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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No.: 18011828
	) CDTFA Case ID: 838472
MMD, INC.	)
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:	Faith A. Devine, Attorney Alexandra Baluka, CPA
For Respondent:	Randy Suazo, Hearing Representative Chad Bacchus, Tax Counsel IV Jason Parker, Chief of Headquarters Operations

J. ALDRICH, Administrative Law Judge: On September 7, 2021, the Office of Tax Appeals (OTA) issued an Opinion sustaining a supplemental decision issued by respondent California Department of Tax and Fee Administration (CDTFA). CDTFA's decision reduced the understated measure of tax from $4,032,184 to $2,250,197, which resulted in a reduction to the tax, deleted the negligence penalty, and otherwise denied a petition for redetermination filed by MMD, INC. (appellant) of a Notice of Determination (NOD) dated July 10, 2014. The NOD is for $373,134,89 in tax, plus applicable interest, and a negligence penalty of $37,313.43, for the period January 1, 2010, through December 31, 2012 (audit period).

On October 7, 2021, appellant timely filed a petition for a rehearing (PFR) which set forth the following grounds: there was an irregularity in the appeal proceedings which occurred prior to the issuance of the Opinion and prevented fair consideration of the appeal; there was insufficient evidence to justify the Opinion; and there was an error in law in the appeals hearing. We conclude that the grounds set forth in this petition do not constitute a basis for a new hearing.

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OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the proceedings that prevented the fair consideration of the appeal; (2) an accident or surprise that occurred, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the written Opinion; (4) insufficient evidence to justify the written Opinion; (5) the Opinion is contrary to law; or (6) an error in law that occurred during the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Do*, 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654)[1]

Irregularity in the appeal proceeding

Here, we must determine whether appellant has established that there was an irregularity in the proceedings that prevented a fair consideration of the appeal. (Cal. Code Regs., tit. 18, § 30604(a)(1).) An irregularity in the proceedings warranting a rehearing would generally include any departure from the due and orderly method of conducting the appeal proceedings by which the substantial rights of a party have been materially affected. (See *Jacoby v. Feldman* (1978) 81 Cal.App.3d 432, 446.)

First, appellant claims that the Opinion incorrectly states that the subsequent audit began in 4Q13. Appellant contends this statement is based on the comments of CDTFA's hearing representative (Mr. Suazo) during the hearing. In support of a different start date, appellant provided a copy of the Assignment Activity History, Form 414Z (414Z) for the subsequent audit period to show that it began in July of 2013. Appellant argues that if it had been given the opportunity to have CDTFA's auditor (Mr. Kennard) present as a witness then this fact could have been clarified and would be properly submitted into evidence. Appellant claims that instead, Mr. Suazo was allowed to testify about the audit without evidentiary support which deprived appellant of the right to a fair hearing and resulted in OTA's consideration of incorrect facts.

Second, appellant claims that the Opinion found the subsequent audit to be unpersuasive because appellant moved to a different business location. Appellant claims that this fact is based

[1] As provided in *Appeal of Wilson Development, Inc.*, *supra*, it is appropriate for OTA to look to the Code of Civil Procedure section 657 and applicable caselaw as relevant guidance in determining whether to grant a new hearing.

upon erroneous statements made by Mr. Suazo. To prove that the fact was erroneous, appellant submitted a copy of its January 2014 lease. Once again, appellant argues that if Mr. Kennard had been available for examination, this fact could also have been clarified and properly taken into evidence. Appellant asserts that by allowing incorrect facts to be considered, appellant was deprived of the right to a fair hearing and a fair comparison of the two audits.

Third, appellant claims if it had been able to question Mr. Kennard regarding the subsequent audit then it would have assisted OTA in determining the reasonableness of the audited average sale per customer. Appellant argues that the 2015 Marijuana Business and Investor Survey (2015 Survey) referenced in the Opinion "is pure hearsay, speculative, and not probative in light of CDTFA's 2013-2016 no change audit." In support, appellant provided the Schedule of MMD's POS Daily Sales for February and March 2016 from the subsequent audit. Appellant claims that it was not allowed the full and fair opportunity to present the subsequent audit's findings.

In sum, appellant essentially argues that the denial of appellant's subpoena request of Mr. Kennard and the adoption of unsupported argument from Mr. Suazo was an irregularity in the appeal proceeding which occurred prior to the issuance of the Opinion and prevented fair consideration of the appeal.

In response, CDTFA argues that the 414Z, referenced above, shows that Mr. Kennard was unable to review appellant's records until December 1, 2016, and notes that the statute of limitations had already run on the third quarter of 2013. CDTFA asserts that both the Report of Field Audit, and NOD, which are in evidence, show the subsequent audit period is from October 1, 2013, through September 30, 2016. CDTFA, therefore, argues that appellant's assertion that the subsequent audit period began July 1, 2013, is incorrect. Next, CDTFA asserts that appellant's witness provided testimony that appellant's business location moved.[2] CDTFA argues that according to the hearing transcript, CDTFA's statement that the location closed at the end of December 2013 is consistent with appellant's PFR and the supporting material attached thereto (e.g., the January 2014 lease). Regarding the audited average sales price per customer, CDTFA asserts that the cannabis menu appellant provided in its post-hearing brief supports

[2] Ms. Baluka stated as follows: "I believe that location changed earlier than 2013. I can -- I can verify the exact date, but I believe that it was a bit before" and "I believe it was at the end of the day of 2012, but I would have to – I would have to find the exact date in my records because, I mean, I don't have it in front of me. I can research it further in my files."

CDTFA's position that the average sales price was $50.33. CDTFA also argues that the audit schedules attached to appellant's PFR examined sales, beginning February 12, 2016, for the subsequent audit period, and that CDTFA would expect that the average sales per customer would vary from the audit at issue based on different sales factors.

Since Mr. Kennard's absence at the May 26, 2021 oral hearing is central to appellant's argument, we examine the relevant procedural history. On March 23, 2021, appellant's counsel signed a Request for Subpoena, OTA Form L-04, which was submitted together with a Motion for Discovery. Therein, appellant requested to subpoena Mr. Hastings, the auditor for the audit at issue in this appeal, and Mr. Kennard, the auditor for the subsequent audit period. Appellant stated, "Three months prior to the Appeals Conference [on November 17, 2016], the BOE initiated another audit of Appellants [sic] business for the tax years 2013 to 2016."

On April 26, 2021, CDTFA responded to appellant's subpoena request objecting to the subpoenas based on relevance, materiality, undue burden, and undue consumption of time. Regarding Mr. Kennard, CDTFA wrote:

> [his] thoughts and determinations made during the subsequent audit are all memorialized in the audit workpapers [(AWPs)] for that audit, which the Department has provided to appellant. Surely, Mr. Kennard's contemporaneous notes found in the audit reports are more accurate than his testimony of what transpired several years in the past.

CDTFA also wrote that:

> the subsequent audit . . . did not use the observation test method because many of appellant's business practices had changed. The most significant change happened in the middle of the second audit period when appellant moved its business twice, ending at a new, more profitable, location. The auditor could not perform an observation test at the new location and then project those findings to the period when the business was at the original location (i.e., the fourth quarter of 2013).

After conferring with the parties during the prehearing conference on May 5, 2021, we issued our May 6, 2021 Prehearing Order denying appellant's subpoena requests. In our analysis, we noted that Mr. Kennard was not the lead auditor, author of the audit reports, or author of the AWPs for the audit at issue; therefore, his testimony would likely be repetitive and not helpful. Also, we indicated that the subsequent audit was not before OTA and the Report of Field Audit from the subsequent audit had been submitted by appellant as an exhibit without objection. Pursuant to our May 6, 2021 Minutes and Orders of Pre-Hearing Conference, the

deadline to submit additional exhibits was May 11, 2021. Appellant did not submit additional exhibits (e.g., the 414Z; the January 2014 lease; POS Daily Sales for February and March 2016), request a postponement, or otherwise respond to our May 6, 2021 Prehearing Order. Based on the procedural history, we find appellant's argument regarding an irregularity pertaining to the subpoena request denial of Mr. Kennard to be unfounded.

We now address appellant's assertions that the Opinion improperly relied on CDTFA's argument as if it were testimony. Appellant claims that the panel "assured appellant that it would not consider any statements made by Mr. Suazo." However, a more accurate reading of the hearing transcript shows that the panel clarified the difference between testimony and argument. OTA may consider the arguments raised by either party, whether raised in briefing or at the hearing; however, we will not make a factual finding based solely on unsworn statements or oral argument. Nevertheless, both testimony and argument are part of the oral hearing record. (Cal. Code Regs., tit. 18, § 30102(q).) Evidence for purposes of OTA hearings is defined as any information contained in the oral hearing record that the panel may consider when deciding an appeal. (Cal. Code Regs., tit. 18, § 30102(i).) The California Evidence Code and the California Code of Civil Procedure (CCP) shall not apply to oral hearings before OTA. (Cal. Code Regs., tit. 18, § 30214(f).) Instead, all relevant evidence shall be admissible, and the panel may use the California rules of evidence when evaluating the weight to give evidence presented in a proceeding before OTA. (Cal. Code Regs., tit. 18, § 30214(f)(1), (4).)

In light of this regulatory framework, we consider appellant's claims. The first and second of appellant's claims, as discussed above, involve the start date of the subsequent audit and the change of appellant's business location. While appellant asserts that the panel relied on Mr. Suazo's argument as if it were testimony, we note that the information in the first and second claim is also available in appellant's exhibits. Appellant's Exhibit 1, Report of Field Audit 2013-2016, which was admitted into evidence pertains specifically to the subsequent audit. Therein, we find the following relevant information: appellant's Cahuenga Boulevard business address, which is different from appellant's North La Brea address for the audit at issue; the audit period for the subsequent audit, which is October 1, 2013, through September 30, 2016; and other relevant information. For example, the Report of Field Audit states:

> The [appellant] maintains a single entry set of books and records supported by source documents. The taxpayer maintains books and records in-house using a POS system. Books and records are adequate for Sales and Use Tax purposes.

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> . . . A review of sales invoices indicated that sales tax reimbursement was added to the selling price of taxable sales.

As such, we find appellants first and second claims to be unsubstantiated, and that OTA's finding was supported by admitted evidence.

Regarding appellant's third claim that the 2015 Survey is hearsay, speculative, and not probative in light of CDTFA's 2013-2016 no change audit, we find this argument unpersuasive. The administrative hearsay provision under Administrative Procedures Act section 11513, which limits the admittance of hearsay to supplement direct evidence, is inapplicable to proceedings before the OTA. (Cal. Code Regs., tit. 18, § 30216(d).) Without this limitation, evidence that is admitted without objection is sufficient to sustain a finding. (*Powers v. Board of Public Works* (1932) 216 Cal. 546, 552; *Gallagher v. Connell* (2004) 123 Cal.App.4th 1260, 1268.) Here, the 2015 Survey was properly admitted into evidence without objection. Whether a panel finds evidence to be probative is under the purview and at the discretion of the panel, not a party's counsel. (See Cal. Code Regs., tit. 18, § 30214(f).) Accordingly, we find appellant's third claim is without merit.

Based on the foregoing, we find that appellant has failed to establish that there was an irregularity in the proceedings which prevented a fair consideration of the appeal.

Insufficient Evidence

Next, we address whether appellant has established that there is insufficient evidence to justify the Opinion. (Cal. Code Regs., tit. 18, § 30604(a)(4).) To find that there is an insufficiency of evidence to justify the opinion, we must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, the panel clearly should have reached a different opinion. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P; *Sanchez-Corea v. Bank of America* (1985) 28 Cal.3d 892, 907.)

For the same reasons discussed above, appellant argues that the consideration of the "incorrect facts" in the Opinion demonstrates that there is insufficient evidence to justify the Opinion. CDTFA does not agree; it argues that appellant's PFR is mostly a reiteration of the same contentions made in its opening brief, additional brief, and oral arguments. In addition, CDTFA posits that appellant chose not to include the subsequent audit working papers in its exhibits despite possessing them. CDTFA asserts that it timely submitted evidence of appellant's liability throughout the briefing process.

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During the appeals proceeding, CDTFA submitted the AWPs, the reaudit workpapers, the NOD, the documentation on the Statewide Compliance and Outreach Program Lead, as well as other evidence to support its position. We agree that appellant's PFR reiterates arguments that were heard, but nevertheless rejected, by the panel in the underlying appeal. Appellant's attempt to reargue an issue that we have already considered and decided are not grounds for a hearing. (*Appeal of Graham and Smith*, 2018-OTA-154P.) Moreover, appellant could have submitted additional documentary evidence regarding the subsequent audit after the denial of appellant's subpoena requests, yet it elected not to. Based on the foregoing, we find that appellant has failed to establish that there was insufficient evidence to justify the Opinion.

Error in Law

Finally, we must determine whether appellant has established there was an error in law that occurred during the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(6).) As stated in CCP section 657, an error in law "occurring at the trial and excepted to by the party making the application," is grounds for a new trial. This includes situations where, for example, the trial court made erroneous evidentiary or procedural ruling. (See, e.g., *Donlen v. Ford Motor Co.* (2013) 217 Cal.App.4th 138; *Ramirez v. USAA Casualty Ins. Co.* (1991) 234 Cal.App.3d 391.) It must be "reasonably probable" that the party moving for a new trial would have obtained a more favorable result absent the error. (See, e.g., *Saxena v. Goffney* (2008) 159 Cal.App.4th 316; *McCoy v. Pacific Maritime Assn.* (2013) 216 Cal.App.4th 283.) "'Reasonable probability' does not mean 'more likely than not'; it means merely a 'reasonable chance, more than an abstract possibility.'" (*Martin–Bragg v. Moore* (2013) 219 Cal.App.4th 367, citing *College Hosp. Inc. v. Superior Court* (1994) 8 Cal.4th 704, 715.)

Appellant argues that OTA's denial of appellant's right to examine Mr. Kennard, the panel's consideration of Mr. Suazo's statements made during the hearing, and CDTFA's failure to provide written evidence supporting its statements about the subsequent audit constitute an error of law that should be corrected at a rehearing. Appellant claims that this error can be corrected by allowing a limited examination of Mr. Kennard to ascertain the correct facts surrounding his audit that are relevant, probative, and helpful to the panel in reaching a decision on whether the observation test and the $50.33 average sales price per customer are reasonable.

In response, CDTFA asserts that appellant has not argued that there was a procedural error made in the hearing. CDTFA argues that appellant's disagreement with the findings

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contained in the Opinion is an argument that there is insufficient evidence to justify the Opinion. As such, CDTFA claims there is no evidence that there was an error in law.

Although appellant argues that there was an error in law regarding the subpoena request denial, our review of the procedural history associated therewith does not support appellant's argument. There is no statutory or regulatory right to subpoenas in an appeal before OTA. Instead, unless otherwise provided by law, any use of a subpoena in an appeal before OTA must be approved by the panel. (Cal. Code Regs., tit. 18, § 30214(e).) OTA, in its discretion, *may* allow issuance of a subpoena for good cause. (Cal. Code Regs., tit. 18, § 30214(e).) In denying the subpoena request, we found that appellant failed to establish good cause. Since we determined that appellant failed to establish good cause, our order denying the request was not an error. For reasons already discussed, we also find appellant's claim that the panel erroneously relied on Mr. Suazo's statements to be unsubstantiated. Lastly, there is no evidentiary ruling or procedural matter in the record that would have prevented appellant from submitting the AWPs from the subsequent audit or other evidence regarding the average sales price per customer prior to the issuance of the written Opinion. We, therefore, find that appellant has failed to establish an error in law.

For the foregoing reasons, we find that appellant has not established grounds for a rehearing.

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

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Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
3CADA62FB4864CB...
Andrew Kwee
Administrative Law Judge

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