

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
ROLANDO GARCIA
SR AP 53-008507

) OTA Case No. 18011968
) CDTFA Account No. SR AP 53-008507
) CDTFA Case ID: 586817
)
) Date Issued: October 21, 2019
)

OPINION

Representing the Parties:

For Appellant: Timothy P. Creyaufmiller, Attorney
For Respondent: Joshua Aldrich, Tax Counsel
Scott Claremon, Tax Counsel IV
Lisa Renati, Hearing Representative

N. DANG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Rolando Garcia (appellant) appeals a decision by respondent California Department of Tax and Fee Administration (CDTFA) on a timely petition for redetermination of a Notice of Determination (NOD) for the period July 14, 2006, through December 31, 2007.¹

Office of Tax Appeals Administrative Law Judges Nguyen Dang, Andrew J. Kwee, and Douglas Bramhall, held an oral hearing for this matter in Los Angeles, California, on August 20, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether appellant is personally liable for a portion of Caribbean BBQ Islands, Inc.’s (Caribbean’s) unpaid tax liability for the period July 14, 2006, through September 30, 2007, pursuant to R&TC section 6829.

¹ Prior to July 1, 2017, CDTFA’s sales and use tax functions were administered by the State Board of Equalization (SBE). (See Gov. Code §15570.22.) Therefore, for ease of reference, when referring to acts or events that occurred prior to July 1, 2017, “CDTFA” shall refer to SBE.

FACTUAL FINDINGS

Caribbean's Business

1. Caribbean was a California corporation that operated from July 14, 2006, through December 31, 2007, as a manufacturer and retailer of custom barbeque islands holding a seller's permit with CDTFA.
2. The following individuals were involved in Caribbean: (1) Appellant's spouse, who was its sole shareholder and president; (2) appellant, who was its chief financial officer; (3) Peter Tariche, who was its vice president; and (4) Raymond Simpson, who was its business manager.
3. Appellant and appellant's spouse were the only individuals listed on Caribbean's bank account.
4. Appellant's signature is the only one that appears on Caribbean's sales and use tax returns for the liability period.

Embezzlement by Caribbean Employees

5. In August 2007, appellant was contacted by an employee of Caribbean who informed appellant that a customer had called regarding servicing of a fire pit which had been purchased from Caribbean. The employee found this to be suspicious, because Caribbean's records indicated that no fire pit had been sold to the customer. Appellant followed up with the customer and discovered that the customer had been issued a different sales invoice from Caribbean for the fire pit, and was instructed by Mr. Tariche to issue payment for the sale to a company that he owned.
6. Appellant then contacted several other customers of Caribbean, and discovered that they too had purchased items from Caribbean which were not recorded on any sales invoices, or for which the actual sales price was significantly higher than what was noted in Caribbean's sales records, and that payment for those items were likewise made to Mr. Tariche's company.
7. Appellant also reviewed checks issued by Caribbean and found that many were fraudulent and had been issued either for sales which did not exist or were duplicate checks issued for sales where commission had already been paid.
8. Based on this information, appellant concluded that several Caribbean employees,

including Mr. Tariche and Mr. Simpson, had embezzled roughly \$200,000 from the business.

9. Appellant terminated Mr. Tariche's and Mr. Simpson's employment with Caribbean.
10. In reviewing Mr. Simpson's claim for unemployment benefits, the California Employment Development Department (EDD) issued an Obstructed Claim Report dated October 31, 2007, finding that Mr. Simpson was responsible for Caribbean's daily operations and that his duties included, among other things, handling Caribbean's finances and tax compliance.

CDTFA's Audit

11. Upon the termination of Caribbean's business operations, CDTFA performed a close-out audit of Caribbean for the period July 14, 2006, through December 31, 2007, in which CDTFA found an aggregate deficiency measure of \$1,913,467 consisting of unreported taxable sales of \$1,908,025 and taxable transportation charges of \$5,442.
12. CDTFA determined the measure for unreported taxable sales by first computing an 86.23 percent taxable ratio based on an examination of 155 sales invoices provided by Caribbean. Next, CDTFA applied the taxable ratio to Caribbean's sales-related deposits of \$2,240,405, resulting in audited taxable sales of \$1,931,940. Comparing audited taxable sales to reported taxable sales of \$23,915 for the audit period, CDTFA determined that Caribbean had underreported its taxable sales by \$1,908,025.
13. On October 22, 2009, CDTFA issued an NOD to Caribbean for the audit liability, which included a 10-percent penalty for negligence. Caribbean did not pay or petition the NOD, and it became final. CDTFA then added to the liability an additional 10-percent penalty in accordance with R&TC section 6565 (finality penalty) for failure to pay the NOD when it became final.

Procedural History

14. Due to the closure of the business, CDTFA investigated the individuals involved in Caribbean to determine whether they could be held personally liable for Caribbean's unpaid tax liability pursuant to R&TC section 6829.
15. CDTFA determined that appellant was one such individual, and on July 25, 2011, issued an NOD to appellant for the unpaid tax liability of Caribbean, less those amounts for

- which Caribbean had not collected tax reimbursement. The penalties incurred by Caribbean and included in the NOD issued to appellant were also prorated accordingly.
16. Appellant's liability was further reduced based on CDTFA's determination that the measure for unreported taxable sales as initially determined, had inadvertently included disallowed claimed exempt sales for which Caribbean had not collected tax reimbursement.
 17. Appellant petitioned the NOD. In response, CDTFA's appeals bureau issued a decision relieving Caribbean of the finality penalty (subject to conditions), but otherwise finding that appellant's petition should be denied.
 18. Appellant filed this timely appeal with OTA, during which CDTFA further concedes that appellant is not personally liable for Caribbean's fourth quarter 2007 (4Q07) tax liability.

DISCUSSION

R&TC section 6829(a) provides that upon the termination, dissolution, or abandonment of the business of a corporation, any person having control or supervision of, or who was charged with the responsibility for the filing of returns or the payment of tax, or who was under a duty to act for the corporation in complying with any requirement of the Sales and Use Tax Law, is personally liable for the corporation's unpaid tax, interest, and penalties if the person willfully failed to pay, or cause to be paid, any taxes due from the corporation. (See also Cal. Code Regs., tit. 18, § 1702.5(a).)

The term "willfully fails to pay or to cause to be paid" means that the failure was the result of a voluntary, conscious, and intentional course of action. (Cal. Code Regs., tit. 18, § 1702.5(b)(2).) A person has willfully failed to pay the taxes, or to cause them to be paid, only where CDTFA establishes all of the following: (1) on or after the date that the taxes became due, the responsible person had actual knowledge that the taxes were due, but not being paid; (2) the responsible person had the authority to pay the taxes or to cause them to be paid on the date the taxes became due and when the responsible person had actual knowledge that the taxes were due but not being paid; and (3) when the responsible person had actual knowledge that the taxes were due but not being paid, the responsible person had the ability to pay the taxes but chose not to do so. (Cal. Code Regs., tit. 18, § 1702.5(b)(2)(A)-(C).)

CDTFA must prove, by a preponderance of the evidence, that appellant willfully failed to pay or cause to be paid, Caribbean's tax liabilities. (Cal. Code Regs., tit. 18, § 1702.5(d).)

The primary issue in this appeal is whether appellant had actual knowledge of Caribbean's unreported taxable sales during the requisite time period. While there is no direct evidence that appellant possessed such knowledge, CDTFA contends that it may be reasonably inferred from the following evidence: Caribbean's sales of tangible personal property were predominantly taxable; there was a substantial discrepancy between Caribbean's reported taxable sales and its sales-related deposits; appellant's signature appears on all of Caribbean's returns for the liability period; appellant and appellant's spouse were the only individuals listed on Caribbean's bank account; and appellant acknowledged that appellant performed an in-depth review of Caribbean's sales records. Under these circumstances, we would ordinarily find it difficult to believe that appellant was unaware of Caribbean's unreported taxable sales.

However, appellant offers a plausible explanation for why, despite this evidence, appellant was unaware of Caribbean's underreporting. Appellant testified that at the time he had limited English literacy and no experience operating a business selling tangible personal property, and that due to these limitations and appellant's preoccupation with operating appellant's trucking business, appellant relied entirely on Mr. Tariche and Mr. Simpson to operate Caribbean and handle its sales and use tax matters.

Appellant's testimony in this regard is consistent with the statements made by Mr. Simpson and appellant many months prior to the start of CDTFA's audit of Caribbean, and years prior to the issuance of CDTFA's June 22, 2011 "Dual Memorandum." As summarized in an EDD Obstructed Claim Report dated October 31, 2007, Mr. Simpson stated that he worked as a business manager for appellant, and that Mr. Simpson's "duties as a business manager were many." Mr. Simpson "assisted [appellant] in legal, human resource, finance, **tax reports**, customers' resolutions, sales, hiring new employees, in addition to filing payroll reports with IRS and EDD and other tax agencies" (Emphasis added.) This report also states that "[appellant] acknowledged [Mr. Simpson] as his business manager who basically ran business [sic] for him with another individual Peter Tarchie [sic] Jr. who is listed as a corporate officer. [Appellant] added that [Mr. Simpson] was brought in to help in the sales department however and due [sic] to his other business, [appellant] had to rely on [Mr. Simpson's] services to run the whole business." We find these statements, based on the timing and context in which they were made (i.e., an unrelated matter concerning Mr. Simpson's employment at Caribbean that occurred well

before any sales tax issues arose), to be highly persuasive evidence that appellant was unaware of Caribbean's underreporting.

Appellant also testified that appellant trusted Mr. Tariche and Mr. Simpson implicitly, and signed Caribbean's checks, which were presented to appellant by those individuals, without scrutinizing them. While it is hard to imagine that a corporate officer would blindly sign checks, the record supports that appellant did just that. Appellant signed numerous commission checks for sales that never took place and for sales where commission had already been paid. This tends to show that appellant lacked any substantive working knowledge of Caribbean's sales.

The record also shows that Mr. Tariche deposited numerous checks issued to Caribbean into accounts which he alone controlled, and that he altered Caribbean's sales invoices to conceal the theft from appellant. Appellant estimates the total theft by Mr. Tariche and other individuals to be \$200,000. The apparent ease with which Mr. Tariche and others were able to embezzle large amounts of money from Caribbean, raises further doubt as to appellant's knowledge of Caribbean's sales.

Further, we are not persuaded that appellant's review of Caribbean's sales records, under these circumstances, would have alerted appellant to Caribbean's underreporting during the requisite time frame. Plainly, appellant's purpose in reviewing Caribbean's sales records at the time was to identify suspicious transactions and not to perform a sales tax reconciliation. In fact, appellant was not informed of any issues with Caribbean's reporting until CDTFA initiated its audit many months later, and there is no evidence indicating that appellant reviewed any documents prior to this time, such as a tax accrual report, which would have directly alerted appellant to Caribbean's underreporting.


Based on all the foregoing, we find that Mr. Tariche and Mr. Simpson operated Caribbean with little to no oversight by appellant, such that appellant was likely unaware of the extent of Caribbean's taxable sales. Accordingly, we conclude that CDTFA has not met its burden of establishing that appellant had actual knowledge of Caribbean's underreporting.

HOLDING


Appellant is not personally liable for Caribbean BBQ Islands, Inc.'s unpaid tax liability for the period July 14, 2006, through September 30, 2007.

DISPOSITION

Appellant's petition is granted in full.

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Nguyen Dang
Administrative Law Judge

I concur:

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Douglas Bramhall
Administrative Law Judge

A. KWEE, concurring:

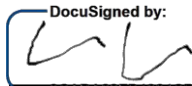
The California Department of Tax and Fee Administration (CDTFA) bears the burden of establishing responsible person liability by a preponderance of the evidence. (Cal. Code Regs, tit. 18, § 1702.5(d).) Here, CDTFA is correct in emphasizing that there are inconsistencies in appellant's testimony. For example, appellant conceded on several occasions that he signed all the sales and use tax returns up until the day of the oral hearing. At the hearing, appellant testified and alleged for the first time that his signature on all the returns in the record, except for one, were forged. Additionally, at the hearing appellant testified that only he and his wife had access to the corporate bank account, but later, in response to questioning, he testified that other people had authority to manage the corporate funds to ensure that the checks did not bounce. Although appellant initially admitted to CDTFA that sales tax reimbursement was collected, he later contended that sales tax reimbursement was not collected. There were also conflicting statements as to when and how appellant discovered the embezzlement. Admittedly, some of the inconsistencies may reasonably be explained as a natural loss of recollection considering the amount of time that has passed: over 10 years. Nevertheless, these inconsistencies are, to some extent, a red herring because they do not directly resolve the heart of the dispute: whether appellant willfully failed to pay or cause the corporation to pay its sales and use taxes.

On the issue of willfulness, appellant provided evidence that he was an absentee owner and a victim of a criminal conspiracy to embezzle funds from the corporation. Further, despite the inconsistencies in his testimony, I believe it clear, and nobody disputes, that appellant and his wife, as the owners of the corporation, were the ultimate victims of such a financial crime. Thus, for example, it may reasonably be concluded based on the evidence that appellant had no knowledge that the employees who oversaw the day-to-day operations of his corporation were embezzling hundreds of thousands of dollars from his business. This, in conjunction with appellant's alleged inability to read or speak English at the time of the crime, may reasonably support a factual finding that appellant had no knowledge that the employees responsible for running the corporation were also causing appellant's corporation to underpay its sales and use taxes to the state. Of course, an alternative finding that one might conclude (which would support a finding of willfulness) is that appellant, in conjunction with the embezzlers, knowingly underpaid the state sales and use taxes, that his signatures on the tax returns were not forged (he did, after all, admit to signing one return and knew that returns were required to be filed), and

that appellant was merely the victim in the additional element of embezzlement. In summary, there are many conclusions that one may reasonably draw from the limited evidence available to substantiate willfulness. I do not agree with the majority that there is “highly persuasive evidence” of any such conclusion. I also do not believe that it is legally necessary to determine whether appellant persuasively established lack of willfulness. (Cal. Code Regs., tit. 18, § 1702.5(d) [placing the burden of proof on CDTFA, not appellant].) As such, I do not concur in the analysis of the majority opinion.

In summary, based on the various arguments for and against willfulness that one might draw from the available evidence, which I believe approximate a finding close to equal weight for and against willfulness, I do not believe that CDTFA has offered sufficient evidence to conclude that, *more likely than not*, appellant knew the corporation failed to pay its taxes and chose not to cause those taxes to be paid. In reaching in this conclusion, I do *not* absolve appellant. In other words, I do not believe appellant persuasively established that he lacked knowledge of the underreporting or otherwise established that he lacked willfulness. Therefore, I do not agree with the majority that the evidence is “highly persuasive” that appellant lacked knowledge of the underreporting. I further do not believe such a finding is legally necessary for the conclusion. As such, I concur only in the outcome of the holding that CDTFA failed to establish that, more likely than not, appellant knew that the sales and use taxes were also not being paid as a part of the criminal conspiracy to which, and by all accounts, appellant was the victim.

I concur in the outcome to grant the petition under the highly unusual facts of this case. I would emphasize that this was by no means a clear and easy decision to reach. Furthermore, considering the unique nature of this appeal and circumstances involved, I would further emphasize that the factual analysis and legal conclusions of this case should not be relied upon in any other cases.

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Andrew J. Kwee
Administrative Law Judge