

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
LUOSQ, LLC,) OTA NO. 21129287
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 APPELLANT.)
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TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Tuesday, July 26, 2022

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 9:30 a.m. and concluding at 10:47 a.m. on
Tuesday, July 26, 2022, reported by Ernalyn M.
Alonzo, Hearing Reporter, in and for the State
of California.

APPEARANCES:

Panel Lead: ALJ KEITH LONG

Panel Members: ALJ JOSHUA ALDRICH
ALJ ANDREW KWEE

For the Appellant: HONG YE

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

NALAN SAMARAWICKREMA
KEVIN SMITH
JASON PARKER

I N D E X

E X H I B I T S

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California; Tuesday, July 26, 2022

9:30 a.m.

JUDGE LONG: We are now going to go on the record.

This hearing is for the Appeal of Luosq, LLC, OTA Case Number 21129287. The date is Tuesday July 26, 2022, and it's approximately 9:30 a.m. This hearing is being held electronically.

I am lead Administrative Law Judge Keith Long, and with me today is Judge Josh Aldrich and Judge Andrew Kwee. We'll be hearing the matter this morning. I'm the lead ALJ, meaning I'll be conducting the proceedings, but my co-panelists and I are equal participants. And we will be all reviewing the evidence, asking questions, and reaching a determination in this case.

Will the parties please state your name and who you represent for the record, beginning with Appellant.

MR. YE: My name is Michael Ye. I'm representing the taxpayer.

JUDGE LONG:

MR. SAMARAWICKREMA: Nalan Smarawickrema, Hearing Representative for the Department.

MR. PARKER: Jason Parker, Chief of Headquarters Operations Bureau with CDTFA.

MR. SMITH: Kevin Smith from the Legal Division with CDTFA.

JUDGE LONG: Thank you.

Today we're covering the issues of whether Appellant has shown that any further reduction to the amount of unreported taxable sales is warranted; and whether Appellant was negligent.

CDTFA has submitted Exhibits A through I, which are admitted into evidence with no objection.

(Department's Exhibits A-I were marked for identification by the Hearing Officer.)

We will begin with Appellant's opening presentation.

Mr. Ye, you have up to 15 minutes, and you may begin whenever you're ready.

MR. YE: I'm ready. Excuse me just one second. Let me close the door. One second. Sorry for that. I apologize for that. Okay. Can I start?

JUDGE LONG: Yes, you may begin.

MR. YE: Okay. Thank you.

PRESENTATION

MR. YE: Taxpayer operated a buffet restaurant. CDTFA started out and requested records for the audit. We provided the records for the audit. And after CDTFA takes

two observation tests, CDTFA decided to impeach the records, not to accept the records, and use the observation test as their basis to establish the audit tax liability.

Now, our position is that the two observation tests CDTFA did were too short. Just not representative at all. Okay. CDTFA clearly did not follow the requirements of the Audit Manual. Audit Manual clearly stated that one-day test may be used as a preliminary examination to verify accuracy and/or reliability of the records provided by the taxpayer at the start of the audit or to verify the reliability of the records provided by the taxpayer during the audit. If the preliminary test reveals a material discrepancy, auditor may use the test as a basis to impeach the records. However, the test cannot be used to project sales without expanding the period to a full three days.

Now, the two observation tests that CDTFA did was way too short. As I indicated in the response to the Department and to the Appeals Bureau, we can see that the CDTFA did one test on September 12th, 2018, for lunch sales as the tests started from 12:20 p.m. to 1:30 p.m. Now, for the other tests, which is for the dinner sales, CDTFA did it on September 22nd, 2018, started from 6:30 p.m. to 8:15 p.m. So as you can see, the two test

are way too short, and they are not in-line with the requirement of the Audit Manual.

Now, CDTFA based on the results of the two tests, you know, impeached the taxpayer's records. In other words, CDTFA decided not to accept the records we provided for the audit. We do not agree with it because we don't think the test that they did was reasonable, was long enough to give them the basis for impeaching the taxpayer's records. So after the audit was completed by CDTFA, we filed an appeal with the Appeals Bureau. And the Appeals Bureau made a recommendation to revise the original audit.

As you can see from the records, the adjustment -- I think the adjustment recommended by the Appeals Bureau -- okay. Decreasing the taxable audit measure from 2 -- about \$2.4 million to \$1.2 million, roughly. In other words, the original audit that the CDTFA did was not reasonable, was not fair at all. Okay. When CDTFA claims that the first audit -- the original audit they did was fair, and by using the best available information available to CDTFA, this is not the case here, okay, you know, as evidenced by the decision and recommendation made by the Appeals Bureau. So when CDTFA claims that the audit they did is representative, it may not be the case.

Now, we filed a reconsideration request to the Appeals Bureau after the Appeals Bureau made the recommendation to reduce the taxable measure \$2.4 million, roughly, to about \$1.2 million. We agreed with the audit approach recommended by the Appeals Bureau, which is using the audited daily sales instead of credit card cash percentage method that the CDTFA did originally. But we do not agree with the way that the average daily sales was calculated.

Again, as you can see from my previous request, the way that the Appeal Bureau recommended to calculate the daily sales was to use the observed sales for lunch on Wednesday and dinner sales -- their dinner sales for Saturday, and then put them together to calculate the daily sales. And then they moved on to estimate the -- the, you know, their audited sales for the audit period. Now, our position is that it is not fair to use a Saturday dinner sale for calculating the daily sales for Wednesday. I mean, the lunch hour was, say, observation was the busiest hours of the day -- I mean, of the lunchtime. And also with the observation they did for dinner sales was also the busiest hours of the dinner. And they used that to calculate the daily hour sales for lunch and for dinner.

Now, talking about the proof of burden, who has

the proof of burden to explain the basis for the tax deficiency? Okay. In this case, you know, as you can see the audit approach and the method they calculated the daily sale, which they used as a basis to establish the audit sales clearly was not reasonable. Okay. When CDTFA assessed tax liability, it is not reasonable. The burden of proof does not shape the taxpayer to prove that the assessed deficiency is not right. Okay.

There was a court case explaining how, you know, the burden of proof shifts between taxpayer and the CDTFA. Okay, mainly stating that when CDTFA's explanation appears reasonable, the burden of proof shifts to taxpayer to explain why the CDTFA asserted deficiency is not valid. In this case, the CDTFA's audited approach and the results are not reasonable. So that, you know, the burden of proof to show that the assessment of tax deficiency is not right, does not shift to the taxpayer.

That's all.

JUDGE LONG: Thank you, Mr. --

MR. YE: Oh, can I add something? Okay. I'm sorry. Let me add something here, okay?

CDTFA claims that the taxpayer failed to provide the records and documentation to support maximum daily sales that they calculated were excessive. Well, taxpayer provided the records at the beginning of the audit to show

how much their sales were. I mean, CDTFA decided to, you know, not accept the records. So taxpayer did provide the records to prove that the assessed liabilities are excessive. CDTFA decided not to use taxpayer's records.

That's all.

JUDGE LONG: Thank you, Mr. Ye.

Before we move to CDTFA's presentation, I would like to open it up to my co-panelists to see if they have any questions, beginning with Judge Aldrich.

JUDGE ALDRICH: Good morning. I don't have any questions at this time. Thank you.

JUDGE LONG: Thank you Judge Aldrich.

And, Judge Kwee, do you have any questions?

JUDGE KWEE: Hi. This is Judge Kwee. Yes, I did have a question or two. So the last point that he had mentioned was the September 2018 guest check data that you provided to -- or that Appellant had provided to CDTFA. You were mentioning that CDTFA did not accept those records. And my understanding was that CDTFA did not accept them because the guest checks were missing numbers, and those numbers, for example, correlated to cash sales because CDTFA had an undercover auditor come in on two separate occasions, and they received a guest check number. And when they cross referenced that with the -- with the September 2018 total guest checks provided by the

taxpayer, those two guest checks were not there.

And I was wondering from Appellant's perspective, do you agree that they were missing cash sales in the data provided to CDTFA, or do you have an explanation for why they're not there?

MR. YE: Well, yes. Yes. I -- I do agree that some of the guest checks were missing. I don't know how many were missing based on the test that CDTFA did. What my position is -- okay. If the CDTFA found out that some of the guest checks were missing, they should have expanded the test so that the test they did was fair and reliable. Okay. All the information they got by doing the observation test was from such a short test. Okay.

They failed to expand the test as required by the Audit Manual to at least one day to impeach the records or at least three days to yield it as a basis to project sales. CDTFA failed to do the appropriate tests required by the Audit Manual. So we don't know how many guest checks were missed for the audit period. Maybe a few were missing during the observation test, but who knows how many were missing. I mean, if CDTFA, you know, decided they found out that some guest checks were missing, they should have expanded the test so that they can get full records and results for their test.

JUDGE KWEE: Thank you. And I had another

question. So, you know, this -- what they did do, CDTFA used their prices from the menu in September 2018. Do you agree that the prices were the same throughout the audit period, or do you have a position on whether the prices changed at all during the audit period?

MR. YE: Well, I don't know of any -- know of any price changes during the audit period. So I'm okay with that.

JUDGE KWEE: Okay. Thank you.

Judge Long, I don't have any further questions at this time. So I'll turn it back to you.

JUDGE LONG: This is Judge Long. Thank you.

I don't have any questions at this time.

CDTFA, you may begin your presentation. You have 20 minutes. You may start whenever you're ready.

MR. SAMARAWICKREMA: Thank you, Judge.

PRESENTATION

MR. SAMARAWICKREMA: This is Nalan Smarawickrema.

Appellant is a California limited liability company that operated a buffet-style restaurant serving Chinese food in Lynwood, California. The restaurant had a seating capacity for 150 to 180 customers and was open daily.

The Department audited Appellant's business for

the period April 1st, 2015, through November 30th, 2018. During the audit period, Appellant reported taxable sales of around \$2.4 million. And that will be on your Exhibit B, page 62.

During our presentation we will explain why the Department rejected Appellant's reported taxable sales; why the Department used an indirect audit approach; and how the Department determined Appellant's unreported sales tax for the audit period; and why the Department recommended a negligence penalty for this Appellant.

During the audit Appellant failed to provide complete sales records. Appellant did not provide complete documents of original entry, such as guest checks, cash register receipts, and credit card sales receipts for the audit period. In addition, Appellant failed to provide complete purchase invoices or purchase journals for the audit period. The Department did not accept Appellant's reported taxable sales due to lack of reliable records, low reported book markups, high credit card sales ratios, and high rent ratios.

It was also determined that Appellant's record was such that sales could not be verified by a direct audit approach. Therefore, the Department determined audited sales using average daily sales method instead of other audit methods, including credit card sales ratio

method, guest check purchase method, and rent ratio method for the audit period, just to give a benefit to Appellant. The Department completed five verification methods to evaluate the reasonableness of Appellant's reported taxable sales.

First, the Department reviewed 36 months of Appellant's available bank statements, which disclosed Appellant did not deposit any of his cash sales into its bank for 31 months or the 36 months. And that will be on your Exhibit C, pages 163 and 164. The Department also compared the net bank deposits of around \$1.8 million with cash deposits of around \$30,000 reflected on Appellant's available bank statements and calculated an overall cash deposit percentage of around 2 percent for this period. And that will be on your Exhibit C, pages 163 and 164.

Second, the Department reviewed Appellant's federal income tax return and noted low recorded net income of around \$6,500 for year 2015, \$9,000 for year 2016, and \$13,000 for year 2017. And that will be on your Exhibit C, page 166. The amounts claimed for wages also appeared low for a business operating seven days a week. And that will be on your Exhibit C, page 166. Therefore, the Department determined that the amount of total sales and claimed total expenses are understated.

Third, the Department compared reported taxable

sales of around \$2 million for the cost of goods sold of around \$800,000 reflected on Appellant's available federal income tax returns and calculated an overall reported bookmark up of around 149 percent. And that will be on your Exhibit C, page 166. However, based on the items sold, menu prices, customer base, and the location of the restaurant, the Department expected to say a higher bookmark up than the reported bookmark up for a buffet-style restaurant.

Fourth, the Department compared reported sales of around \$2 million to the rent of \$675,000 reflected on Appellant's available federal income tax returns and calculated overall rent ratio of 34 percent. And that will be on your Exhibit C, page 166. Based on these high rent ratios, the Department determined that Appellant did not report all its sales in its sales and use tax returns. Based on his experience in audit of a similar restaurant in Appellant's area, the Department expected to see a rent ratio of 8 percent to 15 percent for this type of restaurant. However, based on the audited sales, the overall rent ratio was around 23 percent. And that will be on your Exhibit A, page 36.

Fifth, Appellant did not provide complete sales information for the audit period. Therefore, the Department obtained Appellant's credit card sales

information for the period April 1st, 2015, through December 31st, 2017. And that will be on your Exhibit C, page 163. The Department compared the reported total sales to the credit card sales and calculated an overall total credit card sales ratio of around 80 percent, ranging from as low as 72 percent to as high as 88 percent for the period April 1st, 2015, through December 31, 2017. And that will be on your Exhibit C, page 159.

Based on his experience in audit of a similar restaurant in Appellant's area, the Department determined this is a high credit card sales ratio for this restaurant. This is an indication that not all of Appellant's cash sales transactions had been reported in its sales and use tax return for the audit period. In contrast, based on the short observation test information, the calculated credit card sales ratio is around 41 percent, which the Department determined to be a more reasonable credit card sales ratio. And that will be on your Exhibit C, pages 149 and 150.

Appellant was unable to explain the reason for low cash deposit percentage, low reported net income, low reported book markups, and high reported rent ratios, and high reported credit card sales ratios. Therefore, the Department conducted further investigation by analyzing Appellant's credit card sales, credit card sales ratios,

and credit card tip ratio, and average daily sales. The Department requested Appellant to provide the sales information for September 2018. And that will be on your Exhibit C, pages 154 and 155.

The Department made controlled purchases on Wednesday, September 12, 2018, and Saturday, September 22nd, 2018, to verify the completeness of the September 2018 sales information. And that will be on your Exhibit C, page 70. The Department also observed the business' activities on September 12, 2018, and on September 22nd, 2018, and noted a credit card sales ratio of 31.2 percent for September 12, 2018, and 49.13 percent for September 22nd, 2018. And that will be on your Exhibit C, pages 149 and 150.

The Department also noted average hourly lunch sales of around \$320, an average hourly dinner sale of around \$270. And that will be on your Exhibit C, pages 149 and 150. And the Department determined the audited credit card sales ratio of 40 percent, an average audited daily sale of \$208. And that will be on your Exhibit C, pages 149 and 150. The Department reviewed the September 2018 guess checks provided by Appellant and noted that the guest checks for each controlled purchase were not there. The Department, thus, determined not to use the September 2018 guess checks to --

JUDGE LONG: Excuse me. Sorry for the interruption.

Mr. Ye, would you please mute your microphone. Thank you.

JUDGE LONG: CDTFA, please continue.

MR. SAMARAWICKREMA: The Department, thus, determined not to use the September 2018 guest checks to establish an audited credit card sales ratio and average daily sales.

The Department attempted to schedule an observation test during October and November 2018. However, Appellant's representative was either unavailable or requested an extension and was not able to arrange observation days. And that will be on Exhibit A, page 15 and Exhibit C, pages 129 and 134. Therefore, the Department was unable to perform a three-day observation test due to the business closing down on November 30th, 2018.

Therefore, the Department evaluated the audited taxable sales for the audit period using three different methods: First, determining audited taxable sales using credit card sales ration of around 40 percent. And that will be on your Exhibit C, pages 147 to 151. Second, determining using taxable sales using average daily sales of around \$2,800. And that will be on your Exhibit A,

page 30. The third, determining audited taxable sales using guest check purchases. And that will be on your Exhibit A, page 35 and Exhibit C, page 102.

These methods determined audited taxable sales of around \$4.8 million from the first method, \$3.6 million from the second method, and \$4.8 million from the third method. And that will be on your Exhibit A, pages 30 and 35 and Exhibit C, pages 147 to 152. Therefore, the Department based the audited taxable sales for the audit period on the second method, average daily sales for the audit period. And that will be on your Exhibit A, page 30. This audit approach reduced Appellant's audited taxable sales by around \$1.2 million. And that will be on your Exhibit A, pages 34 and 35.

Ultimately, the Department decided to use an audit method which yield the lowest deficiency measure to give a benefit to the Appellant. The Department then compared the audited taxable sales of around \$3.6 million with reported taxable sales of around \$2.4 million to determine unreported taxable sales of around \$1.2 million for the audit period. And that will be on your Exhibit A, page 13.

The Department then compared the unreported taxable sales with the reported taxable sales of around \$2.4 million to calculate the error rate of around

50 percent for the audit period. And that will be on your Exhibit A, page 30. The Department analyzed Appellant's available sales and business expense information to verify the reasonableness of audit finding.

During the audit Appellant provided only its federal income tax returns for years 2015, 2016, and 2017. Appellant did not provide any other documents of original entry such as cash register tapes, purchase invoices, wage information, insurance information, and other business expense details for the audit period. Therefore, to compute average daily business expenses, the Department relied on reported expenses on Appellant's federal income tax returns. And that will be on your Exhibit A, page 36.

The Department reviewed Appellant's available federal income tax returns and noted wages and wage-related expenses were not accurately reflected in Appellant's federal income tax return. And that will be on your Exhibit A, page 36. The Department also found Appellant did not report enough daily sales to cover its actual daily expenses. Also, the ratio of reported daily expenses to reported daily sales was 99 percent. And that will be on your Exhibit A, page 36.

This shows that Appellant's reported daily sales are not sufficient to cover its actual daily expenses for these years. This is an indication that Appellant did not

report all its sale on its sales and use tax returns for these years. Similar analysis was made comparing reported daily expenses to average audited daily sales. In 2015 the ratio of daily expenses to audited daily sales was 61 percent. In 2016 it was 69 percent, and in 2017 it was 70 percent. Based on these analyses, the Department concluded that the audited taxable sales were reasonable. And that will be on your Exhibit A, page 36.

Appellant believes that the way the average daily sales computed by the Department are overstated because the Department considered Appellant's sales during off-peak hours are the same as his sales during peak hours. Appellant also contends that the Saturday dinner hours may be the busiest hours of the week. And thus, using observation dinner sales which took place during peak hours on a Saturday to compute average daily sales also overstated the audited average daily sales. The Department acknowledge that Appellant's sales during off-peak hours could be less than the sales observed during peak hours, but there are other factors that could offset this variance.

The Department observed lunch sales on Wednesday computed at around \$320 per hour, and that the observed dinner sales on Saturday computed at around \$270 per hour. The Department, thus, reject Appellant's argument that its

Saturday dinner hours were the busiest hours of the week.

The minutes and orders of prehearing conference dated July 6, 2022, requested the parties to address Footnote 11 of Department's supplemental decision. Footnote 11 supports that the third quarter of a restaurant business is slower as shown in the Appellant's own reporting. Footnote 11 correctly stated Appellant's reporting amounts. The short observation test took place in September, 2018, in general, a slow month for restaurants. It is also at the end of the audit period and just two months before the close of business.

Therefore, the Department determined that Appellant's sales during the earlier part of the audit period are higher than its sales during September 2018 when the short-observation test took place. The Department also notes that the purpose for computing average-daily sales without making any adjustment for sales made during off-peak hours was to determine if the audit result derived from other audit approaches, including credit card sales ratio approach, rent ratio approach, and guest check purchase approach were reasonable.

To date Appellant has not provided any documentary evidence to support that the daily sales of \$208 are excessive. For these reasons, the Department

will not give any weight to the fact that the reported fourth quarter sales in 2015 and in 2016 were either stable or less than the third quarter sales in determining whether the audit method was reasonable. The audit calculation of unreported taxable sales based on the average daily sales were reasonable and was in Appellant's favor since it was the difference determined.

As mentioned earlier, Appellant did not provide complete source documentation such as complete guest checks, cash register receipts, credit card sales receipts. Appellant also did not provide complete purchase invoices. Appellant failed to provide documentary evidence to support its taxable sales for the audit period. The Department was unable to verify the accuracy of reported sales tax using a direct audit method. Therefore, an alternate audit method was used to determine unreported sales tax. Accordingly, the Department determined the unreported sales tax based upon the best available information. The evidence shows that the audit produced fair and reasonable results.

Finally, the Department imposed a negligence penalty based upon its determination that Appellant's books and records were incomplete and inadequate for sales and use tax purposes, and because Appellant failed to accurately report its taxable sales. Specifically,

Department noted that Appellant provided limited records for the audit period, and Appellant failed to provide documents of original entry to support its reported sales tax liability.

The Department also notes that it specifically requested Appellant to maintain and provide all of the guest checks for September 2018 for review, but Appellant still provided incomplete guest checks, which is clearly evidence of negligence. As a result, the Department had to compute Appellant's taxable sales based upon short observation tests. In addition, the audit examination disclosed unreported taxable sales of around \$1.2 million, which when compared with reported taxable sales of around \$2.4 million for the audit period, resulted in an error rate of around 50 percent. This high error rate is additional evidence of negligence. Appellant has not provided any reasonable documentation or evidence to support an adjustment to the audit finding. Therefore, the Department requests the appeal be denied.

This concludes our presentation, and we are available to answer any questions the panel may have. Thank you.

JUDGE LONG: This is Judge Long. Thank you. My only question involves Footnote 11 of the supplemental decision which you addressed in your presentation. So I'd

like to open questions to my panel members, beginning with Judge Aldrich, to see if you have any questions.

JUDGE ALDRICH: Hi. This is Judge Aldrich. I have no questions for the Department. Thank you.

JUDGE LONG: Thank you.

And, Judge Kwee, do you have any questions?

JUDGE KWEE: Hi. This is Judge Kwee, and yes. So I have a question for CDTEFA, or two. You had gone over your Exhibit C, page 154 and 155 of your exhibit binder, and that was, you know, the guest check data for the month of September 2018. And I have a question about that. So do you have concerns about there being with the electronic data, you know, for concerns about missing electronic payment data? Or is the only concern with that data that it was missing, you know, guest checks for cash transactions?

I think you're muted.

MR. SAMARAWICKREMA: Yeah. May I have a moment, please? Yeah.

This is Nalan Samarawickrema. The same schedule page 150 and 155 under Column I is \$43,502 as credit card sales for that month, based on the credit card sales information all the 1099 information for that month is \$44,156. So it appears the credit card sales also understated.

JUDGE KWEE: Oh, just a quick clarification. So the \$44,156 was the -- with the tax. So if you look at Column E, that list \$44,155. So it looks like there's only a dollar difference.

MR. SAMARAWICKREMA: Yeah. This is Nalan Smarawickrema. No, the I -- Column I include tax and tip. Tax -- I'm sorry. Tax and -- it included tax but exclude tips. But according to the actual 1099 information for September 2018, the total sales, including tax and tips, is \$44,156.

JUDGE KWEE: Okay.

MR. PARKER: This is Jason Parker. Judge Kwee, you are correct that the amounts basically from Column E match the amounts on the 1099K for that month. So the Column I is without the tips, so a calculation was done.

JUDGE KWEE: Okay. So -- this is Judge Kwee. So then there isn't concerns, then, about the accuracy of the electronic payment sales? The concern is about the cash sales; is that correct?

MR. SAMARAWICKREMA: That's -- this is Nalan. Yeah, that's correct. I'm sorry. Yeah, it's listed in Column E.

JUDGE KWEE: Okay. This is Judge Kwee. So the reason I was asking this is because I'm just wondering, you know, you have the electronic payment sales. You also

know that there was 1,114 electronic payment transactions. So, you know, you could calculate an average transaction amount, you know, if you just divided those two amounts. It comes to about \$39 per transaction. And then you also know that there are 1,673 transactions during that month of September.

So, you know, even though we don't know what the cash sales were for several guest checks numbers, you could just multiply with a total number of transactions by, you know, like the average sale amount to figure out what the total cash plus electronic sales were for September. At least that's what I was looking at and wondering why that would not be, perhaps, a more accurate or representative calculation than looking and looking at potentially the peak hours of, you know, one-and-a-half -- two observation tests, which are one-and-a-half-hours each.

I'm just wondering why the Department just didn't, you know, perhaps cross check what the total sales were just by -- by taking an average sale amount per transaction and multiplying it by the total number of transactions, you know, which is the guest check starting number minus the guest check ending number. Because, you know, that seems like it would accurately determine an average sales amount for all transactions for the month of

September.

MR. SAMARAWICKREMA: This is Nalan Samarawickrema. That approach is a reasonable approach if we know the start and the ending guest check sequence numbers. But based on our -- based on the Department's controlled purchases listed in page 170, the Department determine that they use different set of -- Appellant used a different set of guest checks, and we were unable to identify the actual number of transactions based on the guest checks the Appellant provided.

And if you may refer to 836 in summary, the Department got the guest checks information from Sysco. Based on the controlled purchases, it appears the taxpayer has another way that we did not have that guest checks information. So the Department -- it is the Department's position that the Department was unable to identify the correct number of transaction just referring to provided guest checks.

And also, the credit -- the -- if we determine the guest checks that they purchased were only from Sysco, yeah, then Judge Kwee's approach is a reasonable approach to consider. But for this audit, we were unable to identify the correct -- the actual number of guest checks, I mean, number of transactions just comparing the start sequence number with the ending sequence number of that

guest check.

JUDGE KWEE: This is Judge Kwee. So I think I understand. So on Exhibit C, page 154, you have guest check starting number, you know, 13001 and guest check ending number 14674. And what you're saying is that the two guest checks that you got from the undercover purchase are not even included in the sequence. So it's likely they had a different sequence so you can't -- you can't figure out how many transactions are missing?

MR. SAMARAWICKREMA: Yes. That is the reason we didn't use that approach.

JUDGE KWEE: Okay. I -- I understand now. Thank you. I think that was my -- that was it for my questions, so I'll turn it back over to Judge Long. Thank you.

JUDGE LONG: Thank you.

Judge Aldrich, I understand you had a question?

JUDGE ALDRICH: Hi. I have two questions. One for Appellant, and one is for the Department. I'll ask the Department first.

But in calculating the average daily sales, sales tax reimbursement and tip were excluded; is that correct?

MR. SAMARAWICKREMA: This is Nalan Samarawickrema. Yeah. According to our reaudit Number Two, we exclude the sales tax using 10.25 percent.

JUDGE ALDRICH: The sales tax by using

10.25 percent?

MR. SAMARAWICKREMA: Yeah.

JUDGE ALDRICH: And so would that take into account the fact that the drinks were \$1.85 with tax included?

MR. SAMARAWICKREMA: Yeah. The total sales were adjusted by 10.25. So we took the total sales based on the average hour, then divided by sales tax rate factor that is 110.25. And that's the -- that's the only adjustment the Department made during that second reaudit.

JUDGE ALDRICH: Okay. And the next question is for Appellant or Appellant's representative. Sorry. And if you could unmute yourself. All right.

So I guess I was wondering what response do you have to the Department's argument that they offered October and November observation test dates and to expand the observation test, but either you were unavailable or the Appellant was unavailable?

MR. YE: Oh, it happened so long since -- I don't think quite exactly why the -- whether the Department made a request or not. I cannot recall. I cannot recall whether we talked about the -- expanding the observation test. I don't -- I don't know why, you know, the extended observation test was not performed by the Department.

JUDGE ALDRICH: I guess my question is, do you

dispute that you were given the opportunity to expand the observation test?

MR. YE: No. No. No. Okay. Now, if we were given the opportunity to do a full observation test like, you know, such as, you know, the test that is required by the Audit Manual, three days, we will be more than happy to have the Department perform the test so that they can get us a better, more accurate, you know, result from the test. But, you know, again I cannot recall whether we talked about the expanded test request or not.

Taxpayer closed out the business even before, you know, informing me. I didn't know until I called the taxpayer, and he said, "You know, we have to shut down business."

I said, "Why?"

"Because we cannot keep losing money."

Because the landlord kept raising their rent, so they cannot afford the rent any further. Now, the taxpayer did talk about, you know, the sale of the business. I said, "Why you did not sell the business?"

He just -- you know, taxpayer just closed down the business without, you know, selling it. Okay. So pretty much they lost all the money they invested into the business. Taxpayer told me that because nobody was interested in that location because the rent was so high.

Nobody wanted to buy the business from her. That's why she had to abandon the business.

I -- I, you know, earlier the Department was talking about the rent sales ratio. You know, I had a hard time pulling the schedules the Department was talking about earlier. For this particular business, rent is their biggest business expense. You can see from the business income tax returns that rent is over, like, \$200,000 a year. That -- that was one of the reasons they could not survive anymore.

I know CDTFA did a lot of audits, you know, on similar businesses of buffet restaurants. Normally, their size is pretty large, and their rent is pretty high because of the size of their location. Does the rent have direct relationship to their sales? I don't think. Everybody wants to make more sales, more income so that they can afford the rent. But rent is not -- I don't think rent is directly, you know, related to their sales. The more rent you have doesn't mean that you're going to have more sales.

JUDGE ALDRICH: Okay. Thank you. Also, so in the supplemental decision of the Department, they discussed how you had proposed to calculate daily sales. And my understanding is that -- so you would have 370 for a 1-hour peak times 50 percent times three-and-a-half off

of peak hours, do you have any documentations that would, like, support that calculation for daily use sales?

MR. YE: Well, I don't have --

JUDGE LONG: Sorry. It was the lunch calculation.

MR. YE: I don't have documentation to support the numbers I calculated, but that's -- I think that's the best way that I can do it. Because, apparently, by using the peak-hour sales to calculate the, you know, the daily sales is not fair. I mean, the Department assumed that the off-peak hour sales are the same as the peak-hour sales. And then they did observation test during the peak hours, and they assume the peak-hour sales were the same as the non-peak hour sales.

For example, the taxpayer's dinner started at 3:30 p.m. to 9:30. And the observation test the Department did was from 6:30 p.m. to 8:15 p.m. And then the Department assume the sales for the peak hour, which they did observation, was the same as the sales for the non-peak hours. I mean, how do we expect the taxpayer to have sales from 6:30 to 7:30 p.m. to be the same as sales from 3:30 to 4:30 p.m.?

JUDGE ALDRICH: Yeah. Mr. Ye --

MR. YE: It's that obvious -- this is an obvious mistake. I mean, I don't know why the Department make

such assumption. I mean, this -- and also for dinner sales it's the same case. Dinner started at 11:00. You know, the Department assumed that the 11 hours -- 11:00 to --

JUDGE ALDRICH: Mr. Ye, I don't mean to interrupt, but your welcome to incorporate some of that argument into your closing or rebuttal, but as far as answering my question, you did. So at this time, I'm going to refer back to Judge Long. But thank you very much.

JUDGE LONG: This is Judge Long. Thank you.

Mr. Ye, would you like to take five minutes to make a closing statement?

MR. YE: Okay.

CLOSING STATEMENT

MR. YE: Again, like I said earlier, I had a hard time following the schedules the Department was talking about earlier regarding the work that CDTFA did during the audit process. As far as I can remember, the CDTFA -- the Department did talk about the credit card ratio. The credit card ratio they derived based on the short test, Saturday sales was -- credit card ratio, I think, is 49 percent, and the lunch sales is 31 percent. So you can see a big difference here.

And they are not consistent, and it's not right to use. The Department went ahead and averaged out the two ratios they came out with. They combined them and, you know, divided by 2 and come out with 40 percent. And they use that ratio to establish the audited sales during the original audit, which is clearly not right, you know, which, you know, discovered by the Bureau of Appeals. There is a big difference.

The Department -- the -- the Department did several methods to come up with the sales -- audited sales. But we can see that each way the audited sales they came out with are so different. There was a big difference. Again, the first method they use was using the credit card ratio which came out with the measure about \$2.2 million. And when they used the average daily sales, you know, the message came down to about \$1.1 million. Big difference.

We don't think the Department was reasonable originally, and we don't think the Department is reasonable after the recommendation made by the Appeals Bureau. And also regarding the sales, the third quarter and fourth quarter comparison during the prehearing conference, the Department was requested to talk about it. We notice that the third quarter sales does not necessarily have to be less than the fourth quarter sales.

Okay. Test results were reporting more sales in the fourth quarter and then the third quarter than the fourth quarter. Check the numbers that the taxpayer reported on their return.

CDTFA -- I have a, you know, used some of the information from the federal income tax returns to support their position. But, you know, I'm of the opinion that CDTFA picked the information on the federal income tax return to use for their benefit. I mean, they talk about the rent and other expenses. You know, CDTFA claim there was the expenses test result was not able to cover the expenses from their sales. They assume the taxpayer should have more sales.

Well, nobody -- no business have to expect to cover all their expenses. I mean, some of the businesses cannot succeed. They fail. I mean, that's a reality. That's a fact. Not every business can succeed. I mean, it's not right to expect every business to be able to cover their expenses. If that's the case, everybody can make money. Everybody can succeed. If taxpayer have more than another \$1.2 million in their sales, she would not have to abandon her business. I mean, if she had another \$1.1 million in additional sales, why does she have to abandon her business?

And also the -- the Department question regarding

the markup. Okay. Can I do that?

JUDGE LONG: Thank you, Mr. Ye. You have about a minute left if you would like to wrap up.

MR. YE: Okay. Okay. Our position is that because even if CDTFA did short tests, we don't think the short tests are reasonable or fair. The measures that the CDTFA came up is expensive, and it's not acceptable. CDTFA cannot support their assumptions are reasonable or fair. And we don't have the burden to prove that the assessment -- the deficiency assessment by the CDTFA is -- is right.

So position is the assessment of deficiency by CDTFA is not valid. I mean, we don't know why CDTFA do not have to follow the Audit Manuals. Even for the preliminary short test, they did not follow the Audit Manual's requirements.

And that's all.

JUDGE LONG: Thank you, Mr. Ye. We now have the information you provided today.

This concludes the hearing. The Judges will meet and decide the case based on the documents and testimony presented and admitted as evidence today. We will send both parties our written decision no later than 100 days from today. Thank you for your participation. The case is submitted and the record is now closed.

The hearing is now adjourned, and we'll resume at approximately 11:00 a.m. Or the next hearing will resume at approximately 11:00 a.m.

Thank you.

(Proceedings adjourned at 10:47 a.m.)

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 15th day of August, 2022.

ERNALYN M. ALONZO
HEARING REPORTER