
7 additional taxable sales. So the amount of sales that
8 have been reported, which is on Exhibit B, page 2,
9 what you'll see from this schedule, this is a schedule
10 of their quarterly taxable sales. So if you look at
11 Column G, it will have their gross sales. Column I
12 will be the nontaxable sales. And then the Column J
13 will be their taxable sales.

14 So in this case, their taxable sales come out
15 to 44 percent of their reported total sales. And this
16 is in conflict with the reported taxable sales as
17 compared to total sales, which was 77 percent. So as
18 I go back to the reported taxable sales, which you'll
19 see from this schedule on Column J, is \$1,240,000.
20 The taxable purchases that we have in our audit are
21 \$1.486 million.

22 So we're doing a comparison of purchases to
23 sales, but even still, you can see that not all the
24 purchases have been reported as taxable sales. So
25 there is a significant issue. And that's basically

1 the crux of why we impeached their records and decided
2 to calculate the liability based on the markup method.

3 And at this particular point, that's the only
4 method, really about the only method I can think of
5 that you would be able to calculate the audited tax or
6 the audited taxable measure. So what we did with --
7 so once we did that, and let me take a step back.

8 In regards to the reported audible taxable
9 sales, what I would point out is in Column G, their
10 gross sales, during this time period, there does not
11 appear to be any kind of pattern as to sales
12 increasing or sales decreasing. It seems to be a
13 random sales from quarter to quarter.

14 And that's pretty much the same thing with
15 the nontaxable sales. There's an inconsistent pattern
16 there that may fluctuate based on the time of the
17 year. But as far as one year to the next, there
18 doesn't appear to be a significant difference.

19 So what the department decided to do was a
20 shelf test. And we took the prices from September of
21 2012. And those were obtained from both the shelf and
22 from the taxpayer. And we compared those sales prices
23 to the cost of their August 2012 purchase invoices.
24 And the reason why we do that, and there's generally a
25 lag between the purchase invoices and the sales

1 prices, is because we want to get a purchase cycle.

2 So we'll usually take whatever their purchase
3 cycle is, and it's generally a month for these types
4 of business, and that's what we did in this particular
5 case.

6 So what we're looking for is the markup for
7 each individual item, and then we calculate that by
8 category. So it would be liquor, beer, cigarettes, et
9 cetera.

10 So in regards to purchases, what we typically
11 do, and what we did in this particular case, is we
12 will take a couple months of purchases and we will get
13 a percentage, which will be the percentage of beer,
14 percentage of cigarettes, et cetera, and we apply the
15 percentages to their total purchases.

16 So we would take the total purchases, we
17 multiply that by their taxable percentage, and then we
18 apply a markup to that. And that's what we did in
19 this case, but that is a little bit different in this
20 particular case is that the appellant came back with
21 the total purchases, total taxable purchases that they
22 made for the audit period.

23 So instead of us using a percentage, we used
24 the actual purchases for the year, or for the audit
25 period. For the three years we used actual purchases.

1 So we broke those down by the different categories and
2 then applied the shelf test markup to each one of
3 those categories to get a weighted markup.

4 And in this case, they came out to 28, I
5 believe, point 72 percent. And this -- well, what I
6 would refer to is the report of a discussion that the
7 principal auditor had in his report, which is Exhibit
8 D, page 2.

9 And I'll just read from an excerpt from here.
10 And it says, "As an additional factor, Ms. Sertsu
11 contends that the markup should be 25 percent.
12 However, based on the shelf test, the computed average
13 weighted markup is 33.71 percent, which is consistent
14 with markups that have been observed and tested for
15 like businesses within the San Francisco district.

16 It should also be noted that the computed
17 shelf test factored in discounted costs and the
18 related discounted selling prices. So what the
19 principal auditor is saying here is that this markup
20 that we conducted, which was originally, I believe,
21 close to 34, might have been over 34 at one point, was
22 consistent with what we would find in this particular
23 area. And I'll get into the explanation of the
24 competition and location at the end of my
25 presentation.

1 So this isn't anything unusual what we would
2 find for this type of business in this area, in the
3 San Francisco area. In fact, the markup would be on
4 the lower side of what we would expect to find.

5 So several adjustments were made to the
6 purchases. There was an adjustment made for pilferage
7 of two percent. There was an adjustment made for
8 self-consumption at two percent. And then there was
9 also an adjustment for inventory taking beginning and
10 ending inventory, and there was an adjustment made for
11 that as well. So, and you'll see that on -- one
12 second.

13 You'll see the calculation on Exhibit B, page
14 8, how we came up with our calculation. And that's
15 essentially it. You took your purchases, adjusted for
16 inventory, took out the adjustments, and then marked
17 it up by the shelf test markup.

18 So getting to the taxpayers' arguments in
19 regard to their two exhibits. The first exhibit in
20 terms of competition, the Safeway, and there's a
21 couple Safeways that are nearby, and there's at least
22 one Trader Joe's. Those were there during the audit
23 period, and those were also there during the shelf
24 test.

25 The competition, as far as the other liquor

1 stores also were there during the period. There's no
2 evidence to indicate that the markup during the audit
3 period was any different than what we found that took
4 place in September of 2012.

5 In regards to their calculation, which was
6 Exhibit 2, what I would point out is that we both used
7 the same information. We used the purchases as well
8 that you see -- well, there's not a column there. But
9 in Exhibit 2, the second column which is headed up
10 Total Purchases, this is actually total taxable
11 purchases.

12 And the difference between their number and
13 our number is that this number is adjusted for what
14 they claim to be exempt purchases. So they made an
15 estimate on -- and that's the majority of it is the
16 estimate on three vendors that there was a 10-percent
17 nontaxable purchase from those vendors.

18 Our evidence shows from the invoices that we
19 had that there was 0.6 percent nontaxable. And so
20 that's a majority of the difference in their
21 particular schedule. The next area is the markup
22 range.

23 And the reason for my questions to the
24 witness was I was trying to figure out what -- how
25 they calculated that markup. And there's, in the

1 industry, there is a difference between mark-on and
2 markup. The department calls what we do a markup.
3 The industry considers it to be an add-on or a mark-on
4 to it. And so there's a difference in the way you
5 calculate the markup.

6 So the one example that I gave for a \$1 7UP
7 soda, the witness said that it was -- that the cost of
8 that, it would sell for 99 cents, and that the cost
9 was 81 cents. That leaves a profit of 18 percent. If
10 you divide the profit into the cost, it comes up to
11 about a 25-percent markup.

12 So the example I would give you is that if
13 you sold something for a dollar, and you sold it for
14 66 cents, you'd have a 34 percent -- or a 34-percent
15 profit. The way we calculate it, that would be
16 essentially a 50-percent markup.

17 But if you took the profit and compared it to
18 the sales price, you'd have a 33-percent markup. And
19 so I'm not sure if that's what happening here, but
20 that's a possibility that there's a difference between
21 what they consider to be a markup percentage and how
22 we would consider it.

23 The second point I would point out is that we
24 actually used the selling prices from the shelf test.
25 There's no evidence on how this information was

1 obtained. So the department's method of the markup
2 test is how it's established in our audit manual, and
3 we followed that. And therefore, our procedure would
4 be the more accurate method unless they can point out
5 areas of deficiency in that particular markup in which
6 from the original markup they did, and we did make
7 adjustments.

8 And in some cases, we just arbitrarily took
9 out the highest markup item out of a different
10 category just to be on the conservative side for that.

11 So I believe I've covered the areas that I
12 would like to, so I'm available for questions.

13 ALJ GEARY: Judges, any questions for the
14 department? All right. Thank you, Mr. Lambert.

15 Ms. Saechao, would you like to take five
16 minutes or so for a rebuttal?

17 MS. SAECHAO: May I have a brief recess with
18 my clients?

19 ALJ GEARY: Yes. How much time do you need?

20 MS. SAECHAO: Ten minutes.

21 ALJ GEARY: Ten minutes, all right. Let's
22 take a ten-minute recess. Thank you.

23 (Recess taken.)

24 ALJ GEARY: If you're ready to give your
25 final closing, you can proceed.

1 MS. SAECHAO: Thank you. In addressing the
2 department's statement that the department found the
3 Golden 7 had 40 percent nontaxable sales, which he
4 remarked as being high for this industry, we'd like to
5 address the fact that as for Golden 7, they actually
6 do have 40-percent nontaxable sales because 25 percent
7 of that, 40 percent is lottery sales. And that
8 evidence has been submitted to the department.

9 With respect to the differences between the
10 appellant's analysis, the department highlighted two
11 items that I would like to address: One being that
12 they mentioned there were three vendors that the
13 appellant had written off 10 percent of the purchases
14 as exempt. And they stated that the department found
15 it was more like 6 percent of the purchases were
16 exempt.

17 There's no evidence -- there has been no
18 evidence presented that 6 percent of those purchases
19 were exempt. In reviewing and creating -- in
20 reviewing the documents and creating this analysis,
21 Ms. Sertsu reviewed the invoices by those particular
22 vendors. And it's not indicated in the invoice
23 statements that -- or there's no breakdown of taxable
24 versus nontaxable sales items in those invoices.

25 So we'd be interested to hear how the

1 department obtained that 6-percent figure. In absence
2 of such evidence, the taxpayers have testified that
3 they have or Mr. Feleke works in the store every day.
4 He sets the prices weekly. He reviews the invoices.
5 They deal with the vendors. And in their experience,
6 they know that these particular vendors, there is a
7 10-percent exempt purchase history for each of these
8 vendors.

9 The last item that I wanted to address is the
10 markup range in Ms. Sertsu's analysis. These ranges
11 or just the customary range in the history of their
12 owning and operating this market, a markup range of
13 what they would apply to each particular item, so they
14 wouldn't go below or above this range. This is just
15 their customary practice. That is how they knew to
16 use this range in their analysis.

17 And for the benefit this of just for the
18 exhibit itself and their analysis, they did use the
19 highest markup rate just for demonstrative purposes.

20 ALJ GEARY: Does that complete your comments?
21 Okay. Thank you very much. This concludes the
22 hearing in this matter. The record is now closed.
23 The judges will get together and deliberate, decide
24 the issue, and a written opinion will be issued and
25 sent to the parties within 100 days.

1 Any questions? Hearing none, I'm adjourning
2 this hearing.

3 (Whereupon the proceedings were
4 adjourned at 10:38 a.m.)

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REPORTER'S CERTIFICATE

I, Amy E. Perry, a Certified Shorthand Reporter in and for the State of California, duly appointed and commissioned to administer oaths, do hereby certify:

That I am a disinterested person herein; that the foregoing hearing was reported in shorthand by me, Amy E. Perry, a duly qualified Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewritten form by means of computer-aided transcription.

I further certify that I am not of counsel or attorney for any of the parties to said hearing or in any way interested in the outcome of said hearing.

IN WITNESS WHEREOF, I have hereunto set my hand this 9th day of April, 2019.

AMY E. PERRY
Certified Shorthand Reporter
License No. 11880