

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
)  
GKHALSA, INC., ) OTA NO. 19034559  
)  
APPELLANT. )  
)  
\_\_\_\_\_ )

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, May 19, 2020

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE OF, )  
 )  
GKHALSA, INC., ) OTA NO. 19034559  
 )  
 ) APPELLANT. )  
 )  
 )  
\_\_\_\_\_ )

Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Cerritos, California, 90703,  
commencing at 10:05 a.m. and concluding  
at 11:05 a.m. on Tuesday, May 19, 2020,  
reported by Ernalyn M. Alonzo, Hearing Reporter,  
in and for the State of California.

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

APPEARANCES:

Panel Lead: ALJ JOSHUA ALDRICH

Panel Members: ALJ DANIEL CHO  
ALJ KEITH LONG

For the Appellant: JAMES TAHERAN

For the Respondent: STATE OF CALIFORNIA  
DEPARTMENT OF TAX AND  
FEE ADMINISTRATION  
By: LISA RENATI  
JASON PARKER  
CHRISTOPHER BROOKS

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

I N D E X

E X H I B I T S

(Appellant's Exhibits 1-19 were received into evidence at page 6. )

(Appellant's Exhibit 20 was marked for identification at page 6.)

(Appellant's Exhibit 20 was received into evidence at page 6. )

(Department's Exhibits A-E were received into evidence at page 8.)

OPENING STATEMENT

PAGE

By Mr. Taheran	8
By Ms. Renati	21

CLOSING STATEMENT

PAGE

By Mr. Taheran	38
----------------	----

1 Cerritos, California; Tuesday, May 19, 2020

2 10:05 a.m.

3

4 JUDGE ALDRICH: We are opening the record in the  
5 Appeal of Gkhalsa, Inc., doing business as Circle K before  
6 the Office of Tax Appeals, Case Number 19034559. This  
7 hearing is being convened telephonically on  
8 May 19th, 2020, at 10:00 a.m. [sic]. The hearing location  
9 was scheduled for Cerritos, California.

10 And should you experience any connectivity  
11 issues, please try to connect as soon as possible.

12 So please state your appearances, starting with  
13 Appellant or his representatives; in other words, who you  
14 are and who you are representing.

15 MR. TAHERAN: Good morning, Your Honor. James  
16 Taheran for the Appellant.

17 JUDGE ALDRICH: Thank you.

18 And for the Department.

19 MS. RENATI: My name is Lisa Renati. I am a  
20 hearing representative for the Department. With me today  
21 are Chris Brooks, Tax Counsel and Jason Parker, Chief of  
22 Headquarters Operation.

23 JUDGE ALDRICH: Thank you.

24 This is Judge Aldrich. The issue before us is  
25 whether any additional reduction to the amount of

1 unreported taxable sales based on the mark-up method is  
2 warranted.

3 Is that correct, Mr. Taheran?

4 MR. TAHERAN: Yes, it is, Your Honor.

5 JUDGE ALDRICH: And Department?

6 MS. RENATI: Correct.

7 JUDGE ALDRICH: Thank you.

8 Pursuant to the May 1st, 2020, minutes and  
9 orders, we admitted Exhibits 1 through 19 for Appellant  
10 and Exhibits A through E for the Department. These  
11 exhibits were admitted without objection.

12 (Appellant's Exhibits 1-19 were  
13 previously received in evidence  
14 by the Administrative Law Judge.)

15 (Department's Exhibits A-E were  
16 previously received in evidence  
17 by the Administrative Law Judge.)

18 JUDGE ALDRICH: On May 14th, 2020, Mr. Taheran  
19 e-mailed Ms. Lopez and carbon copied or cc'd the  
20 Department with a request to admit an additional exhibit.  
21 The proposed exhibit is marked for identification purposes  
22 as Exhibit 20.

23 (Appellant's Exhibit 20 was  
24 marked for identification by  
25 the Administrative Law Judge.)

1 JUDGE ALDRICH: Proposed Exhibit 20 is four  
2 pages, including the cover sheet, and is purported to be  
3 correspondence from the IRS to Appellant regarding the  
4 2014 and 2015 tax years.

5 Is this accurate, Mr. Taheran?

6 MR. TAHERAN: Yes, it is, Your Honor.

7 JUDGE ALDRICH: And for what purpose are you  
8 offering Exhibit 20 -- proposed Exhibit 20?

9 MR. TAHERAN: Just to offer the accuracy of the  
10 records for the taxpayer.

11 JUDGE ALDRICH: Okay. And does the Department  
12 have any objection to admitting proposed Exhibit 20?

13 MS. RENATI: We have no objection.

14 JUDGE ALDRICH: Okay. Would the Department  
15 require a post-hearing brief to be submitted with the  
16 limited scope of addressing Exhibit 20?

17 MS. RENATI: No, we do not.

18 JUDGE ALDRICH: Okay. Thank you.

19 In the minutes and orders I indicated that the  
20 time estimates would be as follows:

21 Appellant, you will present your opening argument  
22 or statement, which I estimated at 30 minutes. Then  
23 Department will have a combined opening and close  
24 statement for approximately 20 minutes, and then Appellant  
25 will have 10 minutes to close or rebut.

1           Mr. Taheran, are you ready to begin with your  
2 opening statement?

3           MR. TAHERAN: Yes, I am.

4           JUDGE ALDRICH: Please proceed when you're ready.

5           MR. TAHERAN: Good morning, Your Honor. James  
6 Taheran for the Appellant.

7           JUDGE ALDRICH: If I could just interject. Hold  
8 that -- I failed to admit Exhibit 20 into the record. So  
9 I'm going to move that into the record as admitted.

10           (Appellant's Exhibit 20 was received  
11 in evidence by the Administrative Law Judge.)

12           JUDGE ALDRICH: Sorry to interrupt you,  
13 Mr. Taheran. Please proceed again.

14

15   OPENING STATEMENT

16           MR. TAHERAN: Good morning. Again, my name is  
17 James Taheran for the Appellant. My opening statement  
18 today has five sections and goes through the exhibits  
19 sequentially.

20           Section 1, Introductory Facts. The Appellant,  
21 hereinafter the taxpayer, is a franchisee of the Circle K  
22 convenience stores. Taxpayer operated three Circle K  
23 stores during the audit period. Taxpayer was audited by  
24 the California Department of Tax and Fee Administration,  
25 hereinafter Department, for the tax period April 1, 2012,



1 to March 31st, 2015. A tax liability of \$91,267.74 plus  
2 interest was assessed on or about July 6, 2016. See  
3 Exhibit 1.

4 Taxpayer uses Radiant point-of-sale system,  
5 hereinafter POS. Radiant is made by National Cash  
6 Register or NCR, a leading manufacturer of POS systems for  
7 convenience stores. Taxpayer uses a barcode reader to  
8 scan products itself. Over 99 percent of products in the  
9 store have a bar code. See Exhibit 2.

10 Products are either taxable or nontaxable.  
11 Nontaxable products usually have larger profit margin than  
12 taxable products. This is true, not only in the  
13 taxpayer's business, but also in all convenience stores.  
14 One notable exception is sale of California Lotto Lottery  
15 which typically has five to seven percent margin. The  
16 products are scanned at the point of sale. The POS system  
17 will then capture what is taxable and what is not taxable.  
18 The POS system captures every single transaction ticket by  
19 ticket.

20 Taxpayer uses an outside CPA firm to prepare the  
21 sales tax returns. Taxpayer prints a sales reported --  
22 excuse me -- a sales report generated by the POS system  
23 and gives it to the CPA. The report shows the total sales  
24 and what is not taxable. See Exhibit 3. Collected sales  
25 taxes were reimbursed to the Department.

1           Section 2, Audit Manual and Process. Audit  
2 manual, hereinafter AM 404.05, states, quote, "Auditor's  
3 function is to determine whether correct amount of tax has  
4 been reported," end quote.

5           Two approaches are discussed in AM 404.05. One  
6 is direct approach, and the other is indirect approach.  
7 The indirect approach is applied when, quote, "Reliance  
8 cannot be placed upon the formal account," end quote. See  
9 Exhibit 4.

10           Here the formal account would have been  
11 taxpayer's POS records. AM 405.20 allows for two  
12 categories of testing. The preferred method is  
13 statistical sampling, and the other method is block  
14 sampling. The block sampling assumes, quote, "That  
15 differences disclosed in the test period, which are  
16 audited in detail, will occur in the same proportion in  
17 the balance of the audit period," end quote.

18           AM 405.20(a) further places three conditions  
19 before block sampling is used. One, units of sales and  
20 items of claimed deductions are uniformed throughout the  
21 audit period. Two, basic characteristics of business  
22 remains the same throughout the audit period. And if not,  
23 a separate test should be made for each specific period.  
24 Three, sample must contain sufficient items. See  
25 Exhibit 5.

1           AM 405.20(k) contains -- excuse me -- cautions  
2     that, quote, "Auditor must be alert to indications that  
3     projection of sample results is possibly unreasonable. If  
4     the results appear unreasonable, the auditor and taxpayer  
5     should come to some agreement as whether or not the  
6     results are representative of the business for the time  
7     periods in question." See Exhibit 6.

8           Standard of evidence is preponderance of  
9     evidence. AM 101.22 defines the standard as, quote, "Such  
10    evidence as, when weighed with that opposed to it, has  
11    more convincing force and the greater probability of  
12    truth," end quote. See Exhibit 7.

13           Section 3, Department's Work Papers Flaws and  
14    Noncompliance. The audit period covered three years or  
15    36 months. When you consider it had three stores, the  
16    population expands to over 100 months of sales and  
17    records. The auditor examined two incomplete months or  
18    less than two percent of the records. We believe this is  
19    contrary to AM 405.20(a) addressed earlier. Department's  
20    work schedule 414M shows taxable percentage to be  
21    54.5 percent for the first four quarters and 67.25 percent  
22    for the next quarters, yet, no data was tested for the  
23    first four quarters.

24           We believe this is contrary to AM 405.20  
25    addressed earlier. See Exhibit 8. The auditor's purchase

1 segregation for November 2014 and December 2014 was 58,108  
2 and 71,562 respectively. The December purchases were  
3 higher by 23.15 percent, yet, no inquiry was made, and no  
4 explanation was noted in the work papers. Nevertheless,  
5 the auditor proceeded with her analysis and projection of  
6 error percentage. This, again, is contrary to AM  
7 405.20(a). See Exhibit 9.

8 Observation test, a popular mechanism for the  
9 Department, was not conducted. Auditor made no attempt or  
10 inquiry into the taxpayer's POS system. The POS system  
11 has a bar code reader, yet, no inquiry or observation is  
12 noted. The POS system tracks every single ticket, every  
13 single transaction ticket by ticket. No inquiry or  
14 observation was made. The audit supervisor, upon  
15 reviewing the record, agreed that a re-audit was  
16 warranted. Her decision was primarily based on disparity  
17 and purchase segregation. See Exhibit 10.

18 The reaudit was conducted by a different auditor  
19 assigned by the audit supervisor. Unlike the original  
20 audit where two incomplete months were tested, three  
21 quarters were tested. All three quarters were within a  
22 margin of error. See Exhibit 11. Excuse me. If these  
23 three quarters were the test basis, the result of the  
24 audit would have been a no-change audit. The problem in  
25 writing and accepting the reaudit results -- decided to

1 average it, this would make as much sense as a teacher  
2 incorrectly giving you a score of 50. And when you bring  
3 the error to his or her attention, offers to average it  
4 rather than correcting the mistake. We offered to test  
5 more quarters, but they declined to review. See  
6 Exhibit 12.

7 As stated earlier the taxable ratio still in the  
8 first four quarters of the audit period were lower than  
9 the remaining audit periods. One reason is that  
10 petitioner was an approved Women Infant and Children,  
11 commonly known as the WIC or W-I-C vendor. These items  
12 that have been sold to WIC recipients are tax free.  
13 Department declined to make appropriate adjustment. See  
14 Exhibit 13.

15 The audit period started in 2012. That is eight  
16 years ago. Back then not everyone had a cell phone,  
17 especially among lower economic class in taxpayer's  
18 market. As a result, phone calls were a prevalent form of  
19 communication and majority were purchased from convenience  
20 stores. Phone calls were also exempt from sales tax.  
21 This was a common knowledge, especially among experienced  
22 sales tax auditors. Yet, auditor failed to make any  
23 allowance for it when he projected the test results over  
24 the audit periods.

25 Section 4, Department's Position. Department

1 will assert the following: One, the POS system is  
2 unreliable. They will keep on telling you that the POS  
3 system is unreliable. Yet, in pages and after pages of  
4 the report, they never once said what type of POS system  
5 taxpayer had. They never asked the taxpayer how it works.  
6 They never asked to see a report it generates. They could  
7 have easily looked at one day of sales ticket by ticket  
8 and analyze it, but they didn't. They could have  
9 conducted a day or half a day of observation, but they  
10 didn't.

11 They even admitted that second quarter 2014  
12 records were accurate in the May 10, 2019 report. How  
13 could the POS be so unreliable, yet, admit that its report  
14 for one quarter match with purchase segregation. See  
15 Exhibit 14.

16 Department will attempt to substantiate the  
17 reasoning why the POS is unreliable by simply multiplying  
18 total sales by tax rate and ignoring the fact that total  
19 sales include nontaxable sales. The caption under  
20 schedule clearly reads, "Total Sales for POS." It does  
21 not read total taxable sales for POS. See Exhibit 15.

22 Had the Department clearly studied the report and  
23 subtract nontaxable sales, they would have realized that  
24 there are no differences as suggested by the Department.  
25 See Exhibit 16. They will assert that POS markup is

1 substantially higher than shelf-test markup. For POS  
2 system to correctly calculate markup, it must enter the  
3 inventory cost for each item purchased. Taxpayer never  
4 claimed that they entered inventory cost into the system.  
5 Frankly, it should have been obvious to the Department as  
6 nobody has that much markup absent getting their  
7 merchandise for free. See Exhibit 17.

8 Furthermore, the Department unrelieved -- excuse  
9 me. Furthermore, the Department's unreliability argument  
10 is made after the fact. There is nothing in the original  
11 report to substantiate unreliability, other than say it  
12 was unreliable. They never even mentioned that POS system  
13 has a bar code reader.

14 Two, the Department will argue the cost of goods  
15 is inaccurate. Three quarters were agreed to by the audit  
16 supervisor and tested during the reaudit. The differences  
17 between taxable purchases and taxable sales reported are  
18 as follows: For second quarter 2014, taxable purchases  
19 and taxable sales reported were 72.76 percent and  
20 69.30 percent. For fourth quarter 2014, taxable purchases  
21 and taxable sales reported were 74.52 percent and 72.33  
22 percent. For second quarter 2018, taxable purchases and  
23 taxable sales reported were 76.09 percent and  
24 73.54 percent respectively. The average for the three  
25 quarters were 74.46 percent for taxable purchases tested

1 and 71.72 percent for taxable sales reported.

2 The average taxable sales reported is  
3 96.32 percent of taxable products purchased. It should be  
4 noted that taxable sales reported would never equal with  
5 taxable purchases for convenience stores due to one, theft  
6 or shrinkage; two, personal consumption; three, timing  
7 differences; and four, nontaxable sales usually have  
8 higher profit margin which leads to lower taxable  
9 percentage.

10 In order to better understand the impact of  
11 markup and, ratios, assume that you purchase two items for  
12 one dollar each. One is taxable and the other is  
13 nontaxable. In this scenario the taxable purchases would  
14 be 50 percent of total purchases. Now, further assume  
15 that taxable item sold for \$2 and nontaxable item is sold  
16 for \$3. Total sales would have been \$5. Although,  
17 taxable purchases was 50 percent in this hypothetical, the  
18 taxable sales was only \$2 or 40 percent.

19 Nevertheless, taxable purchases are within margin  
20 of error for the three quarters tested, and that margin of  
21 error was at least admitted to be reasonable by the  
22 Department for the second quarter 2014. Since the other  
23 quarters are within the same margin, a reasonable mind  
24 would conclude that the Department should accept the other  
25 quarters as well. Keep in mind that the auditor who



1 reaudited the records verbally told us that the tested  
2 records match.

3           The Department would argue that second quarter  
4 2018 was outside the audit period and therefore it be --  
5 cannot set the basis for any determination. There are  
6 several flaws with this assertion. One, the audit  
7 supervisor agreed to it. Two, Department does it  
8 routinely. Observation test is a perfect example of a  
9 test done outside of the audit period and, yet, its result  
10 is projected to the audit period. It is also widely used  
11 among auditors because they claim records are more readily  
12 available and tend to be more complete.

13           We can analyze Department's assertion from a  
14 different perspective. The Department may have two  
15 separate and distinct theory in mind when they claim cost  
16 of goods inaccuracy. One, purchases are inaccurate. Two,  
17 gross receipts are understated. Let me begin by saying  
18 that the Department never examined the general ledger to  
19 understand the makeup of the purchases. Furthermore,  
20 Department could have obtained records from taxpayer's  
21 vendors, as they often do but they didn't.

22           Finally, they never claimed that gross receipts  
23 are understated. Three, Department will argue negative  
24 markup for taxable purchases. As I stated earlier, the  
25 Department never examined the markup -- I'm sorry -- the

1       makeup of the cost of goods for inclusion of nonfood items  
2       such as supplies and others.

3               Even if we assume that cost of goods sold does  
4       not include nonfood purchases, the Department is using  
5       80 percent taxable segregations based on their first  
6       audit, which they concluded to be incorrect. If the  
7       Department uses the reaudit findings, the result would be  
8       positive. The Department will correctly assert that they  
9       arbitrarily made allowance for nonfood and others.  
10       However, this assertion contradicts their negative markup  
11       assertion as their Work Schedule R-12A-1 shows a  
12       13 percent markup.

13               Department will argue that even at 65 percent,  
14       rather than 80 percent taxable purchases, the markup would  
15       only be 17.87 percent. Well, they once again disapproved  
16       their own negative markup theory. Here's why. Department  
17       admitted that second quarter -- second quarter records  
18       match. So let's use the second quarter. The taxable  
19       sales reported for the second quarter 2014 was \$423,507.  
20       The taxable purchases for the second quarter 2014 was  
21       \$362,681. The markup is roughly 17 percent.

22               If we adjust the purchases by just 1 percent,  
23       which is less than what Department allows for theft,  
24       personal consumption, and timing differences, the markup  
25       would be 20 percent, which is a far cry from negative

1 5 percent.

2 Department will argue that WIC was irrelevant.  
3 As discussed earlier, Department will assert which sales  
4 were irrelevant. Even as it may, it still does not  
5 relinquish the responsibility under the audit manual  
6 guideline to separately examine periods with significant  
7 disparity.

8 Section 5, Summary. In summary, the Department's  
9 findings are nothing but fruit of poisonous tree. The  
10 findings are based on two incomplete months, which they  
11 admitted to be complete. On the other hand, taxpayer's  
12 findings are based on three full quarters; chosen quarters  
13 were agreed to and tested by the Department. The auditor  
14 who audited the records verbally stated that records --  
15 records provided match. The Department is on record that  
16 second quarter -- second quarter records match. Taxpayer  
17 offered to test more quarters, but Department declined.

18 One thing is for sure. Department cannot project  
19 an error rate that admitted to be unreliable and,  
20 moreover, project an error rate to quarters that it tested  
21 and found to be reliable. The Department's actions were  
22 not in detail as required by the audit manual. The early  
23 periods for taxable ratios were lower and not tested as  
24 required by the audit manual.

25 And lastly, the Department's evidence failed the

1 standard of proof required by the audit manual as it did  
2 not outweigh the evidence opposed to it. I must also add  
3 that I recently learned that taxpayer was audited by the  
4 IRS for the tax years 2014 and 2015 and accepted the  
5 return as filed. So their system couldn't be that  
6 unreliable. See Exhibit 20.

7 I'm done with my opening statement, Your Honor.

8 JUDGE ALDRICH: Thank you. Does -- Judge Long,  
9 do you have any questions for Appellant's representative  
10 at this time?

11 JUDGE LONG: No questions. Thanks.

12 JUDGE ALDRICH: And Judge Cho, do you have any  
13 questions for Appellant's representative?

14 JUDGE CHO: Not at this time. Thank you.

15 JUDGE ALDRICH: Okay. Before we transition to  
16 the Department's combined opening and closing statement, I  
17 want to confirm with Mr. Taheran that he will not be  
18 calling any witnesses consistent with his May 5th, 2020,  
19 e-mail and the May 1st, 2020, minutes and orders.

20 Is that correct, Mr. Taheran?

21 MR. TAHERAN: Correct, Your Honor.

22 JUDGE ALDRICH: Thank you.

23 Department, are you ready to begin your combined  
24 opening and closing statement?

25 MS. RENATI: I am, Your Honor.

1 JUDGE ALDRICH: Thank you. Please proceed.

2 PRESENTATION

3 MS. RENATI: Good morning. I am Lisa Renati,  
4 Hearing Representative for the Department of Tax and Fee  
5 Administration.

6 The Department performed an audit of the  
7 Appellant's sales and use tax account for the period of  
8 April 1st, 2012 through March 30th, 2015. During this  
9 period the Appellant operated three separate Circle K  
10 franchise convenience stores selling alcoholic beverages,  
11 tobacco, soda, sundry items, food, et cetera. The Euclid  
12 Street location is in the city of Anaheim, which is within  
13 the boundaries of Orange County.

14 The North Loara Street location was also in the  
15 city of Anaheim. The North Loara Street location  
16 transferred to a related corporation with a separate  
17 seller's permit as of December 31st, 2014. And the last  
18 location was on Flower Street in the City of Bellflower,  
19 which is in Los Angeles County. This location was sold to  
20 another unrelated entity as of October 8th, 2013.

21 The Department reviewed the Appellant's sales tax  
22 returns and found the reported taxable percentage for the  
23 three-year period of 2012 through year 2014 was about  
24 51 percent; Exhibit B, page 30. The reported  
25 taxable percent appears low for the business based on the

1 Department's experience. Department performed an  
2 examination of the Appellant's point-of-sale system  
3 reports and noted that the sales are summarized under  
4 "Category". The POS reports provided did not segregate  
5 between taxable and nontaxable charges; Exhibit D.

6 The POS report simply listed a total sales amount  
7 for each category. For example, on Exhibit D, page 160,  
8 there's an entry for package beverages totaling \$6,737.31.  
9 It is presumed this amount includes all prepackaged  
10 beverages including carbonated sodas, energy drinks,  
11 water, fruit juice, tea, and the like. Thus, taxable and  
12 nontaxable amounts are commingled. Total sales tax  
13 collected is listed as a separate line item at the end of  
14 the report -- the POS report. See Exhibit D, page 163.

15 The Department reconciled the Appellant's sales  
16 tax reported per POS report and amounts reported for sales  
17 tax returns. An unexplained difference of over \$8,000 in  
18 tax was found; Exhibit B, page 73. An analysis of the  
19 markup of cost using sales amounts reported to the  
20 Department and cost of goods sold amount for Appellant's  
21 federal income return was performed. The Department used  
22 an estimate of 80 percent of taxable purchases to allocate  
23 the cost of goods sold amount taxable. An analysis  
24 revealed a combined negative markup of cost of negative  
25 2.49 percent for the two-year period 2012 and 2013;

1 Exhibit B, page 77.

2 The Department also noted the exempt sales markup  
3 was very high at over 174 percent for the same two-year  
4 period. A negative taxable markup means the Appellant's  
5 cost of sales is greater than the amount received for the  
6 goods. That is, the items were sold at a price less than  
7 the Appellant's cost. A negative markup on taxable items  
8 coupled with very high markup on nontaxable items  
9 indicates possible ringing of errors where taxable items  
10 are rung up as nontaxable. Based on this analysis, the  
11 Department performed indirect testing using a markup of  
12 cost audit methodology to compute audited taxable sales.

13 The Department performed separate shelf tests of  
14 the Euclid and Loara Street locations. To compare the  
15 Appellant's actual sales prices for September 2015 and  
16 corresponding cost amounts for purchase invoices for the  
17 same month. All testing included the unit purchases and  
18 selling prices noted for each locations. For example, the  
19 Appellant did not sell liquor at the North Loara Street  
20 location, but liquor was sold at the Euclid Street  
21 location.

22 The individual percentage of purchases and  
23 markups of cost were affected by these types of  
24 differences. The Department also transcribed all  
25 September 2015 purchase invoices so that separate

1 shelf-test markups could be weighted by purchase category.  
2 The results of the test can be found on Exhibit B, page 40  
3 and 61.

4 Department noted that the resulting markup  
5 percentages were in line with those found in similar types  
6 of businesses. The shelf-test markups were combined and  
7 weighted to compute and overall audit of taxable markup of  
8 cost of 31.88 percent on Exhibit B, page 38 to find that  
9 calculation. At the same time, the Department also  
10 calculated a combined and average taxable purchase  
11 percentage of about 80 percent.

12 The Appellant claimed the 80 percent purchase  
13 percentage, computed using September 2015 purchase  
14 invoices, was not indicative of the purchase percentages  
15 during the audit period. The Department agrees to compute  
16 the weighted taxable purchase application using available  
17 purchase invoices for the period within the audit period.  
18 The Appellant provided and the Department transcribed  
19 purchase invoices for approximately six months.

20 Specifically, for the Euclid Street location, the  
21 Appellant provided purchase invoices for November 2014,  
22 December 2014, and September 2015. September 2015  
23 purchase invoices were also provided for the Lora Street  
24 locations. And combined purchase information for both the  
25 Euclid and Lora locations were provided for the periods of



1 April 2014, May 2014, and June 2014. The Department  
2 computed an overall weighted taxable segregation  
3 percentage of 75.13 percent, which was accepted by the  
4 Department; Exhibit B, page 72.

5 The Department applied the 75.13 audited taxable  
6 percentage to the Appellant's claims cost of goods sold  
7 for tax returns for years 2012 through '14. To account  
8 for the possible inclusion of supply items with the  
9 claimed cost of sale amount, the Department reduced the  
10 cost of sale amounts by an estimated 10 percent.  
11 Additional allowances for self-consumed merchandise at 2  
12 percent and pilferage at 2 percent were also provided.  
13 The resulting in that amount represents audited taxable  
14 purchases available for sale.

15 The audited taxable shelf-test percentage was  
16 applied to audited taxable purchases to calculate audited  
17 taxable measure. And a comparison of the remote -- the  
18 amount -- reported amount and audited amount resulted in  
19 unexplained differences. To account for the  
20 understatement based on Appellant's quarterly reporting  
21 basis, separate percentages of error calculated for each  
22 year using the understated amount and corresponding  
23 reported amount for each year.

24 Because the cost of sale amounts for 2015 were  
25 not -- for first quarter of 2015, rather, were not

1 available, the Department used the year 2014 error  
2 percentage and reported taxable sales for first quarter  
3 2015 to calculate the understated sales.

4 The Appellant claims the purchase records used to  
5 compute the segregation percentages are incomplete and do  
6 not include small vendors. The Appellant provided  
7 purchase summaries for 2000 -- second quarter 2018 and  
8 fourth quarter 2014 to support their claim. The second  
9 quarter 2018 amounts were not considered by the Department  
10 because these periods are three years outside the audit  
11 period. The Department's testing of purchases for  
12 September 2015, which is only seven months after the audit  
13 period, showed an 80.8 taxable percentage for purchases.

14 During the audit examination the Appellant  
15 claimed this achieved 80 percent taxable percentage was  
16 too high and was not representative of their purchases.  
17 So the Department asked that the percentage period seven  
18 months after the audit period are in accurate. The  
19 Department concludes that the purchases for periods three  
20 years later would be more accurate.

21 Regarding the Appellant's fourth quarter '14  
22 summary, which can be found on Exhibit C, page 138 to 146,  
23 the Department rejected these reports because complete  
24 purchase invoices were not provided to ensure the  
25 allocations were correct and accurate. The purchase

1 segregation amounts are close to the Department's audit  
2 amount.

3 And the estimated additional nontaxable amounts  
4 added for various vendors, such as ALDI, Walmart,  
5 Smart & Final, noted on Exhibit C, pages 140, 143, and  
6 145, and 145 are not supported. Additionally, as regards  
7 to estimates for ALDI, the Department notes that ALDI did  
8 not operate in Southern California until 2016. So  
9 addition of these amounts for 2014 is disingenuous.  
10 Accordingly, no adjustment is recommended to the audited  
11 taxable purchase segregation percentage.

12 The Appellant also claimed the Department's audit  
13 calculations do not consider the additional exempt sales  
14 of food products through the federal WIC program. The  
15 Appellant stopped participating in the WIC program at the  
16 beginning of the audit period. For the Euclid location  
17 the program was terminated as of July 2nd, 2012. For the  
18 Bellflower location the program was terminated on  
19 November 7th, 2013. See Exhibit C, page 136. And there  
20 is no evidence the Loara Street location participated in  
21 the program.

22 The Appellant has not provided substantive proof  
23 that nontaxable items were purchased during these periods.  
24 And Appellant has not provided any voucher information  
25 from the program, such as reported rate amount of

1 nontaxable sale. A review of cost of goods sold per  
2 income tax return shows no significant change in purchase  
3 amounts between 2012 and 2013. Therefore, without  
4 evidence to the contrary, the Department presumes the  
5 Appellant's WIC program participation was minimal, and  
6 these amounts would not materially affect the calculation  
7 of audited taxable sales.

8           The Appellant also contends the audited taxable  
9 purchase percentage is flawed because of an increase in  
10 purchases from November 2014 to December 2014. An almost  
11 \$13,800 increase in taxable purchases was noted between  
12 November 2014 and December 2014. The Department  
13 transcribed all purchase information provided by the  
14 Appellant and presumed the information provided was  
15 complete. A review of the segregation schedule shows that  
16 the additional taxable purchases is due to purchases of  
17 alcoholic beverages and taxable item through Coremark.

18           An increase in purchases during November or  
19 December is not unusual for convenience stores, as  
20 businesses frequently purchase more inventory for the  
21 holiday months. The same increase in purchasing can be  
22 found seasonally. The Department reviewed total purchase  
23 amounts for the six separate months tested and notes for  
24 the total purchase amounts and taxable purchase amounts  
25 for November 2014 appear to be less than the other month.

1 This indicates that November 2014 purchase information may  
2 be incomplete. See Exhibit B, page 39 and 72.  
3 Accordingly, no adjustment is recommended to the audited  
4 taxable purchase segregation.

5 As regards to Appellant's last-minute submission  
6 of Exhibit 20, the Department reviewed the information and  
7 recommends no adjustments to the audit findings. First,  
8 the documents do not include any information regarding the  
9 scope of the examination by the Internal Revenue Service  
10 or other information regarding the records that were  
11 included in the review. The audit findings of the IRS are  
12 not binding to the Department.

13 The Department used a recognized audit  
14 methodology to compute audit taxable measure, which  
15 results in a fair and reasonable audit finding. The  
16 Department's Schedule R 12A-1, which can be found on  
17 Exhibit B, page 37, includes the Appellant's claim year  
18 2014 cost of goods sold amount obtained by the Department  
19 from the Franchise Tax Board. The amount is \$2,204,762.  
20 The reported gross sales for sales and use tax returns,  
21 excluding sales tax, was \$2,389,177.

22 Using these amounts the reported gross sales  
23 markup is only 8.36 percent, which is very low.  
24 Additionally, if allowances are provided for supplies,  
25 shrinkage, self-consumes, only the taxable percentage

1 purchases are considered. The reported taxable markup  
2 would only be about 13 percent, if the shelf test  
3 performed by the Department shows the Appellant's taxable  
4 markup is much greater at 31.88 percent.

5 Lastly, the Appellant claims their POS system  
6 captured each sale and charged tax accordingly, and that  
7 these reports were used to report their taxable sales  
8 liability. The Department notes that no POS system,  
9 including those with a bar code system, is infallible.  
10 The accuracy of the system depends on whether the items  
11 are correctly coded in the system. Additionally, if a  
12 cashier fails to scan all items sold or some other  
13 operator error occurs, then the POS system would not  
14 capture all transactions accurately.

15 The Department's markup tax analysis using  
16 Appellant's reported amount showed a negative taxable  
17 markup of cost. This is evidence of understated taxable  
18 sales, and also evidence that the Appellant's report from  
19 their POS system used to report their taxable sales is  
20 unreliable. Additionally, Appellant's Exhibit 16 includes  
21 detailed sales reports which are extracted from the  
22 Appellant's POS system on August 9th, 2019. These  
23 detailed reports differ from the reports provided to the  
24 Department per Exhibit D, page 152 to 157, which have an  
25 extraction date of July 13, 2015.

1           If you look at Appellant's Exhibit 16, pages 84  
2 to 86, you will see reported taxable sales for January,  
3 February, and March totaled \$226,099. For the same  
4 quarter the Appellant reported \$188,779 in taxable  
5 measures; Exhibit B, page 31. This is a difference of  
6 over \$37,320. In Department's audit finding for first  
7 quarter 2015 on Exhibit B, page 36, shows a difference of  
8 only \$31,573 in understated taxable measures.

9           This means the audit findings of the Department  
10 are less than the actual sales of the Appellant's, per  
11 their own exhibit. Accordingly, the Department is  
12 confident the audit findings for the audit period are  
13 reasonable and fair. We request that the Appellant's  
14 appeal be denied.

15           This concludes my presentation. I'm available to  
16 answer any questions you may have.

17           JUDGE ALDRICH: This is Judge Aldrich again.  
18 Thank you.

19           Judge Long, do you have any questions?

20           JUDGE LONG: I do. In the briefing the CDTFA  
21 states that the taxpayer did not have a bar code scanner;  
22 is that correct? Is that CDTFA's position, because it  
23 seems we've gotten some conflicting information today.

24           MS. RENATI: Sir, give me one moment please.  
25 This is Lisa Renati. Your Honor, can you point me to

1 where you find this information?

2 JUDGE LONG: Yeah. So the -- let me see.  
3 Appellant's attorney stated several times that they did  
4 have a bar code. However, the July 15th, 2019, brief,  
5 page 2, 4th line -- sorry -- third line. Appellant's POS  
6 system in use during the audit period did not have a bar  
7 code system.

8 MS. RENATI: Okay. Give me a second. I'm going  
9 to look at the audit report real quick. Your Honor, I  
10 looked at the audit report. And when that was composed,  
11 we were using the information available on the audit  
12 report, and our audit report did not include that there  
13 was a bar code system. We weren't -- did not include that  
14 into our report until we received the Appellant's  
15 exhibits.

16 JUDGE LONG: Okay. To follow up, is it still  
17 your position that they didn't have a bar code, or is it  
18 now that they did have a bar code?

19 MS. RENATI: Well, when we looked at exhibit --  
20 Department's exhibit -- let me get the exact page for you.  
21 When I looked at Exhibit B, page 9, which is the reported  
22 discussion by the principal tax auditor, that the  
23 mentioned -- didn't mention a bar code system. All that  
24 was mentioned talked about was looking at the POS system  
25 and examining the POS system and finding that items --



1 they're saying categories were -- indicates that  
2 categories were rung up using the actual cash register.  
3 It doesn't indicate a bar code system was used.

4 The Appellant has provided information via their  
5 exhibit showing that purportedly a POS system with a bar  
6 code system used. So we are -- I -- I am -- I can't -- I  
7 don't have information other than the auditor does not  
8 mention nor does the supervisor or the district principal  
9 auditor that a bar code was used.

10 So my presentation includes the information  
11 because I knew that the -- because Appellant's  
12 representative did bring up the bar code system.

13 JUDGE LONG: Okay. Thank you.

14 JUDGE ALDRICH: This is Judge Aldrich again. So  
15 I guess this is for Appellant's representative this  
16 question. But is it your assertion that Appellant used  
17 Radiant as the POS system for each location, Mr. Taheran?

18 MR. TAHERAN: That's my -- that's my  
19 understanding, Your Honor.

20 JUDGE ALDRICH: Okay. And is that the only POS  
21 system that was used by Appellant?

22 MR. TAHERAN: That is my understanding, yes.

23 JUDGE ALDRICH: I guess -- is SSCS Passport a  
24 separate POS system from Radiant?

25 MR. TAHERAN: I don't know the answer to that,

1 Your Honor.

2 JUDGE ALDRICH: Okay. Ms. Renati, do you have  
3 any insight as to whether or not Radiant and SSCS Passport  
4 are companion POS systems or how they differ?

5 MS. RENATI: I do not.

6 JUDGE ALDRICH: Okay. Judge Cho, did you have  
7 any questions?

8 JUDGE CHO: Hi, this is Judge Cho. Yeah, just a  
9 quick question for Mr. Taheran. The Department brought up  
10 your Exhibit 16, I believe, which was the POS records and  
11 they compared it to the reported amounts for the first  
12 quarter of 2015 and noted in understatement that roughly  
13 aligned with what they found using the markup method. Do  
14 you have a response to that?

15 MR. TAHERAN: Excuse me one second, Your Honor.  
16 Exhibit 16 you said?

17 JUDGE CHO: Yes.

18 MR. TAHERAN: Okay. And what was exactly the  
19 assertion, Your Honor?

20 JUDGE CHO: I believe it was the Department added  
21 up your total sales for all three of those months that you  
22 had in Exhibit 16. And then they were -- they looked at  
23 your reported -- not yours -- but the taxpayer's reported  
24 sales for first quarter of 2015, and they found that  
25 Exhibit 16 actually adds up to a higher amount than the

1 reported amount.

2 MR. TAHERAN: Yeah. Because typically when they  
3 report or they prepare a sales tax return, they do not  
4 include Lotto lottery. And that's -- that's the  
5 difference.

6 MS. RENATI: May I interject, Your Honor?

7 JUDGE CHO: This is Judge Cho. Sure, Ms. Renati,  
8 you can make a response.

9 MS. RENATI: This is Ms. Renati. The amounts I  
10 presented were the taxable sales amounts, not total sales  
11 amount.

12 JUDGE CHO: This is Judge Cho. Thank you for the  
13 clarification.

14 Mr. Taheran, do you have a response to that? She  
15 was looking at total taxable sales, not total sales. I  
16 misspoke. I apologize.

17 MR. TAHERAN: If the Department knows what was  
18 reported for that period, I would be happy to do the math  
19 really fast. But top of my head, I don't have a number  
20 for you, sir.

21 JUDGE CHO: This is Judge Cho. It's your  
22 Exhibit 8. If you look at your Exhibit Number 8, I  
23 believe it's line 22 on the BOE 414M Sales and Use Tax  
24 Schedule.

25 This is Judge Cho. Mr. Taheran, while you look

1 for that information and formulate a response, I just have  
2 a quick question for Ms. Renati and CDTFA.

3 I know you mention it in your presentation, but I  
4 think I must have missed it. Would you mind explaining  
5 again one more time why there could be ringing up errors  
6 if they did use the bar code reader, or is that because  
7 you were under the impression they did not have a bar code  
8 reader, Ms. Renati?

9 MS. RENATI: Yes. This is Lisa Renati. Hold on  
10 a second. I need to get everyone to mute. Okay. This is  
11 Lisa Renati. So the reason why -- let me go back to  
12 that -- well our first -- our first comment is that no POS  
13 system is infallible, that it all depends on how it's  
14 used; whether the items are coded correctly or in their --  
15 within the records as taxable versus taxable.

16 Also cashiers can fail to ring up items that are  
17 taxable, leading to understated taxable items. Or they  
18 can make sales with cash register open. So all of those  
19 items would make a bar code system in place not  
20 necessarily record all the taxable sales that are due,  
21 which is why our taxing analysis is performed to see if  
22 the reported amounts are correct.

23 In this case the Department used basic markup of  
24 cost method and using markup of cost based on the reported  
25 amounts, which are purportedly reported per the sale --

1 per the POS system reports, showed a negative markup for  
2 year 2012 and year 2013.

3 So a negative markup means they sold it for less  
4 than cost, which is not reasonable. Even if we are making  
5 adjustment based on all the different items, markup would  
6 still be less than the audited markup we calculated.  
7 Therefore, we've impeached the taxpayer's records and  
8 their POS system and used the indirect audit methodology  
9 of the markup of cost.

10 JUDGE CHO: This is Judge Cho. Thank you very  
11 much for the explanation.

12 And Mr. Taheran, were you able to give us a  
13 response?

14 MR. TAHERAN: No, Your Honor. Right now I do  
15 know, again, and I'll be happy to provide that. But back  
16 when I looked at it, and it's been a while, I do know that  
17 Lotto lottery was -- was a factor and redemptions was also  
18 a factor. Outside of that, right now it doesn't come to  
19 me. I'm blank on the point.

20 But one thing I do want to comment, Your Honor,  
21 is this. They -- all of these assertions they're making,  
22 it is made after the fact. One thing is for sure. The  
23 easiest thing for the Department to have done is to do a  
24 half of day test, one day observation test. They could  
25 have watched -- watched them ring and come to a conclusion

1 that the POS system is unreliable.

2 One of the other things that I do want to point  
3 out, it just comes to mind --

4 JUDGE CHO: I'm sorry. I'm sorry. This is  
5 Judge Cho. Mr. Taheran, I don't mean to cut you off.

6 MR. TAHERAN: That's okay.

7 JUDGE CHO: It's just that it sounds you're going  
8 to go into rebuttal and not a response to my actual  
9 question, which is totally fine, but I think that should  
10 be saved for your final presentation. If there's no  
11 further response to my question, I -- I'm okay with that,  
12 and I will thank you for your time and your presentation.  
13 I have no further questions.

14 MR. TAHERAN: Thank you, Your Honor.

15 JUDGE ALDRICH: All right. Mr. Taheran, would  
16 you like to make a final statement or rebuttal to the  
17 Department or further address to any of the questions we  
18 had?

19 MR. TAHERAN: Yes. Yes, I do.

20

21 CLOSING STATEMENT

22 MR. TAHERAN: Let me begin with what I was about  
23 to say, and that is -- and I don't remember exactly --  
24 exactly what page of their exhibits, but I think it's in  
25 their May 10th report, and it is part of my exhibit as

1 well where they sent the auditor for a detailed review.  
2 But if you take a look at the very same page that you were  
3 talking about, page 9, it does say that the auditor was  
4 sent for a cursory review. Even a cursory review they  
5 would have learned that POS system has a bar code.

6 Now, with respect to a few things that Ms. Renati  
7 brought up that these reports are combined and that  
8 taxable and nontaxable items are perhaps commingled.  
9 Aside from there is no evidence to that, this report that  
10 is generated and given to the CPA. It's basically a  
11 summary report for the CPA to see how much tax was  
12 collect, what are the nontaxable sales item, so they can  
13 do the return. This is not the only report that POS  
14 system can generate.

15 Like I said, they -- they -- it does have limited  
16 capacity, but they can't -- they could have been able to  
17 see ticket by ticket transactions. They could have been  
18 able to really examine whether the POS system is capturing  
19 taxable and nontaxable correctly. That's one item. The  
20 other thing is -- is that they keep going back to this  
21 negative margin. And what I did not hear from them is why  
22 are they averaging the results.

23 It was noted to them, substantiated to the  
24 Department that -- that the taxable sales follows the  
25 taxable purchases within margin of error. And, yet, there

1 was no comment as to why you're averaging the results.  
2 You've done an audit. You did agree that the test basis  
3 was incomplete. That was the premise that the audit was  
4 warranted according to the audit supervisor. You were  
5 proven that taxable purchases, when you look at them  
6 collectively for the entire period and compare it to the  
7 period that was reported, that the differences are within  
8 margin of error. And I did point out why there could be  
9 some differences.

10 There was to reply to that. All I heard was  
11 that, "Hey, it shows negative markup. Negative markup."

12 Well, the negative markup was the original  
13 theory, and they're sticking to it. When, in fact, the  
14 revised report in and of itself and they did admit that it  
15 doesn't. It actually doesn't have 13 -- at least  
16 13 percent. My contention is it's almost 20 percent based  
17 on my reporting. So but at the end of the day -- at the  
18 end of the day, they have a POS system. And the POS  
19 system was never tested. So unreliability of POS system  
20 according to the Department is basically hyperbole. It's  
21 just nothing. There's no proof of it. They never tested  
22 it.

23 Thank you, Your Honor.

24 JUDGE ALDRICH: This is Judge Aldrich again. We  
25 have your evidence and argument in the record. Is there



1 anything else you would like to tell us before I submit  
2 the case?

3 MR. TAHERAN: No, Your Honor.

4 JUDGE ALDRICH: Okay. Thank you both for being  
5 flexible with the hearing format. I appreciate your  
6 time. We're ready to submit the case. The record is now  
7 closed. The judges will meet and decide the case based on  
8 the evidence and the arguments presented today. We will  
9 aim to send both parties our written decision no later  
10 than 100 days from today.

11 And this concludes the hearing calendar for  
12 today. Thank you.

13 (Proceedings adjourned at 11:05 a.m.)

14

15

16

17

18

19

20

21

22

23

24

25

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

HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

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

I have hereunto subscribed my name this 29th day of May, 2020.

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