



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE OF, )  
 )  
J.E.P. ENTERPRISES, INC., ) OTA NO. 18032425  
 )  
 )  
 APPELLANT. )  
 )  
 \_\_\_\_\_ )

Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Cerritos, California, 90703,  
commencing at 11:00 a.m. and concluding  
at 11:26 a.m. on Thursday, January 23, 2020,  
reported by Ernalyn M. Alonzo, Hearing Reporter,  
in and for the State of California.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

APPEARANCES:

Panel Lead: ALJ JEFF ANGEJA

Panel Members: ALJ JOSHUA LAMBERT  
ALJ LINDA CHENG

For the Appellant: JUAN GUZMAN, Representative

For the Respondent: STATE OF CALIFORNIA  
DEPARTMENT OF TAX AND  
FEE ADMINISTRATION  
By: LISA RENATI,  
Hearing Representative  
KEVIN SMITH,  
Tax Counsel  
JASON PARKER,  
Hearing Representative

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

I N D E X

E X H I B I T S

(Appellant's Exhibits were received at page 6.)

(Department's Exhibits were received at 6.)

OPENING STATEMENT

	<u>PAGE</u>
By Mr. Guzman	7
By Ms. Renati	21

REBUTTAL STATEMENT

	<u>PAGE</u>
By Mr. Guzman	30

1 Cerritos, California; Thursday, January 23, 2020

2 11:00 a.m.

3

4 JUDGE ANGEJA: We are now on the record in the  
5 Office of Tax Appeals oral hearing for the appeal of  
6 J.E.P. Enterprises, Inc., 18032425. Today is Thursday,  
7 January 23rd, 2020, and the time is 11:00.

8 I'm Jeff Angeja, and I am the lead Administrative  
9 Law Judge for this hearing. My fellow co-panelists today  
10 are Linda Cheng and Josh Lambert.

11 And for Appellant, could you please introduce  
12 yourself for the record.

13 MR. GUZMAN: Yes. My name is Juan Guzman, CPA,  
14 representing J.E.P. Enterprises.

15 JUDGE ANGEJA: All right. Thank you.

16 And for CDTFA.

17 MS. RENATI: My name is Lisa Renati. To my left  
18 is Jason Parker, Chief of Headquarters Operation Bureau,  
19 and to his left is Christopher Brooks, tax counsel.

20 JUDGE ANGEJA: All right. Thank you. Welcome.  
21 And this will be a little bit redundant from our  
22 prehearing conference. This appeal involves two issues  
23 which are: Whether reductions are warranted to the  
24 measure of underreported taxable sales; and whether CDTFA  
25 has provided clear and convincing evidence of fraud. I

1 believe that's still correct?

2 MR. GUZMAN: That is correct, Your Honor.

3 JUDGE ANGEJA: All right. And during the  
4 prehearing conference, the parties agreed to the admission  
5 into evidence -- for the proposed admission into evidence  
6 of Appellant's Exhibits 1 through 10, CDTFA's Exhibits A  
7 through F. At that time no one had any objections. Is  
8 that still the case?

9 MR. GUZMAN: That's correct, Your Honor.

10 JUDGE ANGEJA: All right. Then I hereby admit  
11 those evidence -- those exhibits into evidence.

12 (Appellant's Exhibits 1-20 were received  
13 in evidence by the Administrative Law Judge.)

14 (Department's Exhibits A-F were received in  
15 evidence by the Administrative Law Judge.)

16 JUDGE ANGEJA: And it's also my understanding  
17 that neither party has any witnesses for today. So we  
18 just have argument from the parties.

19 MR. GUZMAN: That's correct.

20 MS. RENATI: That's correct.

21 JUDGE ANGEJA: And we had agreed that we would  
22 begin with Appellant's testimony and argument not to  
23 exceed 20 minutes. We can be somewhat flexible with that  
24 if you need it. And then CDTFA would make its  
25 presentation, also not to exceed 20 minutes. And a

1 5-minute rebuttal, if you wish. And the panel could ask  
2 questions of either party at any time. And if there are  
3 no procedural questions, we could get started.

4 So, Mr. Guzman, go ahead.

5 MR. GUZMAN: Yes. Good morning.

6 JUDGE ANGEJA: Good morning.

7

8 OPENING STATEMENT

9 MR. GUZMAN: We have two issues. Obviously, it's  
10 fraud, the issue of fraud. And the other one is the  
11 taxable measure understated. I'm going to start off by  
12 saying that the taxable measure -- hopefully you can  
13 correct me if I am wrong, or someone can -- the measure of  
14 tax that we're looking at \$2,705,128.

15 JUDGE ANGEJA: CDTFA, since you guys have those  
16 documents right in front of you.

17 MS. RENATI: That's correct.

18 MR. GUZMAN: Today I'll be explaining to you why  
19 I think that's incorrect. My estimate that I'm looking  
20 at -- and I'll show how that's been estimated, is  
21 \$2,072,706. That's still an estimate, but my goal is to  
22 present to you the information that I used to compute that  
23 amount.

24 I'd like to start off with the issue having to do  
25 with fraud, if I may.

1 JUDGE ANGEJA: Sure.

2 MR. GUZMAN: Sure. Fraud, obviously, is the  
3 intent of the taxpayer. And I'm going to start off by  
4 indicating who is the taxpayer, the CEO? How  
5 knowledgeable could he be regarding sales tax matters?  
6 Well, in general most people, unless you're specialized in  
7 the field, have no idea what sales tax. Because if you  
8 ask the general public, is can this be taxable, most of  
9 them are going to say, in fact, they have no idea whether  
10 it is or is not.

11 Something as simple as candy, ice cream -- all  
12 I'm saying is the tax law is very specialized, very  
13 difficult unless you have been in the arena. So the CEO  
14 in this case, so you know, he arrived in 1993 from  
15 Argentina not speaking a word of English. English now is  
16 a second language. He worked minimum wage for a warehouse  
17 in Fontana. He has no higher education than high school  
18 that he got in Argentina.

19 He was an insurance broker. Nothing to do with  
20 sales tax whatsoever. He had to study hard to learn the  
21 insurance business. He had a small auto shop or auto  
22 sales shop. There are permits that were obtained. Did he  
23 ever get audited? Well, he had a permit operating those  
24 auto sales shop. No, never been audited. Was he ever  
25 advised at any given point, specifically, how to report,



1       how to record?

2               Like most people, they don't know. Most people  
3       get a permit. At one time you could go to a local office,  
4       take out your permit, have a person in front of that would  
5       provide questions and answers. Now, mostly the Board or  
6       the CDTFA everything was done online. Yes, he had  
7       brochures. Yes, he had pamphlets. He had a wealth of  
8       information. He didn't go to CDTFA. He didn't go to the  
9       websites. Even if he went to the website, the general  
10      public has no idea what to look for or understand how  
11      certain rules and regulations apply.

12              But so learning English is hard enough. Learning  
13      tax law, regulation, and reporting is difficult. Now,  
14      the -- most agencies will agree the CDTFA, the EDD, they  
15      have excellent websites if you know what you're looking  
16      for. And even if you do, the general public does not  
17      understand. That's why they have consultants and people  
18      in that system.

19              Even myself, I remember back a few years ago in  
20      intermediate college. What kind of exposure did we get to  
21      sales tax? I think it wasn't set. The retailer is liable  
22      for the sales tax. That's it. I have graduated from  
23      college. I have no idea what sales tax was. This person  
24      had no college whatsoever. Now, the thing is we talk  
25      about knowledge. I look at knowledge like it's all kinds

1 of a different spectrum. There's actual knowledge.  
2 There's constructive knowledge, precise, and specific  
3 knowledge. General knowledge.

4 Well, most of us have a general knowledge. For  
5 example, I have here Chapter 5, Penalties. I have general  
6 knowledge. And consider myself an expert in sales tax.  
7 Most people don't have precise knowledge, just to give you  
8 an idea. Of course we have *Marchica v. State Board of*  
9 *Equalization*. It indicates pretty much there that the  
10 fact that the mere revision of a tax return of items which  
11 should have been included does not show fraudulent intent.  
12 Yeah. This is not fraudulent. It states the  
13 understatement may have resulted from ignorance, bad  
14 advice, honest mistake, negligence, misinterpretation of  
15 the law. None of which itself constitute fraud.

16 There's another case I looked up. It's very  
17 interesting. It's called Supreme Court Case -- actually,  
18 it's called *Spies, S-p-i-e-s, v. U.S., Section 492*. They  
19 say -- it gets us elements, elements of fraud. Okay. And  
20 these elements are not present in the taxpayer's situation  
21 here. What constitutes the elements of fraud? Double set  
22 of books. Well, there is no double set of books. Making  
23 false or altered entries. Well, there are no false or  
24 altered entries in this case.

25 Making false invoices. There are no false

1 invoices in this case. Concealing sources of income.  
2 Bank statements were there. He was -- he could have been  
3 audited any time, but he had a permit. Handling of  
4 transactions to avoid usual records. What does the  
5 restaurant operator do? So they open from 8:00 o'clock in  
6 the morning, close at 10:00. That means he gets there at  
7 8:00 o'clock in the morning and goes home at 10:00? He  
8 gets there at 6:00 to prepare. He closes at 10:00. He  
9 still has to work after hours. So does he concentrate on  
10 sales tax? No. He has to concentrate on keeping that  
11 business open.

12 I'm going to go over the exhibits that the  
13 Department has provided regarding -- let me take a look at  
14 the exhibits. I dropped something. Before I go to the  
15 exhibits, I want to see Chapter 5. CDTFA obviously should  
16 have actual knowledge of this.

17 I'm going to only zero in on me as, Mr. Taxpayer.  
18 I wanted to see examples of -- for whatever reason --  
19 recording keeping. I have to take out my glasses because  
20 I can't see close up with --

21 JUDGE ANGEJA: Just for clarification, that's  
22 Chapter 5 of --

23 MR. GUZMAN: Chapter 5 of the --

24 JUDGE ANGEJA: -- the audit manual.

25 MR. GUZMAN: -- penalties, audit manual.

1 JUDGE ANGEJA: Okay.

2 MR. GUZMAN: Specifically, Section 0506.40 where  
3 it gives me and it gives the general public examples. And  
4 there's example Number one, if I just change the name.  
5 This would be taxpayer. It says, "Mr. Shep Bartlett."  
6 This could be J.E.P.

7 It says, "Operator restaurant serving breakfast,  
8 lunch, dinner, as well as beer and wine." That's what  
9 this guy does. "During an audit, Mr. Bartlett provided  
10 CDTFA staff with monthly sale summaries. Had not  
11 maintained any source documents, like, purchase invoices."  
12 Well, we have purchase invoices. Sales receipts or cash  
13 register tape. The Department keeps on saying that we  
14 didn't have any available.

15 The staff -- CDTFA staff found taxable sales were  
16 understated. This is the first audit, by the way. He was  
17 advised. It was written in the audit that the next time,  
18 this is not -- you have to have the receipts. Well,  
19 Mr. Bartlett got audited again. What happened? Well, he  
20 opened up a corporation restaurant, again, he had no  
21 receipts. What happened in this situation? They began a  
22 fraud penalty. There was negligence only because he had  
23 been instructed and there was writing in the audit that he  
24 should not -- he should keep all records.

25 Now, there's Example Number 5. That could even

1 be Mr. Juan Guzman. That's still the Section 0506.40.  
2 Mr. Smith is the CPA who's practiced for the last three  
3 years. He has been involved in advising and assisting  
4 business owners, including numerous restaurants. Well, he  
5 retired. "I always wanted to open up a sushi shop." So  
6 he opened up a sushi shop.

7 What happened? He got audited. He had  
8 knowledge. He was an accountant consulting people. Do  
9 you know what happened in this case? He underreported. I  
10 thought that was his penalty. No fraud. He should have  
11 known. So I'm trying to point out examples that we have.  
12 And on Chapter -- let me see -- 0509.10. It says fraud  
13 may be defined as conduct intended to deprive the State of  
14 all legal due. The intent to evade may be defined as an  
15 intent to escape the payment of tax through deception and  
16 misrepresentation. There is no deception here. There's  
17 no misrepresentation.

18 Going on to 1509.25, again, it talks about  
19 falsified records as being evidence. Well, there is no  
20 such thing. Substantial discrepancies between record and  
21 reported amounts which cannot be explained. Well, let's  
22 see. We've been asking for an explanation. I asked for  
23 an explanation. Mr. Taxpayer, how come you reported that?  
24 Well, I thought it was like income taxes, and it was based  
25 on net income. Okay. You know better. Well, you

1 shouldn't have done that but --

2 Willful disregard of specific advice. Well,  
3 there's never been any advice at the time they took out  
4 the permits. There's nothing in the record for my -- I  
5 haven't seen anything from CDTFA that this gentleman would  
6 actually have a sit down and say, "This is the way you're  
7 supposed to report."

8 He did have an auto sales shop. That has nothing  
9 to do with a restaurant. You don't do a credit card  
10 analyses on an auto sales shop. It says right here.  
11 Failure to file, requirements of the law. Knowledge.  
12 Well, he had no knowledge. He had general knowledge. It  
13 says transferring of cumulative -- unreported tax from a  
14 tax accrual account. Well, we don't have that.  
15 Obviously, he collects a sales tax. I mean, all  
16 restaurants have sales tax. That's a given.

17 So now I'm going to go to the -- to the  
18 examples -- to the exhibits. We're going to start off  
19 with exhibit -- well not number, but B that CDTFA has  
20 provided. I hope everybody is on that same page. First  
21 paragraph, deliberate intent. Here, again, I don't  
22 believe it's deliberate intent. In the bottom there's a  
23 last sentence that says that he also operated a used car  
24 dealership.

25 When did he operate? 11/29/01 to 03/30/05. And

1 then there was a gap, I believe, a four-year gap before he  
2 had the restaurant. On page 2, evidence supporting fraud.  
3 That's the last paragraph, I believe, from the third  
4 paragraph -- the first paragraph, evidence for supporting  
5 fraud. Mr. Pintos was aware of the sales being reported  
6 and reported using bank statements, not, here's a  
7 contradiction.

8 You look at that first sentence of the paragraph,  
9 and you look at the second sentence. It says, as we  
10 continue on, "Mr. Pintos," on the first sentence, "was  
11 aware of the amounts of sales being reported to the  
12 Board." The sales being reported were reported using bank  
13 statements. I don't know how the auditor determined that.

14 Because in this next one it says, "No information  
15 or documentation in connection with how the sales and use  
16 tax returns were prepared." On the first paragraph  
17 they're saying he was using bank statements. So the  
18 second sentence it says, "We have no idea." I think  
19 that's a contradiction. We go on to -- let me see all the  
20 exhibits here. Bear with me.

21 I guess the last one would be Exhibit E, and then  
22 the very first page is where we summarize this. We -- we  
23 do have the report of audit field that shows the tax  
24 amount and also the penalty. And on the third page, we  
25 have the auditor's comment, report of field audit. Does

1 he say here? Well, they -- I mean, it says auditor  
2 complete observation test.

3 Well, the only way the auditor could complete an  
4 observation test is if they have guest checks. So the  
5 guest checks were there. The Department keeps on saying  
6 that there were no guest checks. What happened was, I  
7 believe, the taxpayer thought that the guest checks for  
8 the audit period were the ones he couldn't get. The  
9 current period he did supply those. So that's the extent  
10 of my presentation as far as the fraud is concerned.

11 I'd like to jump over to the audit section. And  
12 on the audit, I'll just go on to my Exhibit 3. Exhibit 3,  
13 there is the Schedule 12, Column B. It shows the amount  
14 reported \$488,555. Column C is the audit taxable measure.  
15 Total taxable difference is 2,705,128. Underneath that I  
16 made a summary on the right-hand side of the actual sales  
17 that were observed by the auditor on those 2 days being  
18 tested.

19 On one day it was 1,285.77. The other day was  
20 1,067.44, a total -- the auditor observed sales of  
21 2,350.21 in two days. The average is 1,175. The audited  
22 daily average sales is more than 50 percent more,  
23 2,534.91. My question is where were those other sales in  
24 the two days of observation? So I believe that the  
25 observation test is not representative.



1           However, even if I use that, I come up with  
2 taxable difference that I think that we would owe is  
3 991,783.60. That won't be correct. What I'm proposing --  
4 at least what I'm thinking of is that, I believe, a 20-day  
5 summary that the auditor solved and obtained from the  
6 taxpayer. And I believe that's schedule -- it's noted in  
7 the package in the bottom of the report.

8           The average sale of that 20-day review of the  
9 summary sheets provided by the taxpayer; one was 1,645.  
10 The average daily sales based on that summary sheet was  
11 1,645. So what I do is well, I know there's 1,260 days in  
12 the audit period. I multiple that by 16 -- well, multiply  
13 it by 1,645 by 1,260 days, and I come up with a measure of  
14 2,072 -- 2,072,706. That's what I came up with. That  
15 magical number as we started my presentation.

16           So I'm going to go back and look at the audit.  
17 And I do have another analysis that I made. Based on the  
18 observation test, two days, there were 53 order tickets  
19 for 1 day and 56 order tickets. I'm going to call the  
20 order tickets transactions. So the observed 53  
21 transactions in one day, 56 the other. Each day generated  
22 an average check amount of \$19 in one day and \$24 on the  
23 other. Hence, the average transaction amount is \$21. \$21  
24 for the average transactions for the day.

25           If we divide the proposed audit and measure by

1 the 319,393, I believe that's the total audited measure,  
2 by 21, that would give us meals or transactions to the  
3 extent of 152,084 for the audit period. And if we divide  
4 this by 1,260 this equals 121 transactions. In other  
5 words, if the audit amount is correct, there should have  
6 been 121 transactions on those two day -- each one of  
7 those days. There wasn't.

8 Now, the other thing that I look at to see logic,  
9 well, if I examined 109 transactions and there's 152,084  
10 based on the audited taxable sales, that would give us an  
11 exposure or a test of .00071. In any given test, the more  
12 you have in the population, the better the results are  
13 going to be. Out of 152,084, only 109 transactions were  
14 analyzed. So my point is that the observation is not  
15 representative.

16 However, the point I want to make, I also believe  
17 the taxpayer is not liable of all his tax. But I don't  
18 believe he owes tax on 2.7. I believe he owes tax on the  
19 \$2.2 million. And when we have a percentage of .00071,  
20 it's holding on to a fraud penalty. Well, that's very,  
21 very little exposure. Very little basis for a fraud  
22 penalty. And with that, I submit.

23 Thank you so much.

24 JUDGE ANGEJA: One quick question. I haven't  
25 asked you guys yet. Without getting back into all that

1 math, the basis for the difference between the 2.7 and  
2 your 2.0, for round numbers for purposes of my question,  
3 you're basing off that 20-day summary?

4 MR. GUZMAN: That's correct, Your Honor.

5 JUDGE ANGEJA: All right. Do you guys have any  
6 questions?

7 JUDGE CHENG: Yes. Mr. Guzman, who prepared the  
8 sales and tax returns --

9 MR. GUZMAN: He did.

10 JUDGE CHENG: -- for the audit period. He,  
11 himself prepared the returns --

12 MR. GUZMAN: That's my understanding.

13 JUDGE CHENG: -- he just signed them.

14 THE STENOGRAPHER: I need you to talk one at a  
15 time, please.

16 MR. GUZMAN: I'm sorry.

17 JUDGE CHENG: He didn't just sign the returns.  
18 He prepared them himself?

19 MR. GUZMAN: I did not know Mr. Pintos before  
20 that. So I believe he signed -- he must have prepared the  
21 returns.

22 JUDGE CHENG: Okay. So what's the explanation  
23 for the difference between the reported sales and the bank  
24 statements, the deposits?

25 MR. GUZMAN: Well, that's what he indicates to

1 me, the fact that he was just looking at -- he was just  
2 looking at the -- I guess his income sales minus expenses  
3 and whatever left over and that was his taxable,  
4 regardless of the bank statements.

5 JUDGE CHENG: Okay. Did he also separately state  
6 the sales tax on the receipts?

7 MR. GUZMAN: I didn't -- I guess none of us had  
8 seen the receipts. The auditor, obviously who did the  
9 audit saw the receipts. I have to assume that there was  
10 sales tax. I think that's a concession that there should  
11 have been sales tax charged.

12 JUDGE CHENG: Should have but did --

13 MR. GUZMAN: I have no way of knowing.

14 JUDGE CHENG: Department, did receipts separately  
15 state the sales tax? That, and also was Mr. Pintos the  
16 actual person at the cash register?

17 MS. RENATI: I don't know who was at the  
18 register, but the guest checks had sales tax separately  
19 stated.

20 JUDGE CHENG: Okay. Thank you.

21 JUDGE ANGEJA: Questions?

22 JOSH LAMBERT: No questions.

23 JUDGE ANGEJA: Okay. CDTFA, why don't you guys  
24 go ahead.

25 MS. RENATI: Thank you.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

OPENING STATEMENT

MS. RENATI: The Appellant operates a restaurant serving Mexican style cuisine with a full bar in the city of Riverside, California. The business operates 7 days a week, with posted hours of 11:00 a.m. until 9:00 p.m.

The Department performed an audit for the period of April 1st, 2010, through September 30th, 2013. The only records provided from the months within the audit period were incomplete bank statements. No summary books and records or source documents, such as Z tapes and cash register tapes and the like were made available. The Department reviewed the Appellant's reported taxable sales for sales and use tax returns and found the Appellant's average reported monthly sales was \$11,600 with average daily sales of around \$383.00.

The Department reviewed bank statements and found that the amount of cash deposited each month fluctuated greatly from no cash deposits for two months in the year 2013 to \$75,000 to over \$18,000 for other periods. And that's -- you can see that on Exhibit E, page 36 through 38. When I mentioned the pages, that's the Bates stamp at the very bottom right corner.

JUDGE ANGEJA: Thank you.

MS. RENATI: The Appellant's credit card deposits remained constant throughout the audit period and

1 represented 83 percent of the amounts deposited. The lack  
2 of consistent cash deposits, and the fact that credit card  
3 tips are paid in cash to servers, led the Department to  
4 believe bank deposits were likely understated.

5           Additionally, the Department compared total bank  
6 deposits adjusted for sales tax to reported total sales  
7 for Appellant's sales and use tax returns, an unexplained  
8 difference of over \$1.4 million was noted. That is, the  
9 amount of credit card sales and limited cash deposits was  
10 substantially greater than the total sales reported to the  
11 Department. And that's on Exhibit E, page 38.

12           The Department also noticed that the average  
13 daily bank deposits for the business was \$1,624, which is  
14 much greater than the average reported daily sales of only  
15 \$383. Due to the lack of records available to support  
16 reported amounts, the Department asked the Appellant to  
17 retain current daily records, including guest checks and  
18 cash register tapes.

19           Subsequently, the Appellant provided sales  
20 summary sheets for October 1st, 2013, through  
21 October 20th, 2013. And that's on Exhibit E, page 39.  
22 The sales summary sheets included information for cash and  
23 credit card sales for both the restaurant and bar for that  
24 morning and afternoon shifts. Register tapes and guest  
25 checks were not provided to support the amounts. The

1 Department was unable to verify if the amounts were  
2 accurate because we didn't have the supporting  
3 documentation.

4 The average daily sales for this 20-day period  
5 was \$1,645, which is also significantly higher than the  
6 \$383 of average daily sales reported for Appellant's sales  
7 and use tax returns. The Department asked the taxpayer  
8 again to retain records, and the Appellant provided sales  
9 summary sheets for November 13th, 2013, through  
10 November 25th, 2013. But again, the Appellant failed to  
11 provide source documents such as Z tapes, cash register  
12 tapes, or guest checks to support the recorded amounts.

13 Since the requested records were incomplete, the  
14 Department computed audited taxable sales using a cash to  
15 credit card methodology. The Department performed two  
16 separate observation tests on Tuesday October 22nd, 2013,  
17 and Tuesday November 12th, 2013. For October 22nd, 2013,  
18 the Department observed the Appellant used handwritten  
19 guest checks where sales tax was charged and collected on  
20 all sales.

21 The Department transcribed the guest checks and  
22 noted that total sales, excluding tax for the available  
23 period, was \$1,283, with a credit card sale percentage of  
24 55.4 percent. And that's at Exhibit E, page 32  
25 through 33. For November 12th, 2013, the Department

1 transcribed all guest checks provided. Again, the  
2 Department noticed that they were handwritten, that sales  
3 tax was charged and collected on all sales. Total sales,  
4 excluding tax, was \$1,067 and a credit card percentage of  
5 60.15 percent. And that's on Exhibit E, page 34 to 35.

6 The Department combined the results of the  
7 observation test dates to achieve an audited credit card  
8 percentage of 57.56 percent. The audited credit card  
9 percentage was then applied to credit card sales, per bank  
10 deposits, to compute audited taxable sales. Credit for  
11 taxable sales reported for returns which provided in a  
12 total understatement of approximately \$2.7 million was  
13 computed.

14 Of this amount, more than \$1.4 million represents  
15 a difference noted in the Department's bank deposit  
16 reconciliation. The remainder of over \$1.2 million  
17 represents unreported sales made in cash, Exhibit E,  
18 page 30.

19 The Appellant claims that the results of the  
20 observation testing were not representative because the  
21 observation test both occurred on Tuesdays rather than a  
22 weekend where the Appellant claimed that the average sales  
23 per ticket would be higher, and customers would be more  
24 likely to use a credit card rather than cash. While the  
25 Department agrees that the total sales on weekends could



1 be greater than during weekdays, the Department contends  
2 this increase is likely due to a greater volume of  
3 customer sales and not necessarily higher per ticket  
4 prices for sales.

5 Further, the Appellant has not provided  
6 documentary evidence to support the contention that the  
7 ratio of credit card sales to cash sales on weekends would  
8 have been greater than on weekdays. In fact, the review  
9 of Appellant's sales summaries for Tuesday  
10 October 1st, 2013, through Sunday October 20th, 2013,  
11 shows the percentage of credit card sales was greatest on  
12 Tuesday with Wednesday and Thursdays the next highest  
13 levels. And that's on Exhibit E, page 39.

14 Lastly, Appellant's Exhibit 3, submitted for this  
15 appeal, includes a calculation whereby the Appellant  
16 contends the results of the observation testing should be  
17 used to calculate average taxable sales which can then be  
18 multiplied by the number of days in the audit period to  
19 compute audited taxable sales. The Department rejects  
20 this proposition as the resulting understated amounts are  
21 not reasonable.

22 The audited average daily sales established by  
23 the Department is \$2,535. The Department used the results  
24 of the observation testing to calculate the audited cash  
25 to credit card ratio. The Department is confident that

1 all credit card sales were accounted for in our test  
2 results. Therefore, the Department did accept those  
3 results for just cash to credit sales.

4 But the average daily sales for the combined  
5 observation test is \$1,175, which is far less than the  
6 Appellant's average daily bank deposits of \$1,645. Also,  
7 the average daily cash sales for the 20-day period is  
8 \$118.35. Whereas on the 2-day observation test, we had  
9 \$686.49 in cash.

10 And lastly, the Appellant's proposed total  
11 underestimate of about \$990,000 is much less than the \$1.4  
12 million difference the Department noted in a simple  
13 comparison of bank deposits and reported amounts. And  
14 that's on Exhibit E, page 38.

15 The Appellant claims the Department also failed  
16 to perform secondary testing to support the audited  
17 amounts. The Department notice the Appellant failed to  
18 provide any books and records, including source documents,  
19 federal income tax returns and the like, which would have  
20 allowed the Department to perform additional testing.

21 However, secondary analysis was performed by the  
22 Department's Appeals Bureau and is included on Exhibit F,  
23 page 47. A review of the Appellant's menu per Yelp.com  
24 shows an estimate average selling price for food and  
25 nonalcoholic beverage of \$20 per person. If you divide

1 the audited average daily sales of \$2,535 by \$20, the  
2 average customer paid by about \$127.

3 Since the Appellant's restaurant is open about 10  
4 hours -- it is posted for 10 hours. Although recently the  
5 Appellant said it was open 11 hours per day, the average  
6 number of customers with a 10-hour day would be 13.

7 Considering the fact Appellant's business has a  
8 seating capacity for 70 people in the dining room alone,  
9 and this analysis does not include alcoholic beverages or  
10 sales of food and beverages in the bar, the secondary  
11 evaluation shows the audited amounts are reasonable. The  
12 Department made multiple requests during the audit asking  
13 the Appellant to retain records, but the Appellant failed  
14 to comply. Accordingly, an adjustment to the audit  
15 finding should be denied.

16 As in regards to the fraud penalty, the Appellant  
17 claims all penalty should be abated as this is his first  
18 audit. However, Regulation 1703(c)(3)(a) and Audit Manual  
19 Section 506.4, allow the application of a penalty in cases  
20 of a first audit when the bookkeeping and reporting errors  
21 can be substantiated with evidence. The 25 percent  
22 penalty of evasion should apply as supported by  
23 Department's Memorandum dated May 30th, 2014, which is  
24 Exhibit B, copies of permit information, Exhibit C and D  
25 and Department's Schedule 12, Exhibit E, page 26.

1           The Department observed the Appellant charged and  
2 collected sales tax reimbursement from customers on all  
3 sales made. However, the Appellant consistently and  
4 systematically failed to report a material portion of its  
5 sales throughout the audit period with an understated  
6 error ration of 553.6 percent.

7           The Appellant had prior knowledge of his  
8 responsibility for sales tax, as he's been operating this  
9 business since April 1st, 2005, when the business operated  
10 as a sole proprietor. And he operates the corporation as  
11 the president and sole stockholder. And that's on  
12 Exhibit D. Prior to opening the restaurant, the Appellant  
13 also operated a used car dealership from September '99  
14 through March 2005, which included additional reporting  
15 requirements by the DMV. That's Exhibit C.

16           The Appellant's extensive business experience  
17 running this restaurant for nine years, coupled with over  
18 five years in his previous businesses, demonstrates he is  
19 well-informed of the obligation to properly report the tax  
20 liability of the business.

21           Additionally, each time the Appellant opened one  
22 of four sellers permits issued, copies of pertinent  
23 regulations, tax pamphlets, and other relevant information  
24 was furnished by the Department to provide the Appellant  
25 regarding the application of tax on those transactions and

1 its responsibilities for tax reporting and the requirement  
2 to keep records, and also gave him information on where to  
3 get help.

4 The Appellant was involved in the daily  
5 operations of the restaurant, personally filed the sales  
6 tax returns for the business and ensured funds were  
7 deposited into the bank accounts. A simple review of the  
8 Appellant's bank statements shows bank deposits far  
9 exceeded the amount of reported sales with credit card  
10 sales exceeding reported sales by three times. The  
11 Appellant failed to exercise due care in keeping records  
12 as he failed to provide even basic accounting records to  
13 support the reported amounts.

14 Additionally, the Department made numerous  
15 requests of the Appellant to retain guest checks and cash  
16 register tapes to assist in the verification of sales.  
17 The Appellant intentionally ignored the Department's  
18 request and only provided summary sheets. As the  
19 Department's evidence shows, the substantial deficiency of  
20 over 553 percent cannot be explained as a simple mistake  
21 or lack of attention.

22 Instead the evidence shows there's clear and  
23 convincing evidence that the Appellant is an experienced  
24 businessperson. The Appellant had knowledge that taxes  
25 were due and collected taxes. The Appellant willfully

1 attempted to evade the taxes collected. And the Appellant  
2 intentionally failed to provide records. Accordingly, the  
3 25 percent penalty for evasion should remain.

4 This concludes my presentation. I'm available to  
5 answer any questions.

6 JUDGE ANGEJA: All right. Any questions?

7 JUDGE CHENG: No. Thank you.

8 JOSH LAMBERT: No.

9 JUDGE ANGEJA: You have the opportunity for s  
10 rebuttal.

11 MR. GUZMAN: Oh, that quick? Yes.

12

13 REBUTTAL STATEMENT

14 MR. GUZMAN: Okay. Just a correction.

15 Obviously, the exhibit show the 900-plus measure of tax.  
16 And this is as we started the hearing today. I adjusted  
17 that to \$2 million based on \$1,645 because that summary  
18 sheet is actually supported by the observation test that  
19 was made by the auditor. The auditor had observations in  
20 those two days less than \$1,645. My position is let's  
21 take the \$1,645. That seems to me more reasonable.

22 The Department obviously feels the taxpayer owes  
23 this amount. The taxpayer reported this amount, and I  
24 think he owes the tax on the \$2 million. The other thing  
25 I want to talk about is the audit, and one of the

1 things -- well, the credit card ratio. The credit card  
2 ratio, obviously, is well explained in Chapter 8, Bars and  
3 Restaurants.

4 The reasonableness test, it's always important to  
5 support the credit card ratio. And what the Department  
6 has done in other audits that I've seen, is that they use  
7 the sales on the observation test to support the credit  
8 card. It doesn't support the credit card. If it's done,  
9 for some instances, use the observed sales to justify the  
10 credit card sales, in this case it doesn't match.

11 So I'm saying I don't see a reasonableness test  
12 here as mandated or directed under Chapter 8. The  
13 reasonableness test usually has to do -- I understand the  
14 taxpayer at that time had not even filed or prepared its  
15 federal income tax returns. He doesn't have a profit and  
16 loss statement, but there were purchase invoices. I don't  
17 recall if they asked for them, but there were purchase  
18 invoices.

19 But the point, I'm going back to the audit  
20 amount. I'm saying that the 2-point X is closer to what  
21 it should be based on the 20-day summary. That's  
22 supported by the 2-day observation test done by the  
23 Department. I'm going to move over to the fraud. I'm  
24 going to keep on saying, experience, experience, business  
25 owner. He had a car dealership. Do you use credit card

1 analysis for car dealerships? No, you don't.

2 He has specific information to control the sales  
3 of a car dealership? Yes, you do. You have DMV.  
4 Nowadays, DMV relates the information to CDTFA, and CDTFA  
5 just sends them a bill. So there are two different types  
6 of businesses. He was an insurance broker. It has  
7 nothing to do with sales tax. Even the question, the very  
8 basic question that I asked this morning is ice cream  
9 taxable? Everybody in this room knows what the answer is.

10 Most taxpayers, I bet you 99.9 percent do not  
11 even know how to answer that question. And I've tested it  
12 with all my clients, and nobody seems to have it. So the  
13 other thing about specific information the taxpayer  
14 receives in order to be able to report more accurately, I  
15 just Googled CDTFA for the heck of it. I'm a regular  
16 taxpayer. A tax guide for restaurant owners. This is  
17 their guide. And I have under -- let's see.

18 It doesn't say the page, but it's a Tax Guide for  
19 Restaurant Owners, Recordkeeping. These are the  
20 instructions taxpayers are getting out there. If your  
21 restaurant includes a bar, make sure to keep records that  
22 show restaurant purchases and sales separately from bar  
23 purchases and sales. Okay. You should keep a written  
24 record of your policy regarding free food and beverages.

25 You should keep evidence of price changes and



1 other variables, the usual practices. If you make price  
2 change to your menu, note in your record showing the price  
3 changes. You should keep documents such as cash register  
4 tapes or invoices to show the price changes. This is the  
5 instructions that taxpayers are getting out there. It  
6 doesn't say how -- specifically, how to keep records.

7           You have another -- I think this is a bulletin --  
8 Dining and Beverage Industry. Here again, I go in  
9 recordkeeping. What does it say there? Don't mix bar and  
10 restaurant receipts and purchases, complimentary meals and  
11 drinks, types of records, memo slips. It didn't say much  
12 of anything. This is the information the taxpayer is  
13 getting out there.

14           So it's very, very difficult for -- especially,  
15 for the first time around not knowing. Now, I tell you he  
16 has been audited by CDTFA. Do we have the same problem?  
17 No, we don't. Because he was educated when he was audited  
18 the first time. And so the other question about  
19 Mr. Pintos being at the cash register, more likely than  
20 not that he's not. Why? Because we have several  
21 employees, a lot of clients. He's not there at the cash  
22 register to record every single transaction.

23           And with that, I conclude my presentation.

24           JUDGE CHENG: No questions.

25           JOSH LAMBERT: No questions.

1 JUDGE ANGEJA: So I have got a few, and I can  
2 tell you were chomping at the bit.

3 MS. RENATI: No.

4 JUDGE ANGEJA: Okay, because I have questions,  
5 two of them. It seems to be undisputed that CDTFA asked  
6 several times for supporting documentation. None were  
7 provided. And I don't know an explanation for why the  
8 taxpayer didn't provide the documents that were  
9 specifically requested. And part of the reason for my  
10 question is because even if one didn't know that one was  
11 supposed to retain those documents or there was a language  
12 barrier or a lack of general knowledge, once someone tells  
13 me to retain this, and this and this, I should retain  
14 those things. And I don't see an explanation in the  
15 record for why he did not.

16 I'm asking if your client has an explanation for  
17 that?

18 MR. GUZMAN: Well, my question is where is it on  
19 record these specific requests? Was he told verbally?  
20 Was it in writing? Did they send a letter to him  
21 explaining that he should?

22 JUDGE ANGEJA: Go ahead and answer that.

23 MS. RENATI: I can look in the record and see if  
24 it's written in the notations, but --

25 JUDGE ANGEJA: So you're denying they even asked?

1           MR. GUZMAN: No, I'm not denying that. I'm  
2 just -- I don't know if we have specific records, a  
3 specific letter, or something to say do this. I don't  
4 remember. Verbally they could have. I don't know. I  
5 don't have a record of that.

6           JUDGE ANGEJA: Is it common practice to ask for  
7 that when all you've got is incomplete bank statements?

8           MS. RENATI: It's very common practice to ask for  
9 it. And the fact that we asked it for the October period  
10 and didn't have it. And then gave almost like a second  
11 chance and asked for it again to have the same records  
12 kept for November is indicative of the fact that they  
13 would have had to emphatically asked. The first time they  
14 came through they weren't supported. The second time they  
15 came through, again, they weren't supported. That's when  
16 the auditor then moved on to an observation testing.

17           JUDGE ANGEJA: Okay. And then I had one other  
18 question. I understand the argument that he may not have  
19 had knowledge of sales tax; right?

20           MR. GUZMAN: That's right.

21           JUDGE ANGEJA: And you're arguing the abstract  
22 the amount of knowledge that's out there and what CDTEFA --

23           MR. GUZMAN: Right.

24           JUDGE ANGEJA: Well, my question -- and I'm sorry  
25 to ask what seems to be a pointed question. But by your

1 own admission, there's a liability of -- or a measure of 2  
2 point -- let's call it \$2 million.

3 MR. GUZMAN: Yes.

4 JUDGE ANGEJA: At a minimum there's an amount  
5 deposited in his own bank records -- sorry -- in his own  
6 bank accounts of which he must be aware that he didn't  
7 report. So without regard to what he knew generally of  
8 sales tax, and what he might have learned in a car  
9 dealership operation, there is specific sales tax money  
10 collected and deposited and not reported. Isn't that  
11 knowledge of a reporting obligation, and that it should be  
12 paid? And what's the explanation for failing to report  
13 that, which is shown in his own records?

14 MR. GUZMAN: The failing to -- here again, the  
15 gentleman comes from Argentina. He speaks Spanish. He  
16 thought in general it was like income tax. That's exactly  
17 the explanation he gave me. As an accountant I can look  
18 at that and say, well you deposit X amount. You should  
19 report X amount. I -- I know that. I mean, I'm prep -- I  
20 do preparation to know enough of that.

21 But most restaurant owners didn't -- I bet you  
22 almost anything, he's probably not the only one out there  
23 that -- that has these types of problems having to do with  
24 sales tax. And I want to go back to that example where  
25 the gentleman actually had an audit, similar type of

1 business. He had understatement, and he opened up another  
2 business.

3 He was specifically told in the audit to maintain  
4 guest receipts. He didn't keep them. At most he got a  
5 10 percent penalty. And it was a sizable understatement  
6 according to that example that I mentioned to you. That's  
7 actually in the manual.

8 JUDGE ANGEJA: My last question for the  
9 Department. Why only two days? Why two Tuesdays?

10 MS. RENATI: There's not an explanation for why  
11 only two days. They did do the two days. They chose  
12 Tuesday. They were probably trying to find a day that  
13 would be not too busy, not too slow, so that it would be a  
14 good day they wouldn't get skewed results.

15 And as it turns out, when you look at those two  
16 days of Tuesday's, you know, Tuesdays do end up being  
17 their busy days of the month when you look at the October  
18 1st summary sheets that we have in that 20-day period.  
19 There wasn't an explanation in the record. But as it does  
20 turn out, that was the busiest day. And using the busiest  
21 day for credit cards only benefits the Appellant. Because  
22 the higher the credit card receipts, the more -- you know,  
23 the less likely that -- I mean, the amount of total sales  
24 when you do the projection.

25 JUDGE ANGEJA: Okay. And then I wanted to

1 confirm my understanding because it gets baked into the  
2 question. If you were to project the liability based on  
3 an observation test of sales per day, the audit manual  
4 specifies that that's supposed to be three days, one on  
5 the weekend, that sort of thing.

6 MS. RENATI: And I --

7 JUDGE ANGEJA: This wasn't that; right? This is  
8 a credit card sales ratio?

9 MS. RENATI: Well, I believe the three days  
10 wasn't in the audit manual at that time and place. This  
11 is back in 2013.

12 JUDGE ANGEJA: Okay. Sure.

13 MS. RENATI: I think that changed with May  
14 sometime in '16 or '17.

15 JUDGE ANGEJA: I'm just trying to confirm for my  
16 understanding, they are two different tests?

17 MS. RENATI: There would be two different.

18 JUDGE ANGEJA: In other words, the 3-day rule, if  
19 you want to call it -- if I'm going to call it that for  
20 purposes of my question, that applies to a projection of  
21 observed sales for a representative period of three days.

22 MS. RENATI: That's my understanding.

23 JUDGE ANGEJA: The credit card sales ratio could  
24 have even been on one day?

25 MS. RENATI: Yes.

1 JUDGE ANGEJA: And you still have a valid --

2 MS. RENATI: Yes.

3 JUDGE ANGEJA: In other words --

4 MS. RENATI: Yes. We're just trying to attempt  
5 to get what the credit card -- audited credit card  
6 percentage would be.

7 JUDGE ANGEJA: And I understand that the more  
8 days, the more representative.

9 MR. GUZMAN: Well, the thing is just in general  
10 in auditing. I mean, that's what we were taught back when  
11 we're teaching, they are being taught auditing. The more  
12 the population is -- I mean, the more samples the better  
13 the results.

14 JUDGE ANGEJA: Correct.

15 MR. GUZMAN: In this case, I'm saying, well,  
16 based on those results, we have 152,000 orders, and we  
17 looked at 100.

18 JUDGE ANGEJA: Correct. I'm just trying to  
19 clarify the rule to which the audit manual, the 3-day, the  
20 test.

21 MR. GUZMAN: That came about afterward.

22 JUDGE ANGEJA: Yes. But it also applies to a  
23 test other than the one that was applied here.

24 MR. GUZMAN: Correct. And just for -- yeah.

25 JUDGE ANGEJA: Okay. I don't have any other

1 questions. I think I got pretty far into the league  
2 match. I apologize. If my colleagues have no questions?

3 Okay. Then we will close the record and conclude  
4 this hearing. I want to thank each party for coming in  
5 today. Following this hearing my co-panelist and I will  
6 discuss the case, and we will issue a written opinion  
7 within 100 days of today's date.

8 And that will conclude the hearing.

9 (Proceedings adjourned at 11:26 a.m.)

10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

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 10th day of February, 2020.

---

ERNALYN M. ALONZO  
HEARING REPORTER