

## STATE OF CALIFORNIA

Thursday, December 19, 2019

STATE OF CALIFORNIA OFFICE OF TAX APPEALS

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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE OF, )  
RICARDO'S ON THE BEACH, INC., ) OTA NO. 18063296  
APPELLANT. )  
\_\_\_\_\_ )

Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Cerritos, California, 90703,  
commencing at 2:22 p.m. and concluding  
at 4:05 p.m. on Thursday, December 19, 2019,  
reported by Ernalyn M. Alonzo, Hearing Reporter,  
in and for the State of California.

1 APPEARANCES:  
2  
3 Panel Lead: ALJ SUZANNE BROWN  
4  
5 Panel Members: ALJ MICHAEL GEARY  
6 ALJ NGUYEN DANG  
7  
8 For the Appellant: GARY M. SLAVETT  
9  
10 For the Respondent: STATE OF CALIFORNIA  
11 DEPARTMENT OF TAX AND  
12 FEE ADMINISTRATION  
13 By: SUNNY PALEY  
14 MONICA SILVA  
15 LISA RENATI  
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I N D E X

E X H I B I T S

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(Department's Exhibits were received at page 7.)

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DEPARTMENT'S

WITNESSES:

DIRECT

CROSS

REDIRECT

RECROSS

(None Offered)

APPELLANT'S

WITNESSES:

DIRECT

CROSS

REDIRECT

RECROSS

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1 Cerritos, California; Thursday, December 19, 2019

2 2:22 p.m.

3

4 JUDGE BROWN: We're now on the record in the  
5 Office of Tax Appeals oral hearing for the appeal of  
6 Ricardo's on the Beach. And this is OTA Case Number  
7 18063296. We're in Cerritos, California, and today is  
8 Thursday December 19th, 2019, and the time is  
9 approximately 2:22 p.m.

10 My name is Suzanne Brown, and I am the lead  
11 Administrative Law Judge for this hearing. And my fellow  
12 co-panelists today are Michael Geary and Nguyen Dang.

13 JUDGE DANG: Good afternoon.

14 JUDGE BROWN: First I will ask the parties to  
15 identify themselves for the record, starting with CDTFA.

16 MS. PALEY: I'm Sunny Paley. This is Monica  
17 Silva and Lisa Renati.

18 JUDGE BROWN: Mr. Slavett.

19 MR. SLAVETT: Gary Slavett for Ricardo's on the  
20 Beach. To my right is Mario Ernst, and to his right is  
21 CPA Sam Biggs.

22 JUDGE BROWN: Thank you very much, everyone.

23 I was going to briefly review the basics about  
24 the issues; who the witnesses are going to be. I'm going  
25 to admit the evidence, and then we will begin hearing your

1 presentations with the Appellant's presentation first.

2 Okay. As we confirmed during the prehearing  
3 conference order of the prehearing conference that was on  
4 November 20th, 2019, the issues in this appeal are:  
5 Whether CDTFA has established by clear and convincing  
6 evidence that the 25 percent fraud penalty under Revenue  
7 and Taxation Code Section 6485 is applicable for the  
8 period January 5, 2005, through December 31st, 2011.

9 And then related to that, the other issue is:  
10 Whether the Notice of Determination was timely issued  
11 pursuant to Revenue and Taxation Code Section 6487 for the  
12 period January 1st, 2005, through September 30th, 2008.  
13 And the second issue depends on whether there is a finding  
14 of fraud or intent to evade the law or any authorized  
15 rules and regulations as indicated in issue one.

16 And we also discussed at the November 20th  
17 prehearing conference that there were going to be two  
18 witnesses today and those are both Appellant's witnesses  
19 who are here in person, Mr. Ernst and Mr. Biggs.

20 MR. SLAVETT: Yes, Your Honor.

21 JUDGE BROWN: Okay. And CDTFA does not intend to  
22 call any witnesses?

23 MS. PALEY: Correct.

24 JUDGE BROWN: Okay. And I know we discussed this  
25 previously. I'm just kind of confirming in case -- to

1 check in case anything has changed. All right. And then  
2 as far as the exhibits, we identified the exhibits, and my  
3 office sent everyone a courtesy copy of the exhibits, the  
4 hearing binder. And that contains what we've marked as  
5 Appellant's Exhibits 1 through 9, and CDTFA's Exhibits A  
6 through E. Neither party has indicated any objection to  
7 admission of any of the exhibits. I'll also just briefly  
8 note, for the record, that on December 17th, 2019, I held  
9 a brief conference call with the parties to discuss some  
10 questions about admission of some of the pages in CDTFA's  
11 Exhibit E.

12 And as a result of those discussions, I indicated  
13 to the parties that I would admit Exhibit E in its  
14 entirety. And I will just confirm that neither party  
15 objects to admission of all the proposed exhibits;  
16 correct?

17 MR. SLAVETT: That's correct, Your Honor.

18 MS. PALEY: Yes, thank you.

19 JUDGE BROWN: Okay. Accordingly, I will admit  
20 Appellant's Exhibits 1 through 9 and CDTFA's Exhibits A  
21 through E. They are admitted into evidence.

22 (Appellant's Exhibits 1-9 were received  
23 in evidence by the Administrative Law Judge.)  
24 (Department's Exhibits A-E were received in  
25 evidence by the Administrative Law Judge.)

1 JUDGE BROWN: Okay. And then I'll just briefly  
2 go over our schedule today, and then we'll get started.

3 I indicated in the prehearing conference order  
4 that Appellant will have a total of up to 55 minutes to  
5 present its argument and witness testimony. And that  
6 concludes -- Mr. Slavett, are you intending to do an  
7 opening statement?

8 MR. SLAVETT: Yes, Your Honor.

9 JUDGE BROWN: Okay. So that will include your  
10 opening statement and the initial testimony of your two  
11 witnesses. And then after that, the Judges may ask  
12 questions or CDTFA may ask questions of each of your  
13 witnesses after they have each testified.

14 And then CDTFA will have up to 20 minutes for its  
15 argument, and the Judges may ask questions of CDTFA. And  
16 then after that, Appellant will be permitted to make a  
17 rebuttal, and we indicated up to 10 minutes should be  
18 sufficient. And the Judges may have questions at the end  
19 for either party.

20 And I will clarify that after your opening  
21 statement, Mr. Slavett, I will swear in your first  
22 witness. Who are you intending to call first?

23 MR. SLAVETT: Mr. Ernst.

24 JUDGE BROWN: Okay. I will swear in Mr. Ernst.  
25 And then before Mr. Biggs' testimony, I will swear him in.



1 And I will just clarify that because they are witnesses  
2 their testimony will be evidence in this matter. I'm not  
3 swearing in the representatives because while they will be  
4 making arguments, they will not be testifying and,  
5 therefore, their arguments are not evidence in this  
6 matter.

7 Okay. Does anyone have any questions or anything  
8 to raise before we begin?

9 MS. PALEY: No. Thank you.

10 JUDGE BROWN: Okay. Mr. Slavett, why don't you  
11 go ahead and make your opening statement, and then I will  
12 swear in the first witness.

13 MR. SLAVETT: Thank you, Your Honor.

14

15 OPENING STATEMENT

16 MR. SLAVETT: So why are we here today? We're  
17 here because of the actions of taxpayer's bookkeeper and  
18 outside accountant, Xavier Velazco. We're here because  
19 Xavier took actions that were unbeknownst to the taxpayer  
20 and clearly not authorized by the taxpayer.

21 What did he do? He caused incorrect sales tax  
22 returns to be filed with the State. And he tried to cover  
23 this up during the audit by submitting phony or incorrect  
24 IRS income tax returns.

25 I'm going to tell you a little bit about the

1 business. The taxpayer here, Ricardo's on the Beach,  
2 operates two restaurants, Dinah's Family Restaurant in  
3 Culver City, and Ricardo's El Ranchito in La Habra. The  
4 taxpayer is a C Corp owned by Mario Ernst to my right and  
5 his wife Terri Ernst.

6 Mario did not work in the restaurant day-to-day.  
7 Terri worked very infrequently, maybe once or twice a  
8 month to cover for other managers. Mr. Ernst will explain  
9 more about that in his testimony. Each location had  
10 managers that oversaw the operations of the business.  
11 Those managers were responsible for the day-to-day  
12 activities of the business. Those managers were  
13 responsible for making the cash deposits.

14 The day-to-day bookkeeping was handled by an  
15 outside accounting department at an entity related to this  
16 entity also related to Mario Ernst called TLD  
17 acquisitions. At TLD, that's where Xavier Velazco was  
18 working, and he was preparing the books and records for  
19 Ricardo's -- for both restaurants. It was him and -- and  
20 the accounting function there that was responsible for the  
21 sales tax returns.

22 And our understanding is Xavier would -- would  
23 give the information either to a woman named Jamie Purcell  
24 in that department or another individual, and they would  
25 prepare the returns. In about 2011, Xavier left TLD and

1       opened up his own business.  He had some other clients,  
2       but he continued to do the work for Ricardo's on the  
3       Beach.

4               Again, Mario and Terri -- Mr. And Mrs. Ernst had  
5       no involvement in the day-to-day finance of the business.  
6       He can -- you know, look at the exhibits today.  And when  
7       the audit record, the auditor communicated directly with  
8       Mr. Velazco during the audit.  And it was during this time  
9       that it appears that Mr. Velazco submitted phony incorrect  
10      income tax returns of the taxpayer.  At some point -- and  
11      we'll get more into that -- the examiner contacted the  
12      CPA -- Mr. Biggs who is here to testify -- asking about  
13      those returns and that's when this whole scheme was  
14      uncovered.

15             Mr. Biggs contacted Mario and -- and action was  
16      taken.  The record is very clear that the principals,  
17      Mario and Terri, had no knowledge of incorrect sales tax  
18      returns being filed, and the phony tax returns being  
19      provided to the State's auditor.

20             It is interesting to note that the auditor first  
21      became suspicious when he did a bank deposit analysis and  
22      found large discrepancies.  Why is this important?  This  
23      is important because it shows that all sales were, in  
24      fact, deposited into the bank account.  Hardly an  
25      indication of fraud on behalf of the taxpayers directly.

1           Further, all sales were correctly reported on  
2       federal and State income tax returns, returns that the  
3       State had that were prepared by Mr. Biggs, the outside  
4       CPA. Hardly an indication of the taxpayers directly  
5       trying to commit some kind of fraud here. And so the  
6       fraud occurred in the function that Xavier Velazco was  
7       handling, sales tax returns.

8           So the big question, the big question that's  
9       here. Why did Xavier do it? There are really only two  
10      possibilities. One, the taxpayer, through Mario or Terri,  
11      told him to do it. Number two, Xavier stole some money  
12      from the business and was trying to cover it up. With  
13      respect to number one that Xavier was instructed to do it,  
14      the record is very clear that neither Mario or Terri were  
15      involved in any of the sales tax matters, including the  
16      audit.

17           It was Xavier that handled all these matters. He  
18      handled the audit. Once Mario learned that a phony return  
19      was submitted to the examiner, he immediately took action  
20      to resolve the matter. And he's here to testify, and I  
21      believe you'll find him credible with respect to his  
22      involvement or lack of involvement in this issue. So if  
23      Xavier wasn't instructed to do this by a principal, then  
24      what is it?

25           Okay. Well, he -- it has to be that he was

1 covering something up. It has to be that he was stealing  
2 money from the company. Exhibit 1, it shows that he had  
3 signature authority over the bank account. Okay. So at  
4 the time Mario discovered the activity in 2003, the  
5 business was really suffering, and Mario was focused and  
6 surviving and keeping the business going. He'll explain,  
7 and he will testify. You'll gauge his credibility that he  
8 didn't have the resources to conduct an investigation to  
9 find out the severity of the theft, and he felt like it  
10 would be futile anyways.

11 This guy -- he was never going to collect a dime  
12 from this guy. He -- he acknowledges that he's going to  
13 have to pay the taxes. So he figured he'd move on and try  
14 to resolve this. And -- so this case is really about,  
15 obviously, fraud. And it's the government burden to prove  
16 that the taxpayer committed this fraud.

17 Here the government is attempting to attribute  
18 the actions of the outside books to that of the taxpayer.  
19 Here Xavier Velazco was acting outside the scope of  
20 authority when he admitted the phony income tax returns.  
21 I'm going fast. I'm worried about my time, but I think I  
22 have plenty.

23 JUDGE BROWN: Okay. Go ahead.

24 So the taxpayer was defrauded by Xavier by the  
25 likely theft of funds. He was also defrauded when

1 taxpayer submitted false tax returns to the State. This  
2 was not only a fraud on the State, but a fraud on the  
3 taxpayer. We are here now because of that fraud.

4 As mentioned in our briefs, and I'll talk a  
5 little bit about it, but the briefs kind of lay out the  
6 argument here. A few courts have analyzed Section 6485.  
7 Several courts have analyzed -- analogized them to be 6663  
8 in the Internal Revenue Code. And the State Board even in  
9 a summary decision also cited to the Ninth Circuit case  
10 regarding 6663 to try to apply the standard 6045 is  
11 similar to 6663.

12 And, essentially, case law under federal tax  
13 civil fraud, you know, holds that a penalty may not be  
14 imposed based solely on the fraud of the taxpayer's agent.  
15 This is because the purpose of the fraud penalty is to  
16 punish and deter wrongful acts. In a situation in which  
17 the only wrongful act was an agent, there is no need to  
18 impose a penalty on the taxpayer. It is the agent and not  
19 the taxpayer whose wrongful conduct needs to be punished  
20 or corrected.

21 And I request that you look at, you know, my  
22 brief of the Fulton case. In my brief -- in the Fulton  
23 case the taxpayer hired an accountant, and it's a  
24 14 T.C. 1453. It's a United States tax court case talking  
25 about the 6663 penalty. In that case, the taxpayer hired

1 an accountant to prepare and file his federal income tax  
2 return.

3 The preparer included fraudulent deductions on  
4 the income tax return and filed the return without  
5 allowing the taxpayer to review the return. The U.S. Tax  
6 Court concluded the taxpayer was not liable for the civil  
7 fraud penalty.

8 In this case, without getting into too much  
9 detail, this case is similar to the Fulton case. In both  
10 cases, the taxpayer trusted a tax professional who held  
11 themselves out as a competent person. In both cases, the  
12 taxpayer did not prepare or file the returns at issue. In  
13 both cases, taxpayer was unaware that the returns  
14 contained inaccuracies. In both cases the taxpayer  
15 accepted the inaccuracies in the returns once the tax  
16 authorities raised the issue with the taxpayer.

17 JUDGE BROWN: Mr. Slavett, just in the interest  
18 of time, I'll mention I have read your brief. We've all  
19 read.

20 MR. SLAVETT: Okay. All right.

21 JUDGE BROWN: And also, I'll just remind you,  
22 technically, opening statement is supposed to be a  
23 summary.

24 MR. SLAVETT: Where does my argument come in?

25 JUDGE BROWN: Oh, I guess on rebuttal.

1           MR. SLAVETT: I thought this is all part of my  
2 argument.

3           JUDGE BROWN: It -- okay. Anyway, I'm just going  
4 to assure you that we've read your brief.

5           MR. SLAVETT: Okay. And I want to put out in the  
6 Fulton case, it also -- there was no mention of why the  
7 tax -- why the agent did -- took the acts they took.  
8 There wasn't even relevance in determining whether the  
9 fraud is attributed or not. And so I will -- I'll move  
10 forward to having testimony from Mr. Ernst.

11          JUDGE BROWN: Sorry if I messed up your rhythm.

12          MR. SLAVETT: It's okay.

13          JUDGE BROWN: Okay. If we are ready to proceed  
14 to Mr. Ernst's testimony, Mr. Ernst, I will say please  
15 stand and raise your right hand.

16          MR. ERNST: Yes, ma'am.

17

18                               MARIO ERNST,  
19 produced as a witness, and having been first duly sworn by  
20 the Administrative Law Judge, was examined and testified  
21 as follows:

22

23          JUDGE BROWN: Okay. Thank you very much.

24          Mr. Slavett, are you going do a question and  
25 answer or let him testify in a narrative format?



1           MR. SLAVETT: In a narrative format, but I will  
2 guide him along.

3           JUDGE BROWN: Okay. Go ahead.

4           MR. ERNST: Yeah. Please, questions and answers.  
5 I'm nervous enough. I have to tell you. This is  
6 nerve-racking.

7           MR. SLAVETT: Well, we'll start out easy.

8

9                           DIRECT EXAMINATION

10 BY MR. SLAVETT:

11           Q Tell us about the businesses?

12           A The businesses are really old-time established  
13 restaurants in La Habra and in -- at Dinah's Restaurant in  
14 La Habra. It was created in the mid to late 80s, and it's  
15 a small little Mexican restaurant. It seats maybe 75  
16 people. It's on Beach Boulevard. And it's -- what I  
17 always called it, it's really just like a local diner  
18 except it's a local Mexican restaurant.

19                   It's not built like the -- with all the frills  
20 and everything else that's out there like a lot of the  
21 Mexican. It's just a good little home Mexican restaurant  
22 like you find, really, anywhere else. Except it's not  
23 like you're -- as I said, a typical diner. Dinah's on the  
24 other hand is -- was established in 1959. It was opened  
25 up by my grandfather and it's -- God willing, it's still

1 around after 60 years.

2 And it's a diner. It's a typical 1950s  
3 groovy-style diner, and it's a family restaurant. It's --  
4 we serve the local community, and that's really what our  
5 focus has been over the last 60 years. It's really just  
6 being of service to the community.

7 Q And what was your role -- or did you -- what was  
8 your role in the business?

9 A My role in the business since it was a family  
10 business, is I did not work directly in the business, you  
11 know, from, really, 1999 up until, really, 2000 --  
12 mid-2013. I really oversaw the day-to-day operations of  
13 another business which was in the distribution business.  
14 We distributed bar and restaurant supplies in the Western  
15 United States.

16 So what I had done is because I have been  
17 involved in the restaurant directly and indirectly my  
18 entire life, I set up a management structure where we  
19 have -- we have permanent managers that operate each one  
20 of the different locations. Set up administrative  
21 procedures, you know, for the day-to-day administrative  
22 where we're, you know, with the deposits, how everything  
23 is supposed to handle -- be handled.

24 And then I have an outside party handle the  
25 day-to-day bookkeeping, the accounting to pay, you know,

1     monthly P&L, so on and so forth. And then as my third  
2     check was, I have -- I have -- at that time it was Biggs &  
3     Co. Now it's SingerLewak. But Sam Biggs would prepare  
4     the tax returns on an annual basis. I think Sam has been  
5     preparing our tax returns since 1996, 1997, I think. It's  
6     been almost 20-plus years. And that's how we ran the  
7     operations.

8             My involvement would really come more in time  
9     with -- as even with diners that are very set on their  
10    footing on what type of products. Basically, handling  
11    the -- you know, what menu items; what type of things are  
12    going to happen; what we're going to do with the  
13    community, and some of the marketing aspects. And that  
14    really goes the same way with Ricardo's. You know, it's  
15    not a new-way type of restaurant where we're doing  
16    something new every week.

17            We're -- our focus is really consistency and  
18    providing very warm and friendly service to our clients  
19    that come in. And that's what they come to expect. So  
20    the focus for the day-to-day managers is making sure we're  
21    out on the floor. Make sure, you know, we know our  
22    customers' names and family members, so on and so forth.  
23    And that's how we -- we ran the operations.

24            And that was really what my involvement was, just  
25    making sure we maintain that consistency and that

1 day-to-day type of presentation to the community.

2 Q Were you involved day-to-day?

3 A No.

4 Q Who handled the general bookkeeping and  
5 accounting on a day-to-day?

6 A So the way we had it set up is that as the chef  
7 would bring in the invoices, as they get deliveries during  
8 the day and the day-to-day, they would put everything in  
9 an envelope, and that would be forwarded to Javier. And  
10 that would include the deposits from the day.

11 So the manager would come in. They reconciled  
12 the day before. They put all the stuff together that they  
13 do. Make a deposit with the bank. Handle the  
14 reconciliation with the credit cards. They're doing the  
15 processing at the end of the day, put that all together in  
16 a package. And then once a week that information was then  
17 given to Javier. Then he would enter it into QuickBooks  
18 or some system like that, and then he would handle all the  
19 different administrative functions such as licenses and  
20 all the administrative aspects of it.

21 And then he would prepare a profit and loss  
22 statement. Take care of the -- you know, pay the vendors,  
23 and take care of the bills, those types of things. And  
24 then provide us, you know, give us our P&L so we can  
25 figure out, okay. Are we doing okay? Are we doing all

1 right? And then move onto the next month.

2 Q And how did you come to meet Javier Velazco?

3 A I met Javier in the mid-1990s. He was working  
4 for another restaurant firm that owned Group Hubs in the  
5 Midwest. And he was doing their accounting work. I was  
6 asked to come in and consult to provide some guidance for  
7 the Group Hubs. It was a new business in the mid-90s, and  
8 that's where I came to meet him.

9 Q Okay. And moving forward to the sales tax audit.  
10 How did you know an audit began or that the State was  
11 auditing Ricardo's?

12 A So I was told that -- it was sometime in 2012, I  
13 believe, that early -- I think early 2000. It could have  
14 been in 2012 -- my mind is getting old. It gets a little  
15 bit more rustier -- that we got a sales tax audit. And I  
16 was like, okay. I guess -- oh, well. It's just what  
17 you're supposed to do, whatever that is. You know,  
18 provide him all the documentation. But, I mean, I really  
19 didn't get that detailed. Just make sure, you know.

20 Q Who were you talking to about this?

21 A I'm sorry. I apologize about that. It was  
22 Javier Velazco, and I believe Jamie Purcell at that time.  
23 But I think the contact for me, really, during the  
24 period -- because Javier, once he left TLD, he established  
25 his own little accounting firm and CPA bookkeeping

1 company. So I said well, just keep on doing it. You've  
2 been doing it for 10, 12 years. So you know everything  
3 that's going on. So when he said, "Hey, we're going to  
4 have a sales tax audit," I said okay. Just, you know, do  
5 what you got to do.

6 Q And before the issue arose, did he give you  
7 updates on these sales tax audits?

8 A You know, not really. I just basically -- you  
9 know, in passing I would ask. Or when I got him on the  
10 phone, you know, where we at? Well, you know, providing  
11 him with this documentation. But I was sort of forewarned  
12 it's not a quick process. And I had gone through a sales  
13 tax audit with another company years earlier just as they  
14 went through.

15 And so I knew it wasn't something that it's, hey  
16 it's going to take 10 minutes or a day or two. It's  
17 something that happens, and paperwork goes back and forth.  
18 Just make sure you got all the paperwork for them.

19 Q And during this audit an event occurred.

20 A The event?

21 Q Can you tell us about that event?

22 A I mean, the event regarding this whole thing with  
23 fraud was I was telling Sam as we were talking about, you  
24 know, what should be expected. I mean, I still remember  
25 the time and the day and where I was when Sam had called

1 me. And I was at the Starbucks on La Cienega near Venice  
2 Boulevard having coffee and having a meeting with a friend  
3 of mine.

4 And Sam calls me up in the afternoon, and he  
5 goes, you know, typical, "Hey, how are you?"

6 "Good. Hey, what's going on?"

7 And he goes, "When did you hire a new CPA firm?"

8 And I go -- I can't repeat what I said. I don't  
9 know what you're talking about, you know.

10 He goes, "Well I got a call from an auditor,  
11 okay, from the State."

12 I said, "Yeah. They're doing some audit on the  
13 sales taxes."

14 And he goes, "Well, he submitted -- Javier had  
15 submitted a sales tax to them."

16 I said. "Okay."

17 And he goes, "Well, my name is -- I wasn't on  
18 it."

19 I go, "What do you mean you're not on it?" I go,  
20 "I don't know what you're talking about, you know." And I  
21 said, "I got to call you back."

22 "You know, what's -- he had said, you know, that  
23 your sales were, you know, I think it was a million  
24 dollars."

25 I go, "That's not true." I go, "Where did this

1 all come from?" So I said, "I got to call you back."

2 And then I called Javier. I said, "What the heck  
3 is going on with this -- this tax return?" And I go, "I  
4 just got a call from Sam saying that you had provided a  
5 false tax return." I go, "What's going on here?" And he  
6 just went silent. He just went dead on the phone. And I  
7 said -- I was so perplexed, you know, and angry by it.

8 And then I, you know, immediately I -- then I  
9 called Sam back. I said, "I don't know what the hell this  
10 guy did, you know he's -- I don't know what's going on."  
11 And then I just started communicating with Sam and, you  
12 know, getting ourselves together. And then I think a  
13 month or two later the auditor requested to have a meeting  
14 with Sam and myself. And so we met at Sam's office and,  
15 you know, had the meeting and discussed everything that  
16 had gone on regarding that -- you know, the whole sales  
17 tax, what had happened, and the whole audit procedure and  
18 everything.

19 And, you know, as I told him then, and I'll say  
20 it now. You know, first of all, I couldn't believe that  
21 somebody would do something like that. I mean, we -- we  
22 filed our taxes. We've done them. I mean, everything is  
23 there in the open. I mean, why would you do something so  
24 stupid? You got bank records. State of California can  
25 provide -- you know, they can look up your tax returns.



1       They've got them all. I mean, it's the same.

2               You know, in my mind I don't know whether it's  
3 true or not, but everybody has got access to them. And  
4 you know, as we explained to the auditor at that time, I  
5 said, "I can't speak for why he would do it. You know, my  
6 gut at this point is basically he probably stole a lot of  
7 money."

8               And you know, that was at that time, but the fact  
9 that he did something that was just so reprehensible to me  
10 just completely blew my mind. And, you know, my initial  
11 indication was, you know, I'm going to go after this guy,  
12 you know, and all the things you can pretty much think  
13 about when something like that happened. And, you know,  
14 come to realize after we've gone through and started to  
15 clean up, you know, cleaning up all the books and seeing.

16              I mean, one, the restaurants were not in the  
17 financial shape that was represented to me. I mean, we  
18 were hemorrhaging cash. It went from a -- something I  
19 reviewed on a monthly basis where it was all hands-on  
20 deck. We've got to figure this out or we're going to lose  
21 it. I'm going to -- you know, we're going to lose the --  
22 not only the restaurants, but all the people that have  
23 worked for us for, you know, 10, 20, 15, 30 years out of  
24 work.

25              It was horrible. It's just horrible. I mean,

1 I've spent my entire life, you know, working in the  
2 community trying to do a good job. And to have somebody  
3 just do something that's just so -- is beyond words. But  
4 during that period of time, then we, you know, it was all  
5 hands-on deck. What are we going to do? And like I said,  
6 I wanted to go after him like -- like there was no  
7 tomorrow.

8 But, you know, once you start talking to lawyers  
9 and accountants and, you know, well, it'll cost you  
10 \$50,000 to do a forensics CPA. It's gonna cost you, you  
11 know, if you prosecute him, you're gonna spend another 20  
12 or \$30,000. Then he's going to sue you. And what are you  
13 going to get from it? I mean, and here this guy goes MIA.  
14 And I'm thinking, great, now I've got to spend another,  
15 you know, a couple of hundred-thousand dollars.

16 We have no money. I'm having to pump money into  
17 the company just to save it. It was just let's try to  
18 figure out if we can save the restaurants, number one.  
19 And then if we can, let's move forward. I mean, we owe  
20 the tax. We'll figure it out, you know. We're gonna have  
21 to pay it, and let's just move forward.

22 So, you know, whether that was a good, bad, or  
23 indifferent decision, I mean, that was it. But that's  
24 what happened. And I'm sorry. It's, you know, it's been  
25 in our family. I'm 59 years old. My grandfather

1 established it in 1959. And to have something -- you  
2 know, every business makes mistakes. You've been around  
3 60 years. You're gonna make some mistakes. I get it.  
4 And, you know, you own up. You fix it. You move on.

5 I mean, I don't -- taking responsibility and  
6 accountability for my actions, but to be accused of fraud,  
7 which I didn't do -- to have somebody do something that's  
8 so stupid, which is beyond words. And to put not just the  
9 business at risk, but to put 100-plus employees that work  
10 there at risk and everything; the families and everything.

11 People have worked for us, like I said, 15,  
12 20 years. We don't have high turnover like a lot of  
13 places. I mean, we probably have 10, 15 percent turnover  
14 in a given year. And people stay with us a long time  
15 because we run a really nice operation. We treat  
16 everybody as family. We treat our employees and everybody  
17 we work with as family members.

18 And we're not a gold mine. We're just a little  
19 family business where we provide a good environment with  
20 good living. We do a good job at what we do. And to have  
21 somebody put that at risk just to this day still makes  
22 me -- is just beyond. I'm sorry. I'm done.

23 Q Did you -- just to make it clear, did you  
24 instruct Javier to submit what I'll call the phony income  
25 returns?

1           A    Absolutely not.

2           Q    Do you know anybody that did instruct him to do  
3   it?

4           A    No.

5           Q    Do you know anybody that instructed him to submit  
6   incorrect or cause to be submitted incorrect sales tax  
7   returns?

8           A    No.  Why?  I mean, it's all public record.  I  
9   mean, all the money is in the bank.  Absolutely not.

10          Q    Anything else you would like to add?

11          A    No.  I mean, since that whole thing -- I mean,  
12   since that whole thing erupted, I mean, I -- in the middle  
13   of 2013 I took it over because I just didn't trust that,  
14   you know, didn't trust anybody.  I'm not going to let this  
15   happen again.  And so I've just been doing it just to make  
16   sure.

17          Q    And prior to 2013, did you ever sign a sales tax  
18   return?

19          A    No.

20               MR. SLAVETT:  No further questions at this time.

21               JUDGE BROWN:  Okay.  I think then I will say  
22   CDTFA, do you have any questions for this witness?

23               MS. PALEY:  No, thank you.

24               JUDGE BROWN:  I'm sorry.

25               MR. SLAVETT:  We're good.

1 JUDGE BROWN: Okay. You don't have any  
2 questions. Then I will say does anybody have any  
3 questions?

4 JUDGE GEARY: No. I'm fine for now. Thank you.

5 JUDGE BROWN: Okay. Let me ask. I do have some.  
6 Oh, and Mr. Slavett, I realize I said -- I misspoke  
7 earlier when I was saying about your argument. We can  
8 take your argument once we've heard -- if you have any  
9 additional argument, once we've -- at the end of your  
10 presentation of your case in chief.

11 MR. SLAVETT: Thank you.

12 JUDGE BROWN: So just for you to be thinking  
13 ahead. So I guess I want to make sure I understand the  
14 logistics. TLD is a business that -- that you also own?

15 MR. ERNST: I own part of that business.

16 JUDGE BROWN: Okay.

17 MR. ERNST: I had another partner, and we ran  
18 a -- it was a large company. It was -- we distributed bar  
19 and restaurants supplies in the Western United States. So  
20 we had an accounting staff. I think we had -- just that  
21 portion alone, we had 15 to 20 people between APAR --  
22 oops, accounts payable and accounts receivable and all the  
23 other stuff administrative. It was a -- it was a big  
24 organization. I think we had almost 250, 300 employees.

25 JUDGE BROWN: So --

1           MR. ERNST:  And we're -- and how to tie into  
2   Javier --

3           JUDGE BROWN:  Yeah.

4           MR. ERNST:  Javier had worked at this other  
5   company and then -- where I had worked with him  
6   previously.  And I think it was early 2000, 2001 or '02.  
7   He said, "Well, you know, I'm looking for work."

8           And I said, "Hey, we got this company.  You know,  
9   why don't you work there."  And, you know, we got  
10  plenty -- even at that time we had plenty of work at TLD  
11  because it was a growing concern.  And --

12          JUDGE BROWN:  So I'll -- I'll try and zero in on  
13  what I just need clarification of.

14          MR. ERNST:  Okay.

15          JUDGE BROWN:  Javier worked for -- or Mr. Velazco  
16  worked for TLD for some time.  So he's working for your  
17  related company?

18          MR. ERNST:  Yes.

19          JUDGE BROWN:  Okay.  And then you said that he  
20  went out on his own?

21          MR. ERNST:  Yes, ma'am.

22          JUDGE BROWN:  Do you know approximately when that  
23  was?

24          MR. ERNST:  I think that was 2010 or '11.

25          JUDGE BROWN:  Okay.

1           MR. ERNST: But he was -- when he went out on his  
2 own, basically, he had been doing that work, well, doing  
3 the restaurant stuff with the staff. And then when he  
4 went out on his own, I said, "But you know what? I'll  
5 just be your first client there because you're doing the  
6 work in here anyway. So I'll become one of your clients."

7           I'm sorry.

8           JUDGE BROWN: Just because I've seen a different  
9 reference in the materials referring to him as an in-house  
10 bookkeeper or an outside accountant bookkeeper. So I just  
11 wasn't sure which.

12          MR. ERNST: Yeah. The differentiation is when he  
13 worked at TLD that was for in-house. Because he worked  
14 there, I paid him extra to do Dinah's books. And then  
15 when he left, like I said, "You've got your business  
16 you're starting, you know, that's great. You got at least  
17 one or two others." You know, I knew he had some other  
18 clients he was working with. So --

19          JUDGE BROWN: So then Jamie Purcell.

20          MR. ERNST: Yes.

21          JUDGE BROWN: Which entity did she worked for?

22          MR. ERNST: She worked -- she was also originally  
23 at another company that I had worked with in Orange  
24 County. We had worked together on a place called "Sub  
25 Theater" which is now called "The Grove" near Anaheim

1 Stadium.

2 And it was a music facility -- music venue in  
3 1999. I had worked with her there and previously at the  
4 restaurants in the Midwest, and then we got TLD. I guess  
5 a new company had purchased The Grove, and so she said she  
6 was looking, I think in 2002, 2003. I said, "Well, we got  
7 this company that was growing."

8 JUDGE BROWN: She worked for TLD also?

9 MR. ERNST: Yes, she did.

10 JUDGE BROWN: Okay. So for the times when Jamie  
11 Purcell was the person who signed the sales and use tax  
12 returns for the business --

13 MR. ERNST: Okay.

14 JUDGE BROWN: And, actually, I'll say -- let me  
15 go to -- let me go to that exhibit. So I'm looking at  
16 Appellant's Exhibit 2, for example, top of page 2 of that  
17 exhibit where it's for the 2009 --

18 MR. ERNST: Okay.

19 JUDGE BROWN: -- sales and use tax return, where  
20 it says the preparer's name is Jamie Purcell, and  
21 preparer's title is controller. So she was the controller  
22 of TLD?

23 MR. ERNST: Yes, ma'am.

24 JUDGE BROWN: Okay.

25 MR. ERNST: Yes, Your Honor.



1 JUDGE BROWN: Okay. And so it is your  
2 understanding, based on what I've heard, that Mr. Velazco  
3 gave Jamie Purcell the information, and then she prepared  
4 the sales and use tax returns?

5 MR. ERNST: My understanding was -- is that, yes.  
6 Yes. I'm trying to think -- say it, but the answer is  
7 yes. He would put all the paperwork together and then she  
8 would go online and file it and whatever. It was given to  
9 him. Because she also -- he worked in her department as a  
10 controller. She had the responsibility of those 15, 20  
11 other administrative people. So that was just addition to  
12 what he had that she went online and paid it or did this  
13 part.

14 JUDGE BROWN: And have you asked -- did you have  
15 an opportunity to ask her about her understanding of how  
16 it was that there were such inaccuracies in the returns  
17 that were filed?

18 MR. ERNST: At the time that I show, the answer  
19 is yes. She submitted the paperwork that Javier provided  
20 her.

21 JUDGE BROWN: And does that also cover your  
22 understanding of Sunshine Peralta's role as preparer?

23 MR. ERNST: What had happened at the end of  
24 this -- I'm sure Jamie, she may have been on vacation  
25 or -- or something. And so during that period of time,

1 she would have given Sunshine her logins and sales tax had  
2 to be paid on whatever the date is; login, pay for it, and  
3 take care of it. However, give her the paperwork and  
4 here's the login information.

5 JUDGE BROWN: But it's your understanding that  
6 both Ms. Peralta and Ms. Purcell were just relying on the  
7 information that Mr. Velazco had given them. Is that your  
8 understanding?

9 MR. ERNST: Yeah, that's my understanding.

10 JUDGE BROWN: Okay. So when you said that -- and  
11 I don't -- if you don't know the answer offhand, then I  
12 will follow up with later questions to someone else. But  
13 you said that when Mr. Biggs called you and said, "When  
14 did you switch to a different accounting firm," and you  
15 said, "I didn't," and he indicated, "Well, his name wasn't  
16 on the federal income tax returns."

17 And stop me if any of this is not an accurate  
18 representation of what you said. And you say, "I didn't  
19 switch, you know, we used your returns." Do you know  
20 whose name was on the returns that he was referring to?

21 MR. ERNST: You know, it was one more of those,  
22 you know, a call at 3:00 or 4:00 or 5:00 in the afternoon.  
23 I get a call from my CPA, "Hey, when did you switch  
24 companies? I'm like, what the heck are you talking about?

25 JUDGE BROWN: Right. So you never found out

1       whose names was on, like, the fake returns?

2               MR. ERNST:  You know, I did at that time.  I  
3       don't recall --

4               JUDGE BROWN:  That's fine.

5               MR. ERNST:  -- at this hearing who was on there.  
6       It may have been -- it could have been his name at that --  
7       or maybe not.  It's just --

8               JUDGE BROWN:  If you don't know then I'll --

9               MR. ERNST:  You know, I don't know.

10              JUDGE BROWN:  Okay.

11              MR. ERNST:  I don't recall.  You know, I did six  
12       years or seven years ago when this all -- -

13              JUDGE BROWN:  That -- that is fine.  I don't want  
14       you to guess.  So no problem.  Okay.  I think those are  
15       all the questions I have right now.  So --

16              JUDGE DANG:  I have one.

17              JUDGE BROWN:  Yeah.  Go ahead.

18              JUDGE DANG:  One brief question, Mr. Ernst.

19              MR. ERNST:  Yes, Your Honor.

20              JUDGE DANG:  The Department's opening brief had  
21       mentioned a concern that the deposits in the bank,  
22       Ricardo's bank deposits that were greatly in excess of the  
23       sales that had been reported.  I believe the implication  
24       from that is that Ricardo's was a beneficiary of any  
25       underreporting that had occurred in this instance.  Is

1     there anything that might indicate in our evidentiary  
2     record that Mr. Velazco had benefited from this  
3     underreporting?

4             MR. ERNST:  Are you asking me did I think he was  
5     stealing or something?

6             JUDGE DANG:  Did he -- is there anything you can  
7     point to that might indicate that he had either embezzled  
8     or misappropriated funds?

9             MR. ERNST:  Yeah.  I think he stole.  But, you  
10    know, getting -- going through the whole forensics at  
11    that -- when I'm looking at it, it's I've got this wall of  
12    water coming at me, and I'm dead.  How am I going to  
13    survive?  And how are we going to try to keep this going.  
14    So I'm sure he did somewhere.  I can't tell you how or  
15    what he did, but that's -- that's my suspicion.

16            Because the -- surely -- I'll give you sort of my  
17    financial.  When I, during that period of time, I had to  
18    put money in the restaurant.  So I didn't think it was  
19    doing that great, but it was okay.  I had to put in, you  
20    know, into the restaurant, you know, 5 or \$10,000.  You  
21    know, maybe something happened, labor is tight, food.

22            You know, those are things that occurred, but it  
23    was not -- it didn't come until this whole thing started  
24    to break open where it was like, oh, my gosh.  This is --  
25    this is bad.

1 JUDGE DANG: Is there any possible other  
2 explanation for these bank deposits that were not  
3 accounted for in the sales that were reported to CDTFA?

4 MR. ERNST: Not that I know of. I don't miss --  
5 I know what you're asking, I think. I mean, I don't  
6 know -- I don't.

7 JUDGE DANG: My concern is that you're -- it  
8 appears that you're making some assumption based on the  
9 fact that he had misrepresented the federal income tax  
10 returns that Mr. Velazco was stealing from you -- stealing  
11 from Ricardo's. But it appears that Ricardo's was a  
12 beneficiary of whatever fraud that Mr. Velazco may have  
13 been perpetrating because that money was in the bank  
14 accounts of the business.

15 MR. ERNST: The answer -- I understand what  
16 you're saying, but we weren't making any money. We were  
17 losing money. So I don't know where, you know, after  
18 paying labor, food, and, you know, the basic overhead, we  
19 didn't have money. So -- which meant that one, I was  
20 either getting false information. I was making bad  
21 decisions on that. And which ultimately ended up  
22 happening is that our menu was underpriced, you know, when  
23 we looked at it.

24 Food cost was not 30 percent or 33. We're  
25 running at 45, 50. Everything was off. And so from that

1 point, it was like, oh, my God. How am I going to get  
2 through this? That's really, to this day, that's where  
3 the focus was.

4 JUDGE DANG: Thank you.

5 JUDGE GEARY: I do have a few questions.

6 MR. ERNST: Please.

7 JUDGE GEARY: Mr. Ernst, when you first hired  
8 Mr. Velazco -- and I'm not sure if his name is spelled --  
9 his first name is spelled two different ways in the  
10 records. One is with an X-A, and another with a J. But  
11 when you first hired him, what did you understand his  
12 accounting or bookkeeping background to be?

13 MR. ERNST: I had worked with him in 1990 -- I  
14 think 4, 5, 6 about 2, 3, or 4 years, and he had been  
15 doing the restaurant accounting bookkeeping work for the  
16 3, 4 different Group Hubs that I was helping another --  
17 doing some consulting work on. And so his experience was  
18 doing the accounting work for them.

19 JUDGE GEARY: Did you ask him why he needed work,  
20 why he wasn't continuing to work with the Group Hub. You  
21 indicated earlier he came to you and said he needed work.

22 MR. ERNST: Yeah. He had decided -- they closed  
23 down the Group Hubs in 1990 -- I think in 2000, 2001. And  
24 so because they were closing them down, they didn't have  
25 any use for his services. And so working for that company

1 at that time, I did.

2 JUDGE GEARY: Did you contact his former employer  
3 to ask about his services he had rendered to them?

4 MR. ERNST: At that time I had been working with  
5 his previous employer as actually a consultant. So from a  
6 timing point of view, I had been working as a -- doing  
7 the -- working as a consultant in the late 90s  
8 through 2001 with the person that Javier had been working  
9 with. And so where I was doing the operational side,  
10 Javier was doing the books and records.

11 Then I had an opportunity to go in with another  
12 partner to purchase TLD Distribution Acquisition Company,  
13 which dis -- in late 2001. And that's when we -- when we  
14 opened that up, my buddy decided he was going to close  
15 down the restaurants in the Midwest. And so he had  
16 lost -- he was out of a job. And then since I worked with  
17 him and we worked together, I figured he could come work  
18 over here.

19 JUDGE GEARY: So you formed your own opinion  
20 based upon your own experience with him about his  
21 qualifications to do the work, rather than inquiring of  
22 his former employer the kind of work he did for them?

23 MR. ERNST: Well, I had worked him for 3 or 4 --  
24 3 years prior on an almost day-to-day type of basis  
25 working through those -- working at the other places. And

1 I guess after working three years with him, I was -- part  
2 of working with the books and records, because that was  
3 part of the consulting work that was done, was to help see  
4 if we can turn these around and make them more profitable  
5 or can they make a profit. And so I had been working  
6 hand-in-hand with him.

7           Conversations regarding -- with Mike Wajowski,  
8 who was the owner of the Group Hubs at that time, you  
9 know, I was speaking to him day-to-day. So I guess in a  
10 direct manner, I had formed my own opinion over that three  
11 or four years. The answer is just from day-to-day working  
12 with that person. Mike and I talked quite a bit about it  
13 back -- I wouldn't have hired him on the flip side.

14           I wouldn't have hired him if there was an issue  
15 with Mike. If Mike would have said, "Hey, I'm getting rid  
16 of this guy because there's some bad business," -- it was  
17 all very congenial. In fact, Mike and I had an ongoing  
18 relationship post me leaving and opening up TLD. And, you  
19 know, he came -- it came with his blessing.

20           JUDGE GEARY: When Velazco provided falsified  
21 documents to CDTFA, he was, by that time, operating his  
22 own business, the one in which you were one of his first  
23 clients; is that what happened, is that the timing was  
24 right?

25           MR. ERNST: Yes.



1 JUDGE GEARY: And you understood, when you  
2 learned about the fraudulent documents, that he had other  
3 clients that he worked for?

4 MR. ERNST: Yes.

5 JUDGE GEARY: Okay. Did you try to contact any  
6 of those clients to express to them your concerns about  
7 the fact that you believed he had been stealing from you?

8 MR. ERNST: I did not speak to -- I didn't know  
9 who his other clients were. That was not in my realm to  
10 even ask that. I was -- he said, "I've got my own  
11 business," and great, good for you.

12 JUDGE GEARY: Did you talk to district attorney's  
13 office about possible criminal prosecution?

14 MR. ERNST: I spoke to -- I spent quite a bit of  
15 time speaking with legal counsel and -- my counsel. And  
16 so the answer -- direct answering, the answer is no. More  
17 for the reason of when we laid the case, what is it going  
18 to take to go after him. It's going to require us hiring  
19 a forensic accountant. It's going to hire -- and you're  
20 going to have to hire an attorney to prosecute this.

21 And then I was looking at all the downside aside  
22 from spending the tens and thousands of dollars going  
23 after and prosecute and what am I going to get from it.  
24 And at that time, I was just -- I've got to figure -- I  
25 had to put every ounce of energy into getting these

1 restaurants righted and getting back to being able to  
2 perform and putting it on a path it can move forward.

3 So that's where I spent all my time, energy, and  
4 money. I didn't have any money at that time. I mean, we  
5 had gone -- it had drained everything.

6 JUDGE GEARY: Did Mr. Biggs indicate to you  
7 that -- or state to you an opinion that he should look  
8 through your records to see if Mr. Velazco had stolen  
9 money from you?

10 MR. ERNST: I'm going to let Sam answer the  
11 question for himself. I know we talked about it, what it  
12 would take and part of, you know, if we hire a forensic  
13 accountant, what is it going to take to do that, so on and  
14 so forth. And, you know, at that time it just came down  
15 to, you know, it's just not going to be worth the time,  
16 energy, and money, and effort if we had it, and we didn't.

17 JUDGE GEARY: Okay. Thank you. That's all I  
18 have.

19 JUDGE DANG: Nothing further.

20 JUDGE BROWN: Okay. Then if I heard everything  
21 from Mr. Ernst's testimony, then I can move on to  
22 Mr. Biggs' testimony, and then I can hear any further  
23 argument from Mr. Slavett. And then I'll hear CDTFA's  
24 presentation. Okay.

25 Mr. Biggs, I will swear you in as a witness now.

1 If you could please stand and raise your right hand.

2 SAMUEL BIGGS,

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

6

7 JUDGE BROWN: Okay. Thank you.

8 Mr. Slavett, you can begin your questions.

9

10 DIRECT EXAMINATION

11 BY MR. SLAVETT:

12 Q Mr. Biggs, tell us about your background -- your  
13 professional background?

14 A I have been practicing as an accountant. I had  
15 my own firm for many, many years. Getting close to  
16 50 years by this time. I started out my career with  
17 Arthur Anderson, actually, in 1965. So that'll be, you  
18 know, if you subtract, you know about where I'm coming  
19 from. I was there. You know I have a graduate degree,  
20 MBA credentials. I spent quite a bit of time in corporate  
21 activities after Anderson.

22 I came back and started my own firm in the early  
23 80s, very early 80s and proved that to be a fairly  
24 well-known midsize regional firm in Southern California.  
25 I heavily focused in insolvency areas, litigation,

1 commercial clients. I was trustee with the Central  
2 District California with U.S. Trustee's Office. And still  
3 have a heavy practice in the insolvency arena, act in  
4 fiduciary capacities in many regards, either as a trustee  
5 for estates, trustee for bankruptcy cases, trustee for  
6 conservators and that type of thing.

7           So our practice generally is very heavy in that  
8 type of arena with litigation in insolvency, disputes,  
9 receiverships, all of these areas. And I acted and still  
10 do in those capacities. Five years ago we merged with  
11 SingerLewak, which is a regional firm. We've got 14  
12 offices throughout predominantly California, but we're now  
13 in Nevada and Colorado.

14           I had the insolvency litigation and those special  
15 services for the entire firm. We have roughly 16, 17 on  
16 our staff, some attorneys, CPAs. So we covered all that.  
17 So I'm very familiar with these types of situations and  
18 testimony and court appearances on that. So that's just a  
19 thumbnail of me and my background and what I'm doing here.

20           Q   How did you come to know Mr. Ernst and Ricardo's  
21 on the Beach?

22           A   That goes back many years. I think -- I think  
23 there was a referral someplace along the line, and we met  
24 I guess, in the late 90s. There about would be my guess.

25           Q   And what kind of work did you do for Ricardo's?

1           A    Mostly dealing and handling the tax preparation  
2   services for the restaurants that he has, the Dinah's,  
3   Ricardo's on the Beach.  That's principally -- it's been  
4   principally a tax relationship.

5           Q    And did your firm prepare the income returns for  
6   Ricardo's on the Beach?

7           A    Well, we prepared all the returns that were filed  
8   with the federal and California taxing authorities.

9           Q    And tell me in approximately April 2013, you  
10   received a call from a board examiner.  Can you tell me  
11   about that call?

12          A    You know, I don't remember the call specifically  
13   but -- but I was informed of the tax audit and had  
14   conversations with the auditor.  I don't recall his name.  
15   It's in the records.  But I did have conversations with  
16   him.  He wanted to investigate the records that we had for  
17   Ricardo's on the Beach and the two restaurants.  And we  
18   made an arrangement for me to provide him documents and  
19   proceed with that review.

20                You know, that goes back about nine years, so I  
21   don't remember the specific details of the phone calls and  
22   type of research records on that.  So I'm just going off  
23   memory back then.  But he did present to me and we had  
24   conversations on his tax records and the audits that he  
25   reviewed.  And through those conversations, he was talking

1     about tax returns. And I saw the numbers, and they don't  
2     match anything I've ever seen before.

3             And it was in connection with those conversations  
4     that he presented me with a set of other tax returns for  
5     the years that are in question here. I did question him,  
6     and we had conversations about the type of his audit. I'm  
7     familiar with the approach that the State Board of  
8     Equalization uses, and -- what was the State Board of  
9     Equalization. I'll refer to the old name. That's what is  
10    up here.

11            So -- but there are audit procedures. They had  
12    done sample counts, test counts as I recall and had  
13    documented what they felt to be the sales. They had done  
14    the typical analysis of review of deposits and banking  
15    records and standard procedures to match those numbers  
16    against the tax returns that were filed. Those are the  
17    obvious approaches and the easiest approaches where you do  
18    have records, and it's always done.

19            And we find a lot of these kind of situations,  
20    not like this, but in our bankruptcy cases where we have  
21    claims filed by the State Board of Equalization, various  
22    taxing authorities. And we're reviewing those records to  
23    object the claim or whatever we do. But anyway, we went  
24    through that. I can see that he had done a reasonable  
25    audit. I didn't see really anything to question at that

1 point.

2 But then the question on the tax returns that I  
3 was presented, and I said, "Those aren't the tax returns  
4 that were filed. Where did you get them?"

5 "I got them from Javier."

6 So that's how that arose. I proceeded to call  
7 Mario, and he testified where he and his reaction at that  
8 time. And that's how the discrepancy came about.

9 Q Let me just hone in on something here. I want to  
10 understand chronologically what occurred, if we may. You  
11 mentioned that you talked to the auditor, and about all  
12 the audit techniques, and you looked at the audit. What  
13 happened on the first interaction you had with the  
14 auditor? Was the return that Javier provided to the State  
15 brought up with you?

16 A I don't -- I don't recall really the timing of  
17 the conversations and what was brought up when --

18 Q Was the purpose -- do you believe the purpose of  
19 the call was to inquire as to the returns that Javier  
20 provided to him that appeared to be prepared by your firm  
21 that was inconsistent with what was filed with the  
22 government?

23 A You know, that -- that very well could be. I  
24 know the question was and the reason for contact with me  
25 and our firm was that we had -- we were the accountants.

1 We had prepared the returns, and he wanted to confirm the  
2 tax returns and the -- the records he had been presented.

3 Q So were you surprised to see a return with your  
4 name on it that was different from a return that you  
5 believed was prepared by your firm?

6 A I can't -- I don't specifically recall because  
7 that goes way back. Whether our name was on that return,  
8 I don't know. I could not attest as I'm sitting right  
9 here. I just don't have the recollections to whose name  
10 was on that return.

11 Q And Mario testified that -- that I believe when  
12 that happened the same day, you had contacted Mario to ask  
13 him whether he hired another accounting firm. Do you  
14 recall that?

15 A I -- Mario remembers that -- those specific words  
16 better than I do, but I know I did call Mario to confront  
17 him with the question of, you know, what are these --  
18 where did these other tax returns come from. So I think  
19 this is probably much more vivid in his memory than mine  
20 because he was more shocked by it.

21 I mean, I was -- I've seen -- I have seen  
22 separate sets of books in businesses before in cases. But  
23 you don't know see many of them. But this -- this was  
24 truly a fraudulent tax return. No question about it.

25 Q Having been the CPA in preparing tax returns, do



1       you believe Ricardo's keeps a second set of books?

2           A     Absolutely not.

3           Q     Is it your belief that -- do you believe that  
4       Mario created this phony income tax return?

5           A     No. I don't -- I don't have any belief in that  
6       regard whatsoever. I mean, not to -- I didn't think Mario  
7       has a big financial background, but he does not have the  
8       capability to prepare that tax return in the manner that  
9       it was prepared. Whoever prepared that tax return knew  
10      what they were doing because, for appearance's sake, it  
11      looked like a properly prepared return.

12                And so whoever -- whoever did that knew what they  
13      were doing because they got the numbers to balance, and  
14      they got the numbers to be consistent with the sales tax  
15      returns. So they had the complete picture. There's no  
16      question about that.

17               MR. SLAVETT: Okay. I have no further questions  
18      at the time.

19               MR. BIGGS: Okay. I could comment on --

20               MR. SLAVETT: Would you like to make a couple of  
21      comments on something?

22               MR. BIGGS: Yeah. Yeah. Along the vein and  
23      response to some of the questions that have been raised  
24      here, obviously you know, when it comes to, we get  
25      confronted with these types of situations and I deal

1 heavily in fraud and -- and we put a few people in jail.  
2 The questions always come in your mind. But I have --  
3 there's no question whatsoever that Mario had no  
4 involvement in what happened here. I think that's further  
5 substantiated by the State's auditor that reviewed this.

6 Because it's my understanding he had no position  
7 that Mario was behind this or in any way involved. I  
8 was -- I was concerned at a point, and we had  
9 conversations and he did review this, at least to my  
10 knowledge. So the auditor was convinced from his examine  
11 that there was no culpability for Mario's standpoint. And  
12 there were never any charges -- personal charges to my  
13 knowledge filed against Mario.

14 It was strictly on the Javier situation. The  
15 issue of why in the world somebody would do this is a  
16 prominent question, and I have had many conversations with  
17 him as to why somebody would be so stupid as to do this.  
18 There's no reason to other than personal benefit. I mean,  
19 anybody with a brain in their head, why are they going to  
20 go to commit fraud or do something like this without some  
21 personal benefit. The only one that could have personally  
22 benefitted from this, and he had all the tools in his  
23 hands to do it, was Javier.

24 The question was raised, is Ricardo's a  
25 beneficiary of this because of the cash deposits and how

1     it went through a bank. Those numbers reconciled fairly  
2     closely, as I understand, based on the auditor's examine.  
3     But Javier again being experienced in these areas, he knew  
4     they were going to trace the deposits and accounts for the  
5     deposits and the bank statements. That's standard and  
6     typical. He knew that they would match the numbers on the  
7     tax returns. That is Step 1 or 2 in the nature of an  
8     audit examine.

9             So if you're going to defraud whomever on  
10    underreporting of sales tax, then you're going to have  
11    consistency on all these records. So it started with  
12    removal or the underreporting on sales tax returns. Then  
13    he conformed the other records to be consistent with that.  
14    And the assumption is -- even though we didn't investigate  
15    it because there wasn't any money and we got into that.  
16    But the only reasonable explanation is it went into his  
17    pocket. And we -- I did have those conversations with  
18    Mario.

19            We could have readily investigated, pursued  
20    those. It would have been a costly time-consuming effort.  
21    And to what avail, if you got an individual to no recovery  
22    from a business standpoint just to put somebody in jail  
23    for this for no financial recovery, why do it? It's  
24    you're going to get sued, and it is going to cost you to  
25    begin with.

1           And many instances where we've come up with  
2    fraud, the employers reach a stipulation. The person goes  
3    and no harm no foul. It's all forgiven because I'm not  
4    going to incur cost of the litigation coming back at me  
5    for, you know, what type of recovery. So that is the  
6    assumption on this case, and that's what we reached.

7           So the Ricardo's and the corporate entity was in  
8    financial stress. It had been for many years. I -- the  
9    assumption is that was because of the defalcation of the  
10   funds and their liabilities continued to increase there.  
11   They had large losses during those years. And so based on  
12   the information that I had, my assumption would be is, had  
13   we gone back and documented that, we could have adequately  
14   supported it.

15           But so that's what we found. That's what we saw.  
16   And that's what I believe, based upon my recollection and  
17   experience back then. I'm happy to answer any questions  
18   that you might have.

19           JUDGE BROWN: Thank you. All right. First, I  
20   will say, CDTFA, have any questions for this witness?

21           MS. PALEY: No. Thank you.

22           JUDGE BROWN: Okay. Co-panelist?

23           JUDGE DANG: No questions.

24           JUDGE GEARY: I have a couple of questions for  
25   Mr. Biggs. I believe you testified that the only person

1     who could personally benefit from the preparation and  
2     submission of the falsified documents was Javier; is that  
3     true?

4             MR. BIGGS:  I think that's what I said.

5             JUDGE GEARY:  But am I wrong that you are not  
6     aware of any specific evidence that he did benefit  
7     financially?

8             MR. BIGGS:  We -- we did not pursue that route,  
9     no.

10            JUDGE GEARY:  Did you indicate -- and I wasn't  
11    sure if you were talking about Javier at this point.  But  
12    I think you indicated that Javier would have known,  
13    because of his experience, that the auditor would have  
14    compared the sales and use tax returns, for example, with  
15    the income tax returns.

16            MR. BIGGS:  Based on his alleged experience and  
17    his -- his involvement with this, yes, he should have  
18    known that.

19            JUDGE GEARY:  And you conclude from that that  
20    with that knowledge -- that knowledge was one of the  
21    things, at least, that let him to falsify the returns when  
22    he submitted those to the Department for their review?

23            MR. BIGGS:  Absolutely.

24            JUDGE GEARY:  Okay.  But you also said that he  
25    would have known that they would have compared that

1 information with deposits.

2 MR. BIGGS: He should have been equally alert to  
3 that as well.

4 JUDGE GEARY: Is it your understanding that, in  
5 fact, the deposits were -- matched the correct returns --  
6 the accurate returns?

7 MR. BIGGS: I think that came up in testimony  
8 here. That's not -- that's not a test that -- when we're  
9 doing tax returns, we're not doing an audit or any type of  
10 procedure. We're not doing -- we're not getting audit  
11 statements or reviewed statements or even compiled  
12 statements in this instance. There's no need for those so  
13 we just take the records we're provided and prepare the  
14 tax returns. So we don't do that type of reconciliation.

15 JUDGE GEARY: But is it your understanding that  
16 the evidence in this case indicates that the deposits  
17 matched the amounts recorded on the accurate returns?

18 MR. BIGGS: I -- that's what was testified here  
19 to.

20 JUDGE GEARY: Both Mr. Ernst and you have  
21 testified that the company had been in financial distress  
22 for some period of time. And I'm assuming you meant --  
23 and I'll ask you to clarify -- you mean for some period of  
24 time before these events were all occurring during the  
25 audit?

1           MR. BIGGS: Yes, during the prior period. During  
2 the years under question.

3           JUDGE GEARY: Okay. To what do you attribute the  
4 financial downturn of the restaurant's finances?

5           MR. BIGGS: I don't -- I don't have any basis for  
6 making any attribution there.

7           JUDGE GEARY: Those are my only questions. Thank  
8 you, Mr. Biggs.

9           MR. BIGGS: Okay.

10          JUDGE BROWN: I might have a couple of questions.

11          MR. BIGGS: Go ahead.

12          JUDGE BROWN: When you were preparing both  
13 federal and state income tax returns for the business, do  
14 you -- would you have looked at the sales and use tax  
15 returns as well?

16          MR. BIGGS: No. That's not -- that's not a  
17 customary procedure that we do.

18          JUDGE BROWN: And then you heard my question  
19 earlier to Mr. Ernst about that when you -- his  
20 recollection is that you called him and said, when did you  
21 switch accounting firms because the auditor from Board of  
22 Equalization said that -- indicated that the federal  
23 income tax returns were prepared by someone other than  
24 you. Is that your -- do you have any recollection of  
25 that?

1           MR. BIGGS: I -- yeah. I remember the phone call  
2 not as vividly in those specific words.

3           JUDGE BROWN: Sure.

4           MR. BIGGS: Those are typical words I would use,  
5 and I do believe that the auditor had copies of those tax  
6 returns that I looked at.

7           JUDGE BROWN: Do you have any knowledge or  
8 recollection of who was name -- whose name had -- who  
9 signed the fraudulent returns?

10          MR. BIGGS: No. I -- I -- I don't. It's too  
11 much in the past.

12          JUDGE BROWN: Okay.

13          MR. BIGGS: I don't think I was ever given copies  
14 of those to keep for my records. So --

15          JUDGE BROWN: But you -- you saw them or just the  
16 auditor told you?

17          MR. BIGGS: I'm going to say that he had them and  
18 showed them to me. But, you know, I -- it's a little  
19 rusty back then.

20          JUDGE BROWN: Okay. I understand. I think those  
21 are my only questions for this witness. Then I'll say  
22 Mr. Slavett, if you want to make any additional argument  
23 at this time, you can, or you can save it for rebuttal.

24          MR. SLAVETT: Save it for rebuttal.

25          JUDGE BROWN: Okay. That's fine. Then if I've



1 heard everything from Appellant's presentation, then I can  
2 move on with CDTFA's presentation.

3 (There was a pause in the proceedings.)

4 JUDGE BROWN: If everyone is ready to, proceed,  
5 then I will say CDTFA, you may go ahead with your  
6 presentation. And I believe you're going to take  
7 20 minutes?

8 MS. PALEY: Yes. Thank you.

9 JUDGE BROWN: Okay. Go ahead.

10

11 OPENING STATEMENT

12 MS. PALEY: Ricardo's on the Beach, Incorporated  
13 is a corporation that operates two restaurants, Dinah's  
14 Family Restaurant on South Sepulveda Boulevard in  
15 Los Angeles and Ricardo's El Ranchito on South Beach  
16 Boulevard in La Habra. Both restaurants have been in  
17 business, at least incorporated under this corporation  
18 since June 1998.

19 A Notice of Determination was issued on  
20 August 22nd, 2013, Exhibit D, for approximately \$1.465  
21 million in tax, plus accrued interest, and a 25 penalty  
22 for fraud or intent to evade. Audit methodology and the  
23 amount of tax due is not in dispute. The issue in this  
24 appeal is whether the Department has established by clear  
25 and convincing evidence that the 25 percent fraud penalty,

1 under Revenue and Taxation Code Section 6485 is applicable  
2 for the period January 1, 2005, through December 31st,  
3 2011.

4 In addition, whether the Notice of Determination  
5 was timely issued, pursuant to Revenue & Taxation Code  
6 Section 6487(a), for the period January 1, 2005, through  
7 September 30th, 2008. And that depends on whether there's  
8 a finding of fraud or intent to evade. The audit in this  
9 case originally covered October 2008 through  
10 December 2011. And four BOE 122 waivers, Exhibit C, were  
11 executed, extending the deadline for determination until  
12 October 31st, 2013.

13 And the evidence of fraud, which has no statute  
14 of limitations, expanded the scope back to January 2005.  
15 If fraud is not found, then a negligence penalty would  
16 apply to the original determination period -- original  
17 liability period, October 2008 through December 2011. And  
18 the Notice of Determination for the period  
19 January 1, 2005, through September 30th, 2008, would not  
20 be timely.

21 As a matter of law, fraud is never presumed but  
22 must be proven, and the burden of proof is on the  
23 Department. However, the standard of proof is not beyond  
24 a reasonable doubt as in a criminal prosecution. Instead,  
25 the standard of proof in civil tax fraud cases is clear

1 and convincing evidence. That is, that there is a high  
2 probability that the assertion of fraud is true.

3 Here, the burden of proof has been met.

4 Appellant consistently and grossly underreported its  
5 taxable sales over the six-year liability period by nearly  
6 \$17 million, which is an error ration of over 106 percent.  
7 That means that Appellant reported less than half of its  
8 taxable sales as shown in Exhibit E, the audit work  
9 papers, page 18 as well as 3412, which is worksheet 12-A,  
10 as well as the general tax worksheet.

11 Also as shown in Exhibit E, Appellant falsified  
12 books and records for the audit, including the much talked  
13 about second set of income tax returns, as well as profit  
14 and loss statements at pages 1423 to 1443 and sales  
15 journals, pages 1118 to 1132. The false tax returns  
16 provided by the Appellant are at pages 1069 through 1117.  
17 They are also contained on Schedule 12-L, page 72. And  
18 that's in contrast to the version obtained from and filed  
19 with the Franchise Tax Board, which found at pages 82  
20 through 114, and worksheet 12-B, page 26.

21 Both sets, as you see in the record, denote  
22 Mr. Biggs' firm as being prepared by them. The audit  
23 worksheet discussing the differences is at Exhibit E, page  
24 21, worksheet 12-A-3. Since Appellant did not provide  
25 source documentation from the liability period, the

1 auditor also conducted observation tests and had to  
2 utilize 2012 point of sale business records, Exhibit E,  
3 pages 1132 to 3396 to cross check against the data found  
4 in the banking record, pages 183 to 168; also at Schedule  
5 12-F, page 35, from the liability period to determine the  
6 underreported liability and ultimately, to make their  
7 finding of fraud.

8           Nearly one-and-a-half-million dollars in sales  
9 tax reimbursement was charged and collected from its  
10 customers and kept for Appellant's own use. Further, as  
11 the officers of the closely held corporation,  
12 Mr. and Mrs. Ernst, were actively involved in the daily  
13 operations of the business, handling the corporation's  
14 financial matters, including receiving deliveries and  
15 paying vendors. Those are shown in Exhibit E.

16           Just a few examples that were found within the  
17 audit work papers, Mrs. Ernst signed for receipt of a  
18 Bimbo's delivery on February 7th, 2012. And that's at  
19 page 1656. She signed checks to suppliers, including  
20 Harbor, on July 2nd, 2012, that's at page 1710, and the  
21 Wine Warehouse on May 9th, 2012. That's page 2587. Also  
22 contained in the auditor's 414-Z, page 168 that day when  
23 they were to meet, Mrs. Ernst was the manager for the day.  
24 So they certainly were involved in the businesses.

25           Mr. Ernst specifically has extensive business

1 experience as we've heard as an owner, officer, or partner  
2 in no less than three other businesses. And that's also  
3 contained in the fraud memo, Exhibit B. The substantial  
4 and consistent underreporting of taxable sales cannot be  
5 attributed to simple errors or clerical oversights or mere  
6 negligence. Instead, this is clear and convincing  
7 evidence, a high probability of fraud or intent to evade.

8 Appellant's contentions and cited authority are  
9 misplaced. Specifically, Appellant contends that the  
10 fraud penalty does not apply because they were not aware  
11 of and were defrauded by the actions of their agent,  
12 Mr. Velazco. They specifically cite the Fulton case,  
13 Fulton v. Commissioner from 1950. That case imposes a --  
14 involves a 75 percent penalty for federal civil fraud.  
15 However, it's factually different.

16 In that case, the accountant was found criminally  
17 responsible, and that return was filed without allowing  
18 the taxpayer to review the return. It's quite different.  
19 The court found negligence in that case. However, the  
20 holding also goes on to say, quote, "Nor are we oblivious  
21 to the fact that a taxpayer may not automatic shield  
22 himself by claiming a lack of knowledge of a return's  
23 contents."

24 As demonstrated by Appellant's Exhibit 2  
25 through 5, Mr. Velazco began submitting the sales and use

1 tax returns for the fourth quarter 2011. Until then it  
2 was done by other people, Jamie Purcell and Sunshine  
3 Peralta. People that we heard in the testimony today were  
4 employed by Mr. Ernst and his other company.

5 We know that the underreporting goes back to  
6 2005. Bearing in mind, again, that all of these people  
7 were working for TLD ultimately for Mr. Ernst. So to  
8 categorize Mr. Velazco as an outside accountant would not  
9 be factually appropriate. But most notably, Appellant's  
10 bank records, again, Exhibit E, pages 183 to 1068, show  
11 deposits made into the accounts greatly exceeded the total  
12 sales reported on the sales and use tax returns.

13 In the three years, fourth quarter '08 to fourth  
14 quarter '11, excess bank deposits exceeded \$9 million.  
15 Mr. Velazco did not physically work at either restaurant  
16 and, therefore, had no access to the restaurant's cash.  
17 And that there's no evidence or reports that he made any  
18 fraudulent withdrawals even though he had access as a  
19 signer.

20 The actions taken by Mr. Velazco as its agent  
21 were to the benefit of the Appellant. Specifically,  
22 Appellant benefited from the improper use of nearly  
23 one-and-a-half-million dollars over the liability period.  
24 The fraudulent acts of an agent are imputed to the  
25 principal, even if they are done without knowledge or

1 consent, unless fraud by the agent of the principal.

2 Here no reason or motives have been given that  
3 Mr. Velazco would have undertaken this course of action --  
4 undertaken this course of conduct on his own accord. No  
5 criminal or civil actions have been taken by the Appellant  
6 against Mr. Velazco, no insurance claims, no police report  
7 even made. The only reasonable explanation in this case,  
8 given the scope and duration of underreporting, is a  
9 willful attempt to evade the payment of tax, which  
10 circumstantially would satisfy even the higher criminal  
11 burden of proof standard.

12 The 25 percent penalty in this case should apply.  
13 Appellant contends that there have been corrective actions  
14 taken by their agreement to the taxable sales amount that  
15 they properly owe, and that somehow refutes substantial  
16 evidence of fraud, but it does not. The fraud penalty has  
17 been proven by the Department, and 25 percent penalty  
18 properly applied. Consequently, the Notice of  
19 Determination was timely issued for the entire period.

20 Thank you.

21 JUDGE BROWN: Okay. Thank you.

22 We may have a couple of questions.

23 JUDGE DANG: I just have one quick question, if  
24 you don't mind.

25 JUDGE BROWN: Go ahead. Sure. Go ahead.

1 JUDGE DANG: I believe you had mentioned in your  
2 opening presentation that if we were to find the fraud  
3 penalty did not apply, a negligence penalty should be  
4 imposed?

5 MS. PALEY: Well, simply that if -- if in the  
6 event that the panel did not -- excuse me -- did not find  
7 fraud, then the earlier period would not be brought in  
8 under the statute of limitations if the court made a  
9 finding of negligence. But, yes, we believe and maintain  
10 that fraud applies.

11 JUDGE DANG: Okay. So there's no request here by  
12 CDTFA that we impose a negligence penalty in lieu of fraud  
13 should we find there to be no fraud in this particular  
14 case?

15 MS. PALEY: Well, we would hope that you would  
16 find fraud. We believe that has been proven. But may I  
17 have one moment, please?

18 JUDGE BROWN: Sure.

19 MS. SILVA: We would still maintain that there's  
20 perfectly -- there's an abundant amount of evidence for  
21 negligence, and it would be appropriate for the panel to  
22 impose a negligence penalty if the fraud is not found.

23 JUDGE DANG: Okay. And I'm assuming here that  
24 the negligence penalty is not included in the NOD issued  
25 to Appellant?



1 MS. SILVA: No. NODs aren't issued that way  
2 because it's our -- we maintain the 25 percent penalty,  
3 and that's how the Notice of Determination was issued.

4 JUDGE DANG: Okay. Thank you.

5 JUDGE BROWN: Okay. One of my questions concerns  
6 something that's in the decision and recommendation from  
7 the Appeals Bureau. That's exhibit --

8 MS. PALEY: A.

9 JUDGE BROWN: A, right. Yes. That's Exhibit A.  
10 And I understand how the Appeals Bureau is separate from  
11 the Tax and Fee Bureau. So I understand that no one in  
12 this room wrote the decision and recommendation, but there  
13 was something in here that I was wondering what was meant  
14 or what it referred to, and I don't know if you know.

15 MS. PALEY: I'll do my best.

16 JUDGE BROWN: Okay. Page 2 of the decision,  
17 footnote 2. Oh, I'm sorry. I kept saying decision and  
18 recommendation. I guess this was just a decision.

19 MS. PALEY: Yes.

20 JUDGE BROWN: Footnote 2 says, "Upon BTFD's  
21 discovery of fraud, Mr. Velazco told BTFD he could no  
22 longer represent petitioner."

23 MS. PALEY: Yes.

24 JUDGE BROWN: Do you know is that referring to  
25 something in the documents?

1 MS. PALEY: I tried to find that as well or we  
2 tried to find that as well. And I do not know -- I do not  
3 know where that comes from.

4 JUDGE BROWN: Okay.

5 MS. SILVA: We can only assume that was discussed  
6 at the appeals conference.

7 JUDGE BROWN: Okay. I understand then. Okay.  
8 And then you heard my questioning earlier about who  
9 signed -- whose purported signature was on the false tax  
10 returns.

11 MS. PALEY: Yes.

12 JUDGE BROWN: And my understanding is you're  
13 saying that it was --

14 MS. PALEY: Well, they are unsigned. On  
15 Exhibit E, page 82, is the -- begins the proper or the  
16 returns that were filed with the Franchise Tax Board.  
17 I'll pause so you can find it.

18 JUDGE BROWN: Yeah. Thank you. I think I must  
19 have had them marked but -- okay. Exhibit E, page 82,  
20 you're saying these are --

21 MS. PALEY: Yes. Those are the returns that were  
22 obtained from the Franchise Tax Board. So they are the --

23 JUDGE BROWN: So these are the actual returns?

24 MS. PALEY: Yes, true returns, so, again,  
25 unsigned. We believe they had been submitted

1 electronically, but they are prepared. They denote  
2 prepared by Samuel Biggs. And that is the same -- at  
3 least in that one section -- as the -- I'll just call them  
4 the fraudulently submitted returns, which begin at  
5 page 1069, also denoting Samuel Biggs or his firm.

6 JUDGE GEARY: Do you mean page 1069 of --

7 MS. PALEY: Of Exhibit E.

8 JUDGE GEARY: -- the exhibit as opposed to the  
9 Bates stamp?

10 MS. PALEY: Yes.

11 JUDGE DANG: I have it as the Bates stamp.

12 MS. PALEY: No. No it's --

13 JUDGE BROWN: That's the Bates stamp.

14 JUDGE GEARY: It's the Bates stamp?

15 JUDGE DANG: Yeah.

16 JUDGE GEARY: It's not on mine.

17 JUDGE BROWN: Oh, did it not match up with the --

18 JUDGE GEARY: My page 1069 of page 3492 is  
19 a Wells Fargo Bank statement.

20 MS. PALEY: I have -- our pages go to 3412.

21 JUDGE BROWN: I have 1000 is a --

22 JUDGE GEARY: 1000, is the page --

23 JUDGE BROWN: That's the -- that's the PDF total.  
24 That's the PDF.

25 JUDGE GEARY: That's what I was asking.

1 JUDGE BROWN: Yes.

2 JUDGE GEARY: So it's 1049 of the total PDF?

3 JUDGE BROWN: Yes.

4 JUDGE GEARY: Okay. Thank you.

5 JUDGE BROWN: Okay. So 1049 of the PDF --

6 MS. PALEY: 1069.

7 JUDGE BROWN: 1069 of the exhibit?

8 MS. PALEY: Yes.

9 JUDGE BROWN: So these are the fraudulent

10 returns?

11 MS. PALEY: Yes.

12 JUDGE BROWN: Okay.

13 MS. PALEY: They also denote Biggs and Company.

14 JUDGE BROWN: Okay. You don't have it.

15 JUDGE GEARY: It's not there.

16 JUDGE BROWN: 1149?

17 JUDGE GEARY: Oh, it's 1149.

18 JUDGE BROWN: 11. And also mentioned as a side,

19 as we're going through this, if anyone catches anything

20 that is missing from Exhibit E, also let --let me know,

21 hopefully, before the close of the record. Because our

22 support staff tried to grab everything that was in the zip

23 file, but it wasn't possible for me, given the volume, to

24 cross check it.

25 MS. PALEY: Sure. Yeah. To the best -- I

1       don't -- I mean, as long as we have the same copy, we  
2       believe it's accurate.

3               JUDGE BROWN: Right. And I also will note as I  
4       think I mentioned in my introduction, this is a courtesy  
5       copy. So technically Exhibit E is a zip file that you  
6       submitted --

7               MS. PALEY: Yes.

8               JUDGE BROWN: -- months ago. But we'd like  
9       everyone to be able to refer to this as accurate.

10              MS. SILVA: We appreciate it.

11              JUDGE BROWN: Yes. Do you have --

12              MS. PALEY: It's page 82 of 3412.

13              MR. SLAVETT: This is cumbersome.

14              MS. PALEY: Yes.

15              JUDGE BROWN: Okay. Essentially, then this --  
16       this is why I was asking the witnesses about the reference  
17       to a new CPA because I had seen that both copies were  
18       purportedly --

19              MS. PALEY: Yes.

20              JUDGE BROWN: -- signed by Mr. Biggs.

21              MS. PALEY: Yes.

22              JUDGE BROWN: You're not aware -- that is your  
23       understanding as well?

24              MS. PALEY: Yes.

25              JUDGE BROWN: Okay. That answers my question.

1       Then I guess my next question is, you heard the earlier  
2       questioning about whether there was any evidence that the  
3       business itself, that the Appellant was defrauded by  
4       Mr. Velazco?

5               MS. PALEY:   Correct.

6               JUDGE BROWN:   And I'm going to ask essentially  
7       the same question to CDTFA.   How do we know that Appellant  
8       wasn't defrauded by Mr. Velazco?

9               MS. PALEY:   We have no evidence that he was.   As  
10       the panel's questioning denoted, the bank deposits largely  
11       match up with the accurate tax returns.   So there would be  
12       no evidence of that.   He didn't have access to cash.   We  
13       have no evidence that there was a defrauding by  
14       Mr. Velazco of the corporation or the Ernsts.   We do not  
15       have that.

16               We don't know how Mr. Velazco obtained a copy of  
17       the federal income tax returns to modify them because  
18       they're substantially modified, not just not in the  
19       numbers.   There's a difference between Schedule G denoting  
20       that whether or not Mr. Ernst is 100 percent shareowner or  
21       50 percent.   Again, I don't know that.

22               But all evidence points to fraud whether -- yes,  
23       whether Mr. Ernst was aware of it or not, it is attributed  
24       to him by his agent.

25               JUDGE BROWN:   Okay.   Do my co-panelists have any

1 questions for CDTFA?

2 JUDGE GEARY: I have nothing. Thank you.

3 JUDGE BROWN: Okay. If there's nothing further  
4 from CDTFA --

5 MS. PALEY: No. Thank you.

6 JUDGE BROWN: Then I will say we can next proceed  
7 with Appellant's rebuttal.

8 MR. SLAVETT: Well, if I may, Your Honor, since  
9 the government does not have witnesses here, it's  
10 difficult for me to cross-examine the argument that the  
11 attorney made. So I would like to do that by asking  
12 Mr. Ernst the questions to clarify the arguments made by  
13 the government if so permitted.

14 JUDGE BROWN: Your rebuttal may include further  
15 testimony from your witnesses. So yes, that's fine.

16 MR. SLAVETT: Okay. And I would like to point  
17 out that -- well, I'll get to that in the argument  
18 section.

19

20 REDIRECT EXAMINATION

21 BY MR. SLAVETT:

22 Q The government pointed to -- made some  
23 statements, Mr. Ernst, that you and your wife were -- are  
24 involved -- I don't want to put words in your mouth --  
25 very involved in the ongoing day-to-day operations of the

1 business. She points to Exhibit E, Bates stamp page  
2 number 1656, which is a copy of a Bimbo Bakeries U.S.A.  
3 receipt.

4 MR. SLAVETT: And I don't know if Your Honors  
5 need time to pull it up, or not or if I should just  
6 proceed?

7 JUDGE BROWN: You can proceed while I'm looking  
8 at it.

9 BY MR. SLAVETT:

10 Q Bates stamp Exhibit E, Bates stamp page 1656 is a  
11 Bimbo Bakeries U.S.A. I do see a signature of Terri Ernst  
12 on this. Mario, tell me why you believe Terri's name is  
13 on this?

14 A My wife -- we have two onsite managers that were  
15 sometimes five sometimes six days a week, during that  
16 period of time. They would either work five or six day.  
17 So my -- and then we had a secondary or a third manager  
18 that would cover for the other nights. My wife worked the  
19 operations.

20 She would work one day a week or two days a week.  
21 Usually it was on a Tuesday or Wednesday, and that's  
22 probably -- that bill came in on a Tuesday or Wednesday.  
23 The chef probably wasn't there that morning because he  
24 receives most of the food that comes into that. And  
25 that's probably the reason why she signed that. She



1 was -- her really duty was make to sure the managers get  
2 their breaks and, you know, that they have a life also.

3 Q And I think you mentioned. What day of the week  
4 did she normally cover for them?

5 A She would -- normally, it would be Tuesdays and  
6 Wednesdays.

7 Q And would it surprise you that if I looked up  
8 that day, February 7, 2012, which I have on my phone just  
9 now, that it's a Tuesday? Would that make sense?

10 A Tuesday or Wednesday.

11 Q And what other involvement did Terri have in the  
12 business, if any?

13 A Well, on the -- gosh, let me think. Her  
14 involvement would be, you know, obviously, the filling in  
15 for the managers that run the day-to-day operations. And  
16 that would be really everything from managing the floor,  
17 which is really the primary responsibility. And then at  
18 the shift change, usually being 1:00 o'clock or 1:30, or  
19 2:00 o'clock in the afternoon, changing the banks between  
20 a.m. shift to the p.m. shift.

21 And then on the days that she would work, you  
22 know, obviously when she came in that morning, she would  
23 do the bank deposit and go to the bank on Tuesdays and  
24 Wednesdays. And then if there are vendors that -- we have  
25 a number of C.O.D. vendors that she would write a check to

1     pay for, like -- I think the State pointed out -- Harbor  
2     Distributing, which is a beer vendor.

3             We pay them for the beer delivery or whatever  
4     that was for the day or another. Those would be the types  
5     of transactions on the days that she was there.

6             Q     And there was some discussion about Javier's  
7     motive here and whether he could steal or not steal or, I  
8     guess, access to cash. And did he have signature  
9     authority of the bank account?

10            A     Yes.

11            Q     Could he not write checks?

12            A     Yes.

13            Q     Is one possibility he could write a check to  
14     himself or -- or a vendor that was his company?

15            A     He could write a check, really, to anybody that  
16     he wanted to or overpay vendors.

17            MR. SLAVETT: I'm through with my questioning.  
18     Do I have a rebuttal argument --

19            JUDGE BROWN: Yes. If you would like to make a  
20     rebuttal.

21            MR. SLAVETT: -- or a closing?

22            JUDGE BROWN: Yes. Whatever you would like to  
23     call it, you can make argument at this time.

24            MR. SLAVETT: Okay.

25            JUDGE BROWN: Oh, and I guess I should say,

1 unless there is any further questions of the witness.

2

3

CLOSING STATEMENT

4

MR. SLAVETT: I mean, this case is about fraud.

5

The government has no witness testifying here. The --

6

what I heard from the government today was argument by the

7

counsel to the government. What does the Appellant have

8

here? The Appellant has fact witnesses, Mr. Ernst and

9

Mr. Biggs. I would respectfully put to the Court that --

10

and I say this a lot in hearings -- that it's Your Honors

11

trier of fact job to determine the credibility of the

12

witnesses here. And the witness is here.

13

The burden is on the government. Yet, the

14

government has no witnesses here to testify or for you to

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cross-examine. I implore you, if you have more questions,

16

ask questions. The big question is why did Javier do

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this?

18

Well, the implication the government is -- the

19

implication here is that Mario instructed him to do it.

20

That's what I'm hearing. And I would hope -- yet, that's

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through argument. There's no testimony here. There are

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just records. I would hope that Your Honors would look to

23

the credibility of the witnesses and hold that it's clear

24

that Mario was not -- Mr. Ernst or his wife were not

25

involved in this, and this was Javier on his own.

1           In my opinion the State has no evidence to  
2     contradict that, and it's its burden. I don't care if  
3     it's -- excuse my language -- if it's a 51 to 49. It's  
4     still their burden. Yes, there's no witness here.  
5     There's no evidence to contradict anything that my clients  
6     or Mr. Biggs has testified to.

7           I'd just like to say that the fraud penalty is to  
8     deter and to penalize somebody. And in this case,  
9     imposing the fraud penalty upon taxpayer does neither of  
10    those things. So I would hope that Your Honors would rule  
11    in our favor and determine that the taxpayer did not  
12    commit fraud.

13          We rest our case.

14          JUDGE BROWN: Okay. Thank you very much.

15          All right. If no one has anything further, then  
16    I can -- I've already -- I have admitted the documents.  
17    We have heard witness testimony and arguments from both  
18    sides. And so at this time if everyone is -- I've heard  
19    everything. I'm prepared to close the record.

20          I thank you all very much for attending and  
21    participating today. And my co-panelists and I will meet  
22    to consider all the evidence, and we will issue a written  
23    opinion. Thank you very much.

24          And the record is closed, and we are now off the  
25    record.

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(Proceedings adjourned at 4:05 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 3rd day  
of February, 2020.

\_\_\_\_\_  
ERNALYN M. ALONZO  
HEARING REPORTER