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

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
For Office of Tax Appeals:	Lisa Burke, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 and California Code of Regulations, title 18, section 35019, MMD, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),[1] denying appellant's petition for redetermination of the Notice of Determination (NOD) dated July 10, 2014. The NOD is for tax of $373,134.89, applicable interest, and a negligence penalty of $37,313.43 for the period January 1, 2010, through December 31, 2012 (audit period).

Subsequently, CDTFA 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 the appeal.

[1] Sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

Office of Tax Appeals (OTA) Administrative Law Judges Sheriene Anne Ridenour, Huy "Mike" Le, and Josh Aldrich held a virtual oral hearing for this matter on May 26, 2021. At the conclusion of the hearing, the record was held open for additional briefing. The record closed and the matter was submitted for decision on June 23, 2021.[2]

ISSUE

Are additional adjustments to the audited understatement of reported taxable sales warranted?

FACTUAL FINDINGS

1. Effective May 9, 2007, appellant obtained a seller's permit to operate a medical cannabis dispensary in Los Angeles, California, selling cannabis products, pipes, bongs, and other accessories.
2. During the audit period, appellant filed sales and use tax returns reporting total sales and taxable sales of $777,164.[3]
3. On May 25, 2011, CDTFA's Statewide Compliance and Outreach Program (SCOP) staff visited appellant's 1,200 square foot business location. SCOP staff observed three purchases in fifteen minutes. In the Memorandum of Possible Tax Liability prepared by SCOP (SCOP Memo), CDTFA noted that menu prices were available on a flat screen above the counter and a menu was posted online, and that it observed the various prices as follows: thirty-six (36) cannabis strains averaging $20 per gram or $400 per ounce; hash from $15 to $40 per gram; and edibles starting at $4 to $15. CDTFA also observed a display case with glass pipes, tobacco paper, and vaporizers individually priced. According to the SCOP Memo, appellant had eight employees and offered free bongs and

[2] Our May 28, 2021 Post-Hearing Order held the record open to give appellant an opportunity to submit a copy of its menu(s) during the audit period and provide additional documentation relating to sales that included a free vaporizer or bong. Appellant provided a copy of its menu and indicated that there were no sales large enough for a free vaporizer or bong during the audit period. The record was also held open for CDTFA to provide a copy of appellant's sales and use tax transcript for the 2010 and 2011 tax years, which CDTFA provided.

[3] Appellant asserted that its reported taxable sales for the first quarter of 2011 (1Q11) should be increased by $50,355, because appellant had inadvertently excluded the measure of tax represented by its prepayments of $4,909 for January 2011 and February 2011 from the amounts it reported on its sales and use tax return for 1Q11. Based on prepayment information recorded in its Integrated Revenue Information System, CDTFA agreed to increase reported taxable sales by $50,355, from $777,164 to $827,519, in its computation of unreported taxable sales in the reaudit.

vaporizers with a $350 donation. The SCOP Memo indicated that the reported taxable sales would not cover the overhead costs, which warranted additional investigation.

4. SCOP conducted two one-hour observation tests outside of the business premises. On Monday, October 1, 2012, SCOP observed no patients or customers (customers) entering the business premises between 12:12 p.m. and 1:12 p.m. On Thursday, October 4, 2012, SCOP observed seven people entering the business premises between 10:45 a.m. and 11:45 a.m. SCOP observed six people leave with white bags. Estimating seven customers per hour making purchases of 1/8th ounce of cannabis product or $45 each, SCOP estimated annual taxable sales of $1,146,000, which substantially exceeded appellant's reported taxable sales of $272,353 for 2010 and $236,382 for 2011.[4] Therefore, SCOP referred the case to CDTFA's Culver City District for audit.
5. For audit, appellant provided its federal income tax return (FITR) for 2010, daily sales summaries for 2011, business bank statements, and handwritten sales tickets for the audit period.
6. On the FITR for 2010, appellant reported gross receipts of $227,359, reported no costs of goods sold, and deducted expenses of $229,594, which resulted in a net loss of $2,235. Appellant's reported gross receipts were less than its claimed expenses.
7. CDTFA used the daily sales summaries for 2011 to compile recorded total sales of $290,951, which exceeded appellant's reported total sales of $236,382 for that year by $54,569. During the audit, appellant provided no explanation for the discrepancy.[5]
8. To test the accuracy of appellant's sales summary, CDTFA compiled the sales tickets provided by appellant for a one-day test on January 2, 2011 (one-day test), in numerical sequence and found that 31 sales tickets were missing for that day. Appellant explained that the missing sales tickets were used for non-sale purposes (e.g., recording purchases, logging inventory, and keeping miscellaneous notes). CDTFA noted that none of the sales tickets for the one-day test showed sales for $60 or more. Sales of $869 shown in

[4] If the SCOP staff had estimated 3.5 customers per hour based on the combined results of its two hourly observations on October 1, 2012 (0 customers), and October 4, 2012 (7 customers), the resulting estimated taxable sales of $573,300 ($1,146,600 ÷2) per year would still substantially exceed appellant's reported taxable sales for 2010 and 2011.

[5] As noted above, appellant asserted that its reported taxable sales for 1Q11 should be increased by $50,355 to allow for its reporting error, and CDTFA agreed. Therefore, the difference between appellant's recorded and reported sales was $4,214 ($54,569 - $50,355).

the sales tickets provided for January 2, 2011, reconciled with sales recorded in the daily sales summary for that day, but because many sales tickets were unrecorded, CDTFA found that the daily sales summaries could not be relied upon.

9. CDTFA decided to conduct three one-hour observations from a location outside of appellant's business premises based on several concerns (e.g., federal raids, crime targeting dispensaries due to large amounts of cash purportedly kept on site, the odor of cannabis affecting audit staff, and excessive heat during the summer). CDTFA observed nine people entering the dispensary on Wednesday, June 5, 2013, from 11:00 a.m. to 12:00 p.m., four people entering the dispensary on Friday, June 7, 2013, from 1:30 p.m. to 2:30 p.m., and five people entering the dispensary on Wednesday, June 12, 2013, from 2:00 p.m. to 3:00 p.m. CDTFA combined the results of these tests with the results of the observation site test on October 4, 2012, during which seven people entered the dispensary, and computed an audited average of 6.25 customers per hour ((7 + 9 + 4 + 5) ÷ 4 hours).[6] CDTFA stated that the auditors conducting the observation test were unaware that there was rear customer entrance; thus, those customers were not observed.

10. Based on CDTFA's understanding at the time of the audit that appellant's business was open from 10:00 a.m. to 12:00 a.m. every day throughout the audit period, CDTFA computed 98 hours of operation each week (14 hours x 7 days).[7] CDTFA multiplied 98 hours by 52 weeks to compute 5,096 hours of operation per year, and then multiplied 5,096 hours by 6.25 customers per hour to compute that appellant made 31,850 sales per year, on average. Based on its analyses of similar businesses, CDTFA expected that customers, on average, would purchase 1/8 ounce of cannabis during a visit. Using appellant's menu, CDTFA computed that appellant's average selling price for 1/8 ounce of cannabis was $50.33. Based on 31,850 sales per year and $50.33 per sale, CDTFA established unreported taxable sales of $4,809,348 for the audit period, which exceeded reported taxable sales by $4,032,184.

[6] The SCOP staff also performed a site observation test for one hour on October 1, 2012, during which no one entered the dispensary. As discussed below, CDTFA later conceded that the results of that observation test should have been combined with the results of the other four hourly tests to compute the audited average number of people entering the dispensary each hour. Therefore, the audited average number of customers was reduced from 6.25 to 5 per hour ((0 + 7 + 9 + 4 + 5) ÷ 5 hours).

[7] On appeal, CDTFA agreed that appellant's hours of operation prior to November 1, 2011, were from 10:00 a.m. to 8:00 p.m. In other words, appellant operated for 10 hours per day prior to November 1, 2011.

11. CDTFA issued the NOD to appellant on July 10, 2014, based on unreported taxable sales of $4,032,184.

12. On July 25, 2014, appellant filed a timely petition for redetermination. Appellant argued that not every customer purchased product.[8] Appellant provided a self-prepared schedule of 1,004 sales ticket numbers for the 12-day period of January 2, 2011, and January 9, 2011, through January 19, 2011, combined (12-day period). Appellant's schedule represented 556 available sales tickets and 448 missing sales tickets. Appellant argued that it provided sufficient evidence, including two signed affidavits by employees, to explain that the missing tickets were used for: inventory counts, total register counts, ordering supplies, recording lunch purchases, collecting lunch purchases, collecting customers' email addresses, receiving inventory, or logging inventory to convert into marijuana joints.[9] Appellant computed that 45 percent of its sales tickets were not accounted for (448 ÷ 1,004), and appeared to concede that its reported taxable sales were understated by 45 percent. Appellant multiplied the reporting error rate of 45 percent by reported taxable sales of $777,164 and computed unreported taxable sales of $346,782 for the audit period. Appellant also provided federal income tax returns for 2011 and 2012, and general ledgers for 2010, 2011, and 2012. Records regarding vendor purchases were not provided.

13. In its internal appeals process, CDTFA determined that the use of the observation method was warranted because appellant did not use a cash register, all of its sales were cash-only, and the books and records provided for audit were incomplete. CDTFA conceded that the amount of reported taxable sales for the first quarter of 2011 (1Q11) should be increased by $50,355, the average number of sales per hour should be reduced from 6.25 to 5, and the number of hours of operation should be reduced from 14 to 10 for the period January 1, 2010, through October 31, 2011. CDTFA also agreed to reduce the audited average number of sales to allow for one person entering and leaving the business daily without making a purchase. CDTFA calculated $221,341 per quarter for 1Q10 through

[8] Appellant indicated that some customers came to receive a doctor referral, consult, participate in group meetings, or simply window shop.

[9] While appellant computed a total of 1,004 sales tickets (556 + 448), CDTFA computed that the ticket numbering sequence represented 990 sales tickets. Of those, 504 tickets showed the sale of merchandise, 52 tickets were used for other purposes, and 434 tickets were missing or not made available to CDTFA.

3Q11, $281,572 for 4Q11, and $311,689 per quarter for 1Q12 through 4Q12 in the reaudit. In total, CDTFA computed audited taxable sales of $3,107,832, which exceeded appellant's reported taxable sales for the audit period by $2,280,313. Because the audited understatement was substantially reduced and this was appellant's first audit, CDTFA agreed to delete the negligence penalty.

14. In its April 27, 2017 Decision and Recommendation, CDTFA noted an error in computing audited taxable sales for October 2011. To correct the error, CDTFA reduced unreported taxable sales, from $2,280,313 to $2,250,197, deleted the negligence penalty, and otherwise recommended that the petition be denied.

15. In its Request for Reconsideration (RFR) dated May 21, 2017, appellant argued that CDTFA should not have disregarded appellant's records for audit in favor of using the observation test to establish audited taxable sales for the audit period. Appellant contended that the maximum additional sales tax liability for the audit period should not exceed $33,811 or $346,782 in measure.

16. In response to the RFR, CDTFA issued its Supplemental Decision on April 11, 2019, ordering no further reductions to the audited deficiency measure of $2,250,197. This timely appeal followed.

17. On November 21, 2019, appellant provided 231 sales tickets for the six-day period January 3, 2011, through January 8, 2011, and three additional sales tickets for January 2, 2011. On August 12, 2020, CDTFA responded that based on the ticket numbering sequence for the six-day period, 225 sales tickets are missing. CDTFA noted that the three additional sales tickets for January 2, 2011, were not part of the missing sales tickets found in its examination of the ticket numbering sequence for that day.

DISCUSSION

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) "Sale" means and includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (R&TC, § 6006.)

If CDTFA is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession or may come into its possession. (R&TC, § 6481.) It is the retailer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When a taxpayer challenges an NOD, CDTFA has a minimal, initial burden showing that its determination is reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) If CDTFA carries that burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c); Evid. Code, § 115; *Appeal of Estate of Gillespie*, 2018-OTA-052P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.) To satisfy its burden of proof, a taxpayer must prove both (1) that the tax assessment is incorrect, and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Here, appellant was referred for audit after CDTFA's SCOP staff estimated appellant's taxable sales based on its observations and found that appellant's reported taxable sales were likely understated. Upon audit, CDTFA determined that the books and records provided for examination were incomplete and unreliable for several reasons. CDTFA found that the only FITR provided by appellant was unreliable because appellant's reported gross receipts for that year were less than its claimed expenses, with no reported costs of goods sold. During the audit period, appellant did not use a point-of-sale system; rather, it utilized prenumbered handwritten sales tickets that were entered into a daily sales summary. When CDTFA attempted to verify the accuracy of appellant's daily sales summaries, it found that 31 of the sales tickets provided by appellant for a one-day test were missing. CDTFA also noted that none of the sales tickets provided for the one-day test were over $60, even though appellant's menu offered higher-price items (e.g., a free bong or vaporizer with a $350 donation). Appellant explained that it used sales tickets to record purchases, log inventory, keep notes, and other non-sales purposes. CDTFA concluded that appellant's explanation that it used its sales tickets for purposes other than recording sales was not sufficient to support the reliability of the recorded sales. Based on

the foregoing, we find that it was reasonable for CDTFA to conclude that appellant's records were not reliable and to use an alternate audit methodology to establish appellant's taxable sales.

As described above, CDTFA decided to use an observation test to establish audited taxable sales. CDTFA explains that the decision to perform its observations from outside the business location was made after consideration of several factors including risks of federal raids on dispensaries, the targeting of dispensaries for crime due to large amounts of cash purportedly kept on site, and the odor of cannabis affecting audit staff. According to CDTFA, once it had made a decision to perform testing outside the business, it decided to perform tests for one hour each time during daylight hours due to health and safety concerns.

The observations occurred on five different days, none of which was on a weekend. The first two observations occurred during the audit period, performed by SCOP staff. The last three occurred reasonably soon after the end of the audit period (i.e., approximately within six months). The total time of observation was five hours, and in the reaudit, CDTFA computed an average of five customers per hour.[10] We recognize that five hours of observation warrants additional scrutiny because it is far less than the minimum time established by section 0810.30 of CDTFA's Audit Manual (Audit Manual), which now recommends three full observation days to project sales.[11] However, according to CDTFA, and undisputed by appellant, appellant stated that it was opposed to an expansion of the observation test, and thus, there was no remedy to cure the deficiency in the number of hours observed. (See *Appeal of AMG Care Collective*, *supra*, [taxpayers should make timely objections to observation times to allow CDTFA an opportunity to conduct further observations before circumstances change].) We note that the auditor(s) was unaware that there was a rear entrance at the time of the observation tests, and thus those customers were not accounted for during the observation test. We also note that, while CDTFA's observations did not include times after 3:00 p.m. or any weekend hours, there is no evidence that the volume of customers during those times would materially impact the test to

[10] Initially, CDTFA concluded that each person entering the dispensary made a purchase. In the reaudit, however, CDTFA assumed that one person entered the dispensary and left it each day without making a purchase.

[11] At the time the audit was conducted, CDTFA deemed two days to be a sufficient test for a bar or restaurant. CDTFA's procedures, however, were revised in January of 2017. The Audit Manual language regarding observation testing is in Chapter 8, entitled "Bars and Restaurants." (https://www.cdtfa.ca.gov/taxes-and-fees/staxmanuals.htm.)

appellant's detriment. In fact, it is reasonable to expect that there may have been more customer traffic on weekends.[12]

Based on its experience auditing similar businesses in the area, CDTFA estimated that, on average, each of appellant's customers purchased one-eighth ounce of cannabis or the equivalent. CDTFA used the selling prices for one-eighth ounce of 45 different strains of cannabis shown on appellant's menu to compute an average selling price of $50.33 for one-eighth ounce.[13] Appellant argues that CDTFA should have estimated that the average sale to each customer was $24.60 based on appellant's self-prepared schedule, or similar to $27 based on an article entitled "Take a guess, this is how much an average legal user spends on marijuana each year" by Polly Mosendz, Bloomberg News.[14] CDTFA points to a 2015 Marijuana Business and Investor Survey, which shows that the average purchase amount from a dispensary in California was $70, and among seven states, the lowest average purchase from dispensaries was $63 per customer and the highest average was $101. We note that $50.33 sales price stems from appellant's menu and the average sale amount of one-eighth is consistent with other industry related opinions. (See *Appeal of AMG Care Collective*, *supra*.) In the absence of a complete set of sales tickets from which the amount of appellant's average sale could be computed, we find that it was reasonable for CDTFA to estimate that appellant's sales to each customer averaged $50.33 based on the average selling price for one-eighth ounce according to appellant's menu.

Using 10 hours of operation per day from January 2010 through October 2011, and 14 hours per day from November 2011 through December 2012, five sales per hour, and an average sale amount of $50.33, CDTFA computed audited taxable sales of $221,341 per quarter

[12] We note that appellant provided a schedule of a total of 990 sales tickets for January 2, 2011, and January 9, 2011, through January 19, 2011. Of those ticket numbers, 52 represent tickets used for purposes other than recording sales of merchandise, and the remaining 938 are attributable to sales. Appellant's business was open for 10 hours per day during that 12-day period. We compute that the documentation provided by appellant shows 7.8 sales per hour (938 sales ÷ 120 hours). Thus, CDTFA's estimate of five customers per hour based on five hours of observation appears to be conservative.

[13] Upon examination of appellant's menu, submitted pursuant to our post-hearing order, the $50.33 average for 1/8th ounce appears to be accurate [$805 of Indica (55+60+50+55+60+55+55+50+60+55+55+50+45+50+50) + $770 of Sativa (50+55+55+50+45+40+50+50+50+45+45+45+45+50+45+50) + $690 of Hybrid (55+50+50+45+45+50+50+50+45+50+50+50+50+50) = $2,265. $2,265/ 45 (strains) = $50.33].

[14] In its Decision and Recommendation, CDTFA states that, in part, the article states, "Headset Inc., a cannabis intelligence firm, reviewed about 40,000 legal marijuana purchases made in Washington State from September 2014 to July 2016…and found that customers in their twenties spent a median of just $27 per visit to a dispensary but made trips more frequently than other generations…The median spend per trip also increased with age, topping out at $64 for those in their eighties."

for 1Q10 through 3Q11, $281,572 for 4Q11, and $311,689 per quarter for 1Q12 through 4Q12 in the reaudit. CDTFA determined that this alternative audit methodology was necessary because the sales records provided by appellant for examination were incomplete and unverifiable through third party sources since appellant operated a cash-only business and did not provide purchase records (e.g., credit card ratio using Form 1099-Ks or a markup analysis from known vendors). (See R&TC, § 6012(a); CDTFA Audit Manual, §§ 0405.25, 0407.050.)

Under the facts and circumstances presented here, we find that CDTFA met its initial burden when it conducted observation tests for five hourly periods, made adjustments for appellant's actual hours of operations, made adjustments to the average number of purchasing customers per hour to accommodate one customer per day who entered without purchasing, and calculated the average selling price based on appellant's menu. In light of all evidence, we find that CDTFA's determination was reasonable and rational. Thus, the burden shifts to appellant to provide additional documentation or other evidence from which a more accurate determination may be made.

As stated above, appellant provided a self-prepared schedule of sales tickets for January 2, 2011, and January 9, 2011, through January 19, 2011, combined. The average selling price according to the self-prepared schedule is $24.60, which CDTFA considered to be low. CDTFA noted that, during the 12-day period, appellant used 26 books of prenumbered handwritten sales tickets that included a four-digit number followed by ticket numbers 1 through 50, and had no internal controls in place to retain all of the sales tickets. From a sequence of 990 sales tickets, 485 tickets showed sales of product, 19 documented samples of product, and 52 included information to document purchases of goods, purchases of expense items or meals, customer information, voids, etc. The remaining 434 sales tickets from the numbering sequence were missing. Appellant claims that the 434 missing sales tickets were used for purposes other than recording sales of product and provided affidavits in support.[15]

While some of the missing tickets may have been used for purposes other than recording sales, the affidavits do not represent sufficient evidence to support the argument that all of the missing sales tickets were used for purposes unrelated to sales. In appellant's proposed alternative to CDTFA's determination, appellant computed that 45 percent of its sales tickets were not accounted for and suggested that its reported taxable sales were understated by

[15] See Factual Finding 17.

45 percent. However, appellant's proposal that the amount of unreported taxable sales be established by multiplying its reported taxable sales by 45 percent assumes that the sales shown in the available sales tickets were included in its reported taxable sales, and that the sales shown in the missing sales tickets were in similar amounts as the amounts shown in the available sales tickets. Appellant has not provided sufficient evidence to support either assumption. Therefore, we find that appellant has not demonstrated that multiplying its reported taxable sales by 45 percent would result in a more accurate determination.

As another alternative to the observation test used by CDTFA to establish audited taxable sales, appellant proposes using a bank deposit analysis. Appellant provided copies of its bank statements and checks, and prepared an analysis that shows additional taxable sales of $95,057 for the audit period. CDTFA, however, argued that because appellant only accepted cash as payments from its customers, and it is common for businesses that receive substantial cash payments to use cash for operating expenses such as payroll, then there would be no way to independently verify that all of the cash transactions were deposited into appellant's bank account. As an example, CDTFA referred to appellant's payroll records, which show wages declining from $42,729 in 2010 to $37,676 in 2011, and $30,547 in 2012, despite the increase in the hours of operations from ten hours per day to fourteen hours per day. CDTFA argued that it would be unreasonable to accept the payroll records as accurate because it would mean that the employees were working more hours in exchange for less pay. CDTFA also argued that the bank deposit analysis approach would be unreliable based on appellant's failure to provide vendor records as well as records relating to bartered transactions (e.g., accepting a strain of cannabis in exchange for another). Based on the lack of verifiable records, we find that a bank deposit analysis for this business does not provide reliable evidence of appellant's taxable sales.

Additionally, appellant asserts that audited taxable sales for the audit period at issue are substantially higher than its reported taxable sales for the period October 1, 2013, through September 30, 2016, which CDTFA accepted in a subsequent audit. Appellant provided a copy of an audit report for that period dated June 27, 2017, showing that appellant had reported taxable sales of $513,243 for the audit period, and the only deficiency measure established was for the unreported cost of merchandise withdrawn from resale inventory for self-consumption of $78,473. Appellant also argued that since the auditor in the subsequent audit accepted appellant's books and records as adequate, CDTFA should have accepted appellant's books and

records as accurate in the audit at issue. Furthermore, appellant argued that because CDTFA accepted the accuracy of reported taxable sales for the later audit period that are significantly lower than the amount of audited taxable sales established for the audit period at issue, the observation test used for the audit at issue clearly resulted in an overstatement of taxable sales. However, we note that the subsequent audit began in 4Q13, whereas the observation tests were conducted in 4Q12 and 2Q13. While comparing other audits may be helpful in certain situations, we do not find the subsequent audit to be persuasive in this appeal because appellant moved to a different business location between the two audits, appellant's business practices, as well as record keeping practices, changed (e.g., appellant's owners were directly involved in business operations at the beginning, purchase records were provided in the subsequent audit, and a point of sale system was later utilized), and there may have been changes to the industry.

In light of all of the above, appellant has not met its burden of establishing error in the audit procedures or computations and proving a more accurate determination. Accordingly, we find that no additional adjustments to the audited understatement of reported taxable sales are warranted.

HOLDING

Additional adjustments to the audited understatement of reported taxable sales are not warranted.

DISPOSITION

We sustain CDTFA's Supplemental Decision to reduce the audited understatement of reported taxable sales from $4,032,184 to $2,250,197, delete the negligence penalty, and otherwise deny the appeal.

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
Huy "Mike" Le
A11783ADD49442B...
Huy "Mike" Le
Administrative Law Judge

Date Issued: 9/7/2021