

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
TMHR COLLECTIVE CORPORATION,) OTA NO. 18043020
)
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 APPELLANT.)
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, June 17, 2020

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
12900 Park Plaza Dr., Suite 300, Cerritos,
California, 90703, commencing at 10:15 a.m.
and concluding at 11:36 a.m. on Wednesday,
June 17, 2020, reported by Ernalyn M. Alonzo,
Hearing Reporter, in and for the State of
California.

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APPEARANCES:

Panel Lead: ALJ KEITH LONG

Panel Members: ALJ ANDREW KWEE
ALJ ANDREW WONG

For the Appellant: DAVID LUTZ
ELIZABETH M. SHELDON

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

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I N D E X

E X H I B I T S

(Appellant's Exhibits A-F were received at page 6.)
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1 Cerritos, California; Wednesday, June 17, 2020

2 10:15 a.m.

3

4 JUDGE LONG: We are now going to go on the
5 record. This is the appeal of TMHR Collective
6 Corporation, OTA Case Number 18043020. The date is
7 Wednesday June 17th, 2020. It's approximately 10:15 a.m.
8 The location of this appeal was intended to be heard in
9 Cerritos, California. However, it is being held via video
10 conference as a result of the ongoing Coronavirus
11 concerns.

12 I am lead Administrative Law Judge Keith Long.
13 And with me today is Judge Andrew Kwee and
14 Judge Andrew Wong. We will be hearing the matter this
15 morning. I am the lead ALJ, meaning I'll be conducting
16 the proceedings, but my co-panelists and I are equal
17 participants, and we will all be reviewing the evidence,
18 asking questions, and reaching a determination in this
19 case.

20 Parties, beginning with Ms. Sheldon, please state
21 and spell your names and who you represent for the record.

22 MS. SHELDON: My name is Elizabeth Sheldon,
23 E-l-i-z-a-b-e-t-h S-h-e-l-d-o-n. We representative -- I'm
24 the representative for TMHR Collective Corporation.

25 JUDGE LONG: And Mr. Lutz?

1 MR. LUTZ: This is David Lutz representing TMHR
2 Collective Corporation, D-a-v-i-d, Lutz, L-u-t-z.

3 JUDGE LONG: And Mr. Suazo.

4 MR. SUAZO: Randy Suazo, Hearing Representative.
5 Randy, R-a-n-d-y, Suazo, S-u-a-z-o.

6 JUDGE LONG: Mr. Brooks?

7 MR. BROOKS: Good morning. This is Christopher
8 Brooks, C-h-r-i-s-t-o-p-h-e-r, Brooks, B-r-o-o-k-s.

9 JUDGE LONG: And Mr. Parker?

10 MR. PARKER: Hi. Jason Parker, Hearing
11 Representative, J-a-s-o-n P-a-r-k-e-r.

12 JUDGE LONG: And the purpose of today's hearing
13 is to determine whether any additional reduction to the
14 amount of unreported taxable sales is warranted, and
15 whether Appellant was negligent.

16 Prior to this hearing, taxpayer submitted
17 Exhibits A through F, which are admitted into evidence
18 with no objections.

19 (Appellant's Exhibits A-F were received
20 in evidence by the Administrative Law Judge.)

21 JUDGE LONG: CDTFA has submitted Exhibits A
22 through E, which are admitted into evidence with no
23 objection and no new exhibits.

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

1 JUDGE LONG: We will begin with opening
2 statements.

3 Ms. Sheldon, you have up to 10 minutes, and you
4 may begin whenever you're ready.

5 MS. SHELDON: Thank you, Your Honor. I will
6 begin now.

7

8 OPENING STATEMENT

9 MS. SHELDON: It is our position that at the time
10 the BOE, now the CDTFA, did not conduct a legitimate audit
11 and no additional tax is warranted. I will refer
12 specifically to the burden of proof as memorialized in
13 Riley B's, Inc. versus BOE. When a taxpayer challenges a
14 Notice of Determination, the Department has the burden to
15 explain the basis for the deficiency.

16 That's also -- we see that in the rules for tax
17 appeals, Article 4, Conduct of a Board Meeting and Burden
18 of Proof, Section 5541. The burden of proof rests with
19 the Department. It is our position that the Department
20 has not met their burden of proof.

21 With regard to the actual audit, this is where
22 TMHR raise their primary concern. As found on the CDTFA
23 website Regulation 1695.5 Audit Procedure, (b), the Board
24 has a duty and an obligation to utilize its audit
25 resources in the most effective and efficient matter

1 possible. The regulation also provides for appropriate
2 and timely communication between Board staff and the
3 taxpayer of requests, agreements, and expectations related
4 to the audit.

5 Additionally, Section (c)(3) of that same
6 section, Site Visitation. Regardless of where the audit
7 takes place, Board staff may visit the taxpayer's place of
8 business to gain a better understanding of the business
9 operation. For example, plant tour to understand a
10 manufacturing process or visit a restaurant to observe a
11 seating facility or volume of business.

12 Board staff may not visit secure areas or areas
13 that are regulated by the federal government. Federal
14 security clearance is necessary, unless authorized by the
15 taxpayer. Board staff generally visit on a normal workday
16 of the Board during the Board's normal business hours. In
17 this particular instance, the TMHR was a collective that
18 had medicinal marijuana on premises, and there was a layer
19 of legislation state -- legislation that limited access to
20 the business on a whole with specific regard to an area
21 where cannabis sales were undertaken.

22 TMHR had a bifurcated store. So the front half
23 of the store was accessible without the need of medicinal
24 marijuana prescription or card or authorization. And it
25 would need -- it would need such for the back end -- back

1 end of the store where the cannabis sales were taking
2 place.

3 It's our understanding that CDTFA at no time
4 entered the premises but instead chose to conduct their
5 audit by sitting in the parking lot in a car, and
6 according to the audit report, watched people -- counted
7 people coming in and coming out.

8 We have received, from the CDTFA, the logs which
9 are in evidence that shows the time and the number of
10 people coming, what appears to be, in only. We have
11 received nothing from the CDTFA that would indicate how
12 many people actually left, if any of these people were
13 employees, if people left with any sort of bags or
14 containers or any sort of remnants that a sale had taken
15 place.

16 We think it's important to note that TMHR in the
17 front half actually offered free food. The location of
18 TMHR was on -- let's see -- Highland in Santa Monica. I
19 don't know if the judges are familiar with that area, but
20 as far as West Hollywood is concerned, it's a rather
21 depressed area and financially challenged. So there's
22 lots of homeless and indigent people in the area.

23 And as part of the community, TMHR offered free
24 sandwiches, free water. They would go in. They could
25 take them. They could put them into a bag, and then they

1 could leave. That wouldn't qualify as a purchase of food,
2 let alone anything else.

3 So we have serious concerns that just counting
4 people coming in and coming out and observing absolutely
5 no sale whatsoever is not consistent with the
6 methodologies outlined in the audit manual. I will speak
7 specifically to Section 8 of the CDTFA Audit Manual when
8 it comes to how an audit should take place and the
9 duration that would qualify as a legitimate audit.

10 The short audit is considered 1 day, 1 business
11 day. As reflected in the papers, TMHR was open from
12 10:00 a.m. to 8:00 p.m. for a 10-hour day. The totality
13 of time observed by the CDTFA is arguably 5 hours. One of
14 the days that they chose to sit in the car and watch
15 people go in was October 28th. This is West Hollywood.
16 That's three days from Halloween. There is some
17 discussion in the code with regard to close to a holiday.
18 So arguably five hours could be considered four hours, if
19 you disregard the 28th.

20 I would also like to point out the last day of
21 the observation, which was November 7th, there was a
22 period of time that was observed on the 7th. However,
23 when they came back to do additional observations, the
24 business had closed and had closed permanently. So when
25 we talk about potential unusual circumstances outlined in

1 chapter 8 of the audit manual, they were closing.

2 They actually had closed on November 7th at about
3 noon. And the audit observation period for November 7th
4 was from 10:00 a.m. to 12:00 p.m. So it seems quite
5 likely that lots of the people entering that store may
6 have been employees or owners who are going to close out.

7 So we have serious concerns about the conclusion
8 from the CDTFA, the people actually walking into the store
9 are now imputed as customers -- paying customers who paid
10 the same amount every time somebody walked into the room,
11 bought the same thing for the same amount and came out.
12 And we have absolutely no records of anybody exiting and
13 no observation of any sales, no observation of any medical
14 marijuana coming out of the store. Or at least there's no
15 notation in the audit notes that indicated that.

16 So the audit notes do indicate they counted
17 people coming out. We have no documentation to support
18 that, specifically, with regards to the auditor's position
19 that the auditor used observation method to establish the
20 additional taxable sales since the taxpayer did not
21 provide any reliable records.

22 The, CDTFA, BOE at the time, had been explained
23 from the representative of TMHR in 2014 that on
24 August 26th of '14 in Los Angeles -- I'm sorry. The IRS
25 had summoned all records from the -- from TMHR. And then

1 on September 8th, just a week and a half later, the Los
2 Angeles Police Department raided TMHR; confiscated all
3 records, all paraphernalia, all product. Everything was
4 taken from the store on September 8th.

5 So while we understand that there weren't
6 reliable records, we don't understand why the CDTFA didn't
7 contact the IRS. We tried to contact the police
8 department. The records had been destroyed. So we
9 understand that there were no reliable records. However,
10 it was not for lack of records. It was simply that the
11 other authorities had already claimed those records prior
12 to CDTFA getting involved.

13 The other position was the auditor conducted a
14 four-day observation test at different times to get an
15 average number of customers for an hour for the business.
16 Well, there were lots of overlapping times reflected on
17 the observation. In fact, it looks like most of the times
18 were duplicative. On October 2nd they were there from
19 1:50 to 2:50. On October 28th they were there from 1:30
20 to 2:30. Both of those -- one was a Thursday, and one was
21 a Tuesday.

22 On October 7th they were there from 11:00 to
23 12:00. On 11/7 they were there from 12:00 -- from 10:00
24 to 12:00, again, overlapping. One on a Tuesday. One on a
25 Friday. At no time did they come on a weekend. The audit

1 manual does indicate that if a busy time is a weekend or
2 evening, that the audit should take place on a weekend or
3 evening. No weekend hours, no evening hours were
4 represented in the audit report. Additionally, only
5 five -- actually, four legitimate hours of observation
6 were undertaken, and no sales were undertaken.

7 There was some discussion as to why the CDTFA
8 could not enter the store. We don't know if they
9 neglected to reach out to the Department of Health who
10 could have authorized their attendance in an otherwise
11 restricted area, if they had contacted local law
12 enforcement or the local mayor of West Hollywood to --

13 It's hard to believe that CDTFA is simply barred
14 from observational audits from medicinal marijuana
15 collectives, even in 2014. But the fact remains that they
16 observed no sales, and the audit report reflects only
17 people going in. There is no discussion about coming out
18 with any sort of sales. And yet, every single person that
19 went in, the CDTFA is representing as purchasing something
20 for \$50. And then basically --

21 JUDGE LONG: Ms. Sheldon.

22 MS. SHELDON: Yes, sir.

23 JUDGE LONG: This is Judge Long. I'm sorry to
24 interrupt. I just want to make you aware of the time, if
25 you could please take a minute or two to conclude your

1 opening statement.

2 MS. SHELDON: I'm absolutely at the end. Yes,
3 sir, I'm happy to do it.

4 So again, we find that the imputing sales on
5 people walking into a business and observing absolutely no
6 sales does not qualify as an audit. Spending four hours
7 when a minimum of a short audit would be 10 hours. And a
8 short audit is only valid to substantiate a no change or a
9 no change on a change audit. A substantial audit would
10 have been warranted, which would have been 30 hours,
11 3 days minimum. That was not undertaken.

12 There is no foundation to assess additional tax.
13 In an analogy to criminal law, it is somewhat similar to
14 the fruit of a poisonous tree. You didn't conduct an
15 audit, yet you've assessed tax. That is our position,
16 Your Honor.

17 JUDGE LONG: Thank you.

18 This is Judge Long. I'm going to open up the
19 floor for questions from my co-panelists. Judge Kwee, do
20 you have any questions?

21 JUDGE KWEE: Yes. This is Judge Kwee. I do have
22 a couple of questions for the taxpayer. And, basically, I
23 understand you're saying that the records were destroyed,
24 and that's why you're unable -- the taxpayer was unable to
25 provide records to CDTFA to support the reported amounts;

1 is that correct?

2 MS. SHELDON: Partially correct, Your Honor. A
3 timely submission of documents to the CDTFA was precluded
4 because those documents were in possession by the LAPD and
5 the IRS, respectively. Subsequently, those records were
6 unavailable to us some years later to try to get them.

7 JUDGE KWEE: Okay. And do you have any
8 documentation to support that the police seized or
9 destroyed records for this business?

10 MS. SHELDON: I believe the police report was
11 included in, I believe, Exhibit A. I think it starts
12 around page 20 of the -- part of the police procedure. I
13 just know from criminal law that part of the procedure was
14 they were -- in fact, the representative at the time told
15 the CDTFA that the police had come and seized everything.

16 So as far as the actual documentation outside of
17 the police report and the representative at the time
18 telling the CDTFA what had come to pass, I have no
19 additional documentation on that end. I do have a copy of
20 the summons from the IRS. That is included in one of the
21 exhibits. I believe that might be the last couple of
22 pages of A.

23 So beyond those two documents, the police report
24 and the IRS summons and the log from the auditor
25 reflecting that the prior representative did indicate that

1 they were raided, and everything was taken, we have no
2 other documentation, Your Honor.

3 JUDGE KWEE: Okay. So I do see on Exhibit A the
4 police report, the arrest report, and the IRS summons.
5 But in reading those documents, my understanding was
6 that -- well, I do see that the police also were
7 investigating the business. The Honey Spot, I assume, is
8 TMHR Corporation. But from the arrest report it said that
9 they arrested the delivery person, the person delivering
10 product to the business on a probation violation.

11 And I don't -- I don't understand how arresting
12 the delivery man is related to the seizing of records by
13 the business. I don't see in the report that action was
14 taken against the business. It seemed like it was focused
15 on the delivery person for a probation violation. Could
16 you help clarify that?

17 MS. SHELDON: Yes. There were two police
18 reports. That first one did indicate that their -- one of
19 their vendors had been arrested in the parking lot. But
20 there was a second police report. I thought that was
21 attached. I apologize. I don't have that right in front
22 of me. I'm going to have to go and find it.

23 Mr. Lutz, I don't know if you could find that for
24 me.

25 But the -- and, again, in the case notes from the

1 auditor itself -- herself, there are notes from the prior
2 representative indicating that -- that was in 2013, I
3 think, was when the vendor was arrested. But we do have
4 notes from Kathy Huang when she spoke to prior
5 representative Mr. Filian on -- it looks like
6 September 8th, 2014, which is part of the CDTFA exhibit.

7 That does indicate received e-mail from
8 Mr. Filian. He stated, "The business had been raided last
9 week and every single one of the shop people were
10 arrested. All of the inventory and everything in the
11 store was confiscated and destroyed. Mr. Filian will send
12 documentation and pictures to the auditor once they get
13 them."

14 So there is that within the CDTFA file itself,
15 but there should be a second police report. I -- we did
16 supply the dismissal of charges against CDTFA. So there
17 wouldn't have been a dismissal had there not been an
18 arrest. So I apologize for not getting my hands on the
19 second police report.

20 Mr. Lutz, were you able to look at that?

21 MR. LUTZ: This is David Lutz speaking for TMHR.
22 So yes, I did find the -- on page 34 of the petitioner's
23 Exhibit A here. It starts on page 34, was the
24 documentation regarding the dropped suit from the State of
25 California against Mr. Jeff Beckwith regarding the

1 transportation and distribution of marijuana. I do see
2 that, but I don't see the police report originally with it
3 at the moment.

4 JUDGE KWEE: Okay. This is Judge Kwee. Thank
5 you. If it's in there we'll look, and I will refer to the
6 audit notes that you have. Thank you for that
7 clarification, and I did have one other clarification or
8 just question. I was hoping you could help me understand.
9 Because in looking at the numbers that were appointed by
10 the business for this three-year audit period.

11 I have \$318,000. And is the taxpayer's position
12 that it accurately reported the sales for the audit
13 period, or is there a question that the audit by CDTFA is
14 overstated but there was some underreporting? Could you
15 clarify your position on that?

16 MS. SHELDON: Well, when the business closed in
17 2014 on November 7th, it was due to financial hardship.
18 After the police raid, they were unable to recoup their
19 losses, to restock, and to carry on. They tried for about
20 three months and ultimately failed.

21 So their business -- I think the Board may be
22 aware, and I don't know if the judges are, that 2012 is
23 their first active year in business. 2013 their second,
24 and obviously 2014 is their third and final year.

25 So they had a growing business model that got --

1 got taken out at the knees, if you will. But we do not
2 represent the returns as filed as incorrect. They -- they
3 have not made that representation all.

4 JUDGE KWEE: Okay. This is Judge Kwee. Thank
5 you. And so I guess what I'm trying to understand here is
6 because, you know, the CDTF, they have a minimal-initial
7 burden to show an error with the reporting. And then once
8 that burden is met, then the burden goes to the taxpayer
9 to show a different result. And what I'm looking at
10 with as far as the reporting -- and I do understand the
11 concerns and the frustration you have with the audit, you
12 know, the \$50 per head per -- per person; the amount of
13 the hours with the observation test; just the termination
14 of the business coinciding with the observation test.

15 You know, I understand that there is concerns
16 there, and there is issues with support for the audit. As
17 far as the reported numbers, though, that they do seem
18 that they might be low to me. For example, you have the
19 \$318,000 over a three-year period. That's \$106,000 per
20 year or \$8,800 per month. On that amount, the business
21 would have to be paying their workers' salaries. They
22 would have to be paying the security guards' salaries.

23 The police report did mention there were a lot of
24 security guards. They said there were several security
25 guards. They would also have to purchase product. They

1 would have to pay rent. They would have to pay taxes.
2 They would have to pay overhead. I'm just trying to
3 understand how the business survived for three years on an
4 average of \$8,800 a month. That seems -- it seems a
5 little low. And I'm wondering if, you know, that's -- the
6 business reporting such a low amount is sufficient.

7 To me CDTFA's initial burden that there was an
8 issue with the underreporting, you know, I get there are
9 probably -- there might be some issues with the amount
10 actually calculated being high and that adjustments might
11 be warranted. I'm just -- I'm -- just help me understand
12 why \$8,800 a month, why that was a reasonable amount for
13 the business to report, if you can understand what I'm
14 saying.

15 MS. SHELDON: No, sir. I think I do understand.
16 I appreciate the question. Thank you.

17 I will point out, again, in 2011 TMHR formed. It
18 was a shell company, not used at that point. 2012 was
19 their first year in business. Any business showing a
20 profit in the first year, frankly, I find to be
21 remarkable. And to have the business continue to grow
22 seems consistent with how I would expect the business to
23 flourish, if it is successful.

24 As I pointed out in my original -- opening
25 statement, the location of TMHR is one of a depressed

1 neighborhood. So largely the principals involved were
2 there, not there necessarily to retire to the South of
3 France but, in fact, to help the community.

4 In 2014 adult use had not passed. It was purely
5 medicinal. And, again, offering food and offering
6 beverages, their goal was to help the community in a very
7 depressed part of West Hollywood. It seems counter
8 intuitive, but West Hollywood does have a depressed part.
9 In '14 -- I don't know if you are familiar, again, with
10 the area, but Hollywood -- excuse me, Santa Monica and
11 Highland is a very sketchy neighborhood.

12 So I would expect -- and I've -- if you were to
13 look at the police report, the prices during the
14 observation period of the Los Angeles Police Department in
15 2013 -- they actually took the proactive stance of talking
16 to people coming out of TMHR. They interviewed the
17 clients who were coming out to find out did they buy
18 anything? What -- how was their experience? Can they
19 take a picture of the -- the medicinal marijuana?

20 These were all questions you'll find inside the
21 police report. And what you'll find is that their prices
22 were remarkably lower than what's being reflected by the
23 BOE at the time, CDTFPA today. One, I think, Steve --
24 identified as a white male named Steve in the police
25 report said he'd been going to TMHR for about a year and

1 spends about \$30 on an 8th. He didn't buy anything that
2 day.

3 They interviewed another man who refused to give
4 his name. He's identified solely as a white male who went
5 in. They interviewed him, and he had bought nothing that
6 day. So I believe that's why I understand those numbers
7 may seem low, I think for a growing business they're not
8 remarkably atypical. I think even in a depressed
9 neighborhood they were doing well enough to maintain and
10 hopefully grow to a point where they were more profitable.

11 But, again, they just started in 2012 in what
12 would be considered, frankly, a rather area -- competitive
13 field but, again, in a depressed neighborhood. So their
14 business model wasn't one to get rich quick but to become
15 part of the community. So if their sales were low as long
16 as they were growing, the principals weren't remarkably
17 concerned. They felt there was enough to maintain and
18 enough to move forward.

19 They were able to -- I don't think all the
20 security guards were there 24-7. They were open 10 hours
21 a day. I think they had one security guard, maybe two on
22 shift. I think when they closed, probably everybody was
23 there to get their personal belongings, to get whatever
24 they had left there because the business was closing at
25 noon on November 7th.

1 So I appreciate while the numbers may seem low, I
2 think when you look at the totality of the experience of
3 that business, the short two and a half to three-year
4 period they were actually open, that they did in fact
5 continue to grow and report growing sales. And I think in
6 another couple of years we would have seen some much more
7 favorable numbers. But, again, their prices were low
8 intentionally for the community.

9 And their goal really wasn't to, again, have this
10 be get rich quick but, in fact, to be a large growing part
11 of the community and help. I think over time those
12 numbers would have reflected higher, but they were not in
13 business for very long.

14 JUDGE KWEE: Thank you. This is Judge Kwee
15 again, and I did have just one question before I turn it
16 over -- or back to the panelist for additional questions
17 that they may have.

18 You had mentioned a couple of times that the
19 business handed out non -- well, food products for free to
20 the community, and I don't believe I saw reference to that
21 previously in the CDTFA's decision. Or if it was there, I
22 just missed it. And I'm wondering if there's any
23 documentation in the record that had referenced the
24 handouts that you're referring to?

25 MS. SHELDON: I wouldn't expect to see it from

1 CDTFA since they never entered the premises. So I don't
2 believe that CDTFA knew what anybody was walking out with
3 or without or what was within inside. I don't think they
4 even got out of the car and looked into the window or
5 looked into the front door where they could have gotten
6 in. And frankly we believe they would have received
7 authorization to go in and do an actual audit where they
8 actually observed sales.

9 So I'm not surprised it's not in the CDTFA record
10 because they never entered the premises. This information
11 is coming from the principal, Jeff Beckwith, and
12 apologizes if that was omitted from my submission. I
13 believe it was in a narrative that I submitted, but I
14 apologize if that was omitted. I -- I thought I put it in
15 there. I'm pretty sure I did, but I apologize if I
16 omitted that. That was not my intention.

17 But no, there -- as I say, there were -- if you
18 look at the police report, there's a front room and there
19 was a back room. And the front room is where the free
20 food, drinks, et cetera, were located. The CDTFA did have
21 access to that, they just chose not to enter the premises.

22 JUDGE KWEE: This is Judge Kwee. Thank you very
23 much.

24 I will turn it back to the lead judge,
25 Judge Long.

1 JUDGE LONG: This is Judge Long. Judge Wong, do
2 you have any questions?

3 JUDGE WONG: This is Judge Wong. I have no
4 questions for Appellant at this time. Thank you.

5 JUDGE LONG: Thank you.

6 I have a few questions for Appellant before we
7 move on. With respect to the statement of activity,
8 Appellant Exhibit A, pages 37 through 43, you indicated
9 that 2012 was the first year that the Honey Spot was in
10 business. But -- and the statement of activity for 2011
11 is blank. But you look at Exhibit A, page 48, you will
12 see that in the fourth quarter of 2011 the business
13 reported \$24,008 in gross receipts and just over \$2,000 in
14 sales tax. When did the business actually open?

15 MS. SHELDON: The first day of business -- I -- I
16 don't believe I have that information.

17 Mr. Lutz, do you have that information?

18 MR. LUTZ: This is David Lutz for TMHR. I do not
19 have that information, but the California Secretary of
20 State should have the inception date of the entity when it
21 was officially formed. I don't have the opening date of
22 the business.

23 JUDGE LONG: Okay. Thank you. And,
24 additionally, with respect to the statements of
25 activities, were those kept contemporaneously with the

1 business being operated, or were those created at some
2 point afterward?

3 MS. SHELDON: It's my understanding they were
4 contemporaneous, but that is simply my understanding.

5 JUDGE LONG: Okay. And with respect to the
6 criminal case, I saw the dismissal from the D.A.
7 regarding the criminal case. However, I couldn't tell
8 from the exhibit where in the D.A. information that shows
9 that the case was dismissed because the Honey Spot failed
10 to make a sufficient profit, which I believe was your
11 assertion.

12 MS. SHELDON: I think that was Mr. Sharmat's
13 assertion. It was, in fact, when we spoke with
14 Mr. Beckwith, he told us -- we probably should have
15 brought him in as a witness. I do apologize to all Your
16 Honors -- that the reason they closed in November was
17 after the police raid, they were ostensibly done. They
18 were completely tapped. They couldn't recuperate.

19 So I don't think there was necessarily a
20 financial hardship until the Los Angeles Police Department
21 came in and seized everything. So I think that's
22 ultimately what caused the demise for TMHR was the raid
23 from the Los Angeles Police Department. Despite the fact
24 that charges were dropped, that did not recoup any of the
25 things that was seized and not returned to TMHR.

1 I'm not sure if I addressed your question. I
2 apologize.

3 JUDGE LONG: Thank you. I have no further
4 questions at this time.

5 So at this time I'd like to turn it over to CDTFA
6 for their opening statements. You may begin whenever
7 you're ready.

8

9

OPENING STATEMENT

10 MR. SUAZO: Thank you. This is Randy Suazo.

11 The Appellant is a California corporation and
12 operated a medical marijuana dispensary selling marijuana
13 and marijuana related items, along with accessory items.
14 The store was located in Los Angeles. The Appellant was
15 open 10 hours a day from 10:00 a.m. to 8:00 p.m. every day
16 of the week.

17 A timely Notice of Determination was issued on
18 January 12th, 2015. It is unknown how the Appellant
19 reports because no records, other than income tax returns,
20 were provided during the course of the audit or appeals
21 procedure. The Appellant did not provide any sales
22 receipts, sales invoices, cash register tapes, POS system
23 summaries, purchase records for general and subsidiary
24 ledgers.

25 The Appellant also stated that since they were a

1 marijuana dispensary, they did not have a bank account for
2 their business. The Department performed an examination
3 for the period from October 1st, 2011, through
4 September 30 of 2014. The Department compared gross sales
5 per federal income tax returns to the Appellant's sales
6 and use tax returns for the calendar years 2012 and 2013.
7 No differences were noted.

8 A daily average sales amount was computed by
9 using the reported taxable sales and dividing by the
10 number of days in the quarter. Then a daily number of
11 sales were obtained by dividing the average daily sales by
12 an average customer purchase of \$50 obtained from the
13 Department's experience in conducting audits of marijuana
14 dispensaries.

15 For the audit period, the Department calculated
16 the Appellant was reporting an equivalent of only six
17 sales per day. During the period from 1Q 2012 to 1Q 2013,
18 a five-quarter period, only three customers per day were
19 being handled. An average sales per hour was derived by
20 using the sales per day and dividing it by the hours the
21 store was open. This showed barely more than half a sale
22 per hour or only two sales every two -- only one sale
23 every two hours.

24 Based on the very low daily sales and sales per
25 hour, along with the fact that the Appellant did not have

1 any records to review, the auditor elected to conduct an
2 observation test of the business. The Department
3 conducted four observation tests, Exhibit E, pages 43 to
4 48. They were done on Thursday October 2nd, 2014, Tuesday
5 October 7, 2014, Tuesday October 28, 2014, and finally
6 Friday November 11th -- or November 7th, 2014. No further
7 observation test could be conducted as the business has
8 closed.

9 The observation test revealed that an average of
10 10 customers entered the premises per hour. A \$50 per
11 customer sales amount was multiplied by the 10 customers
12 per hour, found on the observation test. An hourly sales
13 of \$500 was established. A \$500 amount was then
14 multiplied by the 10 hours the dispensary was open to
15 compute daily sales of \$5,000 per day, Exhibit D, page 42.

16 The projected daily sales were multiplied by the
17 days in the quarter with an allowance for the store to be
18 closed during holidays. An allowance of 11 holidays per
19 year was allowed. The audited sales were done -- were
20 then compared to reported sales in order to establish
21 Appellant's unreported taxable sales, Exhibit D, page 40.

22 It should be noted that per website dealing with
23 this industry, www.mjbuzzdaily.com, the average California
24 customer purchase is \$70. The U.S. average sales per
25 customer range from \$60 to \$70 per transaction. By using

1 the \$50 sales amount instead of the \$70 sales amount, the
2 Appellant's ratio of sales to customers making an average
3 California purchase is about 7 out of every 10 customers.
4 Therefore, 3 customers would not be making any purchases
5 at all as they entered into the store.

6 During the audit and appeals process, the
7 Appellant and representative were asked many times to
8 produce records to support their sales, yet, they never
9 produced any. The Appellant's representative asserts that
10 the Appellant gave all its records to the IRS in
11 accordance with an IRS summons. However, the summons only
12 requested limited records for the period 2006 and early
13 2007, four years prior to the beginning of the CDTFA
14 audit. This is on Exhibit A, page 10, 14, 15, and 16 on
15 the DNR. This is in recommendation.

16 Further, the IRS requested those records by
17 summons appearance dated -- date of July 11, 2014. Yet,
18 the Appellant has not provided any detailed data from any
19 point after July 11, 2014 through the end of the audit
20 period, including the timeframe when the observation tests
21 were actually being conducted. The auditor was planning
22 to do additional observation tests at the Appellant's
23 facility. However, the location was closed.

24 The review of the Appellant's fourth quarter '14
25 sales and use tax returns show zero sales reported by the

1 Appellant for that quarter, even though they were open for
2 a portion of the quarter and the auditor tracked customers
3 entering the facility. The Appellant did not supply any
4 video surveillance tapes of the inside of the store to at
5 least attempt to show that a lower number of customers
6 made purchases.

7 Instead the Appellant states that in their
8 opening brief dated November 16, 2018 -- this is Appeal
9 Brief Part 1, page 3 -- that they were raided at sometime
10 late August or early September by the Hollywood Narcotics
11 Information Unit, and all tapes were seized. However,
12 they still have -- would have been recording for periods
13 after the raid and during the dates after the observation
14 tests. Yet, no video surveillance tapes were given to
15 disprove the audit findings.

16 Review of police reports provided by the
17 Appellant, Appeal Brief Part 1 Attachment 5, pages 1 and
18 3, show that on August 26, 2013, police watched
19 approximately 10 customers enter and exit the business for
20 this time period from 7:15 to 8:15, which matches the
21 audited average 10 customers per hour. The police report
22 was written 14 months before the auditor's observation
23 tests.

24 Review of police reports also show that the
25 Appellant made both purchases of product to sell. This is

1 on Appeal Brief Part 1 Attachment 5, pages 5 and 6, of
2 supplier's arrest report dated July 17, 2013. Review of
3 the police reports in unison with the sales tax reporting
4 disclose that there were sudden increases in sales
5 following the monitoring of the business activities by law
6 enforcements, example B -- A.

7 Appellant's reporting to the Department disclose
8 that the reported sales more than doubled when police
9 apprehended a supplier of the Appellant when he was
10 delivering to the Appellant. B, sales again doubled after
11 the police had begun investigation into the taxpayer's
12 business. This is on -- for the fourth quarter of 2013.

13 Review of the federal income tax returns for 2012
14 and 2013 disclose that the Appellant did not risk (??) any
15 payroll, wage -- or payroll or wage expense for employees,
16 Exhibit D, page 50. Based on the police report, the
17 Appellant had security personnel on premises. In
18 addition, they had employees selling to customers in the
19 store. Yet, recorded wages were nonexistent.

20 The Appellant states in their opening brief dated
21 November 16, 2018, Appeal Brief 1, page 3, number 4, that
22 if the Appellant was making what the Department has
23 determined, that the company would still be in business.
24 Review of the Department's record show that
25 TMHR Collective Corporation did again start their business

1 under a new permit beginning August -- commencing
2 August 1st, 2016.

3 The Department believes that the negligence
4 penalty is also warranted. There's no records other than
5 the federal income tax returns that have been provided.
6 An indirect method had to be used to determine the amount
7 of taxable sales made by the Appellant, and the amount of
8 the assessment is significant in relation of what was
9 reported. The Appellant has not provided any
10 documentation to support their contentions. Therefore,
11 the Department request that the appeal be denied.

12 This concludes my presentation. I'm available to
13 answer any questions.

14 JUDGE LONG: Thank you. This is Judge Long. At
15 this time I would like to turn over to my panel for any
16 questions.

17 Judge Kwee, do you have any questions at this
18 time?

19 JUDGE KWEE: Yes. This is Judge Kwee. I did
20 have a couple of questions for CDTFA. When you made
21 the -- when you tallied up the average of people coming
22 per hour, for example, if you had 10 people on one day,
23 did that -- each tally, did that count as an individual
24 person? Or if, for example, a group of three people
25 walked in, would that be one -- consider as one person, or

1 would that be considered as three person -- three people?

2 MR. SUAZO: I believe that would have been
3 considered as three persons.

4 JUDGE KWEE: Okay. And as far as CDTFA -- this
5 is Judge Kwee again. As far as CDTFA coming up with the
6 \$50 spend-per person, and then you also mentioned that
7 there was a New Jersey Daily article indicating the
8 average in California statewide was \$70 per purchase; I'm
9 wondering, how did you come up with the \$70 purchase per
10 person. Is that taking into consideration the location of
11 this business? Like, I just don't -- I don't see any
12 support for where you came up for the \$50 figure for this
13 business.

14 MR. SUAZO: The \$50 amount is based on Southern
15 California transactions for marijuana dispensaries. The
16 \$70 come from an industry provided publication that showed
17 \$70 was the average purchase for a customer in California.

18 JUDGE KWEE: So this is Judge Kwee. If I
19 understand correctly, CDTFA has records or information
20 that would indicate in Southern California the average
21 spends per person per visit is \$50. Is that what CDTFA is
22 saying?

23 MR. SUAZO: I believe they're saying that
24 obtained from Department's experience in conducting audits
25 of marijuana dispensary.

1 JUDGE KWEE: Okay. Thank you. And as far as
2 determining that every person who went in there made a
3 purchase, is that -- is that -- I'm just trying to
4 understand why that is reasonable. I mean, for example,
5 if you look at the police report, and as discussed
6 earlier, you know that this business was under police
7 investigation. As a report -- in the conclusion of the
8 police report it says that, "It is our opinion... that
9 the Honey Spot began turning customers away for not having
10 their recommendation" -- that's their marijuana card --
11 "on their person or in their system."

12 So I mean, there is some evidence suggesting that
13 the business stopped selling to customers that came in
14 without a card after a certain point, based on the police
15 investigation. And that was done before your observation
16 test. Your observation test came after the police
17 investigation, which, you know, would suggest that there's
18 some evidence to show that people were being turned away.

19 I'm just wondering if -- like, why it's
20 reasonable to assume that every single person that walked
21 into their business was making a purchase.

22 MR. SUAZO: On the police report that claimed
23 that, if you look right after that police report was done,
24 sales more than doubled. So they went from \$30 to \$60,000
25 basically. And as this -- they found out, I guess, they,

1 you know, under the observation of a police -- police
2 observation. In addition, when the \$50 -- if you were to
3 take it as a California generic -- which is what the
4 industry standard was for \$70s -- basically, what that is
5 doing is saying that 7 out of every 10 would have made a
6 purchase. However, 3 would not have made a purchase.

7 JUDGE KWEE: Okay. This is Judge Kwee. Thank
8 you. And just so I understand what those tally marks in
9 the audit report means, did CDTFA do any contact with
10 people coming out to ask if -- if they were going to the
11 business if they made a business or was it basically just
12 as every person that walked in there was a tally? There
13 was no communication done with the customers.

14 MR. SUAZO: Based on the audit report, it's
15 silent as to that. However, it doesn't appear that they
16 did make any communication.

17 JUDGE KWEE: Okay. Thank you. And this is
18 Judge Kwee again. Just also so that I'm understanding,
19 why was it that the CDTFA auditor did not, for example, go
20 into the business? Is there any indication in the
21 record -- in the file that the taxpayer turned them away
22 and wouldn't allow them to observe inside the business?
23 Is there a health or safety concern?

24 I'm just trying to understand why -- why it is
25 that the auditor would be sitting, you know, outside the

1 business just tallying people coming in and coming out as
2 opposed to other audits where you have, for example, the
3 auditor sitting inside the store for the full eight-hour
4 business day at three separate days, you know, with the
5 consent of the taxpayer making remarks? I'm just trying
6 to understand why it came out like this as opposed to
7 differently.

8 MR. SUAZO: Well, we had asked for records as was
9 stated earlier and no records were forthcoming. They say
10 that the records were confiscated by -- or taken by IRS.
11 However, there was records after that. Nothing was
12 forthcoming. There were videotapes that they say that the
13 police took. However, they would have video recordings
14 after that. None of that was ever provided. That would
15 have been very helpful at the time, and they failed to
16 provide any of that.

17 As to why they didn't -- why the auditor didn't
18 enter might have been a safety issue. As the taxpayer's
19 representative themselves say, the neighborhood is
20 probably not the best. However, that would also mean that
21 if you're going to go there, you're probably going to make
22 more than your usual amount of purchases so you wouldn't
23 have to go there again.

24 JUDGE KWEE: Okay. Thank you. And if just
25 perhaps you can help me understand if -- how this audit

1 was conducted for this dispensary. Is that consistent,
2 generally, with how audits of how dispensaries are
3 conducted. Because I know, for example, restaurants you
4 have in your audit manual, the section you discussed
5 earlier about you have the rule -- the general policy, you
6 know, three full days; and with odds of dispensaries it
7 seems that you don't necessarily follow that similar
8 policy. Do you have, based on your experience, is this
9 audit -- was this audit handled consistently with how
10 CDTFE handles audits of dispensary, generally, or is this,
11 would say, different?

12 MR. SUAZO: Well, normally, when we deal with
13 dispensaries, we are given books and records. And because
14 we were not given the books and records, we had to do
15 alternative means. Again, you know, the books and records
16 that could have been provided after they say that they
17 were -- that they gave it to the -- or it was confiscated
18 by the police, there still would have been books and
19 records after the fact. And they could have given it to
20 the auditor at that point as well, and they failed to do
21 so.

22 Also the IRS' request was for a period that was
23 four years prior to the audit. And, in addition, if they
24 had a CPA or a bookkeeper, they probably would have had a
25 lot of the records electronically still. So to say that

1 they didn't have books and records, they may not have had
2 physical, but they probably would have had computerized
3 books and records.

4 So normally when we do an audit of a dispensary,
5 we do get books and records. If we're not given books and
6 records, we have to do the best way we can. In this case
7 because of the neighborhood, because of the situation
8 being involved, because of the lack of cooperation from
9 the taxpayer, because of the lack of, again, records, they
10 did an observation test.

11 We did five hours. However, that also
12 corresponds -- or 10 customers per hour. However, that
13 correspond to the police report in which was done
14 14 months earlier, which the police themselves state that
15 10 customers entered.

16 JUDGE KWEE: This Judge Kwee. Thank you very
17 much. I'll turn it back to the panel. I'll turn it back
18 to the lead judge.

19 MR. SUAZO: Okay.

20 JUDGE KWEE: Thank you.

21 JUDGE LONG: This is Judge Long. Judge Wong, do
22 have any questions at this time?

23 JUDGE WONG: Hi, this is Judge Wong. I do have a
24 couple of questions for CDTFA regarding the observation
25 test. So the auditor observed 10 persons per hour --

1 customers per hour; is that correct?

2 MR. SUAZO: On average, yes.

3 JUDGE WONG: On average. And then assumed that
4 100 percent of the customers made purchases; is that
5 correct?

6 MR. SUAZO: At a \$50 clip, yes.

7 JUDGE WONG: At a \$50 clip. And then you
8 referenced a \$70 average purchase price. And the
9 difference between the \$50 purchase -- average purchase
10 price, and the \$70 purchase price is three customers per
11 hour; is that correct?

12 MR. SUAZO: Three customers per hour would not
13 be -- three customers at entry would not be buying any
14 merchandise.

15 JUDGE WONG: Per hour or per day?

16 MR. SUAZO: Per hour test, the way it works on
17 this one.

18 JUDGE WONG: Okay.

19 MR. SUAZO: So there was --

20 JUDGE WONG: So --

21 MR. SUAZO: Sorry.

22 JUDGE WONG: So you factor in customers who
23 didn't make purchases into the average purchase price,
24 rather than the 10-person per hour average?

25 MR. SUAZO: Well, that's the way it works out

1 when you look at the -- at the industry average.

2 JUDGE WONG: Okay. Okay. So -- sorry this is
3 Judge Wong again. So I had also a question about the
4 police report. You mentioned the police observed 10
5 persons per hour entering the business; is that correct?

6 MR. SUAZO: Yes.

7 JUDGE WONG: Okay. And I noticed in the police
8 report it mentioned some individuals didn't purchase --
9 some of those individuals who came out didn't purchase
10 anything for customer service issues or because they were
11 turned away. Was that -- would that effect the 10 persons
12 per average -- per hour average?

13 MR. SUAZO: If you're using \$50 it would affect
14 it. If you're using \$70 it would already factor in.

15 JUDGE WONG: Okay. So if you had factored in
16 seven persons per hour multiplied by \$70 purchases, would
17 that affect the outcome, or would that just come out the
18 same?

19 MR. SUAZO: Yeah. Pretty close.

20 JUDGE WONG: Okay. Okay. No further questions
21 at this time. Thank you.

22 JUDGE LONG: Thank you. This is Judge Long.

23 I have a few questions before we move on. First,
24 with respect to this \$70 average sales price, where in the
25 record is this -- is this supported, and is there -- where

1 in the record is there any indication that the auditor
2 took this into account?

3 MR. SUAZO: It's not in the record that the
4 auditor took it into account, but it's in my analysis of
5 how this would play out. The \$70 per hour is quoted in
6 the DNR, the Decision and Recommendation, and it is on
7 page -- it's on Exhibit A, page 5. He also has the
8 website listed on there.

9 JUDGE LONG: Okay. And this is Judge Long again.
10 With respect to the website and the contemporaneous
11 information, let me go to this page. Is that -- is that
12 contemporaneous to the DNR, or was that contemporaneous to
13 the time where the audit took place?

14 MR. SUAZO: I think it would have had -- work
15 under both circumstances.

16 JUDGE LONG: So to be clear, the average price --
17 your position is that the average price per purchase
18 didn't change at all between 2013 and April 7th, 2016.

19 MR. SUAZO: The \$70 is a 2015 figure, okay. If
20 you look at the -- you would have to use a COLA or
21 inflation factor if you want to go back, right. But in
22 2012 and '13 the inflation rate is very low, if you look
23 at the U.S. inflation rates.

24 JUDGE LONG: Okay. And I just want to make sure
25 the audit work papers which is, you know, Respondent's

1 Exhibit E, page 25, the auditor attempted a 5th
2 observation test on November 7th, 2014, and found that the
3 business had closed. The notes in the audit work papers
4 state that the close -- the business termination date is
5 unknown. Is there any dispute that the business was
6 closed for good on November 7th?

7 MR. SUAZO: I can't tell you for sure because it
8 doesn't say when the business actually closed. I'm using
9 what the taxpayer or what the auditor put on the 414Z,
10 okay. And then also though, again, on the fourth quarter
11 return there was no sales even though there is obviously
12 activity since they were donning observation tests in
13 October.

14 JUDGE LONG: Okay. And with respect to -- to
15 follow up on Judge Kwee's question regarding the number of
16 people that walked in, as to be clear, Exhibit E, page 26,
17 the observation test for October 2nd shows that five
18 people walked in at 2:18 p.m. CDTFA's position is that
19 every one of those people made a purchase, and they were
20 all individual purchases?

21 MR. SUAZO: That's the way it would play out
22 based on their scenario.

23 JUDGE LONG: Okay. And now -- based on the
24 auditor's scenario, or based on your scenario --

25 MR. SUAZO: Based on auditor's --

1 JUDGE LONG: -- regarding the \$70?

2 MR. SUAZO: -- scenario.

3 JUDGE LONG: Okay. And then based on the
4 scenario that you presented to us today with respect to
5 the \$70, you would say that --

6 MR. SUAZO: Four out of five.

7 JUDGE LONG: One-and-a-half people --
8 one-and-a-half of these five people did not make a
9 purchase. However, that doesn't matter because the
10 average price that was used in the audit was less than the
11 average price that -- of a sale in California, which is in
12 the Decision and Recommendation?

13 MR. SUAZO: Yeah. Yes, sir.

14 JUDGE LONG: Okay. And with respect to the
15 observations that occurred, the DNR, Respondent's
16 Exhibit A, page 8, indicates that the audit deviated from
17 CDTFA's standard policies requiring at least three full
18 days of observation. It cites to both the audit manual as
19 well as an October 28th, 2015 memorandum. Was that
20 because the business closed?

21 MR. SUAZO: The observation test being cited is
22 for a restaurant. It's Chapter 8.

23 JUDGE LONG: And is October -- the
24 October 28th, 2015, memorandum apply to restaurants as
25 well?

1 MR. SUAZO: That, I do not know.

2 JUDGE LONG: Okay. And with respect to the
3 observation days that did occur, can you comment on the
4 days that were used? They were sometimes weeks apart.

5 MR. SUAZO: That's when the auditor happened to
6 pick those days. Basically, they were trying to get days
7 where they can gather information. I would take it that
8 if they were going to come back on November 7th, they were
9 going to come back with more and more days. However,
10 unfortunately, the business closed.

11 JUDGE LONG: Okay. And so with respect to the
12 time -- the audit dates that did occur, is there any
13 information or clarification you can provide as to why all
14 of the observations occurred between the hours of 10:00
15 and 2:15 p.m. and no other times that the business was
16 open?

17 MR. SUAZO: I would assume because it's business
18 hours for the employee. In other words, if they're going
19 after 5:00 o'clock, you're going to have a -- we might
20 have a different issue.

21 JUDGE LONG: Okay.

22 MR. SUAZO: But, again, the taxpayer or the
23 Appellant could have supplied videotapes as well. Even
24 though they said they were confiscated during the raid,
25 there would have been videotapes after the fact, and they

1 could have supplied those.

2 JUDGE LONG: Okay. Thank you. I don't have any
3 other questions. At this time I'm going to turn over to
4 Ms. Sheldon for her rebuttal and closing statement. Thank
5 you.

6 JUDGE KWEE: Judge Long, this is Judge Kwee. I
7 just have one quick follow-up question for CDTFA if you
8 don't mind.

9 JUDGE LONG: Go ahead.

10 JUDGE KWEE: CDTFA, Mr. Suazo, you had mentioned
11 on a number of occasions that Appellant -- that the
12 taxpayer could have turned over video surveillance, and
13 that seems something that's not normally requested by
14 CDTFA. I'm just wondering if there's any evidence in the
15 record that CDTFA actually asked for video surveillance of
16 the taxpayer's premises?

17 MR. SUAZO: Sometimes when observation test --
18 this is Randy Suazo again. Sometimes when observation
19 tests are done, we do ask for video surveillance cameras.
20 Because it's right next to the register you are able to
21 see the ring up and stuff. And most companies when they
22 do their in -- just for internal control, they want to see
23 to make sure that the sale is being actually rung up,
24 okay.

25 And, basically, whether or not video surveillance

1 was requested, I do not no. However, it could have been
2 volunteered by the Appellant to help support their
3 contention. And it would have been reviewed by the
4 auditor or the audit staff or whoever was going to be
5 taking over the case. We've done that before.

6 JUDGE KWEE: Okay. Thank you. I appreciate the
7 response.

8 I'll turn it back over to Judge Long.

9 JUDGE LONG: This is Judge Long. Ms. Sheldon,
10 you may begin your closing -- rebuttal and closing
11 statement whenever you're ready.

12 MS. SHELDON: I'm sorry, Judge Long. Am I
13 permitted to ask questions of Mr. Suazo and CDTFFA?

14 JUDGE LONG: No. Mr. Suazo is not acting as a
15 witness for CDTFFA in the same way they're not allowed to
16 ask questions of you. They're simply arguing the facts
17 that are on the record. So nothing they are saying is
18 testimony.

19 MS. SHELDON: I understand thank you, Your Honor.
20 I appreciate the clarification.

21

22 CLOSING STATEMENT

23 MS. SHELDON: This is Elizabeth Sheldon for TMHR.
24 It is my understanding that the \$70 foundational price
25 that was used by BOE at the time, CDTFFA today, was from

1 mjbizdaily.com. That's a news cite for the marijuana
2 industry. It is not a marketing cite where they actually
3 do a deep dive into marketing sale prices. That's not
4 their primary function. They're a news outlet or resource
5 for people in the industry -- in the medical marijuana
6 industry.

7 There are sites like weed.com. that does do
8 things like that. More specifically, TMHR had its own
9 website that included prices. Including -- the police
10 report also reflected interviews with actual clients who
11 actually made purchases reflecting prices of around \$30 to
12 \$40. And it did indicate at least two people making no
13 purchase whatsoever.

14 So we feel very strongly that the \$50 imputed is
15 well in excess of what actually TMHR was charging. Again,
16 they were in a rather depressed community. And their
17 point was to assist the community, not to price them out
18 to where people who are native to that area did not have
19 access to medicine that would be helpful to them. That
20 was the point.

21 With regarded to the paperwork that was kept
22 being requested by CDTFA, again, they were raided.
23 Everything was taken in October -- excuse me, in August
24 prior to the audit. So should there been additional
25 documents after the raid? Potentially. They never really

1 got back on their feet.

2 With regard to video footage, it is my
3 understanding the video camera may also have been
4 confiscated by Los Angeles Police Department. I do know
5 that a TMHR representative, prior to my attendance, spent
6 a great deal of time trying to locate the video from the
7 Los Angeles Police Department and was told that too much
8 time had passed, that it had been destroyed. So the TMHR
9 very anxious to get that video footage to CDTFA but was
10 unsuccessful in getting it back from Los Angeles Police
11 Department.

12 With regard to three people going in together,
13 and each one being imputed as a customer to me seems,
14 well, rather presumptive. A group of people can go into a
15 shop and shop together and one person buys something, and
16 somebody doesn't. And imputing sales and everybody who
17 walks in the door, it seems to me patently unreasonable.
18 Especially when the police report specifically says that
19 just wasn't the case. They interviewed people who went in
20 and came out and bought nothing. We also believe people
21 went in, got free food, and left.

22 So we find that the conclusions based on the \$50
23 per person walking into the store to be very random and
24 unsubstantiated. Additionally, we understand that Section
25 8 of the audit manual is with regard to restaurants that

1 was actually cited by the CDTFA. So we did follow suite.
2 However, in Section 4, it does talk about the very limited
3 testing or sampling and the fact that's only appropriate
4 for a no change, or a no change phase, a no change report,
5 and that test for substantial changes that must have
6 sufficient verification, and that's recommended for three
7 days or in this particular case, 30 hours.

8 So it remains our position that there was no
9 authentic audit conducted. It doesn't look as though they
10 tried to enter the business. It is a depressed
11 neighborhood. However, there was a security guard on
12 duty. There was no palpable risk. The police report did
13 not indicate that there were various crimes going on
14 inside the strip mall while their observation period was
15 undertaken.

16 I don't understand why an auditor whose job it is
17 to go in and audit sales didn't go into a business and
18 audit sales. So it seems like all they did was count
19 people going into a shop is really what they did and from
20 there imputed sales. Imputed \$50 of sales even though,
21 again, the website for that actual dispensary existed. It
22 doesn't look like that was relied upon. Prices were on
23 the board inside the dispensary. That was never observed.

24 And from the audit manual, it doesn't appear as
25 though a legitimate audit was ever conducted. So our

1 position remains that the burden of proof stays with the
2 CDTFA to substantiate the additional tax assessed based on
3 an audit. Our position is an audit never really happened,
4 that what they did was observe people walking into a
5 business and then made some very general assumptions.

6 There's no information about coming out. There's
7 no information about with product -- any kind of product,
8 be that medical marijuana, be it a pipe, be it a sandwich.
9 There's no indication. There's no written record of
10 anybody coming out having purchased anything, only people
11 walking in and then imputing sales to these individuals
12 who walk into the store. So the front half of the store
13 being accessible to the general public.

14 People could have out of curiosity -- they are in
15 West Hollywood. They are in Hollywood, that's actually
16 the boarder -- come in, "Oh, I've never been inside a
17 dispensary. Let me go in and look." According to CDTFA
18 that person went in and bought \$50 worth of something and
19 then came back out. So our position does remain that they
20 don't have a foundation to substantiate additional tax
21 assessment.

22 We do understand that the period between October
23 and November 7th may be an opportunity for TMHR to revisit
24 whatever documents may exist. They don't have a bank
25 account because the federal government under FinCEN

1 doesn't allow this industry to have a bank account. So
2 those records could not exist by law. So that would not
3 be something they would be able to provide. They would
4 love to have had a bank account. Unfortunately, that is
5 not something that's afforded to that industry, even
6 today.

7 With regarded to the paperwork, receipts, et
8 cetera, again, October -- excuse me, August, those were
9 confiscated. So two months later they still had not been
10 returned. That's why they weren't submitted, and then,
11 ultimately, the business closed before they got it back
12 from Los Angeles Police Department.

13 So I understand that the CDTFA would love to get
14 all of this paperwork. TMHR would have loved to have been
15 able to provide it had Los Angeles Police Department not
16 confiscated everything. So at this point our position
17 does remain that there was no substantiated audit that
18 would allow the CDTFA to assess additional tax at this
19 time.

20 Thank you, Your Honor.

21 JUDGE LONG: Sorry. I muted myself. Can you all
22 hear me now?

23 MS. SHELDON: Yes.

24 JUDGE LONG: Thank you, Ms. Sheldon.

25 I'm going to turn the hearing over to my

1 co-panelists for any final questions. Judge Kwee, do you
2 have any final questions?

3 JUDGE KWEE: Actually, for the taxpayer I'll ask,
4 what question -- may I ask what question you were going to
5 ask CDTEFA?

6 MS. SHELDON: Yes, sir. I was going to inquire
7 as to why it is the auditor never attempted to observe
8 sales and legitimize the audit and put in the hours
9 necessary. As we've seen in the audit report, the
10 observations started in very early October and went
11 through about five weeks. And within that five-week
12 period one would assume that could get at least 10, if
13 not, all 30 hours completed. But, unfortunately, that was
14 not done.

15 I would like to know why no weekends were
16 included. Generally, with medicinal marijuana
17 dispensaries, weekends are often a busier time. Lunch
18 times they did observe, which is another busy time. But
19 did they talk to the taxpayer with regard to when is their
20 busy time? When is a good time to capture, you know, to
21 see your sales and to observe them and do this audit?

22 So my questions were really more along the lines
23 of why a more substantive audit, and one that was
24 consistent with multiple sections within the audit manual
25 was -- was not attempted. That was really my primary form

1 of questions.

2 JUDGE KWEE: Thank you.

3 And I guess I will ask CDTFA, from the audit
4 record -- again, this is Judge Kwee -- was there any
5 discussion with the taxpayer over the days that would be
6 observed over the timing and the, I guess, if these days
7 were -- these are good days to observe the business. Were
8 there just -- was there any discussion over how that was
9 proceeded and why, for example, weekends weren't used or
10 what time of days -- why the kinds of days, the one-hour
11 blocks were used that the auditor did use?

12 MR. SUAZO: This is Randy Suazo again. There is
13 nothing in the audit working papers as to why the
14 particular days were used. However, all communication was
15 through the taxpayer's representative at the time. So and
16 I basically think that's the way they wanted it to go
17 through the rep. So when you're asking if they contacted
18 the place directly, they were contacting the
19 representative, which they were instructed to do.

20 MR. PARKER: This is Jason Parker. I'd like to
21 add on to that. In the 414Z for the audit, the auditor
22 did indicate that the taxpayer and the representative were
23 not cooperating with the audit. So it didn't appear that
24 they were returning phone calls or e-mails to the auditor.
25 So the auditor, basically, had to conduct the observation

1 tests without discussing it with the taxpayer or rep
2 because they were signing waivers and returning phone
3 calls.

4 JUDGE KWEE: This is Judge Kwee. Thank you.
5 I'll turn it back over to Judge Long.

6 MS. SHELDON: Judge Long, this is Elizabeth
7 Sheldon for TMHR. I'm sorry. That is a new point. Would
8 I be permitted to address that?

9 JUDGE LONG: This is Judge Long. Go ahead.

10 MS. SHELDON: Okay. Yes, yes. TMHR did have a
11 representative. I see throughout the notes that there are
12 claims from the CDTFA that the representative was
13 nonresponsive. Regulations allow them -- the CDTFA to
14 bypass power of attorneys or representatives that if
15 they're not responsive for two weeks, according to the
16 log, that never came to pass.

17 The representative at the time was responsive.
18 It looks like in one instance, the next day. In one
19 instance about 10 days later during the course of the time
20 that they've been raided. And the representative would
21 have been authorized to discuss good times to come in for
22 the audit. Part of being a representative for any
23 taxpayer is being able make those determinations or work
24 with the taxpayer to find those times. So we believe that
25 was something that was available to CDTFA through the

1 representative.

2 Thank you.

3 JUDGE LONG: Okay. Thank you, Ms. Sheldon.

4 Judge Wong, do you have any final question?

5 JUDGE WONG: I had one final -- this is

6 Judge Wong. I had one final question for CDTFA.

7 Sometimes when auditing, I know CDTFA looks at similar
8 businesses and compares them to the business that they're
9 auditing. Was CDTFA contemporaneously auditing other
10 medical marijuana dispensaries in that area? And if so,
11 were they able to formulate an average per sale -- average
12 sale price per purchase?

13 MR. SUAZO: This is Randy Suazo again. In the
14 notes or the audit it doesn't say so. However, they did
15 get the \$50 per sale from something of that nature.

16 JUDGE WONG: Sorry. Could you expand? This is
17 Judge Wong. Could you expand on what you mean by that, by
18 "that nature".

19 MR. SUAZO: Well, based on the audit it says that
20 they, "Obtained the Department's" -- "\$50 is obtained from
21 the Department's experience in conducting audits of
22 marijuana dispensaries."

23 JUDGE WONG: This is Judge Wong. Okay. Thank
24 you.

25 MR. SUAZO: Okay.

1 JUDGE LONG: This is Judge Long. I just had one
2 final question as well. Following up from the earlier
3 discussion regarding the \$70 price that's discussed in the
4 Decision and Recommendation, I just want to follow up with
5 respect to -- I'm looking at Exhibit D, page 27, currently
6 and it says that, "\$50 average sales per customer was used
7 based on the average audited sales per a customer of
8 similar types of audits performed in local" -- "in the
9 local vicinity."

10 I just wanted to verify. CDTFA used this amount
11 because it was local to the Honey Spot. Is that correct,
12 Mr. Suazo?

13 MR. SUAZO: Based on what you just read, would
14 believe so.

15 JUDGE LONG: Okay. Thank you. That is my final
16 question.

17 Ms. Sheldon, thank you for your time today.
18 Mr. Lutz, thank you for your time today. Is there
19 anything else you prepared or would like us to hear before
20 we conclude the case?

21 MS. SHELDON: Thank you, Your Honor. This is
22 Elizabeth Sheldon for TMHR. Thank you, Your Honor. No.
23 I believe at this point, really, our position remains that
24 the foundation for the assessment is catastrophic as
25 logged. So that just remains our position.

1 JUDGE LONG: Okay. Thank you. This concludes
2 the hearing. The judges will meet and decide the case
3 based on the documents and testimony presented and
4 admitted as evidence today. We'll send both parties our
5 written decision no later than 100 days from today. Thank
6 you for your participation. The case is now submitted,
7 and the record is now closed.

8 The hearing is adjourned. Thank you.

9 (Proceedings adjourned at 11:36 a.m.)

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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 9th day of July, 2020.

ERNALYN M. ALONZO
HEARING REPORTER