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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE OF,)
)
DESIGN HOME CENTER, INC.,) OTA CASE NO. 18073484
)
)
 APPELLANT.)
)
 _____)

Transcript of Proceedings, taken at
6150 Van Nuys Blvd., Van Nuys, California, 91401,
commencing at 1:00 p.m. and concluding
at 1:34 p.m. on Monday, October 28, 2019,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: Hon. JEFF ANGEJA

Panel Members: Hon. ANDREW KWEE
Hon. RICHARD TAY

For the Appellant: CARLOS CHAIT
VICTOR CEBALLOS

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX and
FEE ADMINISTRATION
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CLOSING STATEMENT

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1 Van Nuys, California; Monday, October 28, 2019

2 1:00 a.m.

3

4 JUDGE ANGEJA: We're now on the record in the
5 Office of Tax Appeals oral hearing for the appeal of
6 Design Home Center, Case ID 18073484.

7 We're in Van Nuys, California, and the time is
8 approximately 1:00 o'clock, Monday, October 28, 2019. My
9 name is Jeff Angeja. I'm the lead administrative law
10 judge for this hearing. My fellow co-panelists today are
11 Andrew Kwee and Richard Tay.

12 And, Appellants, could you please identify
13 yourselves for the record.

14 MR. CEBALLOS: Victor Ceballos, owner.

15 JUDGE ANGEJA: Okay.

16 MR. CHAIT: Carlos Chait, CPA.

17 JUDGE ANGEJA: Thank you.

18 And for CDTFA?

19 MR. LAMBERT: My name is Scott Lambert. To my
20 left is Lisa Renati, and to her left is Chris Brooks.
21 We're representing the California Department of Tax and
22 Fee Administration.

23 JUDGE ANGEJA: All right. Thank you. And as we
24 discussed in our prehearing conference, this appeal
25 involves two issues which are: Whether reductions are

1 warranted to the audited amount of underreported tax and
2 sales; and, whether the understatement was the result of
3 negligence.

4 Prior to our prehearing conference, CDTFA had
5 identified and provided Exhibits A through D for admission
6 into evidence, and Appellant had no objection. Is that
7 still the case?

8 MR. CHAIT: No objection.

9 JUDGE ANGEJA: All right. I hereby admit
10 Exhibits A through D into evidence.

11 (Department's Exhibits A-D were received in
12 evidence by the Administrative Law Judge.)

13 JUDGE ANGEJA: And then at the prehearing
14 conference, Appellant indicated that it had no exhibits.
15 We allowed some additional time to October 14th to submit
16 any additional evidence if you wish to. We still haven't
17 received anything.

18 MR. CHAIT: It was sent by certified mail, and it
19 was on October 15th.

20 JUDGE ANGEJA: Okay. We don't have that. Is
21 that the e-mail?

22 MR. CHAIT: No. It's certified mail.

23 JUDGE ANGEJA: No. I know. What's the content
24 of the --

25 MR. CHAIT: The content is 1 through 6 Exhibits.

1 It's additional exhibits.

2 JUDGE ANGEJA: Okay. Can we get copies of that?

3 Okay. So while that's being done, we'll go ahead
4 with the rest of housekeeping matters that I've got.
5 Based on our prehearing conference, it's my understanding
6 that Mr. Ceballos will testify today. Is that still
7 correct?

8 MR. CEBALLOS: Yes.

9 JUDGE ANGEJA: Okay. I'll swear you in shortly.
10 We had also agreed that we would begin with Appellant's
11 testimony and argument, which would not exceed 15 minutes.
12 And CDTFA would then be allowed to ask questions if they
13 wish, as with the panel of judges. CDTFA would then make
14 its presentation, not to exceed 15 minutes. Co-panelists
15 can ask questions if they wish, and then we would allow a
16 five-minute rebuttal for Appellant.

17 Do you need those documents to give your
18 presentation? Should we take a quick timeout?

19 MR. CHAIT: Yes.

20 JUDGE ANGEJA: Okay. Let's go off the record for
21 two to three minutes just until she gets back.

22 (There is a pause in the proceedings.)

23 JUDGE ANGEJA: For the record -- I'm sure it was
24 an oversight, but that was mailed to, I think, this
25 building. And Office of Tax Appeals does not have an

1 office here. We're just having the hearing here. So
2 that's probably why we don't have it in our system. So
3 they've not received it. We've not received it.

4 Is CDTFA going to object?

5 MR. BROOKS: Yes, Your Honor. If I could have
6 the mic real quick.

7 Yes, Your Honor. We're going to object. They --
8 obviously it's untimely. Even on the day it was mailed,
9 it was untimely. The order had been that any records be
10 sent by e-mail, so electronic, to both OTA and CDTFA by
11 the 14th of October. Nothing was sent to us at all. And
12 the certified records show that he sent it after the 14th
13 and to the wrong address.

14 JUDGE ANGEJA: All right. And I know that that's
15 correct, but given the likelihood of confusion and the --
16 at least the attempt to try to comply, given it was the
17 holiday, I'll let it in. Rules of evidence don't
18 necessarily apply to the admission of evidence, but it
19 does apply to the weight that we give it.

20 So, you know, I hate to say it this way, but it's
21 something they told us in law school. We'll let this in
22 for what's it worth.

23 (Appellant's Exhibits 1-6 were received
24 in evidence by the administrative Law Judge.)

25 Let me swear you in. Please stand and raise your

1 right hand.

2

3

VICTOR CEBALLOS,

4 produced as a witness, and having been first duly sworn by
5 the Administrative Law Judge, was examined and testified
6 as follows:

7

8 JUDGE ANGEJA: All right. When you're ready you
9 may begin. You are under oath.

10 MR. CHAIT: I'm going to start.

11 JUDGE ANGEJA: Sure. Please speak into the
12 microphone so that the court reporter can hear you.

13 MR. CHAIT: All right. Can you hear me well?
14 Okay.

15

16

OPENING STATEMENT

17 MR. CHAIT: Maybe this is not organized the way I
18 want. It's my first time. I have experience in the tax
19 court and with the administrative and the EDD, but my
20 first time with Office of Tax Appeal. Please allow me to
21 make some mistake.

22 JUDGE ANGEJA: Sure.

23 MR. CHAIT: I'm not a lawyer. I'm just a CPA.
24 Okay. The situation with this audit is we -- and we
25 take -- we, the company, were not well-prepared for the

1 audit. Grand part -- big part of the assessment was,
2 unfortunately, our mistake to not give the right record to
3 not present the case in the way it is.

4 I take over the account of the business only in
5 2018. I get familiar with all the procedures and
6 everything and decide to get back to the record to see
7 what happened. According with the page -- Schedule 12,
8 page 15, it says taxpayer did not maintain formal account.
9 We do that.

10 Other reason we enter this one. The company have
11 a, you can say sophisticate, POS system made for them by a
12 company called Calicarulo (sic) -- Calico. I've been using
13 for a little while. So it's that we have, a report to the
14 sale for the second part of the 2010, this whole year,
15 2011, the whole year, 2012, and the first 6 months of
16 2013. We do have this already. That is on the sale, that
17 is right. Okay. This is on the record.

18 I don't know if I can, but we were holding the
19 second audit. And the second audit, they sent a
20 representative over there to our office, and we meet with
21 them. We explain, and she find point of sale was very
22 good. And, as a matter of fact, the second audit by
23 Mr. Henry Chen, he ordered to be redo. Okay. But let's
24 get back to the first audit.

25 We never have, really, the way to present the

1 information correct today to the audit person. That is
2 our first mistake. The second mistake -- that's the
3 reason I include this letter on the same page called "ACC
4 Receivable Total." Because when the company was passed to
5 Mr. Victor Ceballos, who is the owner of the company, he
6 received the company in very bad shape.

7 Remember 2008, the audit, problem with the home
8 repossession, blah, blah, blah. He has a very big down
9 payment on the furniture. As a matter of fact, many of
10 client he has do not even pay or disappear. Okay. So he
11 get the business in very bad shape. One way to try to
12 recover the business was try to collect account
13 receivables. It was credible, \$300,000. He try to put in
14 that one.

15 What happen in this case? Unfortunately, there
16 is a form called 1099-K. You may be aware of that. It's
17 a form issued by the process -- the company who process
18 the income. It was supposed to be very big for him, these
19 two years. And everybody assume that was sales. It
20 wasn't sales. It was a collection of reduce account
21 receivables or writing a report to the Board of
22 Equalization.

23 And the time 2008, 2009 when the sale was very
24 high, that was affected the evaluation, and was probably
25 also became my mistake to not be aware of that until later

1 on. I become aware I take the accounting. I see the
2 difference between the bank, between the retail sales, and
3 all these things because they were affected by the
4 collection of previous year.

5 That was one of the big problems that we are like
6 in shoe box because we cannot negate. We cannot be the
7 account -- amount cannot negate. Of course it's correct,
8 but that grew not from the year. That create a big
9 difference. And finally, your guy, the guy who did the
10 audit, make something called markup. He markup over
11 there, and we doing two things.

12 Number one, taking all the furniture from the
13 floor, write down the price, and ask my client for the
14 purchase invoice. In some ways that's good, but in this
15 way it's not clear because the price on the sticker is
16 not -- never the same the price sell. There's discount.
17 The guy buy one furniture, two furniture, a complete set.
18 He never ask for the sales invoice he only take the price
19 on the sticker.

20 And the invoice, he also never -- the invoice is
21 there. I mean, there's nothing to hide it. Also some of
22 the stuff was purchased one or two years ago. Another
23 point he has is the inventory. He has a big inventory.
24 He start getting real inventory little by little to have
25 too much in his store sometime. And suddenly everything

1 went down in 2008. You know what happened in those years.

2 So they just picking up inventory starting at
3 whatever price they can get from that. Those are the
4 markup analysis. So show basically maybe close to the
5 reality, but we don't -- we don't accept it. At least we
6 can do something more differently.

7 Okay. Thank you.

8 JUDGE ANGEJA: If I'm understanding your argument
9 correctly, the amount of the 1099-K payments, credit card
10 receipts, you're saying that those represent collections
11 on account receivables from sales made in prior years?

12 MR. CHAIT: Yes. If you want to explain it by
13 that.

14 JUDGE ANGEJA: How does that work? I mean,
15 you've got the accounts receivable already. So they come
16 in and they pay a past-due balance with a credit card?

17 MR. CEBALLOS: So when I took over in the latter
18 part of 2009, my dad had receivables before that. So when
19 he -- when I took over and he went under, he passed
20 everything on to me. So I said I'm going to collect all
21 the receivables that didn't pay. I mean, these are
22 customers from months and years which we still had a right
23 to get. He lost a lot of money. So I didn't want to let
24 it go.

25 So what I was doing is I was learning how to

1 collect legally and as, you know, the best I can do. So
2 we were receiving payments by credit card. I mean, people
3 were coming into the store paying with a card. We were
4 collecting, sending letters, calls, whatever we can do to
5 collect. I just didn't think about the issues I would
6 have later, I guess. It was new to me as far as all this
7 tax owed. But I guess that's what the -- didn't match
8 with when I was doing it.

9 JUDGE ANGEJA: Okay. I have additional
10 questions, but I'll hold off until the end.

11 JUDGE KWEE: I did have one quick question. I
12 just wanted to know on the federal income tax returns,
13 were those reported as a cash basis?

14 MR. CHAIT: Cash basis. I prepare all the income
15 tax.

16 JUDGE ANGEJA: CDTFA, would you like to commence
17 your presentation?

18 MR. LAMBERT: Sure.

19

20 OPENING STATEMENT

21 MR. LAMBERT: In this particular case, we audited
22 the taxpayer for a three-year period. They are a
23 furniture -- retail-furniture store. The Appellant
24 provided income tax returns for, initially, 2010, 2011,
25 2012. And after the initial audit, they provided the 2013

1 income tax return. They provided some purchase invoices,
2 the 2010 profit and loss, and then we had the 1099-K
3 information that they provided for 2011 and 2012 -- or I'm
4 sorry.

5 We obtained from our headquarters' operations,
6 the information that we had obtained. The records that
7 weren't provided were the source documents. They didn't
8 provide sales journals, and they did not provide the sales
9 invoices themselves. And a large percentage of the
10 purchase invoices weren't provided. We did try to contact
11 the suppliers, and we were somewhat unsuccessful in our
12 attempt to verify the purchase invoices.

13 So, essentially, we were -- we accepted the
14 figures that had been reported on their income tax returns
15 because that was all we had. There was large differences
16 noted between each one of the years. And so between what
17 was on the federal income tax returns, and what was
18 reported on the sales and use tax returns was in terms of
19 gross receipts and total sales.

20 So in 2011 the difference was \$266,000. In 2012
21 it was \$382,000, and in 2013 it was \$241,000. And since
22 there was only half of 2013 that we audited, we
23 essentially took half of that figure, which was \$120,000.
24 The amount on the 2010 income tax return matched what was
25 on the sales and use tax returns. But the profit and loss

1 that they had provided us was substantially higher. So we
2 did used the figures from the 2010 profit and loss
3 statement.

4 So, essentially, that's how we audited their
5 taxable sales because that was the only evidence that we
6 had in order to conduct this audit. Now, there was -- we
7 did attempt to verify this, or we did verify it through
8 alternative methods. One was the credit card method. And
9 what that showed is that their credit card sales were
10 about 87 percent of the reported -- or the sales on the
11 income tax returns. And that was a figure that we
12 considered to be reasonable for this type of business.

13 And then we also did a markup test, and we came
14 up a little under 40 percent. It was 39 --
15 39-point-something percent. If we had used the markup
16 method, the liability would be higher than the figures
17 that we obtained from their income tax returns. So
18 because there was not that much of a difference, we went
19 ahead and accepted the figures on the income tax returns
20 as their sales.

21 The taxpayer has indicated that there were some
22 nontaxable receipts included in the gross receipts, but
23 there hasn't been any evidence that's been provided to
24 show that those figures were, in fact, included in the
25 gross receipts on the income tax returns.

1 So, essentially, we have no method of determining
2 what's including in the income tax -- the gross receipts
3 on the income tax returns because we don't have the
4 detailed information. And so what we're relying upon is
5 that or, essentially, is that those sales are subject to
6 tax until the taxpayer proves that they're not, and that
7 hasn't happened yet.

8 In regard to the negligence penalty, we did put a
9 10 percent negligence penalty and was imposed for two
10 separate reasons; one, because there was a substantial
11 underreporting of taxable sales over \$900,000 in taxable
12 sales. And also, because they failed to provide complete
13 books and records for audit.

14 The negligence penalty should be upheld in a
15 first audit if the understatement cannot be contributed to
16 a bona fide and reasonable belief that the bookkeeping and
17 reporting practices were sufficiently compliant with the
18 requirements of the sales and use tax law. So in this
19 case, you have an underreporting of \$917,000, which is an
20 error rate of 175 percent. Essentially, they reported
21 less than half of their taxable sales.

22 They were also able to report the sale on their
23 income tax returns but unable to report their sales and
24 use tax returns. And there was a difference between the
25 1099 for 2011 and 2012 compared to what was reported of

1 \$600,000, as their testimony is that it was because of
2 collecting back payments. That seems like a substantial
3 difference of accounts receivable that were collected
4 during that time period.

5 I note the information that was provided here
6 I -- it was just recently provided today. I've only been
7 able to glance at it and look at it briefly. So at this
8 point, you know, because we have received it recently, it
9 would be the same thing as taking a look at the income tax
10 returns. We do not have the back up for this to show that
11 it is correct. There's nothing to show how these figures
12 were arrived at, other than, you know, what's on this
13 piece of paper.

14 I would point out that we did have a profit and
15 loss for 2010 that we used to establish the liability and
16 the -- I don't know what the difference is between the six
17 months that they've provided here and what we have been
18 provided earlier. So, unfortunately, I'm unable to
19 discuss it more than that, at this time anyway.

20 So with that, I would conclude my presentation.

21 JUDGE ANGEJA: All right. Thank you.

22 Judges, do you have any questions for the
23 Department?

24 JUDGE KWEE: No.

25 JUDGE TAY: No, thank you.

1 JUDGE ANGEJA: So this is where we allow you a
2 five-minute rebuttal if you want to wrap up your argument
3 or respond to what the Department said.

4

5

CLOSING STATEMENT

6 MR. CHAIT: I don't know if it ties with the
7 California Department of Tax and Fee Administration, but
8 it is challenged. I have letter from Mr. Henry Chen, with
9 your Tax Counsel III Specialist, who reviewed the record
10 and find out that their record had to be reviewed again
11 because he agreed. He went to our office and checked the
12 system, both purchase of sale system and find out it was
13 okay.

14 Because he was seeking that when we ask him do
15 some changes for us. And -- but we ask when the audit
16 will be redone. And regarding the tax, let me work on
17 something. I prepared it for them. Okay, basically
18 information provide by company. I can say the profit and
19 loss, gentleman mention, was designed by a system was very
20 poor and incomplete. Unfortunately, they have some person
21 to take the record that do a very poor job.

22 That's the reason I take over that year. But
23 this record for me as a CPA I figure it out. For example,
24 in 2011 in the profit and loss, it mention state tax as a
25 deduction. I don't know how state -- how they conceded

1 the state tax -- the sales tax. Supposed to be reduced
2 from the sales reporting just the net sale. So there's a
3 lot of mistakes, not the tax, the information provide by
4 the tax, by them for tax preparation.

5 And the other thing was that the 1099 came
6 totally and show box, this amount already out. Now, I
7 found out later on what happened. Okay. But, basically,
8 we request if can be redone. So we have the report
9 itself.

10 JUDGE ANGEJA: I had a quick question. You're
11 referring to a letter from Henry Chen?

12 MR. CHAIT: Yes.

13 JUDGE ANGEJA: I can't pull it up fast enough.
14 Are you referring to a subsequent audit period with --

15 MR. CHAIT: Yes, yes.

16 JUDGE ANGEJA: Okay. Now --

17 MR. CHAIT: That letter was supposed to be
18 included in the package I send you.

19 JUDGE ANGEJA: Yeah. Although, if it's not for
20 this audit period --

21 MR. CHAIT: We did make copy as we stated, but
22 that letter was included in the packet.

23 JUDGE ANGEJA: But if it's not part of this audit
24 period --

25 MR. CHAIT: No. It's not the audit period.

1 JUDGE ANGEJA: -- it's not relevant to this audit
2 period. So I --

3 MR. CHAIT: It's relevant in the sense that the
4 guy decide that there have to be a new audit because the
5 information -- they have information to do a correct
6 report.

7 JUDGE ANGEJA: Right. But it's not for the audit
8 period in question.

9 MR. CHAIT: No, no. For the subsequent audit.

10 JUDGE ANGEJA: Okay. And does that conclude your
11 presentation?

12 MR. CHAIT: Yes.

13 JUDGE ANGEJA: Judges, do you have any questions?

14 Okay. All right. So then at this point, I will
15 close the record. We will conclude this hearing. I would
16 like to thank each party for coming in today. Following
17 this hearing, my co-panelist and I will discuss the
18 evidence and the arguments, and we will issue a written
19 opinion within 100 days of today's date.

20 So with that, the record is closed. I thank
21 everybody for attending.

22 (Proceedings adjourned at 1:34 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 by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 14th day of November, 2019.

ERNALYN M. ALONZO
HEARING REPORTER