OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18043020
	) CDTFA Account No. 102-049629
TMHR COLLECTIVE CORPORATION	) CDTFA Case ID 857430
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Elizabeth Sheldon, Attorney

For Respondent: Randolph Suazo, Hearing Representative

K. LONG, Administrative Law Judge: On July 22, 2020, we issued a written Opinion reducing the measure of unreported taxable sales found during respondent California Department of Tax and Fee Administration's (CDTFA) audit of TMHR Collective Corporation's (appellant) business. In the Opinion, summarized below, we held that:

1. CDTFA's use of an outdoor observation test to establish audited taxable sales was justified because appellant failed to provide sufficient books and records.

2. CDTFA met its minimal burden of showing that the number of observations conducted during the observation tests were reasonable and rational because appellant's business closed and no more observations could be performed.

3. CDTFA met its minimal burden of showing that the audited average sales price was reasonable and rational because the audited average sales price was based on CDTFA's knowledge of similar businesses in the area.

4. CDTFA erred in calculating the average audited number of sales per hour because it counted each person that entered the business as a sale. We found nothing in the record to show that CDTFA attempted to determine whether appellant actually made a sale to anyone that entered the business. We also noted several instances in the record that showed where appellant failed to make a sale. Based on this information, we rejected CDTFA's assumption that appellant made a sale to every person who entered the business and ordered a reduction of the taxable measure.

Appellant timely filed a petition for a rehearing (PFR) based on an assertion of insufficient evidence to justify the written Opinion. We conclude that appellant failed to establish a basis for granting a rehearing.

DISCUSSION

The Office of Tax Appeals (OTA) may grant a rehearing where one of the following grounds exists, and the substantial rights of the filing party (here, appellant) are materially affected: (a) an irregularity in the appeal proceedings which occurred prior to the issuance of the written opinion and prevented fair consideration of the appeal; (b) an accident or surprise which occurred during the appeal proceedings and prior to the issuance of the written opinion, which ordinary caution could not have prevented; (c) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to the issuance of the written opinion; (d) insufficient evidence to justify the written opinion or the opinion is contrary to law; or (e) an error in law. (Cal. Code Regs., tit. 18, § 30604(a)-(e); see also *Appeal of Do,* 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654 [explaining that these grounds for rehearing are based on Code of Civil Procedure section 657].)

Here, appellant is petitioning for a rehearing on the grounds that there is insufficient evidence to justify the written opinion and that the opinion is contrary to law. (Cal. Code Regs., tit. 18, § 30604(d).) Citing to CDTFA's Audit Manual, appellant repeats its argument that CDTFA performed an inadequate observation test for the audit. Appellant argues that the Audit Manual requires an observation test to be between one and three full days. Appellant also cites OTA's Rules for Tax Appeals, asserting that CDTFA bears the burden of proof in any fraud proceeding.

CDTFA's Audit Manual summarizes CDTFA's audit policies and procedures. It is a useful resource that OTA may look to for guidance in interpreting the law; however, the Audit Manual is not binding legal authority, and should not be cited as such. As such, OTA must exercise its own independent judgement in determining the weight, if any, to afford CDTFA's construction of the law, as set forth in the Audit Manual. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.)

The question of whether there is insufficient evidence to justify the written opinion or the opinion is contrary to law is not one which involves a weighing of the evidence, but instead requires a finding that the opinion is "unsupported by any substantial evidence"; that is, the

record would justify a directed verdict against the prevailing party. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906.) This requires a review of the opinion in a manner most favorable to the prevailing party (here, CDTFA), and an indulging of all legitimate and reasonable inferences to uphold the opinion to the extent possible. (*Id*. at p. 907.) The question before us on a PFR does not involve examining the quality or nature of the reasoning behind OTA's opinion, but whether that opinion is valid according to the law. (*Appeal of NASSCO Holdings, Inc*. (2010-SBE-001) 2010 WL 5626976.) In addition, insufficiency of the evidence as a ground for a rehearing means the level of insufficiency that causes a trier of fact, when weighing conflicting evidence, to thereafter conclude that facts in support of the decision weigh less than those which are in opposition. (*Bray v. Rosen* (1959) 167 Cal.App.2d 680, 683.)

As discussed in the Opinion, CDTFA's Audit Manual summarizes CDTFA's audit policies and procedures and is not binding authority in an appeal before OTA. Therefore, while CDTFA's Audit Manual may lay out the procedure for an observation test, these procedures are not required by law. Instead, when CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) Further, chapter 8 of CDTFA's Audit Manual applies to bars and restaurants. As such, even if CDTFA's Audit Manual was the relevant authority, the observation test guidelines outlined in chapter 8 do not apply to the type of business in this appeal (i.e., a medical marijuana dispensary). Consequently, we do not give any deference to the Audit Manual section cited by appellant under the facts of this case. Appellant has not shown that our opinion is contrary to law because CDTFA's Audit Manual is neither a statute nor a regulation, and does not apply in this case.

With respect to appellant's contention that this is a fraud proceeding (which requires a higher standard of proof), we note that CDTFA did not assert fraud or impose a fraud penalty on appellant. Rather, CDTFA merely assessed tax on appellant's unreported taxable sales. As such, appellant's appeal is not a fraud proceeding. In the opinion, we addressed CDTFA's minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) We also discussed in great detail whether CDTFA met its minimal initial burden and ordered a reduction

to the taxable measure where that burden was not met. For example, we discussed the fact that although CDTFA's observation test was a mere five hours in length, appellant's business closed, and no further observations were possible. We also noted that CDTFA based the audited average sales price on its knowledge of other dispensaries in the area and that the audited average sales price was lower than the statewide average sales price at that time.

Finally, we found that CDTFA erred in assuming that every person entering the business made a purchase. In rejecting CDTFA's assumption, we noted the following: 1) the record did not show any attempt by CDTFA to determine whether a person entering the business made a purchase; 2) the record did not show any attempt by CDTFA to determine which individuals made a purchase when they entered as part of a group; and 3) a police report issued by the Los Angeles Police Department documented instances where persons entering the business did not make a purchase. Appellant has not shown that there is insufficient evidence to support our finding with respect to the taxable measure. Appellant also has not provided or pointed to any evidence within the record to show that the taxable measure should be reduced further.

Based on the foregoing, we find that appellant has not shown a rehearing is warranted, and therefore its PFR is hereby denied.

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Keith T. Long
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

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Andrew Wong
Administrative Law Judge

Date Issued: 10/21/2020