OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19105387) CDTFA Case ID 647417
MCFLOWER CORPORATION	)
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:	Mitchell Stradford, Representative
For Respondent:	Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

T. STANLEY, Administrative Law Judge: On June 20, 2017, the State Board of Equalization (Board) held an oral hearing in this matter. After considering the arguments and evidence presented, the Board ordered that the average number of customers per hour be based on the full-day observation test that was conducted on April 14, 2015. Otherwise, the Board ordered that the understatement be computed in accordance with the Board staff recommendation.[1] Thus, the Board's order resulted in a reduction of the audited understatement of reported taxable sales, which was $2,596,125 before the Board hearing.[2] The Board also ordered deletion of the negligence penalty.

On September 22, 2017, appellant filed a petition for rehearing (PFR) with the Board. However, before the Board acted to grant or deny the petition for rehearing, appellant filed a settlement proposal. On October 9, 2019, CDTFA notified appellant that the parties had been

[1] Sales taxes were formerly administered by SBE. Effective July 1, 2017, functions of SBE relevant to this case were transferred to California Department of Tax and Fee Administration (CDTFA). (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, the term "CDTFA" refers to CDTFA's predecessor, SBE. All references to "the Board" refer to SBE.

[2] The material provided by CDTFA does not include detail regarding the amount of understatement computed by staff after the Board hearing.

unable to reach a mutually agreeable settlement. Accordingly, appellant's PFR was forwarded to the Office of Tax Appeals (OTA). (See Cal. Code Regs., tit. 18, § 30106(b).) Upon consideration of appellant's PFR, we conclude that the grounds set forth therein do not constitute good cause for a new hearing.

Good cause for a new hearing may be shown where one of the following grounds exists, and the substantial rights of the complaining party are materially affected: (a) an irregularity in the appeal proceedings that occurred prior to the issuance of the written opinion and prevented fair consideration of the appeal; (b) an accident or surprise that 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 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 *Appeals of Swat-Fame Inc., et al.*, 2020-OTA-045P.)

BACKGROUND

Appellant operated a medical marijuana dispensary during the audit period, January 1, 2008, through June 30, 2011. Appellant did not provide complete records to CDTFA. To establish audited sales, CDTFA used two audit methods, an observation test and an analysis of credit card sales and cash sales. Before the Board hearing, CDTFA had issued an audit report and two reaudit reports. In the second reaudit, CDTFA used one full-day observation test and 27 shorter observation tests (from 1 to 3.5 hours each) to establish that, on average, appellant served 10 customers per hour. Also, CDTFA used an average amount per sale of $47.99, which was computed using guest checks provided by appellant for sales on the day the full-day observation was made. CDTFA used 10 customers per hour, the hours of operation, and $47.99 per sale to compute audited total sales for the first quarter 2011. Using credit card receipts for the same quarter, CDTFA computed that appellant's cash receipts were the equivalent of 1.9608 times its credit card receipts. CDTFA used credit card receipts for the period July 1, 2010, through June 30, 2011, along with the factor of 1.9608 to compute audited cash receipts. CDTFA added credit card receipts and audited cash receipts to establish audited sales for those four quarters. For the period January 1, 2008, through June 30, 2010, CDTFA established audited taxable sales for each quarter by reducing sales for the immediately preceding quarters by 10 percent, each.

At the time of the Board hearing, CDTFA had established an audited understatement of $2,596,125 in reported taxable sales.

At the Board hearing, appellant argued that the audit staff had not followed the instructions of the Decision and Recommendation (D&R), which had recommended a reaudit in which the audit staff would observe appellant's operations for two full days, one of which was to be a weekend. Based on what CDTFA deemed to be safety concerns for its employees, it conducted the multiple observations detailed above, which included only one full day. Subsequently, in a supplemental D&R, CDTFA concluded that sufficient observation testing had been conducted.

Appellant argued that the testing was insufficient and that the results were skewed because the test did not encompass two full days. The Board resolved this dispute by instructing CDTFA to use the number of customers observed in the one-day observation, and to exclude the other observation results, thereby decreasing the number of customers per hour calculated by CDTFA. Appellant has not requested a rehearing on this issue.

In this PFR, appellant disputes the percentage of credit card versus cash sales calculated by CDTFA, as well as the Board's decision to not include credit card sales from the first quarter of 2010 (1Q10) and 2Q10 to compute audited sales for those quarters. In pertinent part, CDTFA did not use the credit card sales from the first and second quarters of 2010. Appellant asserted at the hearing before the Board that the lower credit card sales reflect lower overall sales. Because the county in which appellant operates its business passed an ordinance that was effective with 3Q10, appellant alleges that several similar businesses were closed, and therefore its business increased significantly, which is reflected in the increase in credit card sales starting that quarter. CDTFA opined at the hearing that appellant's business has been a primarily cash business in the past, and that appellant's credit card sales were "ramping up" and not fully implemented until 3Q10. Therefore, CDTFA disregarded credit card sales for 1Q10 and 2Q10, and used the credit card percentage established in 1Q11 to establish audited sales for the period July 1, 2010, through June 30, 2011. According to CDTFA, using 2Q11 was in appellant's favor since it produced the highest credit card ratio of any quarter considered (a higher credit card sales ratio would mean fewer cash sales). Using the credit card ratio computed for 1Q11, CDTFA calculated audited taxable sales for 3Q10, and reduced the audited taxable sales by 10 percent for each audit quarter preceding 3Q10, e.g., 10 percent reduction for 2Q10, an additional 10 percent

reduction for 1Q10, and so on. CDTFA concluded that the reductions accounted for appellant's claim that sales were lower in quarters preceding 3Q10. The Board's action following the hearing sustained this part of CDTFA's decision. Appellant's PFR claims that the Board's action in sustaining CDTFA was not supported by sufficient evidence to support its conclusion.[3]

DISCUSSION

Appellant alleges that the Board's decision is contrary to law or there is insufficient evidence to support the decision. For this ground, OTA must determine that the opinion is "unsupported by any substantial evidence." (*Appeals of Swat-Fame, Inc. et al., supra*; *Appeal of Graham and Smith*, 2018-OTA-154P.) This requires a review of the Board's decision to indulge "in all legitimate and reasonable inferences" to uphold the decision. (*Appeals of Swat-Fame, Inc. et al., supra*.) The question before us on a PFR does not involve examining the quality or nature of the reasoning behind the Board's decision, but whether that decision is valid according to the law. (*Ibid*.) A rehearing may be granted when, examining the evidence in the light most favorable to the prevailing party, with all legitimate inferences to uphold the decision, we find that the Board's decision incorrectly stated or applied the law and, as such, it is contrary to law. (*Ibid*.)

The issue for this petition relates to the Board's decision to use the credit card ratio as calculated using credit card data from 3Q10 through 2Q11, and to exclude earlier quarters from the calculation. On that issue, CDTFA was the prevailing party, and we therefore review the Board's decision in the light most favorable to CDTFA. Appellant and CDTFA both argued this point at the hearing. The evidence favorable to CDTFA showed that there was a considerable increase in credit card sales during 3Q10, and that credit card sales for 1Q10 and 2Q10 were unreliable. CDTFA's evidence further established that it had accounted for the lesser amount of sales that appellant made during prior quarters in the audit period by reducing audited sales by 10 percent for each quarter preceding 3Q10. Based upon its analysis of that evidence, the Board could reasonably conclude that the substantial difference between the credit card receipts in the first two quarters of 2010 and in the subsequent four quarters of the audit period was not merely the result of lower sales in the first two quarters, but that the difference instead was an indication of less frequent use of credit cards in those quarters. The fact that appellant introduced evidence

[3] Appellant also claims an error in law but has not explained any procedural defect in the Board's hearing process, and we do not address it further.

that might tend to contradict that premise did not require the Board to find in appellant's favor as a matter of law. We are not persuaded by appellant's assertion that the Board must use all the credit card records because CDTFA had not impeached those records. Appellant has pointed to no law, and we are unaware of any, that would require the Board to accept appellant's evidence because CDTFA did not rebut it. The Board found that CDTFA met its minimal, initial, burden of producing evidence to show a reasonable and rational basis for its findings and that appellant had the burden of proving a more accurate measure. (See *Appeal of Talavera*, 2020-OTA-022P.) Thus, the question is whether appellant carried that burden. (Cal. Code Regs., tit. 18, § 30219(a).) The Board found that appellant did not. As explained previously, the relevant inquiry in examining whether a decision is contrary to law for purposes of a petition for rehearing is not one which involves a weighing of the evidence, but rather is a question of whether there is evidence which, if given its fullest effect, is legally sufficient to support the decision. We find that substantial evidence existed to support the Board's decision to reject appellant's proposed computation of audited taxable sales. To find that there was insufficient evidence to justify the opinion, we must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, the Board should have reached a different opinion. (See *Appeals of Swat-Fame, Inc., et al., supra*.) As such, we find that the Board's decision is not contrary to law, the record contains sufficient evidence to support the decision, and a rehearing is therefore not warranted.

CONCLUSION

Appellant has not shown good cause for a new hearing under the California Code of Regulations, title 18, section 30604. Therefore, appellant's request for a rehearing is denied.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Josh Lambert
Administrative Law Judge

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Andrew J. Kwee
Administrative Law Judge

Date Issued: 11/25/2020