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HEARING
OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Business
Tax Appeals Hearing of:
SUSAN MARIE HENDRICKSON, OTA Case No. 18063320
Appellant.
-----/

REPORTER'S TRANSCRIPT OF PROCEEDINGS

TUESDAY, MARCH 26, 2019

10:23 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:

ANDREW KWEE, ADMINISTRATIVE LAW JUDGE
TERESA STANLEY, ADMINISTRATIVE LAW JUDGE

For Appellant:

ROBERT GOLDSTEIN, ESQ.
LAW OFFICES OF ROBERT L. GOLDSTEIN
100 Bush Street, Suite 501
San Francisco, California 94104

SUSAN MARIE HENDRICKSON, TAXPAYER

For the Department:

SCOTT LAMBERT, HEARING REPRESENTATIVE
California Department of Tax and Fee
Administration

KEVIN C. HANKS, CHIEF
California Department of Tax and Fee
Administration

STEPHEN M. SMITH, TAX COUNSEL IV
California Department of Tax and Fee
Administration, Legal Division

Also Present:

CRISTINA RUBALCAVA, SUPERVISOR
OFFICE OF TAX APPEALS
FOUNDATION SUPPORT

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(Exhibits premarked, described
and retained by Administrative
Law Judge.)

1 TUESDAY, MARCH 26, 2019 - 10:23 A.M.

2

3 MS. RUBALCAVA: Our last case for today is
4 Susan Marie Hendrickson, Case No. 18063320.

5 ALJ GEARY: Good morning, everybody. Welcome
6 to the Office of Tax Appeals. Today is March 26,
7 2019. We're in our hearing room in Sacramento and
8 it's approximately 10:23 a.m. We're not going to
9 discuss things off the record in this case.

10 I believe you were all sitting in the
11 audience when my colleague Judge Margolis gave a
12 presentation about what we're here for, what OTA is,
13 how we're independent from the taxing agencies. I'm
14 going to skip those unless somebody has a question
15 about that, I ask them to speak up.

16 And we're going to move right into the case
17 with my brief introduction. Part of it is that our
18 stenographer, Ms. Perry, as you know, is trying to
19 take down everything that we say. To help her and all
20 of us make a clean and understandable record if we
21 ever have to read it, you need to speak clearly and
22 slowly.

23 Do not speak when someone else is speaking.
24 And it's best not to engage in side discussions at
25 your table because your microphones will pick it up,

1 Ms. Perry may hear it and she may report what is being
2 said. So if you need to talk to your client, it's
3 best to ask for a recess and go outside and do that.

4 As I said, my name is Michael Geary. I am
5 the lead judge in this morning's case. I am joined on
6 the panel by Andrew Kwee and Teresa Stanley, who are
7 equal participants, will be equal participants in the
8 deliberation when we discuss the case and weigh the
9 evidence and decide the issues that you are presenting
10 for our determination. We will all participate in
11 that process.

12 Please state your appearances, beginning with
13 the taxpayer.

14 MR. GOLDSTEIN: Rob Goldstein appearing on
15 behalf of Petitioner, taxpayer Susan Hendrickson.

16 ALJ GEARY: Thank you. And I see
17 Ms. Hendrickson is with you; correct?

18 MR. GOLDSTEIN: Correct.

19 ALJ GEARY: All right. And for the
20 California Department of Tax and Fee Administration?

21 MR. LAMBERT: Scott Lambert.

22 MR. HANKS: And Kevin Hanks.

23 ALJ GEARY: All right. And you're joined, I
24 see, by Mr. Smith, Steve Smith at the table. He
25 doesn't have a microphone in front of him and he's

1 assured me before we went on the record that he
2 doesn't intend to say anything. Will work out just
3 fine.

4 This is an appeal from an action by the
5 department determining \$440,402 of additional tax and
6 applicable interest for the period January 1, 2009
7 through December 31, 2011. It's my understanding from
8 prior communications during the pre-hearing conference
9 and from reading this file that the appellant contends
10 that she accurately reported her taxable sales, had no
11 additional taxes due, and that she was not negligent.

12 Do we have a negligent penalty in this case?

13 MR. LAMBERT: We do not.

14 ALJ GEARY: We do not. All right. The
15 parties agreed at the pre-hearing conference that the
16 issues to be addressed at the hearing are whether
17 Appellant is entitled to a reduction of the measure of
18 the additional taxable sales.

19 The appellant has offered two exhibits which
20 we've marked for identification as 1 and 2. They
21 consist of a one-page document, I think, and a 47-page
22 document, of the latter being what appears to be a
23 number of invoices. And so far, I've heard no
24 objections from the department which was to state its
25 objections in writing by March 18th.

1 Mr. Lambert, do you have any objections to
2 any of the exhibits?

3 MR. LAMBERT: I do not. Just one question.
4 Are we on the record now?

5 ALJ GEARY: Yes, we're on record. We've been
6 on the record since I started speaking, I hope. Yes,
7 she's nodding we are. Okay.

8 There being no objections to the appellant's
9 two exhibits, Exhibit 1 and 2 are admitted.

10 (Appellant's Exhibits 1-2
11 admitted into evidence.)

12 ALJ GEARY: The department has also submitted
13 exhibits. They have been marked for identification A
14 through I, and they consist of 181 pages. I've
15 received no written objections from Appellant.

16 Mr. Goldstein, does the appellant have any
17 objection to the admission of the department's
18 evidence?

19 MR. GOLDSTEIN: No, your Honor.

20 ALJ GEARY: Thank you. Those Exhibits A
21 through I are admitted.

22 (Department's Exhibits A-I
23 admitted into evidence.)

24 ALJ GEARY: Has anybody brought with them
25 today any new exhibits to be offered, Mr. Goldstein?

1 MR. GOLDSTEIN: No. Not today, your Honor.

2 ALJ GEARY: Department?

3 MR. LAMBERT: We have not.

4 ALJ GEARY: All right. During our
5 pre-hearing conference, Mr. Goldstein indicated that
6 he would probably call two witnesses: His client,
7 Ms. Hendrickson; and another individual who I believe
8 is here today.

9 Do you intend to call those two witnesses,
10 Mr. Goldstein?

11 MR. GOLDSTEIN: I reserve the right to.

12 ALJ GEARY: All right. We will get to the
13 point at which you will have to make a decision very
14 soon.

15 MR. GOLDSTEIN: Sure.

16 ALJ GEARY: My understanding is that the
17 department does not intend to call any witnesses; is
18 that correct?

19 MR. LAMBERT: We have no witnesses.

20 ALJ GEARY: Before we actually began this
21 proceeding, I was standing in front of the counsel
22 table speaking with all the parties and their
23 representatives. And I indicated to Mr. Goldstein
24 that if he calls witnesses, he could have the option
25 of having them testify from the witness box or from

1 the table.

2 And I mentioned to the department that if
3 whoever gives the arguments on behalf of the
4 department intends to state any factual matters in
5 argument that they would expect the judges to rely
6 upon, then that argument would have to be given under
7 oath so that those factual matters could be stated
8 under oath during this proceeding.

9 I will leave the decision about whether or
10 not you intend to state any factual matters to you.
11 But when I call upon the department to give its
12 argument, and it will have one opportunity to give an
13 argument, I want you to tell me whether you want to be
14 placed under oath because you do intend to state
15 factual matters that you want the judges to rely upon.
16 Is that understood?

17 MR. LAMBERT: That's understood.

18 ALJ GEARY: All right. Thank you. The plan
19 is if Mr. Goldstein calls witnesses, we will have the
20 witnesses testify, we will have arguments afterwards.
21 If he does plan to call witnesses, I typically will
22 allow the parties to give brief opening statements
23 solely for the purpose of giving the judges an outline
24 of what the evidence will be, including the testimony
25 and the exhibits that now have been admitted.

1 So now, I kind of need to know,
2 Mr. Goldstein, do you want to call a witness to
3 testify in this proceeding?

4 MR. GOLDSTEIN: Yes, your Honor. I will call
5 one witness.

6 ALJ GEARY: And your witness will be who?

7 MR. GOLDSTEIN: Rich Gibbon.

8 ALJ GEARY: Rich Gibbon. Spell his last name
9 for me.

10 THE APPELLANT: G-I-B-B-O-N.

11 ALJ GEARY: All right. Thank you. Do you
12 want to give an opening statement to give the judges a
13 brief summary of what Mr. Gibbon's testimony will be?
14 It's not required, it's up to you.

15 MR. GOLDSTEIN: Yes, I would. I'd like to.

16 ALJ GEARY: Okay.

17 MR. GOLDSTEIN: Just briefly --

18 ALJ GEARY: Before you do that, I want to
19 indicate that if you do, keep it brief, less than ten
20 minutes, I'm sure it will be. And the department will
21 have an opportunity to give an opening statement if it
22 chooses to do that also. All right, Mr. Goldstein.

23 MR. GOLDSTEIN: Just procedural question as
24 far as how in depth I should get in this opening
25 statement. After the witness is called, am I going to

1 get to present an additional argument or is this my
2 time to --

3 ALJ GEARY: This is not your time to argue.
4 This would be no argument. This would be an opening
5 statement solely for the purposes of outlining the
6 evidence, typically what you expect the testimony to
7 be. This is not your argument.

8 When you're through calling your witnesses,
9 we will begin the arguments after the parties and the
10 judges have an opportunity to ask questions of the
11 witnesses, if there are any. Your argument will be
12 after the evidentiary phase.

13 After your testimony of the witnesses is
14 offered, then you will be allowed 15-minute argument
15 to start. The department will have 15 minutes to
16 argue, you will have a five-minute rebuttal. So this
17 is separate from that.

18 MR. GOLDSTEIN: Then I don't think I need an
19 opening statement right now.

20 ALJ GEARY: Okay. So you're ready to call
21 your witness?

22 MR. GOLDSTEIN: I am, your Honor.

23 ALJ GEARY: Mr. Gibbon. And where would
24 you -- would you like him to testify from the witness
25 stand, or would you like him to sit at counsel table

1 with you?

2 MR. GOLDSTEIN: I think I'd rather him sit
3 here if that's okay.

4 ALJ GEARY: Can we ask Ms. Hendrickson to
5 move to that chair just so Mr. Gibbon has -- is it
6 Gibbon or Gibbons?

7 THE WITNESS: Gibbon.

8 ALJ GEARY: -- has an opportunity to speak
9 into the microphone.

10 And if you wouldn't mind, Mr. Goldstein,
11 after you give your opening, when you begin your
12 examination, would you just move the microphone toward
13 the middle so you can both speak into it.

14 First thing I need to do is to administer an
15 oath or affirmation to you. Would you stand and raise
16 your right hand, please.

17 Do you solemnly swear or affirm that the
18 testimony you are going to give here today will be the
19 truth, the whole truth, and nothing but the truth?

20 THE WITNESS: I do.

21 ALJ GEARY: Thank you. Be seated. And
22 Mr. Goldstein, you can begin your examination.

23 MR. GOLDSTEIN: Thank you, your Honor.
24 Everybody can hear me okay?

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RICH GIBBON

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

DIRECT EXAMINATION

BY MR. GOLDSTEIN:

Q Mr. Gibbon, you were the power of attorney
for Ms. Hendrickson during the audit period; is that
correct?

A Yes.

Q So did you have significant contact with the
auditors throughout the audit period?

A Yes.

Q The audit period was for 2009 through 2011;
is that correct?

A Yes.

Q Okay. And to the best of your recollection,
do you recall in around January/February of 2014
agreeing with the auditor that she would look at
second quarter 2013 records to assist her with making
an assessment for 2009 through 2011?

A Yes, as a sample.

Q To be applied toward 2009 through 2011.
And do you recall what you provided to her,
the auditor now, for that second quarter 2013?

A All the records, the work orders, and she had

1 access to pretty much everything we had access to.

2 Q And did you provide her a copy of the second
3 quarter 2013 sales tax return, do you recall?

4 A She had it.

5 Q She had it, okay.

6 And after she reviewed that return, do you
7 recall the result?

8 A Yes.

9 Q And what -- and the documents, I should say,
10 not just the return.

11 And what do you recall was the result of
12 that?

13 A She had said that we had underreported by
14 \$15,000 roughly.

15 Q Okay. And in response to that, what did you
16 do?

17 A I went through all the work orders and did
18 all the math. And my math was different from what her
19 math was. My math was what we had filed in the sense
20 of what the totals were and what the taxes were owed.

21 Q And do you recall what the source or the
22 reason for that discrepancy was?

23 A What I found was that the difference -- the
24 difference between the two, we have motorcycles that
25 come in that have been in an accident, and on those

1 motorcycle work orders, we write it up as an estimate.

2 And on the bottom right-hand corner, there is
3 parts, labor, tax and totals. But if the bike is a
4 total loss, all we do is we write up the tag, but we
5 get towing, storage for the bike. So what that means
6 is that the repair is not done. None of these numbers
7 over here have a total matter anymore.

8 What matters in the sense of our income is we
9 have in the center of the work order, we have to write
10 estimate only, towing, storage and the total of what
11 the insurance company pays us, which is all non --
12 it's not anything based on retail, it's just the labor
13 of doing the damage estimate, the time that the bike's
14 there, however many days, that's storage, and what it
15 costs to have the bike, which we did.

16 So what she had done is just ignored this and
17 added up the total amount. So generally, if it's a
18 total loss, that means that the total amount of the
19 evidence of the job exceeds the value or exceeds
20 70 percent of the value of the bike is what they
21 follow.

22 And so these numbers didn't belong in her
23 total. And I pointed that out to her because the
24 number of what I found matched her discrepancy, and I
25 pointed that out to her that this is damage estimates,

1 they are not jobs, but they were mixed in with
2 everything else because it's still income, if that
3 makes sense.

4 Q And this was on or about February 2014. And
5 then my understanding is two months later, the auditor
6 left and closed out the audit.

7 Do you recall if she ever made any
8 adjustments for the '09 through '11 period based on
9 discovering that estimates had been included?

10 A As far as I know, no. She had access. She
11 didn't come back and go through everything again.

12 MR. GOLDSTEIN: Thank you. That's all I
13 have, your Honor.

14 ALJ GEARY: Does the department have
15 questions for the witness?

16 MR. LAMBERT: We do not.

17 ALJ GEARY: Judge Kwee?

18 EXAMINATION

19 BY ALJ KWEE:

20 Q I just have a question about the work orders
21 and the reported total sales. Total sales were the
22 123,297 for the three-year audit period.

23 And I'm just wondering, so in your work
24 orders, did you always separately state the charge for
25 the parts?

1 A Yes.

2 Q So if you add up all the charges, would that
3 equal the 123,000 in taxable sales that you reported
4 for that audit period?

5 Is that your contention or I guess is that
6 your understanding?

7 A My contention is is that what she was -- I
8 didn't go through and I didn't go through the whole
9 audit. Is that what you're asking about, the audit
10 period?

11 Q I'm just asking how you reported on your
12 sales and use tax returns.

13 So I'm just wondering if you add up the
14 amount of charges for parts on your work orders, does
15 that equal what you reported on the sales and use tax
16 returns?

17 A Yes. On regular work orders. But the
18 estimate, damage estimates is what I was speaking to.
19 The damage estimates is the same -- we tell them this
20 is what it would cost to fix this motorcycle. And so
21 it's written out like a regular work order. But if
22 the bike, if our total estimate exceeds generally
23 between 70 to 75 percent of the fair market value of
24 the motorcycle, they consider it a total loss.

25 So that means that this number here, we never

1 get. What we get and what's on the work order, on the
2 face of the work order is the cost of the estimate
3 itself because it takes time to do, and that's labor,
4 the storage because we charge.

5 On total loss of bikes, we charge a daily
6 storage and then any towing. And then that total is
7 what we are actually receiving from the insurance
8 company. What she had done is she had taken the total
9 over here of the estimate and counted that as if it
10 was an actual transaction in the sense of that we did
11 put the bike back together, we got the money from the
12 insurance company. Does that make more sense?

13 Q Yes. I guess I'm looking at it from a
14 different perspective. So I understand the company
15 reported the \$123,000 in part sales during the audit
16 period, but then their purchases of parts was over
17 \$400,000, so they spent over \$400,000 of purchases but
18 only reported 123,000 in sales.

19 So I'm just wondering if you can help me
20 understand what happened to the rest of the parts that
21 were purchased, or if I'm misunderstanding?

22 A In the audit period or the sample that she
23 took?

24 Q For the three-year audit period, 2009 to
25 2011, my understanding was that the company reported

1 \$123,000 in sales and had over \$400,000 in purchases.
2 If I'm not understanding that correctly, feel free to
3 help me understand if that's not correct.

4 And I'm just wondering how to account for the
5 difference between why the purchases are so much more
6 than the reported sales and parts. I'm wondering if
7 there's an explanation for that.

8 A The only thing that I can -- when it came
9 down to what our taxable liability was is there was a
10 question about markup. And that the
11 markups from what we purchased and from what the
12 customer pays varies. And we have -- we sell a lot of
13 tires. That's not really based on percentage rate but
14 let's say the tire is \$140 tire, we sell it for \$170,
15 it's \$30 on tires back then.

16 And she was saying that the regular markup is
17 closer to 100 percent because we can't sell them for
18 that. We can't take a tire, buy it for \$150 and sell
19 it for 300 because then nobody would buy it because
20 that's what the market does. Does that make sense?

21 ALJ KWEE: Thank you.

22 EXAMINATION

23 BY ALJ STANLEY:

24 Q I do have one question, just a clarifying
25 question.

1 Did you say that you only reviewed the
2 samples for the 2013 quarter?

3 A The one quarter that we went over that she
4 found the problem with.

5 Q Okay.

6 A And that's what we go back through and look
7 at the work orders and try to figure out what went
8 wrong, that's what I found is that damage estimates
9 were added in with everything else.

10 Q Okay. So you didn't review the samples that
11 Ms. Hendrickson provided for the -- during the audit
12 period?

13 A During, we didn't -- when it came to that
14 thing, I didn't go back and go through all the work
15 orders for that quarter to see if those same things
16 were going on in the sense of was she trying to report
17 the damage estimates also. But it seems to make more
18 sense to me.

19 Q So I just wanted to clarify that you didn't
20 have any knowledge whether that happened during the
21 audit period with the samples that were given?

22 A The samples that she was basing on was after
23 the audit period.

24 ALJ STANLEY: Correct. Okay. Thank you.

25 ALJ GEARY: I have a few questions. I'll

1 give you a chance to also follow up when I'm through.

2 EXAMINATION

3 BY ALJ GEARY:

4 Q Mr. Gibbon, what is your -- you said you were
5 the power of attorney during the audit; correct?

6 A Yes.

7 Q So were you at the time the accountant or
8 bookkeeper for the business?

9 A No.

10 Q But you were the one who worked with the
11 auditor? Yes?

12 A Yes.

13 Q I understand what you're saying about certain
14 documents, and I'm not sure, work orders, I guess.
15 You're saying certain work orders were really not for
16 the sale of parts, may have included listed parts and
17 costs, but those were for motorcycles that were going
18 to be totalled. You weren't going to do the repairs.
19 You didn't do the repairs.

20 All you were paid for those motorcycles is
21 towing and storage; correct?

22 A Towing, storage and an estimate fee, yes.

23 Q And an estimate fee.

24 Were any of the invoices that were selected
25 for the sample work orders for estimates only?

1 A Yeah, as part for sample?

2 Q As part for sample.

3 A Yes. That's when we found the discrepancy.

4 Q All right. Do you have -- do you know how
5 many of the invoices that were selected for the sample
6 were work orders for estimates only?

7 A Off the top of my head, I don't.

8 ALJ GEARY: Mr. Goldstein, will you be able
9 to let us know that during your argument?

10 MR. GOLDSTEIN: Not during the argument, no.
11 I would only be able to figure out an estimate of how
12 that would be calculated.

13 BY ALJ GEARY:

14 Q Okay. Did you, Mr. Gibbon, participate in
15 the preparation of tax returns for the business during
16 the audit period?

17 A Tax returns like?

18 Q Yes. Did you prepare tax returns for the
19 business?

20 A I don't think so.

21 Q Who prepared those, if you know?

22 A I don't recall. This was a long time ago.

23 Q And Judge Kwee asked you, I think he asked
24 you at one point how you prepared returns. And I
25 think you indicated that you would go through -- I'm

1 talking about sales and use tax returns.

2 Did you indicate that you would actually go
3 through or somebody would go through the invoices that
4 reflected sales of parts and you would use those
5 numbers as the basis for your reporting of sales?

6 A What I based it on myself, personally, when I
7 would come just with numbers was the work orders
8 themselves.

9 Q That's how you would determine the amount to
10 report to the Board of Equalization or the department?

11 A Yes, because that's what we sold.

12 Q And did you prepare -- did you have a
13 computer program that you used, like Quickbooks or
14 something that you would use to keep track of those
15 things?

16 A No. I'm a pen-and-paper-kind of guy. I'm
17 not a really -- you know, I put the numbers together.

18 MR. GOLDSTEIN: You don't recall, you can say
19 that.

20 THE WITNESS: Okay. When it comes to who did
21 the actual filing --

22 BY ALJ GEARY:

23 Q I'm more interested in who came up with the
24 numbers to report. And I take it that was you, and
25 you did it based on a review of work orders?

1 A Yes.

2 Q Would you do it monthly and then total the
3 monthly ones for each quarter and report, or would
4 you, at the end of a quarter, go through a whole
5 quarter's worth of work orders?

6 A Probably go through a lot of orders but also
7 I'm a mechanic.

8 Q Okay. You also worked as a mechanic at the
9 shops?

10 A Oh, yeah. I do lots of things.

11 Q When you came up with the numbers, do you
12 know whether or not whoever prepared the final returns
13 reported your gross income first to include all of the
14 income you got from towing and storage and mechanic
15 services that did not include parts, or did you only
16 report sales tax from sales of parts?

17 A For the Board of Equalization?

18 Q For the Board of Equalization.

19 A That was all based on work orders. When I
20 say work orders, you know what I mean?

21 Q Yes.

22 A It's the job that was done, the parts that
23 got sold.

24 Q And you only reported the amounts that you
25 received for the parts sold?

1 A Yes.

2 Q Okay.

3 A I would report the total parts number and
4 then get a total number for that, sales tax, and the
5 total number for that, labor, subcontract stuff. The
6 subcontract would be towing or fabrication or anything
7 like that. Does that kind of answer your question?

8 ALJ GEARY: Yes. Thank you. Those are all
9 the questions that I have.

10 ALJ STANLEY: Can I ask another clarifying?

11 ALJ GEARY: Yes. I confused it for you.

12 ALJ STANLEY: When you brought up samples and
13 asked a question of Mr. Gibbon about samples, I need
14 to know that your question referred to the audit
15 period samples, the 89 samples that were given to
16 CDTFA by Ms. Hendrickson, or if you were talking about
17 the 2013 second quarter sample that was used as a
18 basis to buy the audit or to determine that there was
19 a discrepancy.

20 And so I'm asking him more than you, sir, so
21 don't get confused.

22 ALJ GEARY: Well, hopefully we're on the same
23 page. I was referring to the samples actually used in
24 the audit to determine the liability.

25 ALJ STANLEY: Okay. Then I will ask you, you

1 did not review the 89 samples that Ms. Hendrickson
2 provided for 2009 and 2011; correct?

3 THE WITNESS: We didn't -- I didn't go back
4 through and see if the auditor had included the damage
5 estimates or not at that point.

6 ALJ STANLEY: Okay. So you didn't look for
7 that issue with estimates for total loss vehicles for
8 those tax years for 2009 and 2011?

9 THE WITNESS: Did I go back through and
10 double-check all that, no.

11 ALJ STANLEY: Right. Thank you.

12 THE WITNESS: As far as I know, they're part
13 of this whole audit period of time as far as I can
14 guess.

15 ALJ STANLEY: Okay. Thank you.

16 ALJ GEARY: Judge Kwee, nothing? Does the
17 department have any questions?

18 MR. LAMBERT: We do not.

19 ALJ GEARY: Do you have follow-up that you
20 would like to do, Mr. Goldstein?

21 MR. GOLDSTEIN: I do not.

22 ALJ GEARY: All right. If you're through
23 with your witnesses, you do not intend to call
24 Ms. Hendrickson?

25 MR. GOLDSTEIN: I am, your Honor. I've got

1 the exhibit basically is what I wanted to do.

2 ALJ GEARY: Okay. Thank you. You can remain
3 there if you wish to, or you can have Ms. Hendrickson
4 switch seats. It's up to you.

5 We're now at the argument portion. The
6 documents have been admitted. You have some evidence
7 in the record. You're free to argue any of the
8 evidence that's in our records currently. And we'll
9 start with Mr. Goldstein who will have 15 minutes for
10 his first closing argument. Proceed when you're
11 ready.

12 MR. GOLDSTEIN: Thank you, your Honor. It's
13 very common practice obviously for an auditor to look
14 at the audit period three years, but also to seek
15 either confirmation or to utilize information for a
16 more recent quarter which may be more complete to use
17 that data to then apply toward '09, in this case, '09
18 through '11, or to perhaps at least confirm their
19 conclusion from the prior -- prior period.

20 In this case, what happened is, and these are
21 just the notes, this is all evidence by the sales tax
22 board, I'm going to call them Board of Equalization.
23 I know the name has changed. But that's what they
24 were back then.

25 ALJ GEARY: Let me just interrupt you to say

1 we have full sets of exhibits if when giving your
2 argument, you want us to look at anything. Give us
3 the Bates number page so we can go to it.

4 MR. GOLDSTEIN: Sure. So I'm looking at
5 actually the board's page 161 of their exhibit. It's
6 page 10 of 12 of the assignment activity history. It
7 doesn't have the -- is there an exhibit number? Oh,
8 sorry. Exhibit E. Exhibit E. And I'm looking at
9 page 161 of Exhibit E. And specifically, I'm looking
10 at February 10, 2014.

11 And this is where she states she's reviewed
12 the discrepancies found for reconciliation. But prior
13 to that, on page 160, on December 9, 2013 is where she
14 states, you know, the taxpayer before prior to that
15 didn't understand why the invoices didn't add up. And
16 then the next page is about saying, well, gee, there
17 were estimates included.

18 So the auditor was obviously looking at
19 second quarter 2013 to confirm or use those figures
20 from '09 through '11. And logic dictates that the
21 methodology that she'd be using for that quarter would
22 be the exact same methodology she would use for '09
23 through '11.

24 And in using that sample period from second
25 quarter 2013, it is now discovered that, in fact,

1 estimates have been included. And she looked at all
2 the invoices. There was never a time for '09 through
3 '11 where invoices were not looked at.

4 So when we talk about \$444,000 figure, that's
5 a conclusion based upon an erroneous base in that if
6 she was using, which again, logic dictates for second
7 quarter '13 she'd be using the exact same methodology
8 to confirm her numbers from '09 through '11, she was
9 using estimates for work never actually sold or
10 performed, just an estimate.

11 So what that means is that she was using
12 estimates for this whole time because she didn't
13 change her methodology. She's not here obviously, no
14 longer with the board.

15 And that's actually another important point
16 is that this is February 10, 2014. We discovered the
17 discrepancies and the reason for them. And then
18 basically on April or -- sorry, well, April 25th,
19 she's basically saying, hey, I'm leaving the board,
20 I'm no longer going to be here. I'm just turning in
21 my audit report.

22 And there's no indication that between
23 February and April that she ever went back and changed
24 and reviewed any of her prior methodology to see if,
25 in fact, estimates were included. And what we've

1 included in our exhibits, Exhibit 2, are just a sample
2 of the estimated invoices. There are more, many have
3 water damage and literally could not be copied. But
4 they are available for review in person. But these
5 are estimated work orders that her work was never
6 done.

7 So if you're taking these numbers, which
8 these alone, this is a complete set, is \$90,000 worth
9 of work as a sample, that that has been used to
10 confirm the fact there were higher sales or \$444,000
11 base that we're using saying, hey, these were extra
12 sales. Well, they weren't.

13 And again, the methodology she used for
14 second quarter 2013 didn't catch that. That's my
15 initial response, your Honor.

16 ALJ GEARY: Okay. All right. Thank you.
17 Department, two questions: One, are you ready to give
18 your only argument?

19 MR. LAMBERT: We are.

20 ALJ GEARY: And do you intend to state any
21 factual matters in your argument that might require me
22 to administer an oath or affirmation or alternatively
23 just verifying that factual statements in closing
24 arguments are not considered evidence and you can just
25 proceed?

1 MR. LAMBERT: Mr. Hanks will provide factual
2 information, as well as I will.

3 ALJ GEARY: All right. And how do you want
4 to handle that?

5 MR. LAMBERT: At the time that that comes up,
6 that you can swear us in.

7 ALJ GEARY: All right. If it's during this
8 argument, it probably makes sense just to administer
9 an oath or affirmation now, that way you can call on
10 Mr. Hanks to verify things any time you want to. Bear
11 in mind that Mr. Goldstein will have an opportunity to
12 examine -- the judges will have an opportunity to
13 examine Mr. Hanks regarding any factual statements.
14 Okay?

15 MR. LAMBERT: Sure.

16 ALJ GEARY: Mr. Hanks, would you stand and
17 raise your right hand, please.

18 Do you solemnly swear or affirm that the
19 testimony you are about to give in this matter will be
20 the truth, the whole truth, and nothing but the truth?

21 MR. HANKS: Yes.

22 (Mr. Hanks sworn in.)

23 ALJ GEARY: Thank you. Be seated. And I
24 take it that you're going to give your argument, and
25 then when you get to a point where you wish to elicit

1 some factual information from Mr. Hanks, you'll do
2 that?

3 MR. LAMBERT: Yes. I was going to provide
4 some factual information. There was an exhibit
5 provided regarding the now, the subsequent. And it
6 hasn't been argued. I was just going to give a brief
7 statement on that.

8 ALJ GEARY: Factual information. Then you
9 should also stand and raise your right hand.

10 Do you solemnly swear or affirm that the
11 testimony you're about to give in this matter will be
12 the truth, the whole truth, and nothing but the truth?

13 MR. LAMBERT: I do.

14 (Mr. Lambert sworn in.)

15 ALJ GEARY: Thank you. You may be seated.
16 Same caution, that if you testify to any factual
17 matters, I'm going to allow Mr. Goldstein to ask
18 questions, and the judges would also have an
19 opportunity to ask you questions.

20 Mr. Goldstein, yes.

21 MR. GOLDSTEIN: Yes. Just to avoid
22 confusion, can we just set aside the time where just
23 the facts are being discussed because I don't want to
24 misunderstand with fact and argument.

25 ALJ GEARY: I have a feeling that there's not

1 going to be that many facts testified to. If I feel
2 like there's a lot of -- Department's got 15 minutes,
3 not including whatever facts they want to testify to
4 in that 15 minutes. I will keep rough track of how
5 much time is being used for the factual testimony.

6 Do you need to have it tracked in any more
7 careful fashion than that, Mr. Goldstein?

8 MR. GOLDSTEIN: Go ahead.

9 ALJ GEARY: Mr. Goldstein, do you need
10 anything more than that?

11 MR. GOLDSTEIN: Let's see how it plays out,
12 that would be great.

13 MR. LAMBERT: Just to clarify, my facts will
14 be just in regards to the now, subsequent audit, I
15 guess you would call it an audit. And Mr. Hanks will
16 just discuss what we'd expect for this type of
17 business. So those will be our two facts that we're
18 representing.

19 ALJ GEARY: And are you going to ask
20 Mr. Hanks the questions or is he going to just testify
21 in a narrative fashion?

22 MR. LAMBERT: He's just going to testify in a
23 narrative fashion.

24 ALJ GEARY: When it comes to the point that
25 you are going to give that testimony, Mr. Hanks, I

1 want you to give us a brief summary of your background
2 so that there's some kind of foundation laid. You can
3 make whatever statements you intend to make about this
4 type of business. All right.

5 Department, you can begin your closing.

6 MR. LAMBERT: Okay. Thank you. This
7 particular audit is of a motorcycle repair facility.
8 They also have some other operations that are
9 conducted here, but that is separate from what we're
10 discussing here or how we calculated the liability.
11 The audit is for the periods of the years 2009, 2010,
12 2011, which were filed on quarterly returns.

13 When conducting the audit, there was a large
14 difference between the amount of gross receipts
15 reported on the income tax returns and the total sales
16 that were -- or the sales that were reported on the
17 sales and use tax returns.

18 What was particular we looked at was the
19 amount of purchases compared to the amount of taxable
20 sales reported on the sales and use tax returns. So
21 there was a substantial difference between gross
22 receipts and taxable sales that were reported. A lot
23 of that was income, nontaxable from either towing or
24 repair facility, or the repair of the motorcycles. So
25 there was no sales journal. There were limited sales

1 invoices, they didn't appear to be complete.

2 If you look at Exhibit B, page 8, which is a
3 summary of the sales tax returns, what you'll find on
4 there is that there's very small amounts of taxable
5 sales that were reported during the early periods of
6 the audit.

7 In fact, if you look at the purchases or if
8 you look at the purchases for the second quarter of
9 2009, they had \$108,000 in purchases, but they only
10 report the taxable sales of \$3,800. So I should --
11 the 108, and actually, it was 113 total purchases was
12 for the entire year of 2009. There was some
13 adjustment to be made, but I'll explain that.

14 So what the auditor did was basically impeach
15 the records. What they said was the total amount of
16 purchases in the audit which was \$408,000 was
17 significantly higher than the reported taxable sales
18 of \$123,000. And the only way that we could determine
19 how to figure out the audit liability or the amount of
20 taxable sales was what we call the markup method.

21 So what we wanted to do was take a
22 representative period of time, take a look at the
23 sales invoices and compare those to the purchases of
24 those specific parts.

25 So since the second quarter of 2013 was the

1 most complete, we decided to take a look at that
2 particular period. And what we came up with was a
3 almost 45-percent markup for that period.

4 Now, the appellant has argued that there were
5 estimates only. The department would agree that if
6 there was no sale of handled personal property, there
7 is no sales tax that's due. So just the fact of
8 giving an estimate, you didn't tow, have any storage,
9 there's nothing taxable from that transaction.

10 So the issue is that the taxpayer did bring
11 up they were estimates only. And then if you do take
12 a look at our Exhibit E, page 10, going back to that,
13 which is February 10th of 2014, the second paragraph.

14 Second paragraph, second line to the bottom
15 of that paragraph, it says, "Since they were not
16 clearly identified on the actual invoices, that they
17 were estimates."

18 So as you can see from the information that's
19 provided with the appellant's exhibits, you can
20 clearly tell on those sales invoices which ones were
21 estimates or not. It's written on the invoices
22 themselves.

23 But I think the point that I am really trying
24 to make is that even if you did list those sales down,
25 and we thought they were sales, that, in fact, those

1 would have been the prices that you would have
2 charged, and you would have had the purchases.

3 I don't believe it would change the markup
4 other than to say that, in fact, we knew that there
5 were estimates, we would not include them in our
6 markup.

7 So with that said, the taxpayer disagreed
8 with the use of our second quarter of 2013, they felt
9 that the markup was too high. Our alternative was to
10 come back to the appellant and ask them to provide us
11 at least 20 sales invoices for each year, and the
12 purchases, corresponding purchases that go along with
13 that. And that we would then use that as a -- as the
14 markup test. And, in fact, that's what we did.

15 So the information that we are currently
16 using is information that was provided directly by the
17 appellant to us in order to calculate that percentage.
18 This isn't something that we picked out ourselves, but
19 what the appellant provided to us.

20 And what we found was in 2010, they only
21 provided us five invoices that we didn't feel that
22 were taxable and, therefore, we didn't use them. But
23 the markup for 2009 was 41-and-a-half percent. The
24 markup for 2011 was 40 percent.

25 We basically took a weighted average of those

1 two, and came up with 40.91 percent. And now I'll
2 have Mr. Hanks provide his testimony as to whether we
3 consider that to be a reasonable markup or not.

4 MR. HANKS: Good morning, Judge Geary. I'm
5 Kevin Hanks. I'm currently the Chief of Headquarters
6 Operations Bureau within CDTFA. I have approximately
7 35-plus years of experience in working for Board of
8 Equalization or CDTFA in a capacity to review audits
9 as they get generated, also to review audits that find
10 themselves in the appeals or petition process.

11 So throughout my career, I've probably
12 examined 1,000-plus audits, many involving the use of
13 indirect audit methods such as the one used here, the
14 markup method to establish what audited taxable sales
15 are.

16 In my experience, I've seen markups of this
17 type in related industries with the markup of
18 approximately 40 percent for the sales of parts
19 related to -- parts sold for repair, parts for
20 motorcycle dealerships or automotive dealerships.

21 This is a reasonable markup that we
22 traditionally see when we examine books and records of
23 this type of business. So this markup isn't unusual
24 in the sense that the 40 percent calculation was
25 verified over different periods, I think corroborates

1 the reasonableness of the 40-percent markup.

2 Moreover, I believe the taxpayer's own
3 estimate of what that markup should have been, between
4 30 percent and 50 percent, more or less corroborates
5 the validity of the 40-percent blended average markup
6 when calculated and used in her estimates.

7 ALJ GEARY: Thank you. I will give you an
8 opportunity to examine Mr. Hanks after the argument is
9 completed by the department, Mr. Goldstein.

10 MR. GOLDSTEIN: Okay.

11 MR. LAMBERT: So what we did in this
12 particular case is take the purchases that -- and we
13 went through each one of the purchase invoices to
14 obtain these purchases. The appellant went through
15 there and took out some of the items that they said
16 were non-tax or non-purchases.

17 So the 408,000 was obtained on a individual
18 specific basis. We used that amount. We made an
19 adjustment of two percent for shrinkage, in fact, it
20 may not have been sold, taken for whatever particular
21 reason, and then we applied the markup of -- the
22 average markup of 40.91 percent to come up with what
23 we say were the sales for personal property during the
24 audited period.

25 And we compared the reported, which was

1 \$123,000, and we came up with the difference of
2 \$440,000. That's essentially how the audit was
3 calculated.

4 I would point out that there was no evidence
5 that any sales of tangible personal property were
6 exempt for any reason. So there were no resales or
7 out-of-state sales, no information of that that was
8 provided.

9 So -- oh. And I would direct you to Exhibit
10 D, page 1, second-to-last paragraph, in that when we
11 did the audited amounts from this audit period, we
12 came up with 46,663 was the average quarterly figure.
13 And what they had been reporting subsequent to the
14 audit [inaudible] was 45,272.

15 So it appears that the estimate that we came
16 up with was close to the amount that they started
17 reporting in the two years subsequent to the audit.

18 Now, this may be testimony in regards to the
19 now that was provided. And essentially, what it was
20 is there was a subsequent audit that was selected for
21 the taxpayer. Did you want me to give my
22 qualifications or is that --

23 ALJ GEARY: Sure.

24 MR. LAMBERT: Okay. I have 38 years or over
25 38 years of sales and use tax experience as an

1 auditor, as an audit supervisor, as a criminal
2 investigator and also as a hearing representative.
3 And I've dealt with these type of issues and markups
4 for the last, over, well over ten years in particular.

5 So anyway, the now, they were selected for,
6 subsequently selected for audit. The auditor went out
7 to conduct the audit which is a different auditor than
8 the original auditor. They took a look at what the
9 taxpayer was reporting.

10 They used the estimate of the 41 or close to
11 41-percent markup to see if what they had been
12 subsequently reporting was consistent with that.
13 Their determination was that it was close enough, and
14 the auditor decided not to conduct the audit.

15 So it does appear that the reporting had
16 changed since the -- since this particular audit
17 period, that the taxpayer was now in compliance with
18 the reporting.

19 So I think I've covered everything with that.
20 We conclude our presentation.

21 ALJ GEARY: Thank you. Mr. Goldstein, do you
22 have any questions for either of the witnesses to the
23 extent that they testified to factual matters?

24 MR. GOLDSTEIN: I do, your Honor. I'll go
25 with Mr. Hanks.

1 ALJ GEARY: Sure.

2 KEVIN HANKS

3 being first duly sworn, testified as follows:

4 EXAMINATION

5 BY MR. GOLDSTEIN:

6 Q So I have actually several questions.

7 Would you agree that starting in end of
8 '07, '08, there was a great recession as it's now
9 known?

10 A Yes.

11 Q And from your experience, did a lot of
12 businesses go under?

13 A Yes.

14 Q Okay. And did a lot of businesses slow down
15 and have very much lower sales than they had in the
16 prior years?

17 A What we've seen is generally, the businesses,
18 some businesses had marked like fewer sales. What we
19 didn't find was the markup on individual sales items
20 varied, but the overall gross sales may have certainly
21 [inaudible].

22 Q I'm just talking about a business sense, not
23 talking about anything else.

24 Would you say that subsequent to '09, '10,
25 '11, actually the market started improving around

1 '012; correct?

2 A Correct.

3 Q And '13 was markedly better?

4 A Correct.

5 Q So to use '13 as some sort of sample for '09,
6 '10, '11 would actually not really be very accurate,
7 would it?

8 A No. I disagree for the reason that I stated
9 before. Generally speaking, the sales volume is an
10 indicator of what the markup is. The market tends to
11 remain consistent from year to year. It's actually
12 looking at markups from 2013 should be consistent with
13 those found in the earlier periods.

14 And sales volume, total sales volume may be
15 different in those periods for the reasons that you've
16 described. The markup actually remains --

17 Q Let's focus on markup. Talk about a weighted
18 markup. Now, I'm going to talk in general when we
19 talk about this business.

20 If I go to Starbucks and I order a cup of
21 coffee, the markup may be what, 400 percent,
22 200 percent? Would you agree?

23 A It would be high, yes.

24 Q Something like that?

25 A Yes. Yes.

1 Q And if I buy a muffin, perhaps it's coming
2 from a third party at Starbucks, right, but the
3 markup may only be 20 percent; correct?

4 A I doubt that it would be 20 percent, it's
5 probably different than the coffee sales.

6 Q Just for fun, if you can give me a number of
7 what you think it would be, a muffin markup?

8 A 150 percent.

9 Q So coffee's got to be 400 percent, right? I
10 mean, would it cost a nickel and I'm paying a dollar,
11 or whatever that is, what is that, two bucks?

12 What is that?

13 A So I wouldn't want to speak, you know,
14 regarding what the markup business --

15 (Multiple voices.)

16 Q Let's just say we have a markup of
17 200 percent on one item, and a markup of 60 percent on
18 another.

19 Now, if I just combine those and I divide by
20 2, and I say that's the markup, is that an accurate
21 way to determine a markup for an entire business?

22 A What we would say is that using more of a
23 weighted calculation would be more appropriate, which
24 is similar to the methodology that was used in this
25 audit, because what we'd find is that there was a

1 variance of the markup on sales of individual
2 property.

3 So, for instance, a filter, an oil filter
4 might have a markup of 40 percent, but a gasket, you
5 know, might have a markup of several hundred percent.

6 Q And did you figure out how many tires were
7 sold during these years?

8 A I don't believe that we had access to that
9 information.

10 Q So if, in fact, tires, which may have the
11 lowest markup, if you don't have access, you actually
12 can't properly weight the markup if you don't have
13 access to it; correct?

14 A No. In the sense that if we are looking at
15 say 20 representative invoices from each test period,
16 then actually there could be a combined weighting all
17 of those amounts. As I said, the markup trend for
18 individual products is going to vary. If we look at
19 our audit work papers, we'll see that.

20 We've got very low markups on certain sales
21 of product, very high markups on another. So getting
22 a blended markup and combining those selling prices
23 actually gives you that weighted markup.

24 Q Okay. But your prior statement was you did
25 not have access to those records; is that correct?

1 A No. We had access to sales invoices that the
2 petitioner provided to the audit staff. They mirrored
3 those with the purchase invoices that we saw for that
4 property so we could calculate what the market was
5 based on the selling of that property.

6 Q I'm just confused though. When I asked if
7 you had access to the tires, you said no. And now
8 you're saying you did have access to the records to
9 figure out a markup.

10 A We requested sample invoices from the
11 taxpayer, and those were provided for the tested and
12 sample periods.

13 Q So you did have access. So your statement
14 that you did not have access would not be correct?

15 A No. What I indicated was that I don't
16 believe that the records were sufficient where we
17 could identify the number of tires sold by the
18 business over a three-year audit period.

19 Q But you did have access to the records,
20 they're apparently not sufficient.

21 And so basically, you could not have an
22 accurate weighting then because you don't have access
23 to all the tire records; is that what you're saying?

24 A No. So what I'm saying is that based on the
25 available invoices and purchasing, both sales and

1 purchase invoices that were supplied for the test
2 periods we sampled, we were able to calculate a
3 weighted markup of 40 percent as Mr. Lambert
4 described.

5 Q You were not at the audit itself; correct?

6 A Correct.

7 Q So for the auditor to create this markup,
8 this analysis and then use it, do you know exactly
9 what she was looking at? I know you're saying
10 purchase invoices, but she looked at sales invoices
11 too.

12 And can you be sure she wasn't relying on
13 sales invoices in the end?

14 A It's my understanding that she was looking at
15 both or had access to information that confirmed in
16 her mind what the cost price was for the sales
17 reflected on the sales invoices.

18 Q Okay. So if she's looking at both, it's
19 certainly possible then that she relied heavily on the
20 sales invoices, we actually do not know for certain?

21 A She relied on both purchase information and
22 the sales information by the taxpayer's records.

23 Q Okay. So the sales information, we know from
24 second quarter of '13 when she did the review, that it
25 included estimates. And I know there was testimony

1 that apparently they were not properly marked, but as
2 far as we know, all the invoices have always been
3 prepared the same way. And there's a lot of
4 information on these. So it's actually pretty tough
5 to tell that it's an estimate.

6 Can I show you an example?

7 ALJ GEARY: Are you showing the witness now
8 an example of something that's already in the record?

9 MR. GOLDSTEIN: It is.

10 ALJ GEARY: Can you refer us to what, so that
11 we can look at what you are going to be showing the
12 witness?

13 MR. GOLDSTEIN: It's page 1 of Exhibit 2.

14 ALJ GEARY: And the document you're showing
15 the witness, is it the exact same document that you
16 submitted? There's been no other notations made on
17 it?

18 MR. GOLDSTEIN: It is, your Honor.

19 ALJ GEARY: Thank you.

20 MR. GOLDSTEIN: You know what, I should say
21 it's highlighted. This is an original, so probably on
22 the photocopy it wouldn't be highlighted. But I don't
23 think that makes any difference.

24 MR. HANKS: Mr. Geary, we would object to my
25 making comment to invoices. My area of expertise was

1 just testifying with respect to the markup and whether
2 that markup was reasonable for this industry type.

3 Mr. Lambert can provide more detailed
4 information regarding the invoices and how the selling
5 prices were determined.

6 ALJ GEARY: Hold on just a minute. I want
7 Mr. Goldstein to have an opportunity to reply.

8 MR. GOLDSTEIN: Mr. Lambert, you testified
9 earlier --

10 ALJ GEARY: Hold on just a minute. We have a
11 pending objection to the line of inquiry. The grounds
12 being, if I understood correctly, that essentially
13 beyond the scope of the direct testimony from this
14 witness.

15 And I believe Mr. Hanks indicated that he
16 would defer to Mr. Lambert who has amore detailed
17 knowledge regarding the more specific invoices at
18 issue. Is that a fair statement?

19 MR. HANKS: That's correct.

20 ALJ GEARY: So what's your -- maybe if you
21 can help us understand --

22 MR. GOLDSTEIN: I could question Mr. Lambert
23 instead.

24 ALJ GEARY: Or you can explain where you're
25 going with this. If the department is indicating the

1 information is better, the questions are better
2 directed to Mr. Lambert and you're willing to do that,
3 I'll allow you to ask Mr. Lambert the questions.

4 MR. GOLDSTEIN: Okay. Sure. I have a few
5 questions for him.

6 **SCOTT LAMBERT**

7 being first duly sworn, testified as follows:

8 EXAMINATION

9 BY MR. GOLDSTEIN:

10 Q On the invoice, you said it seemed clear, not
11 clear on the second of 2013, but you seemed to
12 indicate that for '09 or '11, it would have been much
13 clearer. You're taking a look at the invoice, there's
14 a lot of information.

15 Is that an original invoice or is that an
16 estimate?

17 A It says it's -- well, it's on a repair order
18 and has a number 5526. On here, it would show the
19 amount nine days of storage 33750, and the damage
20 estimate of 65, it would show 40250. There was no
21 billing for labor parts, the total. So I would say
22 this is an estimate.

23 Q Okay. And thank you. I can take that back.
24 I would like to note for the record that it did take
25 him time to try and figure that out.

1 I'm going to give you another, this is page 3
2 of Exhibit 2. Can you tell me if that's an original
3 or an estimate?

4 A And I did figure that out and that's what an
5 auditor does when they do an audit. They don't jump
6 to a conclusion --

7 ALJ GEARY: I don't need you to explain it,
8 Mr. Lambert.

9 MR. LAMBERT: What's that? On this one, it
10 indicates the same thing. There's a storage,
11 nine days, 37 -- \$337.50, \$65 damage estimate. I
12 don't see on here where the parts are broken out.
13 Well, I see a billing for the parts. It says 3445.

14 But we wouldn't be able to use this for a
15 markup test because what we would need is to have a
16 specific amount here. And in each one of these cases,
17 we had a sales amount that was listed on here, and we
18 also had a corresponding purchase invoice that we
19 traced the amount to.

20 And what I would point out again is that we
21 did not use the markup from the second quarter of
22 2013. In fact, we used the markups from 2009 and
23 2011, an average of those. And those were the
24 invoices that were provided directly by the appellant.

25 So there's no evidence that I have that any

1 of those were estimates. And I would have to question
2 why they would provide those sales invoices to us of
3 repair orders that would have estimates on them. So
4 that's my understanding.

5 ALJ GEARY: Maybe you could try to limit your
6 responses to the questions. Things might move a
7 little bit more quickly. And then when he's through
8 questioning, if you have clarification you want to
9 give, you can give that. Okay?

10 MR. LAMBERT: Okay.

11 BY MR. GOLDSTEIN:

12 Q I would like to follow up on one question for
13 an issue you raised. You stated that you don't know
14 why they provide all the invoices.

15 I believe the earlier testimony, I think it
16 was testimony, was that the board believes that
17 certain invoices were actually missing; is that
18 correct?

19 A When you say invoices, the sales invoices
20 were missing, that's correct.

21 Q Or out of order?

22 A I believe they were missing.

23 Q How would they --

24 A Not just --

25 Q Because of the numbers, or how would they

1 know something's missing?

2 How do you prove the negative if you're not
3 going by a number?

4 A Right. So what you would do is you would
5 compare to the reported sales of tangible personal
6 property compared to your purchases. And in addition
7 to that, there were also gaps in the invoices, the
8 invoice numbers.

9 So, and just -- there were two sets of
10 invoices: One for repair orders; and another one for
11 what they call half sheets, which would appear to be
12 sales that were over the counter. So both of them
13 appear to be missing. They weren't in sequential
14 order, the ones that were provided.

15 Q So you would need to provide these estimates
16 though in order to be as sequentially accurate as
17 possible; correct?

18 I mean, if you're looking at sequences to try
19 to determine if we have everything, then you would
20 need estimated invoices to do so?

21 A Estimated, right. You would need the
22 estimated invoices if you were trying to confirm that
23 all the sales that you have reported were supported by
24 the actual invoices. If that was a method we were
25 using, I would agree that we would want to account for

1 each one of those sales invoices.

2 Q Okay. And in a motorcycle repair shop, I
3 imagine there's a lot of receipt books running all
4 around. You've got people with grease on their hands
5 running between equipment.

6 Just from your experience, would it be common
7 for somebody just to pick up whatever invoice book is
8 there and maybe not sequentially in order all the
9 time, but just pick up what they happen to have in
10 their hand at that point in time?

11 A I don't know. That may be common. Every
12 place has a different way of doing things. And it
13 really depends on the, I guess, the bookkeeper and how
14 you're billing things. Some, if it's a smaller shop,
15 it's more likely that they would have a sales invoice
16 that they were filling out.

17 If you have a bookkeeper, a lot of times you
18 might have something with estimates but they would be
19 the ones that would provide the actual repair order or
20 sales invoice.

21 Q And I'd like to give you just one last
22 exhibit here. This is, I believe it's page 6, on the
23 top, it's Invoice No. 4896.

24 ALJ GEARY: Page 6 of your --

25 MR. GOLDSTEIN: Of my Exhibit No. 2, I

1 believe. Is that moving up? I might have moved out
2 of order, but top of the left is No. 4896.

3 ALJ GEARY: Yes.

4 BY MR. GOLDSTEIN:

5 Q Okay. And can you tell me if that's an
6 estimate or original, please?

7 A [Unintelligible] --

8 Q I don't mean original. Sorry. An estimate
9 or actual sale?

10 A Well, there's an estimate that's given on
11 there. Did this sale actually take place, is that the
12 question?

13 Q Yes.

14 A I would say based on this, that it did not.
15 I mean, one thing that you would have to go to if, in
16 fact, that's what you were trying to do is go to the
17 receipts, your receipts journal to see what amount was
18 listed in that, what was deposited in the bank.

19 This by itself, although it lists each one of
20 the parts items and it does give a price for that, you
21 would have to see what was paid. If I had to I guess
22 at this point guess, I would say it was an estimate.

23 Q Okay. Thank you. So I'd just like to
24 confirm that, in fact, when the auditor went through
25 second quarter of 2013, she actually didn't pick up

1 whether it was an estimate or not. Her first reaction
2 was no, correct? I'm sorry, not no.

3 Her first statement or conclusion was that
4 all of these were sales?

5 A As far as in her -- if the calculation of the
6 markup for the second quarter, because there's two
7 different things that you're discussing.

8 The one issue is when you went through, what
9 she did was she specifically went through for the
10 second quarter of 2013 and she added up each one of
11 the individual sales. And so when you -- and it's in
12 the exhibits here. I don't have it off the top of my
13 head, but it's in here where she's went through each
14 one of them and listed it.

15 And I believe that is the issue is like why
16 did you come up with a higher amount for the second
17 quarter of 2013. What I would point out is it's
18 outside the audit period. But as far as the amounts
19 or the repair orders that are included in the markup
20 test, I don't have any information to show that she
21 included sales that were -- that didn't take place.

22 Q Okay. So we can just confirm that -- we
23 can't confirm it one way or the other whether she used
24 majority of sales invoices to rely upon her markup --
25 or not markup -- but her gross sales, or just the

1 purchase order because her notes say sales purchased.

2 And frankly, from the second quarter, she
3 didn't look at the purchases, she just looked at the
4 sales and found the discrepancy?

5 A I'm not sure exactly if I followed your
6 question. But if you're telling me that she just used
7 the added-up sales to calculate the liability, that's
8 not what happened. She took specific repair orders
9 and used the parts listed on those compared to the
10 ones where she was able to find the purchase invoices.
11 That's how she calculated the 45 percent.

12 The other figure, when she went through and
13 just added up all the second quarter 2013 sales
14 invoices or repair orders, she didn't do anything with
15 that figure. And, in fact, she didn't do anything
16 with the 45 percent either other than to say that
17 there appeared to be a problem with the reported
18 sales.

19 Q All right. She left like before she could do
20 anything; right?

21 A No.

22 Q Just two months later, I mean, if there was a
23 major discrepancy and three years of audit material,
24 not enough time to figure it out, is there?

25 A No. She -- well, the way our audit program

1 works is that somebody -- you should be able to
2 document everything that you do, and that somebody
3 should be able to come in after or if you happen to
4 leave for whatever reason, that someone could come in
5 and take over what you had done.

6 So the fact that she left I don't think has
7 any bearing on the audit itself.

8 Q No. Not that. But -- well, not how she did
9 it and where that is.

10 My point being is that if she based part of
11 the audit on, or confirmed her figures from the sales
12 invoices, that according to second quarter 2013, she
13 made an error?

14 A No --

15 Q So you wouldn't agree she included estimated
16 invoices either as part of her markup or as part of
17 her sales initially?

18 A I don't have any evidence myself that that's,
19 in fact, what happened.

20 Q Well, the notes say here. She said we found
21 a discrepancy, we asked the taxpayer about it. And
22 the taxpayer came back and said, oh, you've been
23 including estimated invoices in your calculations.

24 A I believe that's in regards to -- and I can
25 find the schedule where she added up the second

1 quarter of 2013 sales invoices.

2 I believe that's what the comment is in
3 regards to, is that it's the total that she did and
4 it's completely separate than the test that she
5 conducted for the second quarter of 2013. Other than
6 she did use, on any particular invoice, she did use
7 the listing of the parts.

8 Q For markup only?

9 A For to calculate the markup. She used the
10 parts.

11 Q And the part was sold?

12 A And that part was sold, that's correct.

13 Q So if there were estimated invoices in there
14 that were never actually sold, believing that the
15 parts were actually sold would actually be a mistake?

16 A I would say if that's, in fact, what happened
17 on this document, hypothetically, if you had an amount
18 that was included in there that was a sale that didn't
19 take place for markup purposes, you shouldn't include
20 it in your test.

21 With that said, the amount that was being
22 listed on there is what you would normally charge for
23 that particular part, and so did corresponding
24 purchase invoices. You shouldn't have it in there,
25 but it really shouldn't affect the test because that

1 was a sale that could have taken place.

2 Now, if your argument is that it's an amount
3 that was exaggerated, which I don't believe you would
4 provide that to an insurance company, then that's a
5 different argument.

6 Q But if you were using the sale invoices as
7 confirmation that you believe something was sold,
8 because, again, you actually didn't sound like the
9 auditor had all the purchase invoices, but if you're
10 using the sale invoices to confirm that something was
11 actually purchased when, in fact, it wasn't, it would
12 impact a conclusion; correct?

13 A Yeah. Well, just to correct or clarify your
14 statement, I believe we had all the purchase invoices.
15 We're not arguing different than that. In fact, all
16 the purchase invoices that at least were marking up
17 are on our schedules, and each one of them is listed.
18 So that information is present.

19 The second quarter of 2013 was used to
20 calculate a markup. And just to point out again that
21 it was not used and so, therefore, it was just used to
22 determine that the amount of sales reported on the
23 sales of the tax returns were understated.

24 Q Wouldn't second quarter 2013, her sample be
25 generally how she would have considered the audit for

1 '09 through '11, her process?

2 A The markup test --

3 (Multiple voices.)

4 Q No. I'm just saying she found discrepancy.
5 So she believed there were discrepancy from '09
6 through '11, then perhaps everything else is just
7 confirmation bias.

8 A I don't know how you -- I guess my answer is
9 no.

10 ALJ GEARY: Mr. Perry -- excuse me.

11 Mr. Goldstein, I think probably you should be
12 getting close to making your argument.

13 MR. GOLDSTEIN: That was my last question.

14 ALJ GEARY: Okay. Good. Generally allow
15 five minutes on the rebuttal.

16 MR. GOLDSTEIN: I'm okay, your Honor. I
17 think we got everything out there.

18 ALJ GEARY: You don't wish to do any rebuttal
19 to the department's argument?

20 MR. GOLDSTEIN: Well, sure. I'll give two
21 minutes here.

22 ALJ GEARY: All right.

23 MR. GOLDSTEIN: Yes. I do think there is
24 confirmation bias in this case. I think, you know,
25 how she did second quarter 2013 is indicative of how

1 she considered '09 through '11. I think she included
2 sales that never actually happened. And I think she,
3 however she did her -- tried to confirm her
4 methodology would, again, just believe the
5 confirmation bias saying, hey, there's underreporting
6 because I see invoices that show more sales and there
7 must be a reason for it.

8 Also, you know, there's -- there hasn't been
9 a proper weighting of sales. Yes. Oil's going to
10 have a higher markup than tires. Tires have the
11 lowest markup. But tires also have higher costs. I
12 mean, a can of oil is five bucks. A tire can be over
13 \$100. So I also don't think the board has equally
14 weighted it.

15 There's been no accounting for inventory. In
16 this, they just did two-percent spoilage. That's
17 certainly not enough because they don't even have an
18 inventory. That's just sitting on the shelves. And
19 that's not acknowledged at all in their spoilage. So
20 that's really all I have.

21 ALJ GEARY: I'm going to allow my fellow
22 judges to ask some questions generally about your
23 arguments if you don't mind.

24 MR. GOLDSTEIN: Sure.

25 ALJ KWEE: Yeah. So I understand there's

1 been a lot of discussion and that there's a dispute
2 about the audited taxable sales based on the sales
3 invoices. But I'd like just to take a step backwards
4 and make a big, overall understanding to make sure I
5 understand this case.

6 And it's the taxpayer's position, if I'm
7 understanding correctly, that the originally-reported
8 amount of \$123,000 in reported taxable sales was
9 correct, and they stand by that figure.

10 Is that a correct understanding?

11 MR. GOLDSTEIN: We don't have any information
12 to say that it's incorrect. I mean, other than I
13 think assumptions that are based upon records that are
14 not actual sales. But is there, you know, is there a
15 middle ground here? Is that -- sure. We can make
16 that argument that if you take out the estimates, that
17 they shouldn't be included.

18 ALJ KWEE: Okay. And so my understanding of
19 the CDTFA's position is that they didn't originally
20 accept the 123 figure because they determined that the
21 sale, the reported -- or not reported -- that the
22 purchases of motorcycle repair parts far exceeded the
23 amounts of reported taxable sales of motorcycle repair
24 parts.

25 Was that the findings of the initial

1 determination?

2 MR. LAMBERT: I think ultimately that you're
3 correct in that they reported 123,000 and that they
4 had purchases of \$408,000. Now, you can have as many,
5 I guess, estimates or sales that didn't go through,
6 but something happened to that 275, probably more than
7 that because the 123 is a marked-up figure. If you
8 marked it down, it would probably be over 300,000 in
9 purchases that don't show up.

10 So it's our contention that, in fact, you
11 purchased those, you sold them and it's not on the
12 sales invoices and we have to go to the markup method
13 in order to determine what the true sales were.

14 ALJ KWEE: Okay. Just so I understand the
15 taxpayer's position, do you dispute that you made --
16 or not you --

17 But does the taxpayer dispute that it made
18 \$408,000 in purchases, and that number was far and
19 excessive of the reported taxable sales, or do you
20 agree with that and have some other explanation for
21 the discrepancy?

22 MR. GOLDSTEIN: Yeah. I'd have to see how
23 he's coming up with the 408. But yeah, I thought he
24 said there was \$100,000 in purchases, 108, and then he
25 corrected it to 113 for one of the years. So yeah, I

1 don't think -- and that was total for his numbers. I
2 don't think it's 408, the underreporting of actual
3 purchases.

4 ALJ KWEE: So I guess on Exhibit F, page 5 of
5 7, it shows 113 in audited purchases for one year, 121
6 for 2010, and 173 for 2011. I assume that comes to
7 408. But I was wondering if you're disputing that you
8 made those purchases or the taxpayer made those
9 purchases.

10 And if so, if you have a basis or evidence
11 for why the purchase calculation was incorrect because
12 I understand you had a lot of testimony on the dispute
13 with the sales invoices. But I'm not sure if I heard
14 the dispute regarding the purchase invoices.

15 MR. GOLDSTEIN: But you're looking at Excel
16 spreadsheets, right?

17 ALJ KWEE: It was Exhibit F, page 5 of 7. It
18 was just a summary of the audited purchases.

19 MR. GOLDSTEIN: Right. But that's if the
20 input's not based necessarily on the purchase invoices
21 but has also been based on the sales invoices which we
22 just don't know, it would show up at that. Sure.

23 ALJ KWEE: Okay. I think I don't have any
24 further questions. Thank you.

25 ALJ GEARY: Any questions?

1 ALJ STANLEY: Yes. For Mr. Hanks, I did have
2 a question.

3 So you testified this would be the kind of
4 markup that you'd expect. But even with 35 years of
5 experience, where do you get off the top of your head
6 a motorcycle business that has an associated towing
7 company that's in the specific geographic area and
8 operated by a sole proprietor, how do you --

9 Does CDTFA have databases they go to to find
10 out what a particular markup is in a particular area
11 in a particular geographic segment?

12 MR. HANKS: We don't have databases that we
13 necessarily look at. We do have information on all
14 the audits that are performed. So we could actually
15 look at different industry segments within different
16 geographical areas and look at those audit results
17 individually.

18 I'm speaking from experience of having looked
19 at many hundreds and thousands of audits for areas
20 throughout the state where what we typically find is
21 the markups for this industry don't vary all that
22 much. Markups for say a restaurant industry will vary
23 depending on geographic location.

24 So if we're talking about the restaurants in
25 the Bay Area, for instance, we would probably need to

1 pull some audit results from areas within that area to
2 determine what an overall blended markup is.

3 But for this industry group, we find that the
4 markups are relatively consistent. So I'm speaking
5 from my knowledge, my personal knowledge of seeing
6 audits of this type that are in dispute, more received
7 markup calculations made of weighted average markups
8 on the sales of parts.

9 ALJ STANLEY: Okay. And just to determine
10 even the relevance of it, if I'm understanding this
11 correctly, and this is for either Mr. Lambert or
12 Mr. Hanks. I almost called you Franks, I'm sorry.

13 If I'm understanding it correctly, the 2013
14 sample was only used for two purposes in any event.

15 In the first one was to determine that there
16 were discrepancies in the records that would need you
17 to do a further audit; that's one, correct?

18 MR. LAMBERT: Well, kind of. What we had,
19 what we intended to use that second quarter 2013
20 markup to calculate the liability. So it was only
21 when the appellant disagreed with the results of that
22 that we decided to take figures from inside the audit
23 period.

24 And the reason why we took the second quarter
25 2013 is because we felt that was more complete that

1 they had the sales invoices for that period and they
2 had the purchase invoices. So that's why we used
3 that.

4 It wasn't until they raised an objection that
5 we decided to then have them pull the sales invoices
6 they wanted tested and the purchase invoices. And
7 then we calculated the markups from that.

8 And I point out that the relative markups
9 between the second quarter 2013, 2009 and 2011 are
10 fairly consistent, but that the lower figures were
11 from 2009 and 2011, and that's what we used to come up
12 with our average.

13 ALJ STANLEY: Okay. So intent aside, you
14 didn't end up using that quarter to determine the
15 bottom line markup; right?

16 MR. LAMBERT: That was correct. There was
17 nothing in there that ends up in any audit
18 calculation.

19 ALJ STANLEY: Okay. And then the second
20 reason that I think I'm understanding that you used
21 that is the same reason that you use the estimate for
22 the industry is what I call a gut chuck or a validity
23 test, to see if it closely equates or substantially
24 equates with the actual results from the audit?

25 MR. LAMBERT: That's correct.

1 ALJ STANLEY: Thank you.

2 ALJ KWEE: No further questions.

3 ALJ GEARY: All right. Thank you. This
4 concludes the hearing. We, the judges, will take it
5 under submission. The record's closed. Generally,
6 within 100 days we issue our opinions. Copy will be
7 sent to the parties. And thank you again for your
8 participation this morning. Hearing's adjourned.

9 (Whereupon the proceedings were
10 adjourned at 11:48 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 8th day of April, 2019.

AMY E. PERRY
Certified Shorthand Reporter
License No. 11880