

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

**PARTNERSHIP OF ZULFIQAR
QAMRUDDIN BAWANI, et al.
dba Valley Wide Distribution**

) OTA Case No. 18053151
) CDTFA Case No. 487723
) CDTFA Acct. No. CP STF 050-005036
) Date Issued: May 6, 2019
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)
)

OPINION

Representing the Parties:

For Appellant:

Harry Swartz

For Respondent:

Joshua Aldrich, Tax Counsel
Stephen Smith, Tax Counsel IV
Shelley Anselmi, Business Taxes Specialist II

N. DANG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 30261, the Partnership of Zulfiqar Qamruddin Bawani et al., dba Valley Wide Distribution (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),¹ on a timely petition for reconsideration of a Notice of Determination (NOD) for the period February 1, 2006, through May 31, 2007.

Office of Tax Appeals (OTA) Administrative Law Judges Nguyen Dang, Jeffrey Angeja, and Linda Cheng, held an oral hearing for this matter in Fresno, California, on February 28, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

¹ The Cigarette and Tobacco Products Tax Law was formerly administered by the State Board of Equalization (SBE). On July 1, 2017, the functions of the SBE 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 July 1, 2017, “CDTFA” shall refer to the SBE.

ISSUES²

1. Whether appellant has established that adjustments are warranted to the measure for unreported taxable distributions of tobacco products of \$821,731.
2. Whether CDTFA has shown by clear and convincing evidence that all or part of the deficiency was due to fraud or the intent to evade the payment of tax.

FACTUAL FINDINGS

Appellant and its Partners

1. Zulfiqar Qamruddin Bawani, Shaukat Maredia, and Harry Swartz formed a partnership to operate Valley Wide Distribution, a tobacco products distributor located in Bakersfield, California.
2. Prior to and during the liability period, appellant's partners also owned and operated the following cigarette/tobacco products related businesses, which are described below.
3. Mr. Bawani held a cigarette and tobacco products distributor's license with CDTFA for State Wide Distributors, effective June 7, 2004, through January 15, 2007, and a cigarette wholesaler's license for Taft Cigarette Palace, effective January 1, 2005, through July 30, 2005.
4. Mr. Maredia held a cigarette distributor's license with CDTFA for Cigarette King, effective November 1, 2000, through March 31, 2001, and a tobacco products distributor's license, effective February 1, 1999, through June 30, 2002. On January 8, 2003, Mr. Maredia pled guilty to one felony count of tax evasion pursuant to R&TC section 30480 (relating to cigarette and tobacco taxes), and this made him ineligible to hold any subsequent cigarette or tobacco product related licenses.
5. Mr. Swartz held a cigarette and tobacco products wholesaler's license with CDTFA for Discounts 4 U, effective November 1, 2003, through April 30, 2006. In addition, Mr. Swartz held a cigarette distributor's license for Central Valley Wholesale, effective

² At the oral hearing, appellant argued that, for many reasons, CDTFA's search warrant was invalid. However, we are without the authority to determine whether appellant is entitled to a remedy for CDTFA's actual or alleged violation of any substantive or procedural right, unless the violation affects the adequacy of the Notice of Determination or the amount at issue in the appeal. (Cal. Code Regs., tit. 18, § 30104(d).) Appellant's contention regarding the validity of CDTFA's search warrant has no bearing on either of these issues, and therefore we do not address this contention further.

October 16, 2007, through August 7, 2012, and a tobacco products distributor's license effective October 16, 2007, through December 31, 2012.

6. On or about October 3, 2003, CDTFA issued to Mr. Bawani, a sole proprietor dba Valley Wide Distribution, a tobacco products distributor's license (CP STF 050-003190). CDTFA later discovered that beginning February 1, 2006, Valley Wide Distribution was in fact operated by appellant. Consequently, a new license was created for appellant (under which the liability was established) and Valley Wide Distribution's previously filed returns for the liability period were transferred to that license.

CDTFA's Investigation of Appellant

7. In 2006, following an anonymous complaint that appellant was underreporting its taxable tobacco product distributions, CDTFA obtained tobacco products purchase records from three of appellant's out-of-state vendors (U.S. Smokeless Tobacco Brands, Inc., Altadis U.S.A., Inc., and Swisher International, Inc.). These records indicate that appellant purchased significantly more tobacco products than it had reported as taxable tobacco product distributions for the liability period. Based on this information, CDTFA determined that further investigation was warranted to determine if appellant had underreported its taxable tobacco product distributions.
8. On June 28, 2007, a search warrant was executed on appellant's business location, two nearby unlicensed locations at which appellant stored untaxed tobacco products, Mr. Bawani's personal residence, Mr. Maredia's personal residence, and the office of appellant's outside bookkeeper. CDTFA seized from these locations additional tobacco products purchase records, most of which contained a statement to the effect that no state tobacco tax had been paid, and that the customer (in this case appellant) was responsible for the tax. CDTFA also seized appellant's tobacco products and cigarette inventory.
9. CDTFA determined from appellant's tobacco products purchase records that it purchased untaxed tobacco products totaling \$5,641,677 for the liability period. CDTFA further determined that of this amount, \$719,345 had been sold in interstate commerce and \$209,366 was seized from appellant's licensed business location, and thus, had not been distributed. CDTFA found that the remaining \$4,712,966 (\$5,641,677 - \$719,345 - \$209,366) of appellant's tobacco products purchases for the liability period were distributed in this state, and thus, they were subject to California's excise tax on the

distribution of tobacco products. Comparing this amount to appellant's reported taxable tobacco products distributions of \$3,891,235 for the liability period, CDTFA determined that appellant underreported its taxable tobacco products distributions by \$821,731 (\$4,712,966 - \$3,891,235).

10. Based on the amount of the understatement and appellant's experience operating a tobacco products distribution business, CDTFA also determined that appellant's underreporting was due to fraud or an intent to evade the payment of tax.

Procedural History

11. On November 5, 2008, CDTFA issued to appellant an NOD for the period February 1, 2006, through May 31, 2007.
12. The NOD is based on a November 4, 2008 Field Billing Order (FBO), which asserted a deficiency measure of \$1,024,153 for unreported taxable distributions of tobacco products and a 25-percent fraud penalty of \$119,723.49. By adjusted FBO dated October 23, 2013, these items were subsequently reduced to \$821,731 and \$96,060.38, respectively.
13. Appellant filed a timely petition disputing the NOD. In response, CDTFA issued a decision denying appellant's petition. This timely appeal followed.

DISCUSSION

Issue 1 – Whether appellant has established that adjustments are warranted to the measure for unreported taxable distributions of tobacco products of \$821,731.

The Cigarette and Tobacco Products Law requires every person desiring to engage in the sale of tobacco products to apply with CDTFA for a distributor's license. (R&TC, § 30140.) A distributor shall apply for and obtain a license for each place of business at which it engages in the business of distributing tobacco products. (*Ibid.*) Every distributor shall pay a tax upon his or her distribution of tobacco products based upon the wholesale cost of these products. (R&TC, §§ 30101, 30123, 30131.2(b).) "Distributor" includes every person who distributes tobacco products, or who sells or accepts orders for tobacco products which are to be transported from a point outside this state to a consumer within this state. (R&TC, §30011.) The term "distribution" includes: (1) the sale of untaxed tobacco products in this state; (2) the use or consumption of untaxed tobacco products in this state; and (3) the placing in this state of untaxed

tobacco products in a vending machine or in retail stock for purposes of selling these items to consumers. (R&TC, § 30008.) “Use or consumption” includes the exercise of any right or power over tobacco products incident to their ownership, other than the sale of tobacco products or the keeping or retention by a licensed distributor for sale. (R&TC, § 30009.) Unless the contrary is established, it shall be presumed that all tobacco products acquired by a distributor are untaxed tobacco products, and that all tobacco products manufactured in this state or transported to this state, that are no longer in the possession of the distributor, have been distributed. (R&TC, § 30109.)

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.) 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. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 615-616.)

Appellant argues that the deficiency measure is excessive because CDTFA failed to properly account for all the undistributed tobacco products remaining in appellant’s inventory, which was seized by CDTFA. Appellant provided a schedule in which it estimates that CDTFA seized between \$2,115,686 and \$2,153,289 in cigarette and tobacco inventory and cigarette stamps. Appellant asserts these estimates were computed from its purchase invoices and seized property receipts. While appellant’s schedule does not separately state the wholesale cost of the tobacco products it alleges were seized, at the hearing, Mr. Swartz, on behalf of appellant, clarified that he believes this amount to be roughly \$800,000.

In computing the deficiency measure, CDTFA provided appellant an allowance for all the tobacco products seized from its licensed business location, on the basis that these products were not distributed. No allowance was provided for the tobacco products seized from appellant’s two unlicensed locations. For the liability period, CDTFA computed an allowance of \$209,366 by matching tobacco products from the seized property receipts to the purchase invoices included in the measure of tax. Because these documents are the best available evidence of the wholesale value of appellant’s undistributed tobacco products, we find CDTFA’s determination to be reasonable, and the burden shifts to appellant to demonstrate otherwise.

In contrast to CDTFA’s audit, appellant offers no explanation for how it arrived at its \$800,000 estimate, nor does it present any calculations or working papers demonstrating how

this amount was computed. Without this information, we are unable to verify the accuracy of appellant's estimate, and therefore, we find it to be unreliable. Also, appellant has not identified any specific error or omission in CDTFA's calculations or schedules for our consideration. Regarding the tobacco products seized from appellant's two unlicensed locations, the retention of untaxed tobacco products at a location for which a distributor is not licensed to sell tobacco products, is a distribution of such products. (R&TC, §§ 30008, 30009.) Consequently, appellant is not entitled to an allowance for those products. Based on the foregoing, we find that no adjustments are warranted.

Issue 2 – Whether CDTFA has shown by clear and convincing evidence that all or part of the deficiency was due to fraud or the intent to evade the payment of tax.

R&TC section 30205 provides for the imposition of a 25-percent penalty if any part of a deficiency determination is due to fraud or intent to evade the law. Fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be due. (*Bradford v. Comm'r* (9th Cir. 1986) 796 F.2d 303, 307 (*Bradford*).

It is CDTFA's burden to establish fraud by clear and convincing evidence. (*State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1241; *Marchica v. State Bd. of Equalization* (1951) 107 Cal.App.2d 501, 508.) Although fraud may not be presumed, it is rare to find direct evidence that fraud has occurred, and thus, it is often necessary to make the determination based on circumstantial evidence. (*Bradford, supra*, 796 F.2d at p. 307.) Relevant circumstantial evidence includes an understatement of income, inadequate records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealing assets, and failure to cooperate with tax authorities. (*Ibid.*)

The record provides ample evidence that appellant was aware of its reporting requirements under the Cigarette and Tobacco Products Law. Nearly all of appellant's untaxed tobacco products purchase invoices contain statements expressly informing appellant that it was purchasing untaxed tobacco products, and that appellant was liable for paying the applicable tax. Further, prior to and during the liability period, all three of appellant's partners held other tobacco products distributor's licenses which were used in the operation of similar businesses. The substantial experience of appellant's partners in this regard, and the fact that appellant reported many of its taxable tobacco products distributions, shows that it was aware of its obligation to report and pay tax. Mr. Maredia also pled guilty to one felony count of tax evasion,

and his admission of guilt in this respect demonstrates that he previously acted with the specific intent to evade the cigarette and tobacco taxes *he knew* he was required to report to CDTFA. Based on these facts, we find that appellant, through its partners, were aware of appellant's reporting requirements (Cal. Corp. Code, §16102, subd. (f), "[a] partner's knowledge, notice, or receipt of a notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of a notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner"), and we find it highly suspicious that appellant, with full knowledge of its reporting requirements, would inexplicably report some of its taxable tobacco product distributions, and not others.

Further, appellant failed to report \$831,731 in taxable distributions for the liability period. This amount represents an understatement of \$384,241 ($\$831,731 \times .4676$) tax, which is considerable.³ Appellant also underreported its taxable distributions for 14 of the 16 quarters at issue, which shows that appellant consistently underreported its taxable distributions for the liability period, and there is nothing in the record to indicate that this might be due to an honest mistake or inadvertent error. Appellant's failure to provide a credible explanation for its consistent and substantial underreporting, is further evidence of fraud.

In considering all the above, we conclude that CDTFA has supported its imposition of the fraud penalty by clear and convincing evidence.

HOLDING

1. Appellant has failed to establish that adjustments are warranted to the measure of tax.
2. CDTFA has supported the fraud penalty with clear and convincing evidence.

DISPOSITION

The proposed deficiency, as stated in CDTFA's adjusted FBO dated October 23, 2013, is sustained.

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Nguyen Dang
Administrative Law Judge

³ The difference is due to rounding.

We concur:

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Jeffrey G. Angeja

Administrative Law Judge

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Linda C. Cheng

Administrative Law Judge