OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011260
SKU TRADING, INC.	)
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:	Jane Kim, CPA
For Respondent:	Ciro Immordino, Tax Counsel IV David Gemmingen, Tax Counsel IV
For Office of Tax Appeals:	Mai Tran, Tax Counsel IV

A. KWEE, Administrative Law Judge: On January 29, 2019, we issued a written opinion sustaining the Franchise Tax Board (FTB)'s proposed assessment of $142,208 in tax, plus applicable interest, for the 2007 tax year. Our opinion held that SKU Trading, Inc. (appellant) failed to demonstrate that it reported its taxable income on an accrual basis, or that FTB's proposed assessment was otherwise in error.

Appellant timely petitioned for a rehearing pursuant to Revenue and Taxation Code section 19048, on the following grounds: (1) there is insufficient evidence to justify the Office of Tax Appeals (OTA)'s opinion or the opinion is contrary to law; and (2) newly discovered evidence, which appellant submitted with its petition. We conclude that appellant failed to establish a basis for granting a rehearing.

DISCUSSION

OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the proceedings that prevented the fair consideration of the appeal; (2) an accident or surprise that occurred, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to

issuance of the written opinion; (4) insufficient evidence to justify the written opinion or the opinion is contrary to law; or (5) an error in law that occurred during the proceedings. (Cal. Code Regs, tit. 18, § (Reg.) 30604; *Appeal of Do* (2018-OTA-002P).)

As provided in the State Board of Equalization (board)'s precedential decision in *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654, and as reflected in the board's Rules for Tax Appeals, the board has historically looked to Code of Civil Procedure section 657, for guidance in determining whether grounds for a rehearing exist. (See Cal. Code. Regs., tit. 18, §§ 5461(c)(5), 5561(a).) OTA's precedential opinion in *Appeal of Do, supra*, and OTA's regulations, reflect that OTA adopted the board's established precedent of looking to Code of Civil Procedure section 657, and the applicable caselaw, for guidance in determining whether to grant a new hearing. (See Cal. Code. Regs., tit. 18, § 30604.)

Appellant requests a rehearing on the basis that there is "insufficient evidence to justify the written opinion or the opinion is contrary to law." (Cal. Code. Regs., tit. 18, § 30604(d).) First, with respect to factual disputes concerning the sufficiency of the evidence to support OTA's opinion, the standard of review is that a rehearing should not be granted unless, after weighing the evidence, we are convinced from the entire record, including reasonable inferences therefrom, that a different decision should have been reached. (See Code Civ. Proc., § 657.) Resolution of such a dispute in a petition for rehearing does not involve a weighing of the evidence, but instead requires a finding that OTA's opinion is contrary to law because it is "unsupported by any substantial evidence." (*Sanchez-Corea v. Bank of Am*. (1985) 38 Cal.3d 892, 906.) The relevant question is not over the quality or nature of the reasoning behind OTA's opinion, but whether, after reviewing the evidence in the record, the opinion can or cannot be valid because it is not supported by any substantial evidence. (*Appeal of NASSCO Holdings, Inc*. (2010-SBE-001) 2010 WL 5626976.)

On the other hand, with respect to purely legal issues, a rehearing may be granted on the basis that the opinion is contrary to law when there is "doubt that [the Panel] properly decided the legal issue." (*Arenstein v. California State Bd. of Pharmacy* (1968) 265 Cal.App.2d 179, 187-188.) A rehearing may also be granted on the basis that it is against the law when, on review, the Panel disagrees with the original opinion. (See *Russell v. Nelson* (1969) 1 Cal.App.3d 919, 923.) In summary, the Panel has discretion in granting a rehearing on the

basis that the opinion is against the law. (See *In Re Wickersham's Estate* (1902) 138 Cal. 355, 361.)

In its petition for rehearing, appellant contends that "[i]t is so clear that returns were prepared by accrual basis from the formation of [the] business." In support, appellant submitted a fourth version of its general ledger, sales journal, purchase journal, and other prepared summaries with its petition. Appellant did not furnish, on appeal or in its petition, any contemporaneous source documents. In reference to its six-page "general ledger," which lists balances for accounts receivable and accounts payable, appellant restates its original contention that these types of accounts cannot exist for a cash basis taxpayer, as evidence that it reported on an accrual basis. In response, FTB contends that "these documents appear to have been manufactured solely to obtain a desired result in this appeal, and [to] mislead your Office."

Sufficiency of the Evidence

Here, for the reasons explained in our written opinion, the burden of proof is on appellant to establish that it reported on an accrual basis. Appellant contends that the accounts payable and accounts receivable balances prove that it reported on an accrual basis. Nevertheless, appellant admits that it used QuickBooks accounting software to prepare these summaries. It is a relatively simple task in QuickBooks to convert such prepared summaries from a cash basis to an accrual basis, and thereby show accounts payable and account receivable balances.[1] In other words, we previously concluded appellant failed to meet its burden because the taxpayer-prepared summaries, such as the six-page "general ledger," could have been generated from appellant's records regardless of whether appellant reported on a cash or accrual basis. Appellant failed to provide on appeal, or identify in its petition for rehearing, any contemporaneous source documents establishing that it reported on an accrual basis. As such, we find no basis to conclude that the written opinion is unsupported by the evidence.

[1] For example, in QuickBooks, there is a drop-down menu titled "Accounting method" which allows the preparer to change the accounting method from cash to accrual. (See < https://quickbooks.intuit.com/learn-support/en-us/customer-company-settings/change-your-accounting-method/00/186425 > [as of Jan. 6, 2020].) The parties were placed on notice that OTA was taking official notice of the process for converting from cash to accrual in QuickBooks as set forth above and were provided an opportunity to object or otherwise respond. (Gov. Code, § 11515; Cal. Code. Regs., tit. 18, § 30216(a).) Neither party objected to OTA taking official notice of these facts.

Contrary to Law

Appellant further contends that its 2006 and 2007 Federal income tax returns constitute evidence that it reported on an accrual basis because appellant included beginning and ending balances for accounts payable and accounts payable. FTB, citing *Roberts v. Commissioner* (1974) 62 T.C. 834, contends that, as a matter of law, information reported on a return cannot be used to substantiate the truth of such information.

The law requires a taxpayer to maintain such accounting records as necessary to file an accurate return, and in the absence of reliable books and records, the tax agency is given wide latitude to determine a taxpayer's taxable income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 24651; Int.Rev. Code, § 446; *Appeal of Ghazali* (85-SBE-024) 1985 WL 15808.) Such records include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries both on the taxpayer's books of account and on the tax return. (Treas. Reg. § 1.446-1(a)(4).)

Based on the evidentiary record before us, appellant failed to provide or maintain required records and data, including source documents, to support the entries made on its prepared summaries, to reflect the accounting method used to prepare the return, or to support the items of income and deductions claimed on the return. Under such facts, the law allows for use of any reasonable method to determine appellant's taxable income for 2007. Therefore, we find that our opinion, which sustained FTB's action in making those adjustments to income as set forth in Internal Revenue Code section 481(a), for when a change in accounting method is made during the tax year, was consistent with the law.

Newly Discovered Evidence

Appellant submitted a fourth version of its general ledger, and related taxpayer-prepared summaries, with its petition. Here, appellant is petitioning for a rehearing on the grounds of newly discovered evidence which could not have been discovered and produced prior to the issuance of the written opinion. (Cal. Code of Regs., tit. 18, § 30604(c); see *Hall v. Goodwill Industries of Southern California* (2011) 193 Cal.App.4th 718, 731.) Newly discovered evidence is "material" if it is likely to produce a different result. (*Sherman v. Kinetic Concepts, Inc.* (1998) 67 Cal.App.4th 1152, 1161.)

First, while the fourth version of its general ledger and related summaries are new in that they are different from the prior three versions submitted prior to issuance of the written opinion; they were nevertheless constructed from information which existed prior to the issuance of the written opinion. Therefore, this evidence does not constitute "newly discovered" evidence for purposes of granting a rehearing because it was constructed from information which could have been produced prior to the issuance of the written opinion. (*Appeal of Wilson Development, Inc.*, *supra*.)

Second, with respect to materiality, appellant merely submitted a revised version of documents previously submitted with its appeal. In our written opinion, we previously concluded that these types of documents are insufficient to carry the taxpayer's burden of proof. Above, we further explained that the evidence necessary to carry appellant's burden would have been source documents and contemporaneous records and data as may be necessary to support the entries on the taxpayer's books of account and on the return. As such, we find the documents submitted with appellant's petition to be immaterial to the outcome of this appeal.

In conclusion, appellant has not established that any of the grounds for granting a rehearing were met. As such, appellant's petition is denied.

DocuSigned by:
3CADA62FB4884CB...
Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
8B585BEAC08946D...
Linda C. Cheng
Administrative Law Judge

DocuSigned by:
CA2E033C0906484...
Douglas Bramhall
Administrative Law Judge

Date Issued: 1/31/2020