

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
PHI PHUONG QUACH,) OTA NO. 18083655
)
APPELLANT.)
)
)

TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Wednesday, August 21, 2019

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

BEFORE THE OFFICE OF TAX APPEALS

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Transcript of Proceedings, taken at
355 South Grand Avenue, South Tower, 23rd Floor,
Los Angeles, California, 91401,
commencing at 11:43 a.m. and concluding
at 12:07 p.m. on Wednesday, August 21, 2019,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

APPEARANCES:

Panel Lead: Hon. DANIEL CHO

Panel Members: Hon. NGUYEN DANG
Hon. RICHARD TAY

For the Appellant: HOANG H. NGUYEN

For the Respondent: DEPARTMENT OF TAX AND
FEE ADMINISTRATION
By: SCOTT LAMBERT
LISA RENATI
DANA FLANAGAN-MCBETH

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I N D E X

OPENING STATEMENT

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E X H I B I T S

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CLOSING STATEMENT

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1 Los Angeles, California; Wednesday, August 21, 2019

2 9:00 a.m.

3

4 ADMINISTRATIVE LAW JUDGE CHO: Let's go on the
5 record.

6 This is the appeal of Phi Phuong Quach,
7 OTA Case No. 18083655. Today is August 21st, 2019. The
8 time is approximately 11:43 a.m. We're holding this
9 hearing in Los Angeles, California.

10 My name is Daniel Cho. I'll be the lead
11 Administrative Law Judge for this appeal. With me are
12 Administrative Law Judges Nguyen Dang and Richard Tay.

13 Can the parties please introduce and identify
14 yourselves for the record, beginning with Appellant.

15 MR. NGUYEN: My name is Hoang Nguyen, and I'm the
16 representative for Appellant Phi Phuong Quach.

17 ADMINISTRATIVE LAW JUDGE CHO: Thank you.

18 MR. NGUYEN: Phi Phuong Quach is not here today
19 because he -- he is fully employed, therefore, he cannot
20 go. And his mom is sick because the weather change. And
21 then I was waiting for her this morning to arrive, but
22 they call and said she was too sick to attend the hearing.
23 So I go on their behalf today.

24 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you
25 very much.

1 Department?

2 MR. LAMBERT: My name is Scott Lambert. To my
3 left is Lisa Renati, and Ms. Renati's left is Dana
4 Flanagan-McBeth.

5 ADMINISTRATIVE LAW JUDGE CHO: Thank you. This
6 issue in this appeal is whether adjustments are warranted
7 to the determined measure of tax.

8 With respect to the evidentiary record, the
9 Department has provided Exhibits A through N. There are
10 no objections. Therefore, these exhibits are entered into
11 the record.

12 (Department's Exhibits A-N were
13 received in evidence by the
14 Administrative Law Judge.)

15 ADMINISTRATIVE LAW JUDGE CHO: Appellant has not
16 submitted any exhibits but will just rely on the briefs
17 that they provided previously. Mr. Nguyen, as we
18 discussed at the prehearing conference, you'll have 15
19 minutes for your presentation. The Department will have
20 15 minutes, then a rebuttal.

21 MR. NGUYEN: Okay.

22 ADMINISTRATIVE LAW JUDGE CHO: So whenever you're
23 ready, please begin.

24 MR. NGUYEN: Yes, Your Honor.

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OPENING STATEMENT

MR. NGUYEN: The noodle -- the Hello Noodle House is open because of -- the whole family was unemployed at that time. The father, mother, and the Appellant Phi Quach is also at home along with his siblings, and they decided to try the restaurant business as a small restaurant business to see if they have any luck and new life.

The restaurant is not doing well. Therefore, they have to close the, you know, in the first three years of operations. And the -- during those years, Phi Quach also had to take out a loan on the second mortgage on the house to pay for the expenses. And I was not the one who prepare the taxes for all those years. They only ask me to help them with the, you know, presentation today.

And the person that I talked to when the -- the tax preparer said that they have 1099K, which is the report of sales -- I'm sorry -- of credit card sales along with the amount of cash, which the Appellant received during those years. The explanation is that since this is a type of Boba drinks business, it's not really a sit-down restaurant. Therefore, not too many customers even though they have, you know, a seating area for four or five or, I guess, four or seven tables, I believe.

And they also said things -- it's -- the

1 restaurant is in the area where they have the schools -- a
2 lot of schools and, therefore, the kids use a lot of
3 credit card when they make the purchase. And I can
4 understand that because nowadays, everybody using credit
5 card versus carrying cash. Especially the kids because
6 those kids who go to school. They are subject to bullying
7 and extortions as well.

8 And also when the Department said that they
9 have -- the markup is very high, I agree with the
10 Department that the markup is very high because drinks are
11 just water and sugar. And also, they sell noodles, and
12 the noodles consist mainly of flour and soup. So,
13 therefore, the markup is high. And also, the cost of
14 labor is virtually nothing because all -- everybody --
15 members in the family customarily into the operations of
16 the business. Therefore, they could sustain more than the
17 first year in business.

18 And I would like to say that this disagree with
19 the Department when they using the -- what do they call
20 it? They call it the credit card sales. I don't know
21 whether that position has been ongoing for long, long
22 time, or they just been revise lately. But, actually, the
23 amount of credit card versus cash on this -- on this case
24 here, according to the Appellant's tax return, should be
25 considered correct.

1 And therefore, I would like to do -- the panel to
2 decide for the Appellant on his -- his findings. That be
3 all, sir.

4 ADMINISTRATIVE LAW JUDGE CHO: Thank you very
5 much.

6 Department when you're ready.

7 MR. LAMBERT: Thank you.

8

9 OPENING STATEMENT

10 MR. LAMBERT: In this particular case the
11 taxpayer operates a restaurant, and the audit was for the
12 years 2012 through 2014. The Appellant reports on a
13 quarterly basis. Upon audit, the Appellant had limited
14 records, which basically consisted of income tax returns
15 and some QuickBook -- QuickBooks reports of sales. There
16 were no sales journals. There were no purchase journals.
17 There were no purchase invoices that were provided. There
18 were no guest checks.

19 So, essentially, the audit could not be conducted
20 using a direct method. An alternative method needed to be
21 used in this case. It is true that the markup on the
22 income tax returns is somewhat high in some years and
23 somewhat low in other years. What we found by polling one
24 of the venders that we knew of, which was Restaurant Depo
25 for the year 2012, we found that there were over \$10,000

1 in purchases during that year. Although, the Appellant
2 only reported or claimed \$6,700 of purchases on their
3 income tax returns.

4 So there was a disparity between the cost of
5 goods sold on 2012 income returns and the figures that we
6 were able to obtain from just one supplier. So the --
7 essentially, the method that we use is a credit card
8 method, which is an established method for establishing
9 the audit liability. What we found by looking at the
10 1099K, which is a summary of the credit card receipts for
11 a given period of time which is generally a year, we were
12 able to obtain the credit card receipts from those
13 reports.

14 We subtracted 10 percent for -- for tips, and
15 then subtracted the sales tax out of that amount to come
16 up with what the credit card receipts were for that given
17 year. And I believe it was a little over \$120,000. For
18 the audit period, the Appellant had reported \$141,000 in
19 taxable sales. So, essentially, that comes down to a
20 reported credit card percentage of 86 percent and only a
21 cash amount -- reported cash amount of 14 percent. That
22 is substantially below what we expect to see for this type
23 of business, which is a small restaurant.

24 So we took the credit card receipts that were
25 without tips and sales tax and divided that by 45 percent,

1 which is what we would expect to see from this type of
2 business as a credit card receipts, and we came up with
3 \$270,000 in taxable sales. We subtracted that from what
4 was reported, which was \$141,000, and we came up with a
5 difference of \$129,000.

6 I should also point out on the purchases, when
7 they had purchased from Restaurant Depo, what we found
8 from 2012 is that 71 percent of the purchases from
9 Restaurant Depo for 2012 were paid with cash. So if we
10 look at the reasonableness of what was reported, it was
11 \$141.00 a day in taxable sales. The Appellant is open --
12 we estimated 10 hours a day. But if you do look at their
13 menu on 74 of our exhibits, it shows it's open 11 hours.
14 But, nevertheless, if you take 10 hours a day, it works
15 out to sales of \$14 an hour, which is essentially 2 meals
16 an hour.

17 Our amount that we came up with is \$270 for a
18 day, which still only works out to \$27 an hour. So it's
19 very reasonable. We also conducted five other types of
20 estimates based on the information that we had. And the
21 calculation using the credit card method, actually, came
22 up with the lowest estimated taxable sales. So with that,
23 the Department believes that the figures that we arrived
24 at are the best estimate of what the tax liability is,
25 based on the lack of records that were provided, and the

1 information that's available to us.

2 And that concludes our presentation.

3 ADMINISTRATIVE LAW JUDGE CHO: Thank you very
4 much. Right now I'm going to open it up to questions from
5 the panel.

6 Judge Dang, do you have any questions?

7 ADMINISTRATIVE LAW JUDGE DANG: I just have one
8 question. I was wondering if you could explain to me how
9 the 45 percent credit card ratio was computed, or how it
10 was determined?

11 MR. LAMBERT: Yes. How that was -- how that was
12 arrived at was from a review of other similar businesses
13 in the area and what we have found their credit card
14 percentage to be. And that's the -- it came to around
15 45 percent. I would point out it really depends on the
16 type of business and where they're located as to the
17 credit card percentage. There could be a range from that
18 percentage. Generally, your more nicer -- well, I should
19 say more expensive restaurants, generally, have a higher
20 credit card percentage.

21 So the larger the bill, generally, less people
22 pay with cash. The more of a fast-food type of
23 restaurant, you know, people come in to take it out.
24 It's -- it's generally more towards the cash end of the
25 business.

1 ADMINISTRATIVE LAW JUDGE DANG: Is there any
2 evidence in the record that would support what you've just
3 said, that we could look through these details to confirm
4 with ourselves?

5 MR. LAMBERT: Right. Part of the problem with
6 that is confidentiality runs into it. And the fact of us
7 providing information regarding other taxpayers is not
8 been something we have done in the past. And, although,
9 we can provide you with that information. We -- we do
10 have it, but because of the confidentiality, we
11 generally -- we don't provide that information.

12 ADMINISTRATIVE LAW JUDGE DANG: Okay. Thank you.
13 One final question. As far as the 45 percent figure, is
14 that on the higher or the lower end of the spectrum of the
15 range you had mentioned for businesses of this type?

16 MR. LAMBERT: Business of this type, I would say
17 it's in the middle of the businesses of this type. But as
18 far as, like, an expensive restaurant, you can get up into
19 the 90s percent. And you can have other ones that are
20 down in the teens, depending on the type of business.

21 So for this type of business, I would expect this
22 to be somewhat average for that type of business. There
23 can be higher. There could be lower. But, you know, at
24 this point, we're going to pick the middle because that's
25 what we would -- we're estimating. But using our other

1 five estimates, this is the lowest of the other five.
2 Although, I would point out, we use whatever information
3 that we had available for those other five.

4 So most of the time we would not use those other
5 five to establish the liability. But, unfortunately,
6 because the business was closed out at the time that we
7 conducted the audit, we could not go in and conduct our
8 own observation. Which we would do, if they were still
9 operating. So we weren't able to do that. And then we
10 weren't able to use their records to establish it because
11 they did not maintain the proper amount of records.

12 ADMINISTRATIVE LAW JUDGE DANG: Okay. Thank you
13 so much.

14 ADMINISTRATIVE LAW JUDGE CHO: Judge Tay, do you
15 have any questions?

16 ADMINISTRATIVE LAW JUDGE TAY: Just one question.
17 Can you respond to what the Appellant has to -- or maybe
18 the difference that the Appellant pointed to, between
19 sales of soup noodles versus cold drinks, that might have
20 been purchased and then brought out to take it to go?

21 MR. LAMBERT: In terms of the markup?

22 ADMINISTRATIVE LAW JUDGE TAY: In terms of, I
23 guess, for sales tax purposes.

24 MR. LAMBERT: Okay. Well, all the sales in this
25 particular business are considered taxable. They would

1 fall under the 80-80 Rule. And generally, most of the
2 drinks are, whether it is 80-80 Rule or not, would be
3 subject to tax, and that they're carbonated.

4 If you had food purchases, they were actually
5 cold, and they were to go. They were not consumed there,
6 and you kept record of that, then you would be entitled to
7 a deduction for that. Otherwise, they're considered to be
8 taxable. There are differences in markups, you know,
9 because of the noodles there's generally a higher markup.
10 Unfortunately, in this particular case, we can't rely upon
11 the markup because we don't believe we have all the
12 purchases.

13 And I would also point out that even if we did
14 have all the purchases, it's very difficult in this type
15 of business to establish a markup. It can be done, but a
16 lot of times what we find is the credit card percentage is
17 generally more accurate than a markup. But we would use
18 whatever information is available to us in order to
19 establish the liability.

20 ADMINISTRATIVE LAW JUDGE TAY: Okay. Thank you.

21 ADMINISTRATIVE LAW JUDGE CHO: I just had a
22 couple of quick questions about the exhibits. For the
23 January 1st, 2014, sales receipt, I believe that's
24 Exhibit B, as in boy, is this something that the taxpayer
25 provided?

1 MR. LAMBERT: Yes.

2 ADMINISTRATIVE LAW JUDGE CHO: Okay. Then

3 Mr. Nguyen, do you mind if I ask you a question? So it

4 says the total for that day is \$59.65; is that correct?

5 MR. NGUYEN: Yes, sir.

6 ADMINISTRATIVE LAW JUDGE CHO: Do you know why

7 there's a big -- a negative \$287.08 on that page 3? I

8 don't have a real description. It's right after "Tips

9 Paid Out."

10 MR. NGUYEN: The differences is I -- because I

11 wasn't the one who prepared the return -- the sales tax

12 return, therefore, I don't know.

13 ADMINISTRATIVE LAW JUDGE CHO: Okay.

14 MR. NGUYEN: To be truthful I don't know.

15 ADMINISTRATIVE LAW JUDGE CHO: Okay. Okay. Then

16 another quick question for the Department. In your

17 alternative approach, No. 4, you have -- you did an

18 estimate based on taxable sales reported by similar

19 business in the same city and same street. I believe you

20 just estimated based off of two quarters.

21 MR. LAMBERT: Right. So it would be a similar

22 business nearby. And what that, essentially, shows is

23 that -- and if you're looking at page -- well, I was

24 looking at page 75. But on 103 -- well, actually, I refer

25 you to exhibit page 75. It has all of the different

1 exhibits on that one. And the amount, which is Option 4
2 that you're referring to, was an estimated taxable sales
3 of \$25,000, and our estimate came up with \$24,561.

4 So it's relatively close, but we're gonna use our
5 figure for that because it is based on the 1099, and it's
6 not based on another taxpayer. If we didn't have the 1099
7 information, we may have used the \$25,000 as a business
8 that's similar to this particular one.

9 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you
10 for the explanation.

11 Those are the questions that I have. Panel
12 members, do you have any other questions? Judge Dang?

13 ADMINISTRATIVE LAW JUDGE DANG: No further
14 questions. Thank you.

15 ADMINISTRATIVE LAW JUDGE CHO: Judge Tay?

16 ADMINISTRATIVE LAW JUDGE TAY: Nothing further.

17 ADMINISTRATIVE LAW JUDGE CHO: All right.

18 Mr. Nguyen, you'll have five minutes on rebuttal.

19

20 CLOSING STATEMENT

21 MR. NGUYEN: I would request the Department to
22 qualify when the Department refer to similar business in
23 the area, what kind of business is that? Is that the same
24 noodle house, Boba-drinks type, or it's -- what kind?

25 ADMINISTRATIVE LAW JUDGE CHO: Mr. Nguyen, this

1 is actually, technically your rebuttal. So you can tell
2 us whatever you feel.

3 MR. NGUYEN: Oh, what I feel is because the
4 location of the restaurant is in the wrong location, I
5 have to say that, because a noodle house in the middle of
6 the Hispanic location is wrong. Therefore, I say that
7 he -- they do not doing well selling in sales of food.
8 But probably they do a little bit better with selling
9 drinks, Boba drinks. And that -- that's it.

10 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you
11 very much.

12 Thank you very much for everyone's time. This
13 concludes this hearing. The panel will meet and decide
14 the case based on everything presented today. This case
15 is submitted, and the record is now closed.

16 (Proceedings adjourned at 12:07 p.m.)
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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for
the State of California, do hereby certify:

That the foregoing transcript of proceedings was
taken before me at the time and place set forth, that the
testimony and proceedings were reported stenographically
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foregoing is a true record of the testimony and
proceedings taken at that time.

I further certify that I am in no way interested
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I have hereunto subscribed my name this 19th day
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ERNALYN M. ALONZO
HEARING REPORTER