DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18012079
HAMDIAH SALEH ALDAHEBI	) Date Issued: May 2, 2019
dba Golden 7 Food Store	)

OPINION

Representing the Parties:

For Appellant: Hassen Mohsen, Accountant

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

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Hamdiah Saleh Aldahebi (appellant), dba Golden 7 Food Store, appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] rejecting a timely petition for redetermination of a July 26, 2017, Notice of Determination (NOD). The NOD is for $11,111.54 in tax, plus applicable interest, for the period April 1, 2012, through March 31, 2015.

Appellant waived her right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

Whether appellant established that reductions to the liability are warranted.

FACTUAL FINDINGS

1. Appellant operated a liquor store in Oakland, California, known as the Golden 7 Food Store.

[1] Sales taxes were formerly administered by the State Board of Equalization. In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22; Stats. 2017, ch. 16, § 5.) For ease of reference, when referring to acts or events that occurred before January 1, 2018, "CDTFA" shall refer to the board; and when referring to acts or events that occurred on or after January 1, 2018, "CDTFA" shall refer to CDTFA.

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

2. CDTFA audited appellant for the period April 1, 2012, through March 31, 2015. For the audit, appellant provided profit and loss statements, merchandise purchase invoices for the third quarter of 2014 (3Q14), and credit card merchant statements for the months of May through August of 2014. Appellant stated that she provided merchandise purchase invoices to her outside accountant to compile the sales and use tax returns. According to appellant, the accountant then segregated appellant's merchandise purchases into taxable and nontaxable categories, and then computed appellant's taxable sales by adding a 32 percent markup to the cost of taxable merchandise.
3. Due to the limited records available for audit, CDTFA contacted appellant's 11 known vendors of taxable merchandise and obtained appellant's purchase records from those 11 vendors for the period January 1, 2013, through March 31, 2015. CDTFA traced the purchase invoices that appellant provided for 3Q14 to the purchase records provided by the vendors. CDTFA found that 10 purchase invoices for a total of $11,163 were listed on the vendors' records, but appellant did not provide those invoices for audit. The 10 missing invoices also were not recorded in appellant's 3Q14 profit and loss statement. Accordingly, CDTFA found appellant's reported taxable sales to be unreliable and decided to establish appellant's taxable sales using a markup method.
4. Using the vendor reports, CDTFA compiled total taxable merchandise purchases of $1,176,422 for the period January 1, 2013, through March 31, 2015. CDTFA reduced the taxable merchandise purchases by 1 percent for pilferage, and by another 1 percent for self-consumption, to compute audited costs of taxable merchandise sold of $1,152,894 for the period January 1, 2013, through March 31, 2015. CDTFA determined that appellant's use of a 32 percent markup to compute taxable sales was reasonable, and thus CDTFA applied that markup to the audited costs of taxable merchandise sold to compute aggregate taxable sales of $1,521,819 for the period January 1, 2013, through March 31, 2015. By comparing the unreported taxable sales to the reported taxable sales for the period January 1, 2013, through March 31, 2015, CDTFA computed an overall error ratio of 5.94 percent, which it applied to the last three quarters of 2012 to compute unreported taxable sales of $23,166 for these quarters. In total, CDTFA computed underreported taxable sales of $108,527 for the audit period.

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

5. CDTFA also computed a taxable measure of $15,686 for the cost of taxable merchandise that appellant consumed. Appellant concedes that she owes tax on this amount.
6. Appellant protested the Notice of Determination, arguing that CDTFA had no reason to impeach her recorded merchandise purchases because the 10 missing invoices in 3Q14 were recorded in appellant's books in subsequent periods, when they were paid. Appellant asserts that CDTFA should have accepted her recorded merchandise purchases and her reported taxable sales.
7. Based on CDTFA's further examination of appellant's records, CDTFA concedes that two of the 10 questionable invoices offset each other (one debit invoice and one credit invoice for the same amount from the same vendor), and that another two invoices were recorded in a subsequent period.
8. There remain six missing invoices from the 3Q14 test period.
9. On July 26, 2017, CDTFA's Appeals Bureau issued a Decision and Recommendation in this matter, denying appellant's appeal. This timely appeal to OTA followed.

DISCUSSION

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.)

When CDTFA is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.) It is the taxpayer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer challenges a Notice of Determination, CDTFA has the burden to explain the basis for that deficiency. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610.) Generally, where a taxpayer challenges the additional tax, the government bears the initial burden of establishing a prima facie case that taxes are owed. (*Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950.) Based on *Riley B's, Inc.*

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

and *Schuman Aviation Co. Ltd.*, we conclude that when a taxpayer challenges a Notice of Determination, CDTFA must establish a prima facie case that taxes are owed by proving the basis for that deficiency and providing evidence sufficient to establish that its determination is reasonable.[2]

Where CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to explain why CDTFA's asserted deficiency is not valid. (*Riley B's, Inc., supra,* at pp. 615-616.) The applicable burden of proof is by a preponderance of the evidence. (Evid. Code, § 115; *Appeal of Estate of Gillespie,* 2018-OTA-052P, June 13, 2018, at p. 4.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) To satisfy its burden of proof, a taxpayer must prove both (1) the tax assessment is incorrect, and (2) the proper amount of the tax. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 442; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.)

Here, the books and records appellant provided for audit were incomplete. Specifically, appellant did not provide a general ledger, sales journals, purchase journals, cash register Z-tapes, and purchase invoices covering the audit period. Further, six purchases invoices from the 3Q14 test period are missing. Given that appellant applied a markup to her recorded purchases,

[2] The concurring opinion, below, erroneously asserts that we have misstated the law in *Schuman Aviation*, because it only requires that "Generally, introducing a Certificate of Assessment [(i.e., a copy of the assessment)] establishes a prima facie case that the tax and the imposition of additions to the tax are correct." (*Schuman Aviation Co. Ltd., supra*, 816 F.Supp.2d at 950.) However, we have not misstated the law. As the concurrence notes, the court in *Schuman Aviation* went on to state that "Unless the assessment is 'without rational foundation or is arbitrary,' the burden shifts to the taxpayer to show that the determination is incorrect." (*Ibid.*) Therefore, the test we are applying is correct and well established, albeit from income tax cases. (*See, e.g., Oliver v. U.S.,* (9th Cir. 1990) 921 F.2d 916, 920 (government met its burden by offering evidence that corporation had failed to pay over the $72,602.21 in withheld taxes, and taxpayer prepared checks to pay other creditors, even as she knew that the withheld taxes had not been paid); *see also Delany v. Commissioner of Internal Revenue* (9th Cir. 1984) 743 F.2d 670, 671-672 (government met its burden with evidence that taxpayers brought into the country over $40,000 in gold coins over a two-year period, and there was evidence that in the course of the audit, the taxpayers gave what the IRS deemed incomplete or unsatisfactory answers to inquiries concerning the acquisition of the gold).)

The concurring opinion then notes that it would apply income tax precedents to sales and use tax cases; however, we cited to *Schuman Aviation* because it is an excise tax case (and sales and use taxes are excise taxes), which is therefore more relevant and persuasive than income tax precedents.

We also emphasize that the government's introduction of the tax assessment alone is insufficient for the government to meet its burden of proof, and the government does not meet its burden of establishing a prima facie case until the factual foundation for the assessment is introduced. (*U.S. v. Stonehill* (9th Cir. 1983) 702 F.2d 1288, 1293.) Here, the NOD is not *evidence* probative of the underlying basis for the assessment, and CDTFA's Appeals Bureau's Decision is not evidence, but instead CDTFA has merely offered it as an advocacy brief. Therefore, both the Decision and the NOD are inapposite to CDTFA's burden of proof. To meet its burden of proof, CDTFA must establish a prima facie case by providing evidence to support the reasonableness of its assessment.

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

the missing six invoices are evidence that appellant's reported taxable sales were understated. Each of these is a sufficient reason to question the reliability of appellant's reported taxable sales. (R&TC, § 6481.) Accordingly, we find that CDTFA was justified in questioning the reliability of appellant's reported taxable sales, and computing appellant's taxable sales usingthe markup method.

In computing appellant's taxable sales, CDTFA accepted appellant's 32 percent markup, and applied it to all of appellant's taxable merchandise purchases based on reports obtained from all of appellant's known vendors. Thus, we conclude that CDTFA has established that its determination is reasonable and based on the best-available evidence, and accordingly the burden shifts to appellant to provide evidence from which a more accurate determination may be made.

On appeal, appellant asserts that certain invoices missing from September 2014 were paid in October 2014, and recorded on a cash basis in 2014. Appellant thus asserts that her purchase records and reported sales should be accepted as accurate.

In the case at hand, appellant has neither established that CDTFA's determination is erroneous, nor has appellant provided evidence from which a more accurate determination could be made. For example, appellant has neither provided her accounts payable balances, nor any other records to show that the additional taxable merchandise purchases determined in the audit were actually due to the timing differences in recognizing the merchandise purchases in her books. Absent evidence from appellant from which a more accurate determination of tax can be made, we conclude that appellant has failed to meet her burden of establishing that reductions to the audit liability are warranted.

HOLDING

Appellant failed to establish that reductions to the liability are warranted.

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

DISPOSITION

We sustain CDTFA's action in full.

DocuSigned by:
Jeff Angeja
0D390BC3CCB14A9...

Jeffrey G. Angeja
Administrative Law Judge

I concur:

DocuSigned by:
Alberto Rosas
2281E8D466014D1...

Alberto T. Rosas
Administrative Law Judge

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

CONCURRENCE

A. KWEE, Administrative Law Judge: I concur with the majority's conclusion. In reaching that conclusion, the majority proposes to establish a new two-prong test that the California Department of Tax and Fee Administration (CDTFA) must meet in order to establish a prima facie case. The majority would apply this new test to sales and use tax cases, in lieu of applying the established precedent from franchise and income tax cases for the same issue. This new test is based, in part, on the majority's interpretation of a federal tax case: *Schuman Aviation Co. Ltd. v. U.S.* (2011) 816 F.Supp.2d 941, 950.) *Schuman Aviation* sets forth a different test than the one proposed by the majority.[1]

I do not believe that the term "prima facie" requires any new clarifications or added complexities in the context of sales and use tax cases.[2] I further do not believe that it is necessary to apply a different standard for sales and use tax cases than the standard currently applied for income tax cases. As indicated in the income tax cases cited by *Schuman Aviation,* state and federal tax cases, and precedential opinions of the State Board of Equalization, there is already well-established precedent on this matter. Where an assessment is proposed based on unreported income, the taxing agency generally has the initial burden to show why its tax assessment is reasonable and rational.[3] (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Michael E. Myers* (2001-SBE-001) 2019 WL 1187160.) Federal courts have held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported

[1] *Schuman Aviation* sets forth the rule applied in state and federal income tax cases: "The Government bears the initial burden of proving that federal taxes are owed. See *Palmer v. IRS*, 116 F.3d 1309, 1312 (9th Cir.1997). '[D]eficiency determinations and assessments for unpaid taxes are normally entitled to a presumption of correctness so long as they are supported by a minimal factual foundation.' [Citation omitted.] Generally, introducing a Certificate of Assessment [(i.e., a copy of the assessment of tax due)] establishes a prima facie case that the tax and the imposition of additions to the tax are correct. [Citation omitted.] Unless the assessment is 'without rational foundation or is arbitrary,' the burden shifts to the taxpayer to show that the determination is incorrect."

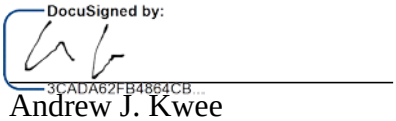
[2] For the meaning of prima facie, generally: "Prima Facie. A Latin term meaning 'at first sight' or 'at first look.' This refers to the standard of proof under which the party with the burden of proof need only present enough evidence to create a rebuttable presumption that the matter asserted is true. A prima facie standard of proof is relatively low. It is far less demanding than the preponderance of the evidence, clear and convincing evidence, and beyond a reasonable doubt standards that are also commonly used." < https://www.westlaw.com/2-518-8779?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0 >

[3] The threshold for meeting this burden is only that of "by a minimal factual foundation." (*Schuman Aviation Co. Ltd, supra,* 816 F.Supp.2d at 950; *Palmer v. IRS, supra*, 116 F.3d 1309; see *U.S. v. Stonehill* (9th Cir. 1983) 702 F.2d 1288.)

DocuSign Envelope ID: 88C223F9-BF66-4597-A86C-C4E3604A2B8C

income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) Once the taxing agency has met this initial burden, the tax determination is presumed correct and the taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan*, *supra*; *Appeal of Michael E. Myers*, *supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.) A taxpayer's failure to produce evidence that is within the taxpayer's control gives rise to a presumption that such evidence is unfavorable to the taxpayer's case. (*Appeal of Don A. Cookston* (83-SBE-048) 1983 WL 15434.) I would conclude that the well-established income tax precedent summarized above applies equally to sales and use tax cases. Therefore, I disagree that any new tests are required, and with the majority's new two-prong test.

Here, CDTFA provided a copy of the Decision (the Decision included no exhibits), its determination, and the audit working papers. The audit working papers provided a reasonable and rational basis for computing the unreported taxable sales. As such, appellant had the burden to establish error in the determination. For the reasons set forth in the majority opinion, appellant failed to establish that the determination was incorrect. Therefore, I concur with the conclusion of the majority.

DocuSigned by:

3CADA62FB4864CB...

Andrew J. Kwee
Administrative Law Judge