BEFORE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,

YNL ENTERPRISES, INC.,

APPELLANT.

OTA NO. 18053170

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, November 8, 2022

Reported by:

SHELBY K. MAASKE

HEARING REPORTER

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Transcript of Proceedings, taken at 12900 Park Plaza Drive, Cerritos, California, Suite 300, beginning at 9:33 a.m. and ending at 11:29 a.m. on Tuesday, November 8, 2022, reported by Shelby K. Maaske, Hearing Reporter.

APPEARANCES:

Panel Lead:	Hon. Andrew Kwee
Panel Members:	Hon. Daniel Cho Hon. Keith Long
For the Appellant:	Marc Brandeis
For the Respondent:	Nalan Samarawickrema, Hearing Representative Christopher Brooks, Tax Counsel Jason Parker, Hearing Representative

I N D E X

WITNESSES

(None)

E X H I B I T S

(Appellant's Exhibits were received at pages 8 and 15.)

(CDTFA's Exhibits were received at page 7.)

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Cerritos, California; Tuesday, November 8, 2022
9:33 a.m.

ADMINISTRATIVE LAW JUDGE KWEE: We are opening the record in the appeal of YNL Enterprises, Inc. This matter is being heard before the Office of Tax Appeals. This is OTA Case No. 18053170, and today's date is Tuesday, November 8, 2022. It's approximately 9:33 a.m. This hearing is being conducted in Cerritos, California, and also being streamed live on our YouTube channel.

Today's hearing is being heard by a panel of three administrative law judges, myself, Andrew Kwee. I'll be the lead administrative law judge. To my right is Keith Long, and to my left is Daniel Cho, and they are the other members of this panel. All three of us will be meeting after the hearing today, and we will produce a written decision as equal participants.

Even though I'm conducting today's hearing, any judge on this panel may participate as an equal participant at any time to ensure we have all of the information necessary to decide this appeal. With the preliminary matters out of the way, would the parties please state your name for the record? And I'll start with the representatives with CDTFA.

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

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

MR. BROOKS: Christopher Brooks, Counsel for CDTFA.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

I'll turn it over to the representatives for YNL Enterprises.

MR. BRANDEIS: Marc Brandeis, CPA for the Appellant.

ADMINISTRATIVE LAW JUDGE KWEE: Great.

Just to do a quick recount, because there has been some new information since the prehearing conference. Just to confirm, there are no witnesses for either party today; is that correct for you, CDTFA?

MR. SAMARAWICKREMA: Yes. No witnesses.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. And for you, Mr. Brandeis?

MR. BRANDEIS: We have no witnesses.

ADMINISTRATIVE LAW JUDGE KWEE: As far as the exhibits, we did get three new exhibits. And before I turn to those, I will start with the exhibits that we discussed at the prehearing conference for CDTFA. We had Exhibits A through P, and those were discussed. And my understanding is that there are no objections from the taxpayer to submit A through P.

CDTFA, is that correct, you don't have any additional exhibits?

MR. SAMARAWICKREMA: That is correct. No additional exhibits.

ADMINISTRATIVE LAW JUDGE KWEE: And, Mr. Brandeis, is that correct that you don't have any objections to CDTFA's exhibits?

MR. BRANDEIS: I have no objections except for there was a memo submitted that did not have the memo from petitions that prompted the DPA to respond to the petition supervisor, so I made a supplemental submission this morning to include that.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. We'll get to your additional memo that is labelled as Exhibit 2 in a moment.

Without objections, other than noting that one of the exhibits might have not been complete, I will admit CDTFA's Exhibits A through P into evidence.

(CDTFA's Exhibits A through P were received.)

ADMINISTRATIVE LAW JUDGE KWEE: And then I'll turn over to Appellant's Exhibit. So I'm just going to start with the exhibit that we discussed at the prehearing conference. I understand that we have Exhibit 1.

And CDTFA has no objections to that exhibit; is that correct?

MR. SAMARAWICKREMA: That is correct.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. I'm going to admit Exhibit 1 into evidence.

(Appellant's Exhibit 1 was received in evidence.)

ADMINISTRATIVE LAW JUDGE KWEE: Then I will turn to the three items that were submitted this morning. The first is labeled Exhibit 2, that was the 8/16/2016 memo. And then I have two additional exhibits which were not marked as exhibits, but I'm going to identify for the record as Exhibit 3, which is the POS Void Report, and Exhibit 4, which is the POS Sales Report.

And, Appellant, Mr. Brandeis, do you have any additional submission besides the three items I just identified for today?

MR. BRANDEIS: No, I don't.

ADMINISTRATIVE LAW JUDGE KWEE: And for Exhibit 3, the Void Report, it looks like there's two tabs. I didn't have any questions about that. But for Exhibit 4, the Point of Sales Report, I just have a question, because it looks like that might be missing entries. Because the line total came out to $1,212,179.00, but there were only 32 entries on that document, so it looks like it might be missing 42,000 -- a little over 42,068 line entries.

I just wanted to clarify if you intended to submit all of the line entries, or only the last 32 line entries, which is 42,068 to 42,100.

MR. BRANDEIS: So I was looking at this file last night. There's a filter under Column H. If you uncheck that filter and hit "select all," you will see that all of the pay was there.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. My apologies. Let me just look at this. So there's a filter and --

MR. BRANDEIS: If you go to "Data 1," and if you click that down arrow and then hit "select all," it will turn off that filter and you will see that all of the data is there.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Just one moment, please.

MR. BRANDEIS: Sure.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Sorry. I wasn't listening. You said "Data 1." Now I see the Data 1 was selected to certain fields. I have unchecked that. So it does look like after unchecking that, there are now 50,177 entries, and it looks like that is sequentially complete. So that answers my question. Thank you. Sorry for the technical hold up.

So with those three exhibits -- CDTFA, did you have any objections to those three additional exhibits, 2, 3, and 4, that we just discussed? I realized that you just got them today. If you like, we could also hold the record open to allow an opportunity to comment on the latest submission. That's an option to finding out what your position is about the three exhibits.

MR. BROOKS: Good morning. This is Christopher Brooks. Regarding Exhibits 3 and 4, we would object that it is untimely, and, yes, it would require time to check those and verify them.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. For Exhibit 2 -- it is my understanding there's no objection to Exhibit 2, or did you have objection to Exhibit 2?

MR. BROOKS: No objection.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. So I just want to get to the -- because I understand that, you know, we had the deadline of 15 days before the hearing, and that would have been 10/24, and we didn't receive this until today. So it was past the deadline that we did list in our minutes and orders, but I do want to find out if the parties -- so it looks like these are a list of point of sale entries that seem -- I just got these today, but at first glance, they do seem comprehensive now after applying that filter.

I would like to get CDTFA's position on whether or not if this were accepted, if it is something which would be relevant and potentially, in CDTFA's position, might result in an adjustment to liability if it were accepted as complete records, or that is something that CDTFA thinks is not relevant?

MR. SAMARAWICKREMA: The Department rejected the Appellant's appeals that we received during the fieldwork. And, therefore, you know, we believe that the data that we received today doesn't change our position.

JUDGE KWEE: Okay. So just to clarify that, because you said that you rejected -- CDTFA rejected the point of sale data during the audit, are you saying that it is CDTFA's position that you already looked at this and determined it was not relevant or helpful, or is this something that's new for you, or do you not know if this is something that CDTFA examined?

MR. SAMARAWICKREMA: We didn't have the time to compare the information with the information we received during the audit time during the fieldwork, therefore, we don't know whether this is an exact copy of the data we received at the time of the fieldwork.

MR. PARKER: I would like to add, these do appear to be to the same files that we have in our audit file. Due to the size of them, we did not include the PDF printout out of these because it would be, like, thousands of pages. So they appear to be what we have in our audit file, however, we haven't validated these amounts with what was in our audit file, but it appears to be the same.

ADMINISTRATIVE LAW JUDGE KWEE: And just a quick clarification. The first -- are these documents that have been previously provided to CDTFA, or is this new information for your client?

MR. BRANDEIS: CDTFA visited the taxpayer and downloaded the data themselves. I wasn't the original representative. I was brought in almost at the point where the fieldwork was completed. We had a heck of a time getting -- when I did take over as representative, we had a heck of a time getting complete records from the Department. We even had to complain to Board Member Horton's office -- at this time, it was the Board of Equalization.

Ultimately, we did get, what I believed to be, a fairly complete record of all of the documents obtained by the Department. In those documents that were provided were these two Excel files, which, I believe, is what they downloaded when they made their site visit. So I'm really just entering it for the record, but this is information that I received from the Department.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. And another question. Do you know why Appellant was not able to provide this by the deadline that we had discussed during the prehearing conference?

MR. BRANDEIS: I wasn't sure if we were going to be able to e-mail the file because it is over seven megs. Ultimately, I decided to give it a shot. It appears that it did go through. And it's my fault. I should have sent it earlier. But this is information that we received from the Department. It's not really new information.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

So, CDTFA, with that, it sounds like Appellant is saying that this is actually the document that you already had in your audit file that you didn't submit. So it sounds like my direction would be to admit it just for completeness sake -- because I'm assuming it was part of your audit file -- but allow CDTFA an opportunity to provide any follow-up comment or concern that they have with this document. But since this sounds like something you already had in your records, it doesn't seem like it's an unfair surprise on your part with admitting it at this time. Do you have concerns with that?

MR. BROOKS: Your Honor, CDTFA does feel like it is a bit of a surprise. There's a lot of files to go through I have never seen. So that's part of my function, to review the exhibits. So, you know, it's certainly a surprise and unfair, but if it's something we already have, we would need time to verify that, and the staff needs to have an opportunity to do that so we can present accurate information to you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. I will allow it with the understanding that it was something that was within CDTFA's record. So I will give CDTFA 30 days to confirm, one, whether or not this is a document that is in their records; and, number two, if they have any concerns with the documents, you can provide additional briefing on that aspect too. So, one, is it a CDTFA document, and, two, are there any concerns from CDTFA with the document?

I do want to have all of the information before us, especially if it was something that was relied on by CDTFA to make an audit determination. And it sounds like, possibly, this was something that was relied on or examined by CDTFA, or perhaps compiled by CDTFA, to get confirmation on CDTFA's position about whether or not this is their document and just have the complete record, I will allow it.

Although, I do understand that this is late. I would ask in the future that documents be submitted timely, especially if they are documents which have already been in possession of the parties for a number of years already. But with that said, I will admit

Appellant's Exhibit 2 of the 8/16/2016 memo without objection, and Exhibits 3 and 4, over the objection for timeliness, and 30 days for additional briefing for, one, whether it's a CDTFA document and, two, if there are any concerns with the document.

(Appellant's Exhibits 2, 3, and 4 were received.)

ADMINISTRATIVE LAW JUDGE KWEE: And I'll send out -- OTA will send out a letter of post-hearing order after the hearing summarizing the additional briefing period, and 30 days will run from when OTA sends out that letter.

Okay. The next item is we had a post-hearing conference from CDTFA, and that was -- it looks like CDTFA was clarifying that there was an adjustment -- downgraded adjustment in Appellant's favor for the measure of tax asserted for the first and second issue, and the summaries come from a second pre-audit letter dated September 21, 2022, which is attached as Exhibit A to CDTFA's exhibit index.

And so I assume, Appellant, you don't have any objections or concerns with the CDTFA's revised position on the measure of tax?

MR. BRANDEIS: No objection.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Okay. So with that said, we have summarized the minutes and orders and the agenda, and also discussed them at the pre-hearing conference. So there were three issues. I'm not going to repeat them now since we already went over them. But I will confirm with the parties, CDTFA, did the minutes and orders correctly summarize the issues to your understanding?

MR. SAMARAWICKREMA: Yes, it is.

ADMINISTRATIVE LAW JUDGE KWEE: And Appellant, did the minutes and orders correctly summarize the issues to your understanding?

MR. BRANDEIS: I agree, it does.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Great.

And then the last item is just a brief overview. So I expect this hearing to last about an hour and 45 minutes. We will have 20 minutes for Appellant's opening presentation followed by 30 minutes for CDTFA's presentation, and then we will conclude and each party will have 10 minutes for final remarks. Are there any questions about the presentation or just questions about the proceedings before we get started?

MR. BRANDEIS: No questions.

MR. SAMARAWICKREMA: No questions.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Then I will turn it over to Mr. Brandeis for your opening presentation. You have 20 minutes. You may proceed.

MR. BRANDEIS: So the taxpayer in question, YNL, operated a Chinese-style restaurant in Studio City, California. They were selected for an audit. I don't know that I would clarify this audit as a random audit. It appears that the Scope Unit had notified Audit that they believed that there was likely under reporting due to differences between reported amounts and 1099K amounts.

1099K, if you are familiar, are the gross proceeds provided by the merchant card processors for credit card transactions. So when credit card transactions exceed reported gross receipts, that's generally an indication that they have a problem. So at that rate, they were selected for audit. Audit period commencing second quarter 2011, and going through the closeout date of July 15, 2014.

They received an audit notice sometime in February of 2014, so about five months before they ultimately shut down. And there was some delay in the auditor getting an appointment with the taxpayers, and also the taxpayer's representative. The 414 Z, I don't think is extremely detailed, but from what I can tell, there was some delay.

It appears to be there was some delay on both sides. But at any rate, the Department came out and made an appointment. And on May 30, 2014, they came out to the restaurant with a second auditor and obtained POS data from the taxpayer's POS system. While they were there, they made general observations: Alcohol is not served, seating available is less than 30, five employees were present, three in the kitchen, two in front.

It appears, also, that the Department performed undercover purchases for cash. So this was a technique that was, I believe, widely used at that time -- eight years ago -- where auditors would frequent restaurants and make purchases and pay for them in cash and keep the receipts, and then when the auditors were given access to POS data, they would then check the data to see if the cash purchases made by the Department showed up in the data.

I don't have a problem with that technique, but the technique is what -- as an auditor with almost 30 years of experience, this is what is called an attribute test. What attribute are you testing? You are testing to see if the sales record is complete, specifically with respect to cash purchases.

So let's make no mistake about it, this is an audit of cash. It's not an audit of credit card transactions. It's not even an audit of third-party online sales. All of that information is being reported on by third parties, credit card sales by the merchant card processors, and the online sales are being reported on by the third-party online companies like Grubhub and Eat24. What really becomes a concern is the cash sales.

So that everybody is on the same page, this is an audit of the cash. It appears that upon review, the Department was unable to locate two undercover cash purchases in the data, and it appears that they subsequently located those purchases in those void files of the taxpayer's POS system.

So, you know, one of the things that I try to do when I take over a case and they find out that they've done undercover purchases, I try to get an idea of how many purchases were made and how many didn't show up.

They disclosed that two didn't show up, but I haven't been able to get a full accounting for the total number of undercover purchases made. At the hearing, the auditor made the statement that it was between 10 and 12 undercover purchases. So it's a little distressing as a taxpayer, how do you know they're giving you a complete picture?

We have had taxpayers where they have done as many as 20 undercover purchases, although 10 is probably more common. But we don't really know. And in this case, we had a real heck of a time getting the Department to provide us with a complete accounting for the undercover purchases.

At any respect, I don't dispute that at least two of the transactions appear to have been removed from the sale's record and placed in the void file. Whenever this happens -- you have to understand, this is a single-location restaurant that is family owned and closely held. The owner can't be there all of the time. They're going to have to entrust at least one or sometimes more than one employee with managerial functions on the POS system.

Whenever an employee has managerial functions, there's always going to be the risk that the employee might delete a transaction from the sales record and pocket the cash. Every company faces this, I don't care if you are a small, one-person-owned restaurant or if you are the Walt Disney Company. There is always a concern.

The internal controls that should be in place to prevent it are only as good as the business owner enforcing or testing those internal controls. And I don't think in this case she did a very good job of testing the internal controls. At any rate, that appears to be the basis for the Department's impeachment of the record. So then they're left with using an indirect audit approach.

So in this case, they chose the observation test approach to develop a credit card ratio of the total sales. So, again, during this time, it was not uncommon for the Department to just do one day, despite the fact that the audit manual says that several days should be used, including a weekday and a weekend. And we take "several" to mean three or more.

We raised this issue. We had an almost identical problem in the Wing Sang case which was heard before the Board of Equalization in 2015, and we received a unanimous decision from all five members on the board, and they took issue with not meeting the audit manual specification of at least three or more days. And even in that case, in the Wing Sang case, there was a missing purchase from the sales record.

So the Department is going to argue -- actually, the Appeals Bureau representative argued that the taxpayer did not notify the Board until afterwards that the business had been sold. And we went through ACFS notes and all kind of -- there's really -- there is no record of when they were notified.

I knew when I took over the case, but I took over the case around the time of the sale when the closeout occurred, and I assumed that they knew. However, I don't think that's the issue. Because when the DPA responded to the memo, Exhibit 2, that came from petition supervisor, Thomas Hopkins, she doesn't mention that as a reason as to why they couldn't perform additional tests, she just says in her response, "They were limited."

I'm not sure what she means by "limited." But it really fits the pattern of what was going on at that time. And using Wing Sang as an example, I think the Board -- the Department in general, just preferred to do one day of testing. And the problem with one day of testing is it may not be representative. I mean, we are talking about -- this test was done on June 19, 2014, a Thursday. Is that representative?

I mean, I've probably represented 150 restaurants, and I have done scores and scores of these observation tests, and I can tell you that the results -- including in the Wing Sang case, the results of the credit card ratio vary, sometimes greatly, from one day to another. And a credit card ratio of 60 percent is, in my opinion, characteristically low for a sit-down restaurant with servers and tipping.

Typically, what I see for restaurants of that nature is a credit card ratio in the range of, say, 75 percent to, maybe, a high of 85 percent. But 60 percent would been uncharacteristically low unless there is some extenuating circumstances. But in this case, they could have done additional testing, because normally -- so after the Wing Sang case, the department management issued a memorandum in August of 2015, mandating that the auditors complete an observation test fact sheet, and this was to prevent auditors from just doing these one-day tests.

However, it is my opinion, that when they scheduled that date -- normally, what auditors do is they schedule all three days at the same time -- not just one -- with the understanding that the Department may do a one-day test and then decide not to do further testing because they're not going to use it to impeach the records. They're satisfied that the records are complete.

But in this case, clearly, they didn't do that. And the Department could have -- even after we took over the case, they could have requested that an observation test be performed by the successor. The successor was aware of the audit. The Department was notified by escrow of the sale, and the Department's response was they demand withhold for the entire funds of escrow, and to notify the successor of the potential for successor liability.

So the successor knew about this. It's not like they were disclosing something that was confidential information. They could have coordinated with the successor. I'm sure they were on good terms, and probably could have had additional observation tests done to meet that requirement in the audit manual, but that was never considered.

I find it problematic that we are going to -- and this body has upheld in other cases where they allow the Department is to, essentially, get away with that, because it sort of raises the question of why do we have an audit manual to begin with? And why do we have policies and procedures to begin with? When the audit manual says you must do it and the Department doesn't do it, and this body upholds that, it makes the audit manual meaningless and it makes audit procedures -- it gives the audit department the presumption that they can do whatever they want because the Appeals Bureau and the Office of Tax Appeal will uphold for them.

And so my opinion is that there should be a reexamination as to whether or not -- the credit card ratio has changed from 60 to, I believe, the latest rendering is now 61.84 percent. But, still, in my opinion, that's too low. I mean, I've only seen it that low in one other case. And in that case, they had a sizable banquet business which explained which banquets were paid in cash, which explained why the credit card ratio of the total sale were so low.

Initially, the Department opined that the transactions in the void file closely mirrored what they proposed is an additional assessment, and so their thinking was, well, all of the transactions are there once you combine the void file with the sales file. And the problem with that is although there may have been valid transactions that were voided improperly, it presumes that none of the voids were proper, and that's just not reasonable.

Anybody that's operated a restaurant or worked in a restaurant knows that voids happen. Sometimes somebody complains the food was terrible and management decides to comp the meal, there are walkouts, there are, hey, I didn't order that and you guys put that on my bill. I mean, these things happen. Anybody that operates a restaurant knows that. And I'm not suggesting that that be the remedy here, but it could be.

It could be a reasonable remedy to assume that maybe some percentage of the void file is valid. I looked at the file that was submitted this morning, and they did put down a reason code. I noticed that there was a number of transactions using the reason code "testing." And this is not an uncommon thing. In the morning, when a restaurant opens up, they may run a few transactions through to test the system because these POS systems are critical to the effect of an efficient operation of the restaurant.

There could also be scenarios where maybe the employees have a meal and they rang it up and they later voided it because they're not going to charge the employee or they are not going to charge the owner for a meal. So some of those voids are valid.

If we could agree on some percentage, that might be a remedy. But I certainly think that using a one-day observation test on a Thursday with such a low credit card ratio is not reasonable.

The second issue that we have has to do with third-party online sales. So the taxpayer contracts with companies like Grubhub and Eat24, so anybody that has used those -- I, personally, have never used them. But anybody that has used those services, you log on to, say, Grubhub's website, and you put down the area you are in and you select a restaurant, and the menu for that restaurant will appear, and you can select whatever items you want. You then instruct that the food is picked up at the restaurant or you can have it delivered for an additional fee, Grubhub then closes the transaction, generally, people, especially if they are having it delivered -- but most people pay with a credit card.

As Grubhub collects the money, they calculate the tax, and they maybe even make the delivery. And then they turn around -- at this time, back in those days -- send a facsimile to the restaurant instructing them that an order had been received via that website, and the restaurant owner enters the order into the POS system, which is what tells the kitchen to prepare the meal.

So we are arguing that those companies, Grubhub, Eat24, and the like are, in fact, the true retailers in these transactions, and the Department is arguing the opposite. But we need to look at what's going on here. I mean, generally speaking -- I mean, I could read to you Revenue Taxation Code 6015, the definition of a retailer. But generally speaking, a retailer is somebody that holds themselves out to the public as making sales of tangible personal property for consumption in the state. That is exactly what Grubhub is doing.

Anybody that goes to Grubhub's website knows they're on the Grubhub website, and they know that Grubhub is collecting the money, collecting the tax, and coordinating the delivery. In fact, if the customer were to receive -- let's say they received their food and the food is cold and they're unhappy, and in a chance that they did call the restaurant, the restaurant would direct them back to Grubhub for processing a refund.

This isn't merely a delivery service, any more than Amazon.com is merely a delivery service. This company is doing, essentially, what Amazon does except for food. So keep in mind that this occurred during a period of time before the passing of the Marketplace Facilitator Act in April of 2019. So at that time, there were no rules under local delivery networks.

So what we look at -- what I used to look at when I was an auditor is who's holding themselves out to the public? It's clearly Grubhub. And the Department relied on a memorandum opinion from 1991 called Mark Pulvers. Mark Pulvers had a business that -- you have to remember, this is pre-internet, 1991. He had a business where he would put little advertising tents in hotel rooms and people could place a call to order food or order a video cassette to be delivered to their room, and Mark Pulvers would then go pick those items up, bring them to the hotel room, collects payment.

He had an arrangement with the restaurant, they would get a certain amount and he would get a certain amount, but he would keep the delivery fee. The Board, at that time, opined that Mark Pulvers was merely providing a delivery service, which clearly, that's not the case. He's doing a lot more than just making a delivery. Similar to what Amazon is doing except on the internet.

The other thing to consider is that Mark Pulvers is a memorandum opinion, it's not the law. It does not carry the same weight and effect as the law does. We think that the Board got that opinion wrong, and in relying on that opinion also is incorrect.

When the case was sent to the Appeals Bureau, Thomas Hopkins, supervising tax auditor, sent a memo, Exhibit 2, to the Department, and he also questions -- and I will quote, "It would appear that Grubhub meets the requirement of a person making a retail sale. Grubhub takes orders, collects payments, collects sales tax, picks up orders, and delivers orders to the customer. Plus, it appears Grubhub would also be the person responsible to collect and remit sales tax to the Board instead of the restaurants."

DPA's response to that, which is page 104 of the -- Exhibit Page 104 in the Department's submission. So basically, she cites a lot of the information that's contained in the Grubhub agreement. One thing I would like to point out is that you -- generally speaking, once you are deemed to be a retailer in a transaction, you're not able to contract away your status as a retailer to another party and thereby assign liability to another party once you are deemed the retailer.

And that's, essentially, what she's arguing, that Grubhub contractually assigned liability to the restaurant. Even their own contract that -- this is page 322 in the Department's exhibit. Item No. 10 notes that "Grubhub shall be responsibile for verifying that the collected tendered sale tax amount is correct, filing all required sale tax returns and associated forms, and remitting all required sales tax to the appropriate taxing authorities."

And that's nice language to have, but it's really irrelevant. When I was an auditor, taxpayers made that argument before, "Well, in my contract, I assigned liability for the sales tax to somebody else." I don't care what your contract says. The law says the retailer is the person responsible for sales tax. So we just need to figure out who the retailer is.

Who is the person holding themselves out to the public as making that retail sales tangible personal property? It's Grubhub. It's their website. They are collecting the money. They are arranging the delivery. Sometimes they make the delivery. This is not merely a delivery service, no more than Amazon is.

I have nothing else.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

I did have a couple of questions about the presentation and items discussed. So I'd like to ask about the void report. So I understand what your position is that there was some embezzlement going on which resulted in overinflated void reports. So looking at the void report, for example, there were 57,000 voids over the course of the three years, and at least two of those items involved undercover purchases by CDTFA, which were listed in the void transaction.

So my understanding of your presentation is that Appellant agrees that -- or, I guess, is arguing that there was some embezzlement going on which contributed to the overinflated void. Is that a correct understanding of what you were saying?

MR. BRANDEIS: I'm not going to go so far as to say there was embezzlement going on, that goes beyond the scope of what I was hired to investigate. What I am saying is that there do appear to be voids that were improper. But, also, to say that there are no proper voids is unreasonable. So we are not disputing CDTFA had a valid reason to impeach the records and therefore used the indirect audit approach, we are just saying they didn't use due care in that indirect audit approach.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. So there were improper voids, but the reasons for the improper is not being specifically asserted. I see what you're saying now.

And the other thing is if we did look at the voids, I guess, I just wouldn't see a basis for allocating proper versus improper, because there's really nothing in the evidence that I could see that would support saying, you know, X percent is improperly taken because we only have a population of two that were verified by CDTFA. So I'm not seeing what basis we would have for distinguishing valid voids versus invalid voids if we were taking it from the indirect audit approach.

MR. BRANDEIS: I agree. Here we are eight years later, and now eight years later it's -- certain tests are not feasible -- can't be done. But, yet, is it fair to ignore written policy in the audit manual, and, you know, test one day when the audit manual clearly makes it clear that it's a minimum of several? -- which I take to mean three or more -- and that you should include a weekday and a weekend. So what is the remedy when the Department ignores their own policies?

ADMINISTRATIVE LAW JUDGE KWEE: So I have another question then. The Eat24 and the Grubhub transactions, would they be included in the point of sale reports that you signed, or were those separately accounted for by the taxpayer?

MR. BRANDEIS: So as I mentioned earlier, when Grubhub and Eat24 receives an order, back in those days, they would send a fax to the restaurant. And so this was -- so the auditor did an observation test, June 19th, and claims he was there from 10:00 a.m. -- from opening to closing. I think it was 11:00 a.m. to 10:00 p.m., something like that -- 11 hours. There were only 27 or 28 transactions during that period of time when this issue came up.

The taxpayer told the auditor that the online orders are entered as cash transactions. The system is capable of setting up a third category, it's called HHACCT, short, I think, for house account, which is where they should have put them so they could have done separate accounting for the third-party online orders and, therefore, not impact the end-of-the-day's cash or credit card counts.

The reason that this shouldn't be included as cash -- the way it works, at the end of the day or periodically -- every two or three days -- Grubhub and Eat24 would then send a check for the gross proceeds less their commission. So, you know, what do they do with the check? Maybe the check gets deposited or cashed, but it's not part of the day's cash receipts.

The auditor claimed he couldn't verify that, which I don't understand. How could you not verify that? Why would you not document how the order comes in? How it's entered in? He just says, "It couldn't be verified." My hunch is -- again, I wasn't there. This is why when -- I represent clients, and when an observation test is done, I make sure that I'm there as well so I can see what the auditor is doing.

What was he doing? There was only 28 transactions. Why didn't he say, "Show me these faxes and verify?" He could have gotten the Grubhub statement later and corroborated the transactions on the Grubhub statement with what he observed that day. But that was one of the reasons for -- I think we had four revisions in this case. I have four or five different versions of the working papers, because in his initial assessment, he included the third-party transaction as part of the cash sales.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. So, basically, if we were to add up the point of sales amount and the void amount, it would be your position that those are the total amount of sales made by the business?

MR. BRANDEIS: No, I'm not saying that. Because, again, if you look at the tri-void file -- so the two transactions that are missing from -- show up in the tri-void file. The first one starts at line 46,614. There were three items ordered, so it ends at 46,616. And the reason code was F7 or customer left. But you can see, there's "system testing, change mind." -- I see a lot of system -- let me see if there are any other reasons here? Wrong order, cashier mistake." They had something called "no money."

Some of these have to be valid. Every restaurant has voids. So, again, it's a challenge now that it's eight years later. I don't know who owns the business now. I'm sure it's changed materially from eight years ago. So there's no longer the feasibility of saying what's the native amount of normal voids as opposed to irregular voids? We don't know.

ADMINISTRATIVE LAW JUDGE KWEE: I understand what you are saying. I guess the reason I was asking that is because if you add up the sum total on the voided list that you provided, it was 313902. So that was the total amount of voided transactions for the document that was submitted this morning. But then if you add up the unreported sales from the second re-audit of 261304, plus the amounts being asserted for Grubhub and Eat24, the total comes to 377328, which is more than the total disallowed voids, so I guess -- so I wasn't sure.

MR. BRANDEIS: Like I said, I don't know. I can't tell you. I don't think -- actually in the DNR, Craig Okoharo opined that he didn't believe that there was any corresponding between the total in the tri-void file and the amount of measure being assessed by the Department, so he rejected it. But there's really no way to go back now and test what would be the native percentage for valid voids.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

I will turn it over to Judge Cho. Did you have any questions for the taxpayer?

ADMINISTRATIVE LAW JUDGE CHO: Yes. I just want to clarify one thing that you have argued. So you stated that it's in your opinion that the one-day observation test shouldn't be relied upon for the credit card ratio of approximately 61 percent. And you argued that in your experience, you believe the credit card ratio should be closer to 75 to 85 percent; is that correct?

MR. BRANDEIS: In my -- in the eight years that I have been -- restaurant audits really picked up around this time. In the eight years I've been doing restaurant audit defense, I would say that your typical credit card ratio is anywhere -- for restaurants with sit-down service, tipping, waiters and waitresses, it's anywhere from 75 percent to 85 percent. That would be the bell curve, if you will. 61.8-something percent would be characteristically low.

ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you. Are you able to point to any evidence in the record before us to get to that 75 to 85 percent? For example, is there any schedule --

MR. BRANDEIS: So if you look at the Beatrich pay file, which is the sales report. If you look at that, there's a pivot table in sheet one, and it says "sum of cash, sum of credit card, sum of tips, sum of discounts." I've worked with this POS system for quite a number of years.

The cash amount includes tax. The credit card amount also includes tax. It does not include tips. So if you were to take the sum of cash and the sum of credit card and compare it to the sum of check amount, the sum of check amount doesn't include tax because there's a separate column from the sum of tax amount.

Let me do that calculation real quick. I believe it comes to 74 percent. So I'm going to add the sum of cash and sum of credit card, and then I'm going to compare that to -- let me add those up. So the only thing I would add here is -- remember, the taxpayer was treating third-party online orders as cash. However, we have all of the statements from Grubhub and Eat24, so we could segregate those out. There is a way that that could be done.

But if I take the sum of cash divided by the total sales, it comes to almost 26 percent, and the credit card amount comes to 74.2 percent. So there's a 74 percent amount for credit card sales. The cash sales number is a little high, but like I said, we have all of the statements for the audit period from Grubhub and Eat24, and we could back those out. That would lower the cash percentage and create a new category called "third-party online sales," which is also verifiable like the credit card. And the only problem is we know that some of the cash transactions were improperly voided.

How do we determine that eight years after the close of the audit? That's going to be a little bit of a challenge. But that's where I get credit card -- since we don't know how much cash was voided -- it actually, if you added more sales due to cash, it would actually drop the credit card percentage from 74.2 to something less than that, depending on how much cash you had.

ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you for that clarification.

MR. BRANDEIS: So even if we agreed it was 70, that would still be below that bell curve that I described to you earlier, but something the taxpayer could live with.

ADMINISTRATIVE LAW JUDGE CHO: Thank you for the clarification.

ADMINISTRATIVE LAW JUDGE KWEE: Thank you, Judge Cho.

I'll turn it over to Judge Long. Judge Long, did you have any questions for the taxpayer?

ADMINISTRATIVE LAW JUDGE LONG: Just a couple of questions. First, I just want to make sure. Looking at the comparison from the POS data to the sales and use tax returns, it looks like there was about $80,000.00 difference there. Is there any dispute that the taxpayer underreported?

MR. BRANDEIS: No, I don't dispute that the taxpayer underreported.

ADMINISTRATIVE LAW JUDGE LONG: So the position is, essentially, that the credit card ratio should be changed?

MR. BRANDEIS: Yes.

ADMINISTRATIVE LAW JUDGE LONG: Okay. And with respect to that, it's your position that it should be this 74 percent; correct?

MR. BRANDEIS: Actually, it's probably less than 74 percent. Because this data in the Beatrich pay file, the sales record, we know that not all of the cash is in there, so, therefore, the total sales has to be higher -- the denominator has to be higher and the numerator is not going to change, so therefore, the credit card to total sales ratio would actually drop for there. How much depends on how much cash sales we have in total sales. So something less than 74.2 percent.

ADMINISTRATIVE LAW JUDGE LONG: And with respect to the void report. I know that every restaurant, let's say, is going to have a system testing, because they have to check that their POS system works right, but there are dozens and dozens of system testing all under different codes. Is it your position these are all accurate?

MR. BRANDEIS: I have no idea. I know that -- my position is some percentage of them are accurate. What percentage that is, I have no idea. An observation test would have helped if they had done at least three. Most restaurants that I know do some system testing in the morning before they open up.

Sometimes -- again, some restaurants will allow their employees to order food and maybe -- I don't see an employee meal reason here, so maybe -- actually, there's no reasons. There's probably 100 different reasons. That seems a little excessive. But, you know, my hunch is that some employees rang up an order and voided it because maybe it's the restaurant's policy that they don't charge employees for meals.

ADMINISTRATIVE LAW JUDGE LONG: Okay. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

CDTFA has their opening presentation. But before that, I did have one question. I will tell CDTFA what the question is, and if they want to answer that during their opening presentation, they can. I'm not going to ask for an answer right now; otherwise, I will ask after their presentation. But the question I am going to ask at some point for CDTFA is, if you look at their void report, that comes to the 313902 -- I am assuming this is the same report that CDTFA has in their records -- but then if you add up the amount asserted by CDTFA for the Grubhub, Eat24 and Issue 1, that comes out to 377328, which was in excess of the total voids.

And I guess that my question was, why CDTFA is asserting more than the total entries in their POS system? If there's a reason for that, why didn't, for example, CDTFA, instead of doing the one-day observation test, just assert the total liability stated in their POS reports which would have been the 313902, assuming that is correct report?

With that said, I will turn it over to CDTFA for their opening presentation. You have 30 minutes starting now.

MR. SAMARAWICKREMA: Thank you. Can we have our last 10 minutes extended to our opening?

ADMINISTRATIVE LAW JUDGE KWEE: So you want 43 minutes?

MR. SAMARAWICKREMA: 40 minutes. Because we had 30 minutes for the opening and then the 10, so we want to combine.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. That's perfectly fine. So I'll give you until 11:13 then.

MR. SAMARAWICKREMA: Okay. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: And waive the rebuttal.

MR. SAMARAWICKREMA: Appellant is a California corporation that operated a restaurant serving Chinese-style food in Studio City, California. Appellant commenced business on June 1st, 2011, and ceased operations on July 15, 2019, when the business was sold.

The restaurant had seating capacity for about 30 customers and was open daily. Appellant also sold food and beverages to Grubhub and Eat24 delivery services. The Department audit period was from the period of June 1st, 2011, to July 15, 2014.

During the audit period, Appellant reported taxable sale of $894,000.00, excluding fixtures and sales and the closeout of the business of $4,300.00, and that would be on Exhibit B, page 27.

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 for this Appellant.

During the audit, Appellant failed to provide complete sales records. Appellant did not provide complete documents of original entries for the audit period. In addition, Appellant failed to provide complete purchase invoices or purchase journals for the audit period.

Appellant stated it compiled its POS sales report and handwritten sales worksheet which was provided to an outside representative who prepared the sales and use tax return for the audit period. Appellant provided copies of the handwritten worksheets to the Department and failed to provide copies of POS sales report for the audit period.

The department did not accept Appellant's reported taxable sales due to a lack of reliable reports, low reporting, and high credit card sales ratios. It was also determined that Appellant's report was such that sales could not be verified by a direct audit approach. Therefore, the Department determined audit sales using the credit card sales ratio method instead of the voided cash sale percentage 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 reportable taxable sales. First, the Department tested Appellant's POS system. Appellant used an open POS system to record its sales for the audit period.

The Department made five cash-controlled purchases to verify completeness of the POS sales information. These purchases were made during the fourth quarter of 2013, and that would be on Exhibit A, pages 52 through 54.

Only three of the five cash-controlled purchases were included in the Appellant's POS sales data, and that would be on Exhibit A, pages 53 and 54.

The POS system data provided by Appellant also included voided sales data, and that would be on Exhibit G, pages 510 through 515, and Exhibit O.

The Department examined the detailed void sales data and discovered that two cash purchases were voided, and that's on Exhibit A, page 54, and Exhibit G, pages 513 and 514.

The Department compared the total cash-controlled purchases of $86.00 with voided cash sale amount of around $48.00 to determine the voided cash sale percentage of 56 percent, and that would be on your Exhibit A, page 51. Therefore, based on the cash-controlled purchases, the Department determined that Appellant voided out 56 percent of Appellant's cash sales, and the Department determined that the taxable sales recorded in Appellant's POS sales data were incomplete and unreliable, and that would be on Exhibit A, page 50.

Also, the Department compared reported total sales of around $872,000.00, which sales reflected on

Appellant's POS system of around $923,000.00 for the period July 1st, 2011, to June 30, 2014, and calculated an overall difference of around $50,000.00 for this period, and that would be on your Exhibit A, page 46.

The Department also compared record sales reflected on Appellant's handwritten sales journal around $830,000.00, which sales reflected on Appellant's POS system of around $923,000.00, and calculated an overall difference of around $90,000.00 for the same period, and that would be on your Exhibit A, page 46.

According to Appellant's POS sales data, Appellant voided around $304,000.00 of its sales for the period July 2011 to June 2014, and that would be on your Exhibit D, page 203.

As based on five cash-controlled purchase tests, the Department determined that Appellant voided around 56 percent of his cash sales, and that would be on your Exhibit A, page 50.

Second, the Department reviewed Appellant's federal income tax returns for years 2011, 2012, and 2013, and the recorded average net income of around $30,750.00 for years 2011, 2012, and 2013, and that would be on your Exhibit A, page 47.

The amount claimed for wages also appeared low for a business operating seven days a week, and that would be on your Exhibit A, page 47. Therefore, the Department determined that the amount of total sales and claimed total expenses are understated.

The Department compared reported total sales to sales reflected on Appellant's federal income tax returns and calculated an overall difference around $20,000.00, and that would be on Exhibit A, page 47.

The Department also compared the reported sales tax with sales tax reflected on Appellant's federal income tax return and calculated an overall difference of around $2,000.00, and that would be on Exhibit D, page 152.

Third, the Department compared reported taxable sales of around $760,000.00 to the purchase of $295,000.00 reflected on Appellant income tax returns and calculated an overall reported book markup of around 157 percent, and that would be on your Exhibit A, page 49.

However, based on the items sold, many prices customer pays, and the location of the restaurant, the Department expected to see a higher book markup than the reported book markup for this restaurant.

Fourth, the Department reviewed 30 months of Appellant's available tax statements which disclosed Appellant did not deposit any of his cash sales into his bank for nine months of the 30 months, and that will be on Exhibit D, pages 245 and 247.

The Department also noted Appellant only deposited $110.00 for the month of February 2013, and that will be on Exhibit D, page 245. The Department also compared the net bank deposit of around $890,000.00 with cash deposits of around $85,600.00, reflected on Appellant's available bank statements and calculated an overall cash deposit of around 10 percent for the period January 2012 to June 2014.

However, based on the menu prices, customer base, and location of the restaurant, the Department expected to see a higher cash deposit ratio than the calculated cash deposit percentage for this restaurant.

Fifth, Appellant did not provide complete sales information for the audit period, therefore, the Department obtained Appellant's credit card sales information for the audit period, and that would be on your Exhibit D, page 48.

The Department compared the report of total sales to the credit card sales and calculated an overall quarterly credit card sales ratio of around 80 percent, ranging from as low as 66 percent and as high as 87 percent for the audit period, and that would be on your Exhibit A, page 48.

Based on audits of similar restaurants in the 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 the Appellant's cash sales transactions had been reported in its sales and use tax return for the audit period.

In contrast, based on the observation testing information, a calculated credit card sales ratio was around 62 percent, which the Department determined to be a more reasonable credit card sales ratio, that would be on your Exhibit B, page 78.

The Department also compared recorded credit card sales reflected on Appellant's POS system with credit card sales reflected on 1099A and calculated an overall difference of around $23,000.00 for the same period, and that would be on your Exhibit A, page 41 to 43.

Appellant was unable to explain the reason for the low average net income, federal income tax returns difference, sales tax difference, low recorded book markups, low cash deposit percentage, and high credit card sales ratios. Therefore, the Department conducted a site observation.

With Appellant's permission, the Department returned to Appellant's restaurant on June 19, 2014, to complete its first site observation. During the site observation, the Department observed the Appellant entered its online third-party sales through Grubhub and Eat24 into its POS system as cash sales so that food preparation orders could be generated for the kitchen staff. However, these online third-party sales were excluded when calculating Appellant's audit of credit card and credit card ratios, and that would be on your Exhibit B, page 78.

Before the Department would perform additional observation of the business, Appellant sold the business on July 15, 2014, without giving a reasonable notice to the auditor staff, and that would be on your Exhibit G, page 458.

This obstructed the Department's ability to gather additional complete facts about how Appellant conducted daily sales at Appellant's location. It also prevented the Department from determining any financial way to Appellant's actual cash and credit card sale on different days and times of the week.

Based on the one-day observation test, the Department calculated an audited credit card sales ratio of around 62 percent, and a credit card calculation of around 11 percent, and that will be on your Exhibit B, page 78.

Appellant did not provide any information that the condition on Thursday, June 9, 2014, was significantly different than the condition during the audit period. In fact, the site observation test was performed within the audit period.

Appellant failed to provide credit card merchant statement for its 1099K forms to establish credit card sales for the audit period; therefore, the Department obtained Appellant's credit card sales information for the audit period, and that would be on your Exhibit A, page 43.

And then the Department used the credit card sales of around $871,000.00, and credit card ratio for around 11 percent, and applicable sales rate factors, and credit card sales ratio of around 62 percent to determine audit sale around $1.2 million for the audit period, and that would be on your Exhibit A, pages 40 and 41.

The Department then compared the audit of taxable sales with reported taxable sales of around $894,000.00 and determined an unreported taxable sale of around $261,000.00 for the audit period, and that will be on your Exhibit A, page 39. Had the Department used the audited voided cash sale percentage of 56 percent, and recorded cash sales for the audit period to determine unreported taxable sales, this would include the unreported taxable sales by over $71,000.00 for the audit period, and that would be on your Exhibit A, page 50.

The audit calculation of unreported taxable sales based on credit card sales ratio approach was reasonable and was in Appellant's favor since it was the lowest of the differences determined.

In addition, the Department observed Appellant's sale of food and beverages to online deliveries to Grubhub and Eat24. The Department determined that the online delivery services were acting as Appellant's agent, and that Appellant was the retailer of food ordered through the online delivery services.

Appellant provided Grubhub sales summary reports for the period of October 1st, 2011, to July 16, 2014, and Eat24 sales summary reports for the period July 26, 2011, through July 15, 2014, and that would be on your Exhibit E and F.

Appellant believed that sales made to Grubhub and Eat24 were expenses and did not report these sales to the Department. Therefore, the Department determined on reported taxable sales of around $56,000.00 to Grubhub and around $60,000.00 to Eat24, and that would be on your Exhibit B, page 81 and Exhibit C, page 121.

In total, the Department determined unreported taxable sales of around $377,000.00 for the audit period, and that would be on your Exhibit A, Page 37. Unreported taxable sales were compared with reported taxable sales of around $894,000.00 to calculate the under rate of 42 percent for the audit period.

The Department analyzed Appellant's available business expense information to verify the reasonableness of audit findings. Appellant did not provide complete sales information, purchase invoices, wage information, insurance information, bills 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 would be on your Exhibit D, page 47.

The Department reviewed Appellant's available federal income tax return and ordered wages and wage-related expenses that were not accurately reflected in Appellant's federal income tax return, and that would be on your Exhibit A, page 47.

The Department also found Appellant did not report enough daily sales to cover its actual daily expenses. The ratio reported daily expenses to reported daily sales was 105 percent, and that would be on Exhibit A, page 47. 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 of its sales and used tax return for these years.

A similar analyses comparing reported daily expenses to average audited daily sales in 2011, the ratio of daily expenses audited daily was 70 percent. In 2012, it was 73 percent, and in 2013, it was 75 percent, and that would be on your Exhibit A, page 47. Based on these analyses, the Department concluded the audited taxable sales, and that would be on your Exhibit A, page 47.

Appellant contends that the one-day observation test is not accurate to determine a representative credit card and a credit card ratio, and is not in compliance with the Department's audit manual. Appellant asserts that the Department had sufficient time prior to July 15, 2014, when the business was sold, to perform additional observation.

Appellant argued that cash sales and credit card sales composition can vary greatly on different days than that. In fact, Appellant believed that a 62 percent credit card sale and 11 percent credit card tip ratio are extremely low and would expect a higher credit card ratio and a credit card tip ratio for a sit-down restaurant such as Appellant's.

As stated earlier, before the Department could perform additional observation of the business, Appellant sold the business on July 15, 2014, without giving a reasonable notice to audit staff. Therefore, the Department used the best available information to determine Appellant's credit card sales and credit card tip ratios to determine audited sales for the audit period.

Appellant has not provided any documents to show that sales during the observation test were not representative to our sales during the audit period. Appellant has not provided any documental evidence such as complete POS data for other periods within the audit period to show its credit card sales ratio and credit card tip ratio are higher than the audited ratios.

As mentioned earlier, they reported low book markup and high expenses to sales ratio, and low net income indicator, the taxable sales reported on the sales and use tax return were understated. Accordingly, the Department rejects Appellant's argument that its credit card sales ratio and credit card tip ratio are higher than the audited ratios.

Appellant asserts that all sales were recorded in the POS system except for two cash controlled purchases, and, therefore, assert that the POS sales report accurately reflects the same. The Department rejects these assertions, because in the Department's audit experience in conducting the audit of all similar businesses, the manager's approval would be necessary to void transactions in the POS system.

That's the unexplained absence of 56 percent of

Appellant's cash-controlled purchases of Appellant's POS sales data is strong evidence that Appellant's POS data inaccurately reflected Appellant's actual sales.

Appellant also contends that Grubhub and Eat24 are the retailers of food sold through their respective website, that's explaining the Appellant is making sales for resale for the food to Grubhub and Eat24. And, here, the Department had to determine whether Appellant was a retailer of food at issue and online ordering services for the agent for Appellant for the online ordering services of the actual retailers of the food at issue.

An agent is one who represents another called a principal in dealing with third person. Such representations are called agent, specifically an agent has the power to alter legal relations between the principal and third party, and the principal has the power to control the agent with respect to matters entrusted to them.

Appellant set the food and beverage prices for Grubhub and Eat24 to display on their respective websites. Grubhub and Eat24 collects payment and proceeds including sales tax reimbursement after deducting fees for its services to Appellant. To determine the relationship between Appellant and third-party online service providers, the Department requested Appellant's contractual agreement directly from Grubhub.

The Department received a copy of Appellant's Grubhub sign up form that states as well that Grubhub shall be an independent contractor of Appellant and provide services to Appellant including advertising, sales, and revenue collection, and that would be on your Exhibit E, pages 322 and 323.

According to the sign up form, Appellant must provide to Grubhub an included copy of its current in-store menu, notifying Grubhub in writing to any changes to the menu at least seven days before the changes goes into effect, and that it shall be solely responsible for losses arising in connection with Appellant's sale of food and drinks, including the calculation of payment of sales tax to the appropriate taxing authority combined with any applicable laws, taxes, and compliance with headquarters with respect to food preparation and all matters concerning the quality and condition of the food and beverages.

Based on Appellant's responsibilities, it is clear that Grubhub has no control over Appellant's business operations. Appellant is the preparer and seller of food, able to set its own prices on food items, and Grubhub is merely a commute for customers to place their orders online. Therefore, for all of these reasons, the

Department determined that Grubhub is an agent for Appellant and rejects Appellant's argument related to Grubhub.

Regarding Eat24, Appellant did not provide a contract or agreement to determine the relationship between Eat24 and Appellant. Appellant bears the burden of proving its right to an exception. Instead, the Department reviewed Eat24's main website on July 9, 2017, which states that the website allowed consumers to order food delivery from your favorite restaurant, and that would be on your Exhibit K, page 556.

This statement makes it clear that Eat24 is not the retailer of food, but merely an online platform allowing customers to order food from restaurants like Appellant's and to arrange for delivery, and that would be on your Exhibit K, page 556.

The Department also examined the Eat24 sales summary reports Appellant provided, and that would be on your Exhibit F. The Department knows that the amount due to the Appellant for sales made through Eat24 is calculated from the total of credit card sales including sales tax reimbursement and tips less credit card processing fees incurred by Eat24, and Eat24's commission on cash and credit card sales. Thus, the Department determined that Eat24 pays to Appellant the same tax collected on credit card sales on behalf of Appellant.

Once rendered to Appellant, it is the Appellant's responsibility to file and remit the sales tax to the Department. Therefore, for all of these reasons, the Department determined that Eat 24 is an agent for Appellant and rejected Appellant's argument relating to Eat24.

As mentioned earlier, Appellant did not provide complete source documentation such as complete sales receipts and copies of contracts between Appellant and third-party online service providers. Appellant did not provide complete purchasing 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 alternative audit method was used to determine unreported sales tax. Accordingly, the Department determined the unreported sales tax based upon the best available information. They didn't show that audit method produced unfair and unreasonable results.

Appellant has not provided any reasonable documentation or writings to support an adjustment to the audit finding, therefore, the Department requests the appeal be denied. This concludes our presentation. We are available to answer any questions the panel may have. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. So I did have one question. I wasn't sure if CDTFA, why they didn't just use the total POS sales plus the voided sales to treat that as the total gross sales for the period as opposed to doing the indirect audit approach or how that would impact the liability if they did it one way versus the other?

MR. SAMARAWICKREMA: During the audit evaluation, the Department concluded that the Appellant's POS data is not reliable. And, also, that it is incomplete. And, also, when we checked the POS data, and we saw that -- the Department saw that they segregated credit card sales and cash sales. So even if you take the recorded -- the credit card sale reflected on the POS system, that now is less than the actual 1099K information. So it is the Department's position that the POS data is incomplete and not reliable, and that's the reason we rejected the Appellant's POS information.

ADMINISTRATIVE LAW JUDGE KWEE: Okay.

MR. PARKER: I would like to add something. The POS data download goes through May 29th of 2014, and the audit period goes from June 14th of 2014. If you add the amounts from the POS data that is in Exhibit P, it's

$922,000.00, and you add that to the voided amount in Exhibit O of $314,000.00, it's a little over $1.2 million -- or $1,236,000.00 or so.

Our audit assessed $377,000.00, and the taxpayer reported taxable sales of $893,000.00, so it was about $1,271,000.00 that we came up with, which is about $34,000.00 difference, which could also be explained with those remaining six and a half to seven weeks of the audit period that aren't in the POS data.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. I see what you're saying. And just to be clear -- going back to the first comment. Just to be clear about the POS data being unreliable. Because my understanding is that there's two undercover transactions. They were picked up in the voids; is that right? -- it just wasn't in the sales, but they were in the voids, or are you saying that there were transactions that were not in either of those?

MR. SAMARAWICKREMA: And, also, the credit card sales listed on the POS is less than the actual credit card for the 1099K.

ADMINISTRATIVE LAW JUDGE KWEE: And the second point was the 1099K amounts exceeded the total of the POS amounts, and then there was this six-week gap, but even if you do consider that, you are saying that it's pretty comparable if you look at total amounts in the POS and what was asserted by CDTFA, notwithstanding that, you are saying it's still comparable to the $35,000.00 difference which could be attributed to the gap?

MR. SAMARAWICKREMA: Right.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. I think that was my only question for CDTFA.

I'll turn it over to Judge Cho. Did you have any questions for CDTFA?

ADMINISTRATIVE LAW JUDGE CHO: I don't have any questions at this time. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. And Judge Long, do you have any questions for CDTFA?

ADMINISTRATIVE LAW JUDGE LONG: With respect to the observation test -- I'm looking at the Assignment Activity History, Exhibit A, and I see that the auditor visited the business on May 30th, and then the observation test itself was conducted on June 19th. The business was sold on July 15th; right?

MR. SAMARAWICKREMA: Yes.

ADMINISTRATIVE LAW JUDGE LONG: And then I don't see any notation to when CDTFA was informed. Was that a surprise?

MR. SAMARAWICKREMA: Do you mean the closeout?

ADMINISTRATIVE LAW JUDGE LONG: Yes.

MR. SAMARAWICKREMA: Yes, it was a surprise.

ADMINISTRATIVE LAW JUDGE LONG: And, then, is there any particular reason -- even still, that's nearly a month before the observation test and the closeout. Is there any reason that that might occur? It doesn't look like -- according to the Assignment Activity History, there are no entries between June 19th and August 1st.

Is there some sort of explanation as to why no other observation tests would have been conducted in that month-long period between the first observation and the closeout?

MR. SAMARAWICKREMA: Yes. And if you go to Exhibit -- in our exhibit, there is a memo from the audit principal for Glendale indicating that in the two months before, the auditor tried to schedule an appointment, and the previous representative gave so many excuses and delayed the process. And they postponed, again, and scheduled it for June 9, 2014, and I scheduled it.

And you are right, there is a gap between June 17th and June 19th and August 8th. And the auditor report doesn't give any reason why there was that gap. But based on reviewing on other audits, it's typical to have a similar gap because the Department auditor is in the POS download. And, also, it takes reasonable time to analyze and come to a conclusion. Because at the time, June 19th, the Department knew they didn't have enough information to conclude whether they needed additional observations. But by the time the Department decided they needed to do an additional observation, the business was closed.

ADMINISTRATIVE LAW JUDGE LONG: Okay. Do you have a page number of that memorandum?

MR. SAMARAWICKREMA: Yes. Page 104, Exhibit A.

ADMINISTRATIVE LAW JUDGE LONG: Okay. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Judge Long, did you have any further questions?

ADMINISTRATIVE LAW JUDGE LONG: No further questions. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Then I believe CDTFA has waived their closing remarks, so that leaves 10 minutes for Appellant's representative to make any closing remark before you conclude today.

CLOSING STATEMENT

MR. BRANDEIS: Judge Long brings up a good question. There's an observation test done on June 19, 2014, and then they don't make any other entries until August 21, 2014, when they are conducting an exit conference. This is sloppy audit work.

They clearly knew by then that the case was in closeout, and they didn't record that. That's a material event that would have been recorded, received an e-mail and notified today by taxpayer the business is closing out. This is sloppy work.

There were undercover purchases made, but none of the undercover purchases were recorded in the -- the day those purchases were made, how many purchases were made. Normally, when an auditor makes an appointment to do an observation test, so as to avoid continuous back and forth correspondence, we would select three days at the same time, with the knowledge that the auditor could abandon the test at any point along the way.

But this district had got themselves into the habit of just doing one-day tests, which is what happened in Wing Sang. The BOE management became aware of it. This was a widespread problem in Third District -- for Horton's district. I don't know if that's Third or Fourth.

And so the BOA management, in August of 2015, came out with a memorandum that mandated the completion of the observation test fact sheet to put an end to this silliness of doing this one-day test, they could no longer do that because they now have to fill out this sheet and list the three days that they planned on testing.

The Department never planned on doing additional tests, and that's why there's nothing noted between

June 19th and August 1st. They never planned on doing it. We don't know when they were officially notified, but by August 1st, they knew. They could have done testing with the successor.

The successor knew there was an audit going on. The successor knew they were on the hook for successor liability. Arrangements could have been made. They're just doing sloppy work. They're doing sloppy work, and they want to get away with it because since the elimination of the board members, they have been able to get away with it.

There have already been other cases where they don't do the number of observation tests required and they don't have sufficient secondary methods, and previous OTA panels have signed off on that. So they have gotten drunk with power. They don't have to follow the audit manual. The audit manual is meaningless.

If you uphold this with a one-day observation test, you're, essentially -- that's another case where OTA is saying you don't have to follow the audit manual. They could have done additional tests. They did sloppy work. The Z is sloppy, and so is the adherence to the Audit Manual of Policies and Procedures.

On the undercover purchases, we have no idea how many undercover purchases they did. At the appeals conference, Edward Kim told us they did between 10 and 12 undercover purchases, now the Department is saying five.

This is always the problem with undercover purchases. We don't really know. They wouldn't give us even receipts and let us know. We had to go to the board member and threaten to go to a taxpayer right advocate to get that information. Further, to then determine 50 percent of the undercover cash purchases had to have been deleted because of this test to five, we have no way of knowing. They previously told us 10 to 12.

What happened to the other five to seven undercover purchases? Certainly, that would result in a lower percentage of cash transactions being voided. They're just doing sloppy work. They continue to get away with it, so they continue to do it.

On the issue of the online third-party vendors, the Department seems to be suggesting that you can contract away your liability as a retailer and that's not true. That's absolutely not true. It doesn't say that anywhere. We look at who is holding themselves out.

If you read law section 6015, a retailer is one that is holding themselves out to the public as making a retail sale of tangible personal property. That's Grubhub. In fact, there's no contract between the restaurant and the consumer. The contract is between the consumer and Grubhub. And so if you look at Meyer v. State Board of Equalization, they determined in that case there has to be a contract between the consumer and the person making the sale. There's no contract between the restaurant and the consumer. The contract is between the consumer and the online third-party seller.

In fact, if there's a problem with the order and the customer wants a refund, they have to go back to third-party seller. Why? Because they are the one that charged the credit card, there are the one that calculated the tax, they are the one that is collecting the fee.

And, in addition, any refund would be a reduction in the fee so it has to be accounted for by the third party online seller. This is a retailer. They're doing a lot more than just making a delivery. And in some case, they are not even making a delivery.

In April of 2019, the legislature of the State of California passed the Marketplace Facilitator Act. In that act, they created law Section 6041.5 which defined a delivery network company. If the law, as previously written, was sufficient, why would they then have to create this new set of laws to identify delivery network companies?

This is really just a way of defining these third-party online sellers. And the law then gave them the election -- and this is really the only place that I know in the law where this happens. They can elect to be an agent of the restaurant. In no other place is that allowed. There's no other place in the law where we allow somebody to contract away their liability as the retailer. No place.

Can you imagine administratively how audits would be performed? If the auditors went out and the retailer said, "We've got to read our contract because we contacted away the liability to another party"? This is sales abuse tax law 101. Sales tax is imposed on the retailer. It's the liability of the retailer. We just need to identify who the retailer is.

The retailer is the one holding themselves out to the public as being engaged in selling TPP to the consumer, that's Grubhub, that's Amazon. Here, the Department wants to treat these third-party food sellers different from Amazon simply because they are selling food instead of nicknacks. They can't have it both ways. Well, they can now that they've passed the Marketplace Facilitator Act, but that law wasn't in effect during the audit period.

The other thing is they're saying that we didn't give them the contracts. Even if we had them, you are going to presume an agency relationship exists? That's absurd. And like I said, if you read the statute on retailers, it's a matter of -- the Board can create, for the effective administration on the law, scenarios where another party is deemed to be the retailer instead of the person making the sale.

So they did that with, like, Cookie Lee and Scholastic Book. The reason they did that for those companies is for effective administrational law. The Board didn't want to permitize hundreds or maybe even thousands of canvassers and whatnot to collect and remit tax. It was more efficiently handled with Cookie Lee or Scholastic Book.

But, here, that's not the issue. The issue isn't you would have to permitize thousands of third-party online sellers, there is only a few of them in this marketplace. So they can't even argue under 6015 that they're doing so to promote effective administration of law.

Finally, on the issue of not providing records. Again, did the auditor issue a subpoena for the records not provided? The only notice that the taxpayer received was the initial audit notice. There's no notice after that, no letter, no subpoena, nothing documented in the Z saying that, you know, we told the taxpayer this is what we are missing and this is what you provided us. They didn't do that because they had already decided that they wanted to go with this observation test method.

And so if you go with the sloppy work that they have done here, the one-day observation test violation, you are still left with a credit card ratio that's somewhere between 61 and 62 percent. And, you know, the Department said earlier that we are alleging that those were the only two missing transactions in the record.

That is not true. That's not what I said in my opening remarks. We have never said that. We have acknowledged that there is underreporting, it's just not at 61 or 62 percent credit card ratio. That's all I have.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

Judge Cho, I believe we are ready to conclude. Did you have any final questions before conclude?

ADMINISTRATIVE LAW JUDGE CHO: No final questions. Thank you very much.

ADMINISTRATIVE LAW JUDGE KWEE: And Judge Long, did you have anything before we conclude today?

ADMINISTRATIVE LAW JUDGE LONG: No further questions. Thank you.

ADMINISTRATIVE LAW JUDGE KWEE: Okay. So thank you, everyone, for coming in today. This case, the oral hearing is concluded on Tuesday, November 8, 2022. We will be holding the record open for 30 days to allow additional briefing from CDTFA on, one, whether their two exhibits, 2 and 3, and provided by Appellant were records maintained by CDTFA and, two, if CDTFA has any concerns or issues that they would like to note -- excuse me. I was saying 2 and 3, and it should be 3 and 4. And with that said, the judges will meet and decide the case within 100 days after the close, and this concludes the hearing in the appeal of YNL Enterprises. And the hearing is now adjourned.

(The hearing was adjourned at 11:29 a.m.)

HEARING REPORTER'S CERTIFICATE

I, Shelby K. Maaske, 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 27th day of November, 2022.

Shelby Maaske,
Hearing Reporter

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