

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
MBSC, INC., ) OTA NO. 19074993  
 )  
 )  
 ) APPELLANT.  
 )  
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, July 21, 2020

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER



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APPEARANCES:

Panel Lead: ALJ DANIEL CHO

Panel Members: ALJ TERESA STANLEY  
ALJ ANDREW KWEE

For the Appellant: SHAWN ZALI

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 1 and 2 were received at page 6.)  
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1 Cerritos, California; Tuesday, July 21, 2020,

2 2:43 p.m.

3

4 JUDGE CHO: Let's go on the record now.

5 This is the appeal of MBSC, Inc., OTA Case  
6 Number 19074993. Today is July 21st, 2020, and the time  
7 is approximately 2:43 p.m. This hearing was originally  
8 scheduled for Cerritos, California. However, due to the  
9 ongoing health concern, we're holding this hearing  
10 electronically with the agreement of all the parties.

11 My name is Daniel Cho, and I will be the lead  
12 Administrative Law Judge for this appeal. With me are  
13 Administrative Law Judges Teresa Stanley and Andrew Kwee.

14 Can the parties please introduce and identify  
15 yourselves for the record, beginning with the Appellant.

16 MR. ZALI: This is Shawn Zali representative for  
17 the taxpayer.

18 JUDGE CHO: Thank you.

19 Department.

20 MR. SUAZO: This is Randy Suazo, Hearing  
21 Representative.

22 MR. PARKER: Jason Parker, Hearing  
23 Representative.

24 MR. BROOKS: Christopher Brooks, Tax Counsel.

25 JUDGE CHO: Thank you very much.



1 and this is the first time I kind of, like, see this kind  
2 of audit. Because the only difference that the -- my  
3 client, the taxpayer, had with the auditor was the cash to  
4 credit card ratio. And due to the sample that the auditor  
5 used for the audit -- my client start catering for Sultan  
6 Adult Health Daycare that we provided the document that he  
7 is to receive checks from that. And they started it in  
8 September 2014.

9 So during the audit period, my client did not  
10 provide any catering services to Sultan Adult Health  
11 Daycare. And the auditor considered those checks that my  
12 client received from Sultan Adult Health Daycare as the  
13 cash and the credit card as a credit card ratio. But the  
14 issue is, during the audit period that we provided the  
15 bank statement to the auditor, and he still considered  
16 those checks as cash. And so those checks bump up the  
17 cash to credit card ratio higher than what was supposed to  
18 be during the audit period.

19 Therefore, we're asking, Your Honor, to take  
20 those checks out of the equation for cash to credit card  
21 ratio, and then you will see my client reported perfectly.  
22 Because my client report based on POS reports and  
23 everything. They sign the POS reports. And also the  
24 guest check that would be provided to the auditor,  
25 everything was perfectly match up because that's how he

1 does it. So he calculate POS report for dining sales and  
2 also every invoice checks for any catering or to go order,  
3 and then report it on a quarterly basis to CDTFA or at  
4 that time Board of Equalization.

5 So, therefore, based on my Exhibit 1, which is,  
6 like, the largest exhibit in this audit, the auditor try  
7 every different audit method that is out there to kind of,  
8 like, get my client to pay some money. So he started with  
9 observation. Okay. So which is like a normal thing for  
10 restaurant businesses. The auditor goes there, you know,  
11 calculate, count customers, grab the receipt and  
12 everything. So everything was good.

13 And then he said, okay, so I need your bank  
14 statements, POS reports, and guest checks. We provided  
15 everything. And the third, he said no, still I'm not  
16 satisfied. And then we said okay, so what are you looking  
17 for? He said markup test. And as you guys know, Your  
18 Honor, you know, and then CDTFA hearing and counsel know,  
19 markup test for a restaurant, especially Persian food is  
20 not easy because there's so many different items.

21 We had to come up, cut the meat, and you, know,  
22 sauté the meat and put it on the weigh -- measure thing --  
23 and then measure it and then come back and then get the  
24 rice and then the herbs and everything. We did  
25 everything. It took, like, about five hours to be honest



1 with you, and we perform it. And also the auditor and  
2 his, I think it was the supervisor at the time, but  
3 someone else from the Board of Equalization at that time.  
4 So three people were present at that time.

5 They look at everything. So they took all the  
6 documents they needed back to their office and came back  
7 and said the markup percentage was perfect based on --  
8 because we explained to them. Persian food markup is not  
9 as high as some other food. That's why you cannot use the  
10 standard markup for restaurant on Persian market because  
11 kabob is very high quality meat. So you cannot do that.

12 So we kind of represented everything to them on  
13 that markup. That took about five hours. They were  
14 satisfied. The only thing they were not satisfied was the  
15 bank statements based on those checks from Sultan Adult  
16 Healthcare, which we provided to them. And also, we  
17 provided bank statements from Sultan Healthcare that  
18 specify every single check that my client received from  
19 Sultan that shows the first check they received was from  
20 September 15, 2014, and all the way out to -- okay -- next  
21 year April, like, 2015, April 21st.

22 And that was the period that they would work for  
23 Sultan Adult Day Healthcare. And that says so during the  
24 audit period they did not work with them. Then after 2015  
25 they did not work for them. So that's what -- that sample

1 size the auditor used is not representative for the audit  
2 period at all, whatsoever.

3 And guest checks at that time were not provided  
4 to the tax -- to the auditor. And the reason was the  
5 taxpayer couldn't find them because they, like, they sold  
6 their house and they moved to the new house and they  
7 thought it was in the attic. But the owner of the  
8 previous house who they sold to was not cooperative. But  
9 in the middle of the audit, we found them, and we  
10 contacted the auditor. And the auditor was, like, "No.  
11 It's in appeal. I'm not going to be able to get it until  
12 they ask me to."

13 So the auditor did not come and take a look at it  
14 until about, like, a year and a half ago that the auditor  
15 came out here, got the box, took to his office. And to be  
16 honest with you, I just received the box a week ago after  
17 a year and a half. The auditor was holding the box of all  
18 the guest checks for catering and to go sales. And I had  
19 to go to the Irvine office and do -- had the curbside meet  
20 up. So I had to park somewhere. He had to drop and leave  
21 it on the curb. I had to pick it up.

22 And he was sitting on this for a year and a half,  
23 and still, like, I don't know if he included it in the  
24 audit or did not. I never received anything from the  
25 auditor at that point. And that was pretty much my

1 opening for this case, Your Honor.

2 JUDGE CHO: Thank you very much.

3 Panel members, do you have any questions for  
4 Mr. Zali?

5 JUDGE KWEE: Yes. This is Judge Kwee. I did  
6 have a couple of questions. Mr. Zali, I understand you  
7 were saying that the liability is based on checks and  
8 non-sales revenue that the taxpayer received from Sultan  
9 Health Center. And looking at your exhibit, I believe it  
10 was Exhibit 2, the total of the checks came to \$96,000.  
11 But from my understanding the audit liability is closer to  
12 \$600,000.

13 So I'm just wondering if you have any other -- if  
14 you were going to address the balance of the liability or  
15 if I might have missed something? Is it based on another  
16 projection that would have gotten it up to \$600,000? I  
17 was just hoping you could clarify that a little bit.

18 MR. ZALI: This is Shawn Zali. Yes, Your Honor.  
19 So pretty much the audit started based on cash to credit  
20 card ratio. And then we explained to the auditor when  
21 people come and take to go item, I mean, it's one  
22 restaurant. It's not a multiple restaurants or franchise.  
23 So it's just one restaurant.

24 So the way the taxpayer, my client, runs his  
25 business, to go orders for hot food is taxable. Or for

1 example, if you order a side salad or side yogurt, because  
2 they are non-taxable if it's to go. Okay. And that's  
3 what we provided based on all the invoice checks that he  
4 said. But that's why, like, nontaxable sales to go was  
5 not -- he didn't charge taxes on it. Also, for catering  
6 the same thing.

7 For example, if you order for big party, if you  
8 order kabob, Persian rice, and if you order a salad, so we  
9 would consider the salad, for example, 10 salads, 10 times  
10 \$10 is \$100 would be nontaxable on that invoice.

11 JUDGE KWEE: Okay. This is Judge Kwee again.  
12 Just so I understand what you are saying, you're saying  
13 that the sales or that the taxpayer did make sales to  
14 Sultan Healthcare, but that the contention is that those  
15 are nontaxable to go transactions. Is that what the  
16 contention is?

17 MR. ZALI: No, the portion of those sales is  
18 taxable. So that is what I'm trying to say. So any hot  
19 food, like, anything including the rice, the kabob or  
20 anything that was hot is considered taxable food, and  
21 still my client charged tax, but the auditor didn't  
22 question that at the beginning. The auditor questions  
23 these are the cash sales. Okay.

24 So the ratio -- because he applied the cash to  
25 credit card ratio from the sample size to the audit

1 period. So he did not get the numbers from audit period.  
2 So it's based on estimation. So the whole audit is based  
3 on the cash to credit card estimations, right. So that's  
4 what I'm saying. So the cash that he's calculating for  
5 September 2014, which is a sample size, is not  
6 representative for the three years from 2011, '12, and  
7 '13.

8 JUDGE KWEE: Okay. Thank you. I think I  
9 understand that issue. And there was one other question  
10 that I did have. So looking at what was included in the  
11 period examined, it looks like a large portions of bank  
12 receipts -- when the CDTFA examined the bank receipts --  
13 it look about a third of them were payments by check. And  
14 I'm just wondering does that -- the check payments when  
15 customer make payment by check, did that include tips? Or  
16 was there evidence, whether or not, that would have  
17 included tips or not?

18 MR. ZALI: This is Shawn Zali. So pretty much  
19 for catering, usually, because they deliver -- every check  
20 that they receive it's for catering. Okay. The large  
21 numbers are for catering. And usually, if the deliver guy  
22 take the amount and get a check, usually that's not  
23 included, the tip. They usually cash tip the delivery guy  
24 because the invoice has to be invoice, and then they will  
25 usually either write a second check or cash to the

1 delivery guy.

2           It's -- they don't have that kind of rule that if  
3 it's, like, more than this many people, more than this  
4 many amount, its tax has to be paid or tip has to be  
5 paid -- sorry, not tax -- the tip has to be paid. So they  
6 don't have that rule. If they want to tip the delivery  
7 guy, they usually either hand him cash or write a separate  
8 check. So the business has nothing to do with the tip.

9           JUDGE KWEE: Okay. Thank you. And just so I  
10 can -- one more clarification on your position. You're --  
11 the taxpayer is more concerned about the  
12 representativeness of the ratio established by the auditor  
13 as opposed to, for example, that some of the checks picked  
14 up might have been non-sales revenue. Is that a correct  
15 understanding of the case?

16           MR. ZALI: This is Shawn Zali again. Yes, Your  
17 Honor. So pretty much the whole -- the issue I had at the  
18 beginning of the audit with the auditor, we represent --  
19 we give the auditor every single document that he asked  
20 for to audit the audit period, right, so 2011, '12, and  
21 '13, everything that he requested; bank statement, POS  
22 report. Everything we handed to him, and he's still very  
23 concerned about, like, I mean, using a sample size,  
24 because it's easier, right.

25           So if he use a sample size -- well, just one

1 month instead of going through three years, I understand  
2 auditors still going to, like, take a look at one month  
3 instead of, like, looking at three years. But my issue  
4 was, like, that month of September 2014 would not be  
5 representative for three years. And at that time we  
6 offered him everything.

7 We told him, oh, you can do observation. We told  
8 him he can do markup test. We can do anything you want,  
9 but he still insists on using the sample size. And the  
10 issue is using those checks from Sultan because like  
11 Sultan was giving him, for example, in the month of  
12 September my client received three checks from Sultan  
13 Healthcare, which I provided the list to CDTFA as well for  
14 almost 10 grand.

15 So three checks, each one was \$3,000. One of  
16 them was \$3,032. One of them and was \$3,042, and the  
17 other one was \$3,159. So \$10,000 additional checks came  
18 into the business that it was not coming into the business  
19 during the tax period. So that's why the cash to credit  
20 card ratio went up by almost by 15 -- 10 to 15 percent.

21 And that's the -- that's the majority of that.  
22 Because if you apply that cash to credit card ratio going  
23 up by 10 to 15 percent, so three years, that's the number  
24 right there the auditor that said that my client did not  
25 report.

1 JUDGE KWEE: This is Judge Kwee. Thank you very  
2 much for taking the time to answer my questions.

3 I will turn it back to the lead judge. Judge Cho  
4 at this point. Thank you.

5 JUDGE CHO: Thank you.

6 Judge Stanley, do you have any questions for the  
7 Appellant?

8 JUDGE STANLEY: Yes. This is Judge Stanley.  
9 That last statement, Mr. Zali, you pretty much answered  
10 the question that I had. With respect to your Exhibit 1,  
11 what you're saying is that to come up with the credit card  
12 ratio for the audit period, we should subtract out the  
13 Sultan Healthcare \$9,000-plus amount in checks; is that  
14 correct?

15 MR. ZALI: This is Shawn Zali. Yes, Your Honor.  
16 So pretty much if we take out any checks from Sultan, and  
17 then you will see the number that the cash and credit card  
18 ratio matches with the cash and credit card ratio for the  
19 audit period. And then my client should not have any  
20 liability because that \$3,000 per check every week, that's  
21 the extra cash to credit card ratio the auditor picked up.

22 JUDGE STANLEY: Okay. And are you the one that  
23 did the Exhibit 1?

24 MR. ZALI: Yes, Your Honor.

25 JUDGE STANLEY: Okay. So it does say that the



1 credit card ratio that was calculated with the exclusion  
2 of Sultan Healthcare would be 77.55 percent. Is that your  
3 contention?

4 MR. ZALI: I'm looking at the exhibit really  
5 fast.

6 JUDGE STANLEY: I'm sorry. This is Judge Stanley  
7 again. As I understand it, CDTFA calculated a  
8 65.99 percent credit card to cash ratio. Are you saying  
9 that if we exclude Sultan that the credit card ratio would  
10 be 77.55 percent as it states on Exhibit 1?

11 MR. ZALI: This is Shawn Zali. Yes, Your Honor.  
12 And to be honest with you, at that time the auditor came  
13 to the restaurant and do the observation. That's how he  
14 calculated based on the three-day observation as well. So  
15 that's why we said this should -- don't count the checks,  
16 this amount. Because the audit period we didn't have this  
17 account. It just came back a year later, but the auditor  
18 did not take out the Sultan checks out of the equation.  
19 That's why we're having this issue at this point.

20 Judge Stanley: This is Judge Stanley. I'll turn  
21 it back to Judge Cho.

22 JUDGE CHO: All right. Thank you. This is  
23 Judge Cho. I don't have any questions at this time.

24 So, Department, why don't you go ahead with your  
25 presentation.



1 and 2012, income statements for 2013 and '14, POS system  
2 summaries, bank statements, and merchant statements.  
3 Purchase invoices were not provided.

4 During the revised audit on January 21st, 2015,  
5 the Appellant provided a September 2014 POS sales summary  
6 report of Wells Fargo bank statement and the credit card  
7 merchant statement; Exhibits D, page 96. After the  
8 appeals hearing on May 13th, 2019, the Appellant provided  
9 what they stated were all guest receipts for catering and  
10 delivery sales. The Department scheduled Appellant's  
11 federal income tax returns from 2011 and 2012, and minor  
12 differences were noted.

13 The Department noted wages, excluding office  
14 salaries, for the federal income tax returns were less  
15 than 9 percent of ex-tax total sales. Industry average  
16 for wages range from 30 to 35 percent of sales for this  
17 type of restaurant. Average daily sales were calculated  
18 using the reported quarterly sales and dividing by  
19 90 days. The average daily sales were consistent from  
20 first quarter of 2011 through the second quarter of 2013,  
21 with average sales of \$3,071 per day for a 10 quarter  
22 period.

23 Average daily sales range from a low of \$2,132  
24 from the quarter of 2011 to a high of \$3,214 from the  
25 fourth quarter of 2012. During the third quarter of 2013,

1 the Department conducted a scope visit. The average daily  
2 sales jumped by \$479 for the second quarter of 2013 where  
3 the average was -- the average daily sales was \$3,119 to  
4 the third quarter '13 average daily sales after the scope  
5 visit at \$3,608.

6 The fourth quarter 2013 average daily sales were  
7 \$3,678. When comparing sales for the first 10 quarters of  
8 the audit period prior to the scope visit of \$3,071 and  
9 the \$3,643 average daily sales for the two quarters after  
10 the scope visit, a daily -- a \$572 daily average increase  
11 was noted, which equated to a 18.63 percent increase in  
12 sales occurring after the scope visit; Exhibit D, page 91.

13 The Department also conducted a markup analysis  
14 on cost of goods sold for 2011, '12, '13, and 14. The  
15 markup was calculated by subtracting the cost of goods  
16 sold, adjusted for self-consumption of 2 percent, and  
17 pilferage of 2 percent from the sales from the federal  
18 income tax returns for 2011 and 2012, along with the  
19 income statements of 2013 and 2014. Please note that 2014  
20 is out of the audit period.

21 The calculated markups for 2011 -- the calculated  
22 markup for 2011 was 108.29 percent, in 2012, 110.84  
23 percent, and for 2013 was 120.29 percent. The overall  
24 markup on cost of goods sold for the audit period was  
25 113.59 percent. For 2014, after the scope visit occurred

1 and as the audit was being in process, the markup jumped  
2 to 142 percent. The markups for the audit period are well  
3 below the industry average of 200 percent for a  
4 full-service restaurant.

5 The Department scheduled Appellant's bank  
6 deposits with adjustments for overdrafts and repayments of  
7 overdrafts. The auditor noted that it appeared that some  
8 payments towards the Appellant's credit card bills were  
9 being paid from another source that was not reviewed. Tax  
10 was then removed from the adjusted deposits and compared  
11 to reported ex-tax sales. An overall difference of  
12 \$64,536 was noted and assessed; Exhibit D, page 80 and 81.

13 Observation tests were attempted on  
14 September 19th, 2014, and September 26th, 2014. During  
15 the observation test, the Appellant did not provide  
16 catering delivery sales to include the observed cash and  
17 credit card amounts. Based on Yelp reviews, it appears  
18 that there are significant catering sales based on user  
19 comments; Exhibit D, 77. When examining the sales  
20 summaries, there were no catering or delivery sales noted,  
21 even though the Appellant has four delivery vehicles.

22 The Appellant did not provide catering records  
23 such as invoices, guest checks, or summary journals when  
24 the revised audit was occurring. When examining the bank  
25 statements for Wells Fargo checking account, Exhibit D,

1 page 76, it was noted that there were significant  
2 noncredit card deposits. These noncredit card deposits  
3 were materially different than what was noted during the  
4 observation. Due to these irregularities, the observation  
5 test was abandoned.

6 Based on the Department's analysis, the POS  
7 systems were considered to be acceptable. However,  
8 delivery and catering sales were deemed to be  
9 underreported. In order to compute delivery and catering  
10 sales, a ratio was show developed using September 2014  
11 sales. Merchant sales, for September 2014 totaled  
12 \$83,396, were obtained and tips included based on the POS  
13 system of \$6,905 which was subtracted out, followed by the  
14 tax included of \$5,666 to obtain ex-tax sales of \$70,825.

15 Checks and cash sales obtained from the bank  
16 deposits were then combined and tax removed to arrive at  
17 ex-tax checks and cash sales of \$44,012. The ex-tax  
18 credit card sales and cash check sales were combined to  
19 compute monthly taxable sales of \$114,837; Exhibit D,  
20 pages 62 to 70.

21 The POS sales of \$758 was then divided by the  
22 \$114,837 total sales to arrive at a 65.97 percent ratio of  
23 restaurant sales to total sales. The restaurant sales  
24 ratio was then applied to the POS system ex-tax sales, and  
25 total sales were established for each year. Audited sales

1 for the audit period of \$3,970,693 were compared to  
2 reported taxable sales of \$3,375,490. A difference of  
3 \$595,203 was noted.

4 Percentage of error was computed for each year.  
5 In 2011 the percentage of error was 24.98 percent. In  
6 2012 percentage of error was 20.31 percent. And in 2013,  
7 percentage of error was 8.47 percent. The percentage of  
8 error for each year was then applied to the respective  
9 quarterly sales. And the bank deposit difference  
10 previously assessed in the bank deposit analysis schedule  
11 was subtracted out to avoid doubling up on the assessment.

12 In order to see if the audited sales amounts was  
13 reasonable, they were compared to recorded purchases and  
14 an audited markup was computed. The overall markup was  
15 now 149.57 percent, which was still low but accepted as  
16 reasonable. When wages, Exhibit D, page 72, are combined  
17 with the audit assessment, the wage to sales ratio is:  
18 For 2011, 25.3 percent; for 2012, 26.25 percent; and for  
19 2013, 23.27 percent.

20 The recorded wage to sales ratio for 2011 and  
21 2012 for the federal income tax returns was only 9 -- was  
22 still under 9 percent. So, therefore, you have a large  
23 increase there. The industry normal ranges for wages  
24 range from 30 to 35 percent for this type of restaurant.  
25 So these ratios are closer to what is the norm for

1 industry average.

2 The Department believes that since the markups on  
3 cost of goods sold was well below the industry average  
4 during the audit period, the increase in daily sales after  
5 initial contact by the Appellant's representative and the  
6 auditor and the recorded low wage ratio when compared to  
7 sales justify the audit findings. The Appellant's  
8 contentions and documentation did not resolve the issue.  
9 Therefore, no adjustment is warranted.

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

12 JUDGE CHO: This is the Judge Cho. Thank you  
13 very much, Mr. Suazo.

14 Panel members, do you have any questions at this  
15 point in time? Judge Kwee?

16 JUDGE KWEE: This is Judge Kwee, and, yes, I did  
17 have one or two questions for the CDTFA representative.  
18 And I just wanted to make sure I understand the  
19 background. So my understanding is that in the appeals  
20 conference with CDTFA's Appeals Bureau, the taxpayer  
21 provided 36 monthly bundles of catering guest checks; is  
22 that correct?

23 MR. SUAZO: Yes, that is.

24 JUDGE KWEE: Okay. So -- and my understanding is  
25 that CDTFA reviewed -- spot tested a couple of those



1 months. And based on CDTFA's reviews, reviewed the point  
2 of sale reports less the monthly bundles for the pertinent  
3 periods equal the -- or matched the reported amounts by  
4 the taxpayer; is that correct?

5 MR. SUAZO: Yes, that is correct.

6 JUDGE KWEE: Okay. So my question there is, I  
7 understand CDTFA also examines the bank deposits. And I'm  
8 wondering do the bank deposits exceed the reported taxable  
9 sales? So even if -- for example, even if we were to  
10 conclude that this amount was tracked properly, there  
11 would still be a concern by CDTFA that the deposits  
12 exceeded what was reported.

13 MR. SUAZO: The deposits are on Schedule 12B, for  
14 \$64,000 difference. What we're saying is there's more  
15 than a \$64,000 difference. So we're saying there's  
16 \$590,000 difference overall.

17 JUDGE KWEE: Okay. So if I understand it,  
18 there's what was reported. There's the bank deposits, and  
19 then there is the audited amounts. And I'm sorry. I'm  
20 using hand gestures, and I just realized not everyone has  
21 video. So I set a hand gesture at one level for the  
22 reported amounts. I set another hand gesture at a middle  
23 level for the bank deposits. And then I set my hand level  
24 at a third highest level for the audited amounts. And if  
25 that's a correct understanding -- I believe you said it

1 was?

2 MR. SUAZO: That is true.

3 JUDGE KWEE: Thank you. Again, this is  
4 Judge Kwee. I did have one additional clarification  
5 question. So my understanding is that if you were to  
6 accept the Appellant's reported amounts, that would have  
7 been the 113 percent markup. If you accept -- CDTFA's  
8 position was if you accepted the audited taxable amount,  
9 that would have resulted in a 150 percent markup. But  
10 then CDTFA also indicate, from my understanding, that the  
11 industry average was 200 percent.

12 And I'm just -- I have a question about that  
13 because I believe the Appellant's position had been that  
14 this type of restaurant had a lower than expected markup  
15 and also considering that there's a significant portion of  
16 catering sales. I'm not sure how that would have impacted  
17 the markup because it's a lot of delivery versus sit down.

18 So I'm just wondering how did CDTFA determine the  
19 200 percent average markup, and whether that took into  
20 account the unique facts, or if they are unique facts of  
21 Appellants business were -- looked like a significant  
22 portion, possibly half at least was based on -- it was  
23 quoting -- almost half was based on catering sale.

24 MR. SUAZO: Basically, the 200 percent markup was  
25 not used. It was shown as a reasonableness test. What

1 was used or what was computed was a 150 percent markup  
2 based on after the audit was done. When he went -- when  
3 the auditor went back and looked and compared it to cost  
4 of goods sold, he saw that's a 150 percent. He's saying  
5 that basically it's still low in comparison to the  
6 industry norm, but he found it to be acceptable in this  
7 circumstance.

8 JUDGE KWEE: Okay.

9 MR. SUAZO: Okay.

10 JUDGE KWEE: Thank you. This is Judge Kwee.  
11 I'll turn it back over to the lead judge, Judge Cho, at  
12 this point. Thank you.

13 JUDGE CHO: This is Judge Cho. Thank you.

14 Judge Stanley, did you have any questions at this  
15 point in time?

16 JUDGE STANLEY: Yes. Once again, Judge Kwee  
17 jumped in and asked, basically, the question I was going  
18 to. But just -- you mentioned the word industry average  
19 for this type of restaurant several times. But given that  
20 one of Appellant's contentions is that Persian food  
21 restaurants tend to have a lower markup, when you say  
22 industry average, are you talking about Persian  
23 restaurants or restaurants in general?

24 MR. SUAZO: Normally, we're talking restaurants  
25 in general. Normally, restaurants range from -- anywhere

1 from 180 to 230 percent. 180 or 230 percent falls within  
2 around 200 percent. And what we accepted on this one  
3 after we did the audit findings was 150 percent, which is  
4 below the industry norm. So we did accept the lower  
5 markup per se, but we still found that there was a  
6 difference of \$595,000 overall.

7 MR. PARKER: This is Jason Parker. I'd also like  
8 to add that if we -- if the Persian restaurant had a  
9 markup of 100 percent, it would mean that their cost of  
10 food sales is 50 percent of their sales. And if their  
11 wages are 30 to 35 percent and then they have rent and  
12 overhead and other items like that, there's no way a  
13 business like that can make a profit. So that's why we  
14 normally see the industry average as being a little bit  
15 higher, at least 150, if not 180 to 230 percent in order  
16 for a business to make a profit.

17 JUDGE STANLEY: Thank you. I'll turn it back to  
18 Judge Cho.

19 JUDGE CHO: This is Judge Cho. I have a couple  
20 of questions as well, Mr. Suazo, if you don't mind.  
21 Appellant submitted Exhibit 1, and he listed three checks:  
22 A check on 9/15/2014, a check on 9/23/2014, and a check on  
23 9/29/2014. Are you aware of whether these checks were  
24 picked up in the audit? If you can take a look at your  
25 Schedule 12A-4, would you be able to determine whether or

1 not these checks were actually examined in the audit?

2 MR. SUAZO: The only one that I could see that  
3 might have been included was the 9/24. I guess it was  
4 9/23 to you. I can't tell if the 9/15 was because there's  
5 a deposit of checks for \$6,961. I don't know if it's  
6 commingled in or not. And the last check you said was  
7 what date?

8 JUDGE CHO: 9/29/014.

9 MR. SUAZO: There's deposits of \$4,569 in that  
10 period. However, there's a breakdown of \$1,302 and  
11 another check for \$3,267.

12 JUDGE CHO: Okay. And let me ask the taxpayer.  
13 Mr. Zali, I think it's your argument that these checks  
14 were picked up in the audit, and they are not  
15 representative of the audit -- of the entire period. Is  
16 that correct, Mr. Zali?

17 MR. ZALI: This is Shawn Zali. Yes, Your Honor.

18 JUDGE CHO: Okay. I was wondering if you could  
19 explain to me why it says, "Cash in bank. Chase  
20 No. 8929." Is that the account that it came from or came  
21 to?

22 MR. ZALI: This is Shawn Zali. Yes, Your Honor.  
23 This statement for the checks we received it from Sultan  
24 Adult Healthcare. This is not from the taxpayer's bank  
25 account. So we requested that the auditor to contact

1 Sultan Adult Healthcare to get these documents because we  
2 try to explain to him, but he would not understand the  
3 situation. So we had him contact. He did it. We  
4 contacted the Sultan, and we received the statement. We  
5 said, "Please send us every single check, that you send it  
6 to us as a statement."

7 So he contact -- I think they went to their  
8 accounting system, and they generated this based on their  
9 QuickBooks. So this is what -- that's why it says, "Cash  
10 back." It means their bank cashed it because our client's  
11 bank deposited the check.

12 JUDGE CHO: Okay. And would you happen to know  
13 where they are deposited in your bank account? Like,  
14 when, I'm sorry. Because I'm looking at Schedule 12-4.

15 MR. ZALI: They only have one bank statement  
16 which is with Wells Fargo, which was present -- they were  
17 presented to the auditor at the time of the audit.

18 JUDGE CHO: Was that your full response,  
19 Mr. Zali?

20 MR. ZALI: Yes. That's -- I mean, your question  
21 was where did they deposit it? They deposit it into their  
22 Wells Fargo bank account.

23 JUDGE CHO: I'm sorry. I should have clarified.  
24 Do you know when they were deposited? Because I asked the  
25 Department to see if they could link the checks with the

1 deposits and the schedule. Would you happen to have the  
2 audit working papers in front of you?

3 MR. ZALI: I don't unfortunately. But they  
4 deposit it with multiple checks. So sometimes it's just  
5 not one check that they deposit. So as you know, for  
6 banking you just write down the total checks and you hand  
7 it at the cashier at the bank and they input the amount.  
8 I don't know if they separate it or put it all together.  
9 I don't know. Different banks run it differently. But at  
10 the time of the audit, we requested multiple times to the  
11 auditor to take it out. And in person -- I know Mr.  
12 Khamil told me in person that he cannot take it out  
13 because it's still considered as cash sales.

14 JUDGE CHO: Okay. Thank you. I guess I have a  
15 follow-up question for you then, Mr. Zali. If you weren't  
16 catering to Sultan -- I'm sorry -- Sultan Adult Healthcare  
17 before September 2014, during the audit period were you  
18 catering to any other customers that you were not catering  
19 to subsequently to the audit period?

20 MR. ZALI: No. Because this is the biggest of  
21 the largest account, they had that was constantly getting  
22 catered. Okay. So they never had this kind of account.  
23 Most of the catering they have is usually -- before  
24 Covid-19 people used to have birthday parties, weddings,  
25 and different parties and stuff. They used to cater to

1       them. But only Sultan Healthcare was their customer that  
2       used to receive food on, like, a daily basis. Okay.

3               So Sultan Healthcare is for elderly people. They  
4       go there. It's like an entertainment place for elderly  
5       people -- Persian elderly people. So they -- my client  
6       used to deliver to Sultan on a daily basis food for  
7       breakfast, lunch, so they can provide it to their client.  
8       But in 2014 they got that account and they lost it in  
9       April 21st, 2015.

10              But before 2013 they didn't have this kind of  
11       account. Every check they received for catering was just  
12       occasionally, like, if you have a wedding, birthday party,  
13       or any party that will deliver to you.

14              JUDGE CHO: Okay. Thank you for your response.  
15       I don't any further questions at this point in time. So I  
16       guess, Mr. Zali, you're welcome to do your final closing  
17       presentation.

18              JUDGE STANLEY: Excuse me, Judge Cho. This is  
19       Judge Stanley. Can I ask a follow-up question to yours?

20              MR. ZALI: This is Shawn Zali.

21              JUDGE STANLEY: Judge -- excuse me, Judge Cho.  
22       This is Judge Stanley. Can I as one follow-up question to  
23       yours?

24              JUDGE CHO: Sure, Judge Stanley.

25              JUDGE STANLEY: And this would be for the



1 Department because you referred -- Judge Cho referred to  
2 Schedule 12A-4, which is in our exhibit binder page 83.  
3 And I do see the one check that Mr. Suazo mentioned for  
4 September of 2014 of \$3,042, but I also see other deposits  
5 that are larger. And the heading on that column says,  
6 "Check Deposits". Would it be a reasonable assumption  
7 that the check deposits noted on a particular day might  
8 include more than one check, Mr. Suazo?

9 MR. SUAZO: They could be commingled, yes.

10 JUDGE STANLEY: Okay. Thank you, Judge Cho.

11 JUDGE CHO: Thank you very much.

12 All right. Mr. Zali, your rebuttal starts now.

13 Thank you.

14 MR. ZALI: Thank you, Your Honor.

15

16 CLOSING STATEMENT

17 MR. ZALI: This is Shawn Zali. So based on  
18 listening to the CDTFA's presentation, I picked up a  
19 couple of points. One of them, the major points they had  
20 was markup percentage, that it was, like, lower than  
21 industry average. I just had just an audit a couple of  
22 weeks ago. They had Subway and they use industry average  
23 for \$200 for that.

24 And we are saying that catering for, like,  
25 multiple people and Subway should have the same markup

1 percentage? I don't think so. The quality of food that  
2 you get at a Persian restaurant would be different with  
3 different types of meat and chicken and the salad that  
4 comes with it. It's like a full plate. It should be  
5 different than Subway, like a tiny sandwich that you  
6 receive, one thing.

7 And second, that's why we requested a markup test  
8 from the Board of Equalization at that time, CDTFA  
9 nowadays. And they showed up one day and we spend five  
10 like hours, and the auditor and the audit supervisor at  
11 that time accepted the markup of percentage, and they  
12 left. And I don't know what happened now and then after.  
13 Like, to be honest with you at that time of the audit, I  
14 had a child and my son is six years old, and we're still  
15 dragging this.

16 But, again, at that time they accepted the markup  
17 because we performed a markup test on it. And now we're  
18 still, like, arguing for, like, I mean, 30, to 40 percent  
19 here because we performed a full markup test. It took  
20 about five hours on that day. And that's about that.

21 And, again, cash to credit card ratio that we  
22 keep mentioning is bank statement. If we're going to use  
23 bank statement, at the time of the audit we give the bank  
24 statement to the auditor. Either we're going to disallow  
25 the bank statement or we're going to accept the bank

1 statement.

2 Because I feel like CDTFA is doing double  
3 standard because they're saying, okay, we're not accepting  
4 bank statement for the audit period. Well, we're going to  
5 take the bank statement for the sample period, which was  
6 September 2014. Either take it, or don't take it. You  
7 just can't accept one whatever you like, and don't accept  
8 whatever you don't like. That's one thing about the bank  
9 statement.

10 And then the third point I have here, that the  
11 \$64,000 extra money in the bank statement that they said  
12 was during the audit period they -- usually in this kind  
13 of business, for example, if they do catering and they get  
14 a check, sometimes the check is not for that day and they  
15 deposit next month. Especially during the Christmas time,  
16 they receive a lot of catering.

17 So, for example, if you're going to use fourth  
18 quarter 2013, a lot of checks they received that they will  
19 cash in January 2014. And so as soon as they receive the  
20 check, they close down the -- checking their POS and then  
21 they will report the sales tax on it. That's another  
22 thing.

23 Another point I was, like, I wanted to mention  
24 is, during the audit period, we provided everything; the  
25 POS report. And after the audit happens, we find the

1 guest check. We provide even that to the auditor, and I  
2 didn't hear that auditor mention that anywhere. Because  
3 they said that the checks -- the sales invoices for  
4 catering and to go orders were not provided.

5 We provided after because we found them, and we  
6 provided a full box. And the auditor had it for over,  
7 like, I think a year and a half. I just got the box back  
8 last week. And I can still provide it to CDTFA. The  
9 auditor had it for the longest time. And we keep  
10 e-mailing him, but he didn't give it back to us for  
11 whatever reason. But we have it; so all the guest checks  
12 and POS and bank statements. This report -- this is  
13 actually reported quarter, and only one month sample size.  
14 And the Sultan cash to credit card ratio is kind of, like,  
15 off track the whole audit.

16 I don't think this is right because we provided  
17 everything possible. We performed multiple tests, three  
18 days observation, and still that was not enough for the  
19 auditor. And then he tried to do markup test. We  
20 performed a markup test. We gave him everything possible.  
21 And after six years we're still, like, kind of dragging it  
22 here, honestly.

23 And that's all my closing statement was, Your  
24 Honor.

25 JUDGE CHO: This is Judge Cho. Thank you very

1 much.

2 Okay. So before we close the record, do my panel  
3 members have any last minute questions? Judge Kwee?

4 JUDGE KWEE: Yes. This is Judge Kwee, and I just  
5 had one question for CDTFA. And, basically, I just want  
6 to see if CDTFA can address the representativeness concern  
7 that the Appellant had. And specifically when I'm looking  
8 at the BOE 414M, that's the summary of the returns filed.  
9 It looks like the taxpayer had pretty consistent reporting  
10 during the three-year audit period of around \$300,000 in  
11 taxable transactions per quarter. And for that period  
12 that was examined by CDTFA, I understand that was in 2014  
13 after the audit period.

14 So I'm just wondering does CDTFA know if the  
15 reported transactions at this time period were consistent  
16 with the reported total transaction -- reported  
17 transactions during the liability period or if there was a  
18 significant variance or increase at this time?

19 MR. SUAZO: Basically, I think that was the whole  
20 crux of our -- one of our arguments was that once they  
21 knew -- once the scope visit came to be, the sales  
22 increase by \$500 after that scope visit. And then once  
23 the audit was in play, then that -- the sales continued to  
24 increase. So once observation was being -- once they were  
25 on notice, then sales had increased significantly.

1           And then the other thing was that during the 2014  
2 period, the markup increased to 142 percent, I believe,  
3 after he's saying that there was such a low markup before.  
4 But this is on their own records. We did not establish  
5 the 142 percent markup. That's on their own records.  
6 This was after the scope visit and during the audit period  
7 when the auditor was there. So it appears that once they  
8 knew that we were there, that sales increased.

9           JUDGE KWEE: Okay. This is Judge Kwee again.  
10 Just to clarify, so the audit report was in '15. Was the  
11 scope period, was that in 2014?

12           MR. SUAZO: The scope visit was on the second  
13 quarter of 2000 -- third quarter -- I'm sorry -- third  
14 quarter of 2013, so during the audit period.

15           JUDGE KWEE: Okay.

16           MR. SUAZO: It would have taken place during the  
17 last two quarters of the audit period. So if we look at  
18 the last two quarters of the audit period, sales increased  
19 on a daily average by 18.63 percent. It went up \$572 on a  
20 daily average once the scope visit took place.

21           JUDGE KWEE: Okay. Thank you. I have no further  
22 questions.

23           JUDGE CHO: This is Judge Cho. Thank you.

24           Judge Stanley, do you have any further questions  
25 or last-minute questions?

1           JUDGE STANLEY: This is Judge Stanley. I have no  
2 further questions.

3           JUDGE CHO: Thank you very much. This is  
4 Judge Cho.

5           MR. ZALI: Judge Cho, this is Shawn Zali. Can I  
6 ask, like, one question from CDTFB?

7           JUDGE CHO: Mr. Zali, actually, you cannot ask  
8 the Department any questions. Their presentation is  
9 pretty much in their briefs and what they've stated.

10          MR. ZALI: Can I add something to it, please?

11          JUDGE CHO: You can add something, yes, if you'd  
12 like, something quick.

13          MR. ZALI: Okay. So yeah. They mentioned the  
14 scope audit during 2013. I don't know if you guys --  
15 well, because at that time I was due -- I was in business.  
16 And after the economy crashed in 2008, it took, like,  
17 slowly year by year for economy to kind of establish  
18 itself and get better and get better. And if you go back  
19 to any business, their mark -- their business get better  
20 by year by year. Okay. So 2011 was more disaster. 2012  
21 got better. 2013 got better. '14 got better. '15 got  
22 better.

23                 And one more thing is their prices went up.  
24 Because I remember at that time in 2011 -- 2010, '11, and  
25 '12 they had lunch special for \$5.99. In 2013 it went to

1 \$6.99. I think in 2016 it went to \$8.99. Now their lunch  
2 special is like \$10.99. So just because they change their  
3 prices on a yearly basis or monthly basis doesn't mean  
4 they're taking money from somewhere else and adding it.  
5 It's just the economy. The economy get better and better  
6 and the price gets higher and higher.

7 So the markup might change every year just  
8 because their change in price is due to the economy gets  
9 better. I don't think that should show something or not  
10 show anything. It just shows that the economy gets  
11 better. People purchase more food. People throw more  
12 parties. Catering is better. Therefore, they buy more  
13 items. So food business is like this. When you purchase  
14 more you get better prices. This is a very simple test.  
15 Your markup might get a little bit higher.

16 That's all. That's what I'd like to add, Your  
17 Honor. Thank you so much.

18 JUDGE CHO: Thank you, Mr. Zali.

19 All right. So this concludes this hearing. The  
20 panel will meet and decide the case based on the documents  
21 and the arguments presented today. We will try to issue  
22 our opinion within 100 days from today. This case is  
23 submitted, and the record is now closed.

24 (Proceedings adjourned at 3:35 p.m.)

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HEARING REPORTER'S CERTIFICATE

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

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

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

I have hereunto subscribed my name this 7th day of August, 2020.

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ERNALYN M. ALONZO  
HEARING REPORTER