

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
LAS PLAYAS #10, INC.,) OTA NO. 18073485
)
APPELLANT.)
)
_____)

TRANSCRIPT OF VIRTUAL PROCEEDINGS

Cerritos, California

Tuesday, January 26, 2021

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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APPEARANCES:

Panel Lead: ALJ JOSHUA ALDRICH

Panel Members: ALJ DANIEL CHO
ALJ ANDREW WONG

For the Appellant: LINDA T. SUNG

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX AND
FEE ADMINISTRATION

NALAN SAMARAWICKREMA
JASON PARKER
CHRISTOPHER BROOKS

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-11 were received at page 8, and Exhibit 12 at page 9.)

(Department's Exhibits A-G were received at page 8.)

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1 Cerritos, California; Tuesday, January 26, 2021

2 10:50 a.m.

3

4 JUDGE ALDRICH: We're going to open the record.

5 This is Judge Aldrich. We're opening the record
6 in the appeal of Las Playas #10 before the Office of Tax
7 Appeals, Case Number 18073485.

8 This hearing is being convened electronically on
9 January 26th, 2021, at approximately 10:50 a.m. This
10 hearing was noticed for Cerritos, California. As a quick
11 point of clarification, we are the Office of Tax Appeals.
12 We're a separate agency from the California Department of
13 Tax and Fee Administration and the Franchise Tax Board.

14 Today's hearing is being heard by a panel of
15 three Administrative Law Judges. I'm the lead
16 Administrative Law Judge for the purposes of conducting
17 the hearing. I'm joined by Judges Daniel Cho and Andrew
18 Wong. While I'm the lead for purposes of conducting this
19 hearing, we three will deliberate and decide all the
20 issues presented. Each of us will have an equal vote in
21 those deliberations.

22 Let's see. I believe we have Ms. Sung
23 representing the Appellant. Beginning with Appellant's
24 representative, please state and spell your name.

25 MS. SUNG: Linda T. Sung. It's L-I-N-D-A, S --

1 and then S-U-N-G.

2 JUDGE ALDRICH: Thank you.

3 CDTFA representatives, please state and spell
4 your name beginning with the hearing representative and
5 ending with the Tax Counsel IV.

6 MR. SAMARAWICKREMA: Nalan, N-A-L-A-N,
7 Samarawickrema, S-A-M-A-R-A-W-I-C-K-R-E-M-A, Hearing
8 Represent.

9 JUDGE ALDRICH: Hi. Just for future reference,
10 could you perhaps speak up a little bit more or closer to
11 your microphone, sir.

12 MR. SAMARAWICKREMA: Nalan Samarawickrema,
13 N-A-L-A-N, last name, S-A-M-A-R-A-W-I-C-K-R-E-M-A.

14 JUDGE ALDRICH: Thank you.

15 MR. PARKER: Jason Parker, Chief of Headquarters
16 Operations Bureau, J-A-S-O-N P-A-R-K-E-R.

17 MR. BROOKS: Christopher Brooks, Tax Counsel.
18 It's C-H-R-I-S, as in Sam, T-O-P-H-E-R. Last name Brooks,
19 B-R-O-O-K-S, as in Sam.

20 JUDGE ALDRICH: Great. Thank you.

21 This is Judge Aldrich. The issues to be decided
22 are as follows:

23 One, whether Appellant owned the business at
24 issue during the audit period; whether Appellant is liable
25 for the unreported audited taxable sales; and three,

1 whether a reduction to the measure of tax for unreported
2 taxable sales is warranted.

3 Ms. Sung, is this correct?

4 MS. SUNG: Yes. It's correct.

5 JUDGE ALDRICH: And Department, is that your
6 understanding as well? Department's representative, is
7 that your understanding of the issues? I believe you're
8 muted.

9 MR. SAMARAWICKREMA: Yes. That is my
10 understanding. Nalan Samarawickrema. That is our
11 understanding.

12 JUDGE ALDRICH: Thank you.

13 So CDTFA submitted an exhibit index identifying
14 Exhibits A through G. Exhibit A was Audit Work Papers and
15 Related Documents; B, Notice of Determination; C, Petition
16 For Redetermination; D, Appeals Bureau Decision; E,
17 CDTFA's Response to Appellant's Opening Brief; F,
18 Appellant's Stock Ownership and Other Related Documents;
19 and G, Appellant's Hardship Waiver Brief.

20 And Appellant's representative submitted an
21 exhibit index identifying Exhibits 1 through 11.
22 Exhibit 1 was a copy of a 2013 Personal Income Return;
23 Exhibit 2, copy of 2014 Personal Income Tax Return.

24 Mr. Brooks, would you mind muting your
25 microphone. Sorry. We're getting just a little bit of

1 feedback.

2 MR. BROOKS: I apologize.

3 JUDGE ALDRICH: No problem.

4 Resuming, Exhibit 3 was a copy of Las Playas #10
5 2015 Income Return; Exhibit 4, Escrow Document; 5, Book
6 Sale Notice; 6, Application For New Seller's Permit; 7,
7 Source Document Daily Sales Report 2015; 8, Reconciliation
8 of Reported Sales With Source Documents; 9, Credit Card
9 Ratio Sample Results From Audit Number 2; 10, Research
10 Evaluation of Restaurant; and 11, research profit margin.

11 So during the prehearing conference, the parties
12 had no objection to admitting the exhibits identified are
13 the ones that I've just read in those indices. Therefore,
14 I admitted the exhibits into the record pursuant to the
15 January 7th, 2021 minutes and orders.

16 (Appellant's Exhibits 1-11 were received
17 in evidence by the Administrative Law Judge.)

18 (Department's Exhibits A-G were received in
19 evidence by the Administrative Law Judge.)

20 So subsequently, we received a photo from
21 Appellant's representative on January 13th, 2021. So my
22 question for Appellant's representative, was the photo
23 intended to be an exhibit or an exemplar, Ms. Sung?

24 MS. SUNG: It's intended as an exhibit for the
25 prehearing. You had asked for more information on the

1 raspados --

2 JUDGE ALDRICH: Okay.

3 MS. SUNG: -- yeah, sold. So that's what I
4 obtained from the client, the Appellant.

5 JUDGE ALDRICH: Okay. And so that would be
6 proposed Exhibit 12. Does the Department have any
7 objection to admitting the proposed Exhibit 12?

8 MR. SAMARAWICKREMA: Nalan Samarawickrema here.
9 No objection.

10 JUDGE ALDRICH: Okay. Hearing no objection,
11 we'll admit Exhibit -- proposed Exhibit 12.

12 (Appellant's Exhibit 12 was received in
13 evidence by the administrative Law Judge.)

14 And let me see. Okay. Just to give everybody an
15 idea of how the hearing is going to proceed, we plan for
16 the hearing to proceed as follows: Appellant's opening
17 statement, which we estimated at 45 minutes. Then the
18 Department will present a combined opening and closing for
19 approximately 25 minutes, and Appellant will have 10
20 minutes to close or rebut. And please note that the Panel
21 may ask questions of either party.

22 Appellant's representative, Ms. Sung, are you
23 ready to begin with your opening statement?

24 MS. SUNG: Yes, I am.

25 JUDGE ALDRICH: Please proceed.

1 So in 2014 when they acquired -- the escrow
2 closed somewhere around mid-December of 2014. So they
3 really didn't start taking over the restaurant until 2015.
4 And you can see that in the Exhibit 4, 5, and 6. So
5 Exhibit 4 is the escrow document that the CDTFA also
6 presented as well. And there's a bulk sale notice that
7 was also filed. They purchased equipment, which is the
8 inventory and also Goodwill of the business.

9 And they also -- Exhibit 6, they apply for a new
10 seller's permit. During this time, so these two
11 Appellants, they're very unsophisticated. The first time
12 owning a business, they had no clue what's going on. So
13 they have all these people advising them, and somehow,
14 they ended up taking over the seller's permit number
15 instead of going through with the application of a new
16 seller's permit.

17 And also on the Exhibit C, which is -- I'm
18 sorry -- Exhibit 3, which is the Las Playa's #10 their
19 first year tax return 2015, you can see that in the
20 depreciation schedule that they depreciated the Goodwill,
21 the equipment, and also the inventory as well. So in a
22 case of stock purchase, you would not -- you would not
23 recognize item purchases such as Goodwill. Equipment,
24 perhaps, is if the previous shareholder owns the equipment
25 personally, that may be. But you would not recognize

1 Goodwill.

2 So all these Exhibits 1 through 6 supports that
3 the intent of the Appellant is to just purchase the
4 business, the corporation. It's not a stock purchase as
5 the CDTEFA has shown. And also the previous
6 representative, I -- the previous representative is the
7 tax preparer for the seller. So in that sense, whatever
8 he presented is not fully in the best interest of the
9 Appellant, which is the purchaser -- the buyer of the
10 business.

11 So he I would argue that because they purchased
12 the corporation, then they're not liable for any prior
13 activities which is, you know, it's totally untrue. So I
14 don't -- whether it's an ignorance on his part or it was
15 intentional. Okay. But he has a -- he serves the prior
16 seller for many years. So whatever he present, it's not
17 in the best interest of these two. So -- so the --

18 JUDGE ALDRICH: It appears we lost the taxpayer's
19 representative. So I think we're going to have
20 five-minute recess to try to get the technical issue
21 resolved. Stand by.

22 (There is a pause in the proceedings.)

23 JUDGE ALDRICH: Ms. Sung, please resume.

24 We're going to go back on the record, Ms. Alonzo.

25 And please resume where you left off.

1 MS. SUNG: Okay. I apologize for the
2 interruption.

3 So from Exhibit 1 through 6 we're trying to
4 support that the Appellant intended to purchase just the
5 business, which is the Goodwill, the equipment, and a
6 little bit of inventory, and also the ABC license as well.
7 It was -- they did not intend to purchase the corporation,
8 the stock as presented in the earlier proceedings.

9 So moving onto the next part is that the auditor
10 used Z-tapes to calculate the credit card sales ratio.
11 Okay. So, generally, the Department will move to an
12 alternative method when there's no books and records
13 available. So for the prior period, prior to the
14 Appellant actually purchasing the business, which they
15 started operating January of 2015. So for the period,
16 that's fourth quarter 2012 through the fourth quarter of
17 2014, it's not under their operation. It's -- it's
18 operated by the seller. So they don't have records.

19 But as for the three quarters that's under the
20 Appellant's operation, they had the Z-tapes. They have --
21 they keep handwritten books and records. There's no
22 mandate of any kind of POS system that a business is
23 supposed to use. They're a mom and pop shop. They are
24 just the two husband and wife operating. So they were
25 keeping their number -- their books in a ledger, a

1 handwritten ledger. So they provided a daily sales
2 report, which is the Exhibit 7, and in Exhibit 8 that we
3 reconciled the daily sales report to the numbers, the
4 amounts that were reported to the CDTFA as well as on the
5 return. So those all reconcile.

6 In addition to that, the Z-tapes, which the
7 15-day Z-tapes that CDTFA used to calculate the credit
8 card ratio, and those numbers also reconciled to the daily
9 sales report. So that proves that the Appellants recorded
10 the daily sales contemporaneously on a daily basis and
11 used that information to -- used that information to
12 prepare and file the sales tax report. Of course, this is
13 for the period that's under their operation, which is --
14 which is the first quarter of 2015 through the third
15 quarter of 2015. Okay. So those all reconciled.

16 And because of that, the Department uses an
17 alternative method when there's nothing else to support
18 the numbers or the amounts that were reported to the
19 Department. But in this case, the Appellant had
20 contemporaneous records on a daily basis, and then they
21 reconciled. And then on top of that, the Department also
22 used that to calculate the credit card ratio. But if all
23 the amounts reconciled, there's no -- I mean, there's no
24 reason, no purpose to calculate the credit card ratio
25 because all the numbers reconciled. So that is our

1 argument.

2 And also for the credit card ratio sample that's
3 used, it's a 15-day ratio. So this Appellant is also
4 being audited a second time. So that's what it's referred
5 to as the second audit, audit number 2. So in audit
6 number 2, the auditor used an 85-day sample. So in that
7 85 days we extrapolated a certain 3 of the 15-day period,
8 and it shows a 7 -- a 0.7 differential. So this shows
9 that the credit card ratio that's used is not
10 representative of -- of this entire -- whether it's the
11 entire 36 months, or we're just talking about the period
12 as under the Appellant's operation, which -- which is the
13 9 months. Okay. It's not a good representation of this
14 entire period.

15 So a longer -- a larger sample should have been
16 used. So in this case, in 2018 -- between 2018 and '19,
17 that's the period, the 85 days, it yield a 73 percent
18 credit card ratio as opposed to this 15-day ratio that's
19 used by -- in this first audit, which yielded a
20 56-point-something percent credit card ratio, which is
21 much lower.

22 So for Exhibit Number 8 -- I'm sorry -- Exhibit
23 Number 9, we're trying to show that the credit card ratio
24 sample used is not a good representation of the audit
25 period. And also, it's too short to truly show what the

1 credit card ratio for the period is. And also, in 2018
2 the credit card ratio is 70 -- 73 percent. Right.

3 And then the last two exhibits, the Exhibit 10
4 and 11, so Exhibit 10 shows the evaluation of a
5 restaurant. So, generally, a sale of a restaurant is
6 based on a certain method. So one of them is based on the
7 gross sales. So basically, it's -- it's typically a
8 quarter, 25 percent of the gross sales. That's the sales
9 price.

10 In this case, the restaurant was sold for
11 \$126,000. So \$126,000 is a quarter of \$504,000. Okay.
12 So \$504,000, based on the operation under the prior -- the
13 seller, he averaged -- in 2013, he had 400 and I believe
14 \$80,000, \$480,000 in sales. I mean, the Department has in
15 their record \$480,000. So it's a little bit less than
16 \$504,000. But if you consider the fact that the owner
17 carried a \$70,000 note on the sale interest free, that
18 could explain why a 504 -- the difference between \$504,000
19 and the \$480,000 that should have been the sales price, if
20 you use the 25 percent of gross sales. So that kind of
21 align with what the sellers reported sales, okay, for that
22 amount of sales price for the restaurant.

23 And finally, the Exhibit 11 shows, kind of, the
24 profit margin because the Department alluded to the markup
25 should be around 230 percent. Okay. Which if you use the

1 profit margin, the set gross profit margin is 70 percent
2 with that calculation. But it really varies from
3 operator, restaurants, the locality, the demographics that
4 the restaurant is in, and also the operator's choice. So
5 these two operators, the Appellant, new in the business
6 really trying to increase sales.

7 And, generally, one way of increasing sales is
8 that you -- you cut down on -- on the profit. Okay. You
9 discount what you sell and to attract customers until you
10 build up a good reputation, and then you're able to
11 increase your margin. So this Exhibit 11 shows that the
12 general gross profit margin is around 50 percent. If the
13 gross profit margin is 50 percent, that means the markup
14 is only 100 percent, not the 230 percent as the Department
15 alluded as the general markup for a restaurant of this
16 size. Okay.

17 So I think that's too much generalization. So,
18 again, any type of alternative method, whether it's markup
19 or using, in this case the credit card ratio is used, is
20 only if the taxpayer is unable to provide any kind of
21 documents substantiating how the sales tax report was
22 prepared. Okay. So in this case, the period under the
23 Appellant's operation, which is January 2015 through third
24 quarter September 30th, 2015, the Appellant had sufficient
25 supporting documents, the daily sales report and also the

1 Z-tapes.

2 Unfortunately, the Appellant don't have the
3 Z-tapes now because they thought everything is over and
4 then done with. But at the time of the audit, the auditor
5 had access to the Z-tapes and could have done, like, the
6 second audit where requested 85 days of Z-tapes as opposed
7 to just 15 days of Z-tapes, and that would calculate a
8 better credit card ratio. And also, it would have
9 substantiated that the daily sales report that's
10 handwritten by the Appellant, all the numbers reconciled.
11 The Z-tapes reconciled to the daily sales report kept, and
12 also reconciles to the sales tax report filed with the
13 Department, as well as reconciled to the tax return that
14 was filed with the Internal Revenue Service.

15 So all of those would have been established.
16 And, therefore, the 2015 period at the very least, should
17 not have -- should not warrant any kind of additional
18 assessment. It should have been accepted as filed. And
19 that is the case with audit number 2, that the period
20 2018, because the Appellant had all the POS tapes and
21 everything reconciled, and it was accepted as filed for
22 that period. Okay.

23 So that is pretty much my presentation. Do you
24 have any questions?

25 JUDGE ALDRICH: I'm going to refer to my -- to

1 the Panel to see if they have questions for you.

2 Judge Cho, do you have any questions for
3 Appellants' representative?

4 JUDGE CHO: This is Judge Cho. I don't have any
5 questions at this time. Thank you.

6 JUDGE ALDRICH: And Judge Wong?

7 JUDGE WONG: This is Judge Wong. I had a couple
8 of questions. Ms. Sung, you had said that your clients
9 didn't intend to buy the corporation, but did they in fact
10 buy the corporation?

11 MS. SUNG: Well, they ended up changing the name
12 to -- in the -- with the Secretary of State. They -- it
13 was after the fact. They did a name change in the
14 Secretary of State for the Las Playas #10. And they said
15 that they were advised by the previous owner and also
16 Mr. Chait, who is the first representative on this case,
17 that it would be easier for transition in obtaining the --
18 what are the ABC license transfer and also the seller's
19 permit.

20 So I don't understand why the seller's permit
21 because you can easily apply for seller's permit. You
22 don't -- you can be a sole proprietor. So they were
23 definitely misinformed in that regard. So they only did
24 the SOS name change because on the recommendation from the
25 representative and also the previous owner. They said

1 that it would be easier that way.

2 JUDGE WONG: Easier to buy the corporation; is
3 that correct?

4 MS. SUNG: Easier to do a name change. It's to
5 take over the corporate stock so it would help them to
6 transfer the ABC license or -- or the -- maintaining the
7 seller's permit. It would be in their best interest to
8 maintain the seller's permit and do it that way.

9 JUDGE WONG: This is Judge Wong. Thank you. No
10 other questions at this time.

11 MS. SUNG: Thank you.

12 JUDGE ALDRICH: Okay. I believe we're ready to
13 switch gears over to the Department. Department, are you
14 ready to begin with your combined opening and closing
15 statement?

16 MS. SUNG: I'm sorry, Judge Aldrich.

17 JUDGE ALDRICH: It's all right.

18 MS. SUNG: I just realized I forget to mention
19 the question you asked regarding the respados.

20 JUDGE ALDRICH: Yeah.

21 MS. SUNG: Okay. So may I present, or I should
22 wait for them?

23 JUDGE ALDRICH: You could go ahead. You still
24 have time.

25 MS. SUNG: Okay. I apologize. So with regards

1 to the respados, which is the last column in the CDTFA's,
2 the credit card ratio that was used. So the respados it
3 turns out is the -- what they call frescas -- agua
4 frescas, which is some kind of drink. It could be a
5 pineapple drink. It could be a guava drink. So those are
6 the drinks that they sell at the restaurant where they can
7 take out -- where the customers can take it with them.

8 So the Appellant said that they sell at -- a
9 small is \$2.99 a cup, and then a large is \$3.99 a cup.
10 And they sell anywhere from 20 to 60 or 70 frescas on a
11 daily basis, depending on the day of the week. So what
12 they said kind of align with what the 15-day period that
13 was recorded the respados was sold. Some of the days were
14 higher. Some of the days lower.

15 And on average, if you average it out at \$3.50 --
16 so \$891 was recorded for the 15-day period. You can see
17 from the CDTFA report the -- if you divide it by 3.5,
18 that's about 20-some cups a day. So they sell more on the
19 weekends than during the week. So that's the nontaxable
20 items that they sell.

21 JUDGE ALDRICH: Okay. So just to be clear, my
22 impression of a respado, which is the word for shaved in
23 Spanish, like shaved ice, they weren't selling like a
24 fruit/shaved ice? They were selling aguas frescas?

25 MS. SUNG: Yeah. So to me -- when I asked the

1 client, you know, regarding respados, they had no idea
2 what I was talking about. So I said, "Well, it's some
3 kind of drink that you sell that, you know, the people
4 take it to go." And they said, "Oh, oh, oh. That's the
5 agua frescas."

6 JUDGE ALDRICH: Okay.

7 MS. SUNG: So I don't -- I don't know if the
8 auditor named it respados because that's what she thinks
9 is respados. But to the Appellant, they don't call it
10 respados. They call it agua frescas, which is shown on
11 the menu, the photos, which is the -- I'm sorry,
12 Exhibit 12 that was added. So on the menu it's referred
13 to as the agua frescas.

14 JUDGE ALDRICH: Okay. I believe that answers my
15 question for that aspect. Are you done with your
16 presentation?

17 MS. SUNG: Yes.

18 JUDGE ALDRICH: Okay. Department, I think we're
19 going to switch over to you now. So is the hearing
20 representative ready to proceed?

21 MR. SAMARAWICKREMA: Nalan Samarawickrema. Yes,
22 we are ready. I'm ready.

23 JUDGE ALDRICH: Okay. Go ahead when you can, and
24 please remember to speak up a little bit so it's easier
25 for Ms. Alonzo to hear.

1 general ledgers or any kind of complete financial
2 statement for the audit period.

3 Appellants claim the Exhibit 7 as a source
4 document in a second paragraph of the Appellants'
5 prehearing conference statements, but those 12 pages are
6 just monthly sales summaries. Department compared the
7 reported total sales to the recorded purchases reflected
8 on Appellants' purchase journals and calculated overall
9 markup of 129 percent. And that will be on your
10 Exhibit D, page 44.

11 Based on the items sold, location of the
12 restaurant, the Department expected to see a book markup
13 of 250 percent or more. Appellants' low book markups
14 raised questions whether Appellants reported all its sales
15 in its sales and use tax returns. Therefore, the
16 Department determined to conduct further investigation by
17 analyzing Appellants' credit card sales and credit card
18 sales ratios for the audit period. Department compared
19 the reported total sales to the credit card sales
20 reflected on Appellants' bank statements and calculated an
21 overall credit card ratio of 79 percent for the audit
22 period. And that will be on your Exhibit A, pages 61 and
23 62.

24 Based on the two-week sales records and the site
25 information, the actual credit card ratio was 56.85. And

1 that will be on your Exhibit A, page 41. The Department
2 also noted that the purchases for year 2014, of around
3 \$200,000 recorded on purchase journals, did not match with
4 the purchases claim on the 2014 federal income tax return
5 of around \$89,500. Appellants did not report 124 percent
6 of its purchases on 2014 federal income tax return. And
7 that will be on your Exhibit A, pages 59 and 60.

8 Both federal income tax return, Appellants
9 reported the net profit around \$5,000 for year 2014. And
10 that will be on your Exhibit A, page 51. Appellants
11 understated his purchases by around \$111,000 for year
12 2014. And that will be on your Exhibit A, page 59. If
13 Appellants included these understated purchases and
14 recompute net losses on 2014 federal income tax return,
15 then the net profit of \$5,000 will become a net loss
16 around \$106,000. Thus, it appears that the Appellants'
17 federal income tax return was incomplete and unreliable.

18 The Department rejected Appellants' reported
19 taxable sales due to lack of reliable records, continuous
20 losses, low book markups, and high credit card ratios. It
21 was also determined that the Appellants' records was such
22 that a sale cannot be verified by a direct auditor
23 approach. Therefore, the Department estimated sales using
24 credit card sales approach for the audit period.

25 The Department requested, including cash register

1 z-tape and credit card receipts for two-week period for
2 October 23rd through November 5th, 2015, to verify the
3 reported credit card sales ratios and average reported
4 daily sales for the audit period. These two weeks of
5 sales records are outside of the audit period. To verify
6 the accuracy of the two-week sales records, the Department
7 performed a one-day observation test of Appellants' sales
8 activities on Friday, November 6, 2015, from 9:00 a.m. to
9 4:30 p.m.

10 The Department determined that the credit card
11 sales percentage observed during the observation test was
12 in line with other days of the two weeks. Therefore, the
13 Department concluded that the two-week sales records were
14 complete and reliable. Thus, the Department combined the
15 two-weeks sales records and the site test information to
16 compute audited credit card sales ratios. And that will
17 be on your Exhibit A, pages 41 and 42.

18 The Department noted that the sales tax rate was
19 8 percent during audit period, except fourth quarter 2012
20 when the rate was 7.75. On Exhibit A, page 41, you can
21 see that the Department calculated two separate credit
22 card ratios. One for each tax rate appears on the
23 two-week sales records and sitor's information. The
24 credit card ratio developed for the 7.75 tax rate computed
25 to be 56.72 percent. The credit card ratio developed for

1 the 8 percent computed to be 56.85.

2 Appellant did not provide any evidence such as
3 that the condition in October and November 2015 was
4 significantly different than the condition during the
5 audit period. Department also computed average daily
6 sales for two weeks before and after the two-week sales
7 record using taxpayer's -- Appellants' Exhibit 7 and
8 computed to be little over 1,100 from October 9th through
9 October 22nd, 2015, and little less than 1,300 from
10 November 7th through November 20th, 2015. Based on the
11 two-week sales records for the test period, the average
12 daily sales were \$1,857.

13 Also, sales recorded on other Fridays were
14 significantly lower than three Fridays of the test period.
15 And that will be on your Exhibit 7, page 2 and 3, and
16 Exhibit 1, page 58. Therefore, the Department rejected
17 the recorded sales on Exhibit 7, except for the recorded
18 sales from October 23rd, 2015, through November 6th, 2015.
19 Appellant provided bank statement for the audit period
20 except December 12th and third quarter 2015. The
21 Department used the bank statement to compute Appellants'
22 credit card sales for the audit period.

23 To account for the missing four months credit
24 card sales, the Department estimate average credit card
25 sale of \$27,147 instead of 32-month average of \$29,639 to

1 give an average benefit of \$2,492 to the Appellant. And
2 that will be on your Exhibit A, pages 49 and 50. Then the
3 credit card sale for the audit period were divided by the
4 audited credit card sales ratios to estimate audited
5 taxable sales. Audited taxable sales were compared with
6 reported taxable sales to compute unreported taxable sales
7 for the audit period. And that will be on your Exhibit A,
8 page 40.

9 Appellant provided Exhibit A, page 53, to support
10 nontaxable respados sales from October 23rd, 2015, through
11 November 6, 2015. However, Appellant did not provide any
12 cash register Z-tapes to support these respados sales for
13 the test period. And that will be on your Exhibit D,
14 page 46.

15 For tax return, Appellants claimed exempt food
16 sale of \$80,150. No documentary support was provided to
17 support claimed exempt food sales. During the auditor's
18 observation, Appellant did not sell any respados on a
19 to-go or take-out basis. And it appeared Appellant added
20 sales tax reimbursement to the selling price of all items.
21 And that will be on your Exhibit A, pages 42 and 46.
22 Therefore, no adjustment was made for exempt food sales.

23 Using the audited sales, we know that the
24 Department recalculated Appellants' overall average markup
25 of 223 percent. And that will be on your Exhibit A,

1 page 44. Appellant recorded credit card sales and the
2 site test information and the two-week sales records,
3 considered the best available information to determine the
4 unreported sales tax for the audit period, although, the
5 gross receipts from the sale of food products are
6 generally exempt from sales tax, sale of hot food and sale
7 of food served in a restaurant are subject to tax. That
8 is Revenue & Taxation Code Section 6359.

9 As mentioned earlier, Appellant did not provide
10 complete source documentation such as cash register
11 z-tape. Appellant did not provide complete sales journals
12 or complete financial statement for the audit period. In
13 general, Appellant failed to provide documentary support
14 for its exempt food sales. Department was unable to
15 verify the accuracy of reported taxable sales, all the
16 claimed exempt food sales. Therefore, an alternative
17 audit method was used to determine unreported taxable
18 sales. Accordingly, the Department estimated the
19 unreported sales tax based on the best available
20 information. The evidence shows that the audit produce
21 fair and reasonable results.

22 Finally, Appellants' current shareholders argue
23 that Appellant is not responsible for unreported sales tax
24 for the period October 1st, 2012, through
25 December 16, 2014, because the current shareholders or the

1 Appellants' talked on December 17, 2014. As stated
2 earlier, Appellants obtained a seller's permit on
3 June 6, 2012, which is still active. The evidence shows
4 that on December 17, 2014, ownership stock of the
5 Appellant was sold. And that will be on your Exhibit F.
6 That is Appellants' stock ownership and other related
7 document. On exhibit G, that is Appellants' hardship
8 waiver brief.

9 There's no evidence that the business itself was
10 ever sold. And we are unaware of any provision in the
11 sales and use tax law that would release a corporation of
12 prior understatement by previous shareholders merely
13 because there has been a change of shareholders.
14 Appellants' Exhibit 6 was defined as an application for a
15 new seller's permit. But it is a letter of inquiry the
16 Department mailed to the Appellant on March 10, 2015. And
17 it is not an application for a seller's permit. The
18 Appellant has not provided any reasonable documentation to
19 support an adjustment to the audit finding. Therefore,
20 the Department request the appeal be denied.

21 This concludes my presentation, and I'm available
22 to answer any questions the Panel may have. Thank you.

23 JUDGE ALDRICH: Thank you.

24 Judge Cho, do you have any questions for the
25 Department?

1 JUDGE CHO: This is Judge Cho. Yes, I had a
2 quick question for the Department. For your credit card
3 sales ratio analysis, if you look at your page 41, it has
4 the two different rates: The sales tax rate of 7.75
5 versus sales tax rate of 8 percent. But you used the same
6 underlying data. So it appears to me, and correct me if I
7 am wrong, aren't you -- isn't the Department
8 re-characterizing some of that sales tax reimbursement as
9 now a taxable sale? Because the total sales that were --
10 the total credit card transactions were \$15,042. The
11 total sales with tax included was \$28,574. Your totals of
12 ex-tax because you applied a 7.75 percent rate was at
13 \$26,519.

14 But then you used the exact same data in the next
15 analysis to get at a different credit card sales ratio.
16 So my question to the Department is, shouldn't that be one
17 ratio because it already incorporates the ex-tax to apply
18 to the fourth quarter of 2012?

19 MR. SAMARAWICKREMA: This is Nalan
20 Samarawickrema. The way the audit was, you know, the way
21 we use it, that's the easiest way and the shortest way to
22 compute the taxable sales for the audit period. That's
23 the shortest way. But if you want to go use a long way,
24 that is page -- Exhibit D, page 57 and 58. It shows the
25 way you like to have it by the both numbers. They are the

1 same except for \$5 rounding off. The auditor used in
2 page 49 that's the shortest way to compute, but the number
3 should be the same.

4 JUDGE CHO: This is Judge Cho. So it looks like
5 you're still -- the Department is still applying the
6 different ratios to the fourth quarter 2012. I think my
7 question was, shouldn't there just be one ratio because it
8 already accounts for the tax amount that's actually
9 collected during that observation test period?

10 MR. SAMARAWICKREMA: It depends on how you
11 apply -- I'm sorry. This is Nalan Samarawickrema. It
12 depends on what base you're going to apply. Because in
13 the credit card, you know, we are applying -- the
14 Department is applying the credit card sales to the total
15 credit card, including tax and tips. And because there is
16 the tax change, because for the whole audit period the tax
17 is 8 percent. So for the fourth quarter 2012, the tax
18 percent is 7.75. And that's the reason we -- the
19 Department use two ratios to account for that tax rate.

20 But I know what you're saying, and if you go to
21 page 57, Exhibit A, the highlighted part. We use a one
22 credit card ratio, and we are using -- the Department is
23 using ex-tax base. So the number under Column U is
24 \$686,529 compared to the way the Department was using two
25 credit cards is, like, a \$5 less than that number. So,

1 again, the number is the same. The reason the Department
2 use in page 41 and 40 is the same number of using two
3 different approach. But at the end the Department
4 correctly identified the correct amount of taxable sales
5 on page 40. So there's no mathematical errors on page 40.

6 JUDGE CHO: This is Judge Cho. Thank you for the
7 explanation. That's the only question I had.

8 JUDGE ALDRICH: Judge Wong, do you have any
9 questions for the Department?

10 JUDGE WONG: This is Judge Wong. I have no
11 questions. Thank you.

12 JUDGE ALDRICH: Okay. Appellants'
13 representative, Ms. Sung, would you like to make a final
14 statement, a rebuttal, or further addressing any of the
15 questions that the Judges had?

16 I believe you're muted.

17 MS. SUNG: All right. I'm back. Sorry. So for
18 the Department mentioned that there is no sales journal
19 provided. So there's no formal P&L because they don't
20 really have a bookkeeper. But the sales journal, the
21 handwritten daily sales journal, that was provided at the
22 time of the audit; correct?

23 JUDGE ALDRICH: Sorry. Are you asking a question
24 or making a statement?

25 MS. SUNG: I'm asking the Department 'cause the

1 Department mentioned that there was no sales journal
2 available. There's no financial statement available,
3 therefore, they have to use alternative methods. So was
4 there -- my understanding is that the sales -- the daily
5 sales journal was provided during the audit.

6 JUDGE ALDRICH: Okay. So the Department isn't
7 testifying. So you can't really direct questions at them.
8 They're just making argument based off of the evidence in
9 the record and -- just like you're just making argument
10 based off of evidence in the record. If that's something
11 you want to assert, then that's fine. But as far as
12 directing a question to the Department, I'd ask that you
13 refrain from that.

14 MS. SUNG: Okay. All right.

15

16 CLOSING STATEMENT

17 MS. SUNG: So the sales journal -- daily sales
18 journal was provided during the audit, and that should
19 have been used. As I said earlier that the total sales
20 amount reconciled to the sales tax report, that's reported
21 with the Department, as well as the tax return reported to
22 the IRS. And I'm referring to the period, of course, is
23 the 2015, which is January 2015 through January -- through
24 September 30th of 2015 for that period.

25 As for the final say on the sale of the business,

1 the Appellant purchase the Goodwill, the equipment, the
2 intangible and tangible assets of this restaurant. But
3 the Appellant did not intend to purchase the corporation,
4 and they do not -- they did not understand what that is,
5 okay, as far as buying -- purchasing the stock. It was
6 only when they were trying to transfer these licenses,
7 they did apply to the CDTFA for a seller's permit. That's
8 why there's a letter responding to their inquiry.

9 But then they were told that it's easier if they
10 just change the name with the Secretary of State, and that
11 will be easier to make the transition. So of course, they
12 are unsophisticated. They were basing it off of the
13 information feeding to them from this representative, and
14 that's what they did. Okay. So the intent, again, is to
15 purchase the restaurant, and the restaurant name changed
16 to "Del Mar". While the Las Playas #10, Inc., remained,
17 that's for the tax purposes, which they have no
18 understanding of they change the name to Del Mar. That's
19 under their operation restaurant.

20 So they should -- I understand that there was no
21 record whatsoever for the time period of the fourth
22 quarter of 2012 all the way through the fourth quarter of
23 2014 because that's under the prior -- the seller's
24 operation. So the Appellants provided their books and
25 records, which is a manually-kept books and records, for

1 the last three quarters of the audit period.

2 So we're asking that for the prior period the
3 Department perhaps can go request from the previous owner,
4 the seller, while any decision made for January 15th
5 through September 15th that will be on the Appellant. And
6 for that period because Appellant has sufficient record to
7 substantiate all amounts as reported on the return, and
8 for that it should be no change.

9 And that's my closing. Thank you.

10 JUDGE ALDRICH: Thank you. We have your evidence
11 in the record and your argument in the record. Is there
12 anything else that you'd like to add before I submit the
13 case?

14 MS. SUNG: No. That's all. Thank you.

15 JUDGE ALDRICH: Okay. Thank you both for your
16 time and being flexible with the hearing format. We're
17 ready to submit the case. The record is now closed.

18 The Judges will meet and decide the case based on
19 the evidence and arguments presented today. We will send
20 both parties our written decision no later than 100 days
21 from today.

22 (Proceedings adjourned at 11:48 a.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 8th day of February, 2021.

ERNALYN M. ALONZO
HEARING REPORTER