

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
NEWPORT JEWELERS BY GABE ARIK) OTA NO. 21098578
CORP (REHEARING),)
)
)
APPELLANT.)
)
)

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Thursday, January 19, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
NEWPORT JEWELERS BY GABE ARIK) OTA NO. 19044686
CORP (REHEARING),)
)
APPELLANT.)
)
_____)

Transcript of Proceedings, taken at
12900 Park Plaza Dr., Cerritos, California,
91401, commencing at 1:05 p.m. and concluding
at 3:38 p.m. on Thursday, January 19, 2023,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ ANDREW KWEE

Panel Members: ALJ ANDREW WONG
ALJ SUZANNE BROWN

For the Appellant: STEVEN MATHER
D. ARIK

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

RANDY SUAZO
CHAD BACCHUS
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-14 were received at page 8.)

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

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1 Cerritos, California; Thursday, January 19, 2023

2 1:05 p.m.

3
4 JUDGE KWEE: So we are opening the record in the
5 appeal of Newport Jewelers by Gabe Arik Corporation, and
6 this is a rehearing matter. This rehearing matter is
7 being heard before the Office of Tax Appeals, and the OTA
8 Case Number is 19044686. Today's date is Thursday,
9 January 19th, 2023, and the time is approximately
10 1:05 p.m. This hearing is being conducted in Cerritos,
11 California, and we're also live streaming on our YouTube
12 channel.

13 The hearing is being conducted and heard by a
14 panel of three Administrative Law Judges. My name is
15 Andrew Kwee, and I will be the lead Administrative Law
16 Judge. To my right is Judge Andrew Wong, and to my left
17 is Judge Suzanne Brown. They are the other two members of
18 this panel. All three of us will be meeting after the
19 hearing, and we will produce a written decision as equal
20 participants.

21 Although I will be the judge conducting this
22 hearing, any member of this Panel may ask questions or
23 otherwise participate during this process at any time to
24 ensure that we have everything we need to decide this
25 appeal.

1 For the record, I'd ask the parties to please
2 state their names and who they represent. And I'll start
3 with the representatives for the tax agency, CDTFA.

4 MR. SUAZO: Randy Suazo, hearing representative,
5 CDTFA.

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

8 MR. BACCHUS: Chad Bacchus with CDTFA's Legal
9 Division.

10 JUDGE KWEE: Okay.

11 And I'll turn to Appellant. Would you please
12 identify yourselves for the record.

13 MR. MATHER: Steve Mather for the Appellant
14 Newport Jewelers.

15 MR. ARIK: Daniel Arik for Newport Jewelers.

16 JUDGE KWEE: Okay. Thank you. And I understand
17 that, Mr. Arik, you'll be testifying today?

18 MR. ARIK: Yes.

19 JUDGE KWEE: Okay. Just may I get your name or
20 title. I believe you're an officer of the corporation,
21 but I wasn't clear if you are, for example, president or
22 vice president or what your capacity was there?

23 MR. ARIK: It was a CFO.

24 JUDGE KWEE: CFO. Great. Okay.

25 And I understand CDTFA does not have any

1 objections to hearing testimony from Appellant's witness?

2 MR. SUAZO: No objections.

3 JUDGE KWEE: Okay.

4 And for the exhibits, OTA distributed exhibit
5 binders, which is basically the documents that the parties
6 provided to us, but we distributed that with the minutes
7 and orders a couple of weeks ago. And I understand that
8 CDTFA has Exhibits A through O, and that I did not receive
9 any additional exhibits following our conference the other
10 week. So that constitutes the entirety of CDTFA's
11 exhibits. Is that accurate for CDTFA?

12 MR. SUAZO: That's accurate.

13 JUDGE KWEE: Okay. And I understand, Appellant,
14 you did not have any objections to admitting Exhibits A
15 through O for CDTFA; is that correct.

16 MR. MATHER: That's correct.

17 JUDGE KWEE: Okay. And for Appellant I have
18 Exhibits Numbers 1 through 14, and I did not receive any
19 additional submissions after the conference. So my
20 understanding is that your exhibits -- the entirety of you
21 exhibits are 1 through 14; is that correct?

22 MR. MATHER: That's correct.

23 JUDGE KWEE: Okay. And, CDTFA, my understanding
24 is there's no objections to admitting those documents into
25 evidence; is that correct?

1 MR. SUAZO: That's correct.

2 JUDGE KWEE: Okay. So Exhibits A through O for
3 CDTFA and Exhibits 1 through 14 for Appellant are admitted
4 into evidence without objection.

5 (Appellant's Exhibits 1-14 were received
6 in evidence by the Administrative Law Judge.)

7 (Department's Exhibits A-O were received in
8 evidence by the Administrative Law Judge.)

9 And as far as the issues, we did discuss the
10 issues in this appeal during the prehearing conference.
11 Those issues are summarized in the minutes and orders, and
12 they are also posted on the agenda, so I won't restate
13 those now.

14 But just to confirm for the parties, CDTFA, are
15 the issues that are listed, are those accurately
16 summarized in the minutes and orders and agenda?

17 MR. SUAZO: Yes, it is.

18 JUDGE KWEE: Okay. And for Appellant, is that
19 also your understanding those are the issues for this
20 appeal?

21 MR. MATHER: Yes, that's right. I haven't looked
22 at it recently. There were a couple of issues that we
23 discussed that were not supposed to be, at least,
24 presented or discussed today. And I just wanted to be
25 clear that, for the record, those are issues that we

1 continue to pursue.

2 JUDGE KWEE: Oh, yes. And I did have the two
3 items that while you are free to mention them, the issues
4 that we are asking the parties to focus on were the issues
5 that were listed on the agenda. Although, this is your
6 hearing if you want to talk about those items, you know,
7 of course, you're free to talk about them. But just the
8 focus of the hearing I think would be most helpful if they
9 focused on the issues that are listed on the agenda and
10 that we discussed at the prehearing conference as the
11 primary issues for this appeal.

12 MR. MATHER: I understand.

13 JUDGE KWEE: I'm sorry one second.

14 We were just discussing that the fan of the
15 server is making a rattle again. Are you guys in the
16 audience, you're not having any problems hearing us?
17 That's not a problem for you, is that?

18 MR. MATHER: No, not at all.

19 MR. SUAZO: No.

20 JUDGE KWEE: Then we will just continue.

21 And, Ms. Alonzo, are you having any issues with
22 the background noise?

23 THE STENOGRAPHER: If everyone can keep their
24 voices up, that will be fine.

25 JUDGE KWEE: So yeah, if the parties, if you

1 don't mind speaking just a little louder. It's kind of
2 harder because it's coming from our end, so we're the ones
3 having a problem hearing you as opposed to you guys
4 hearing us. So yeah, if you do speak up a little bit,
5 that would be much appreciated so that our stenographer
6 can capture what is said today.

7 MR. ARIK: Of course.

8 JUDGE KWEE: Thank you.

9 So the time frame that we had discussed at the
10 prehearing conference was that Appellants would have 20
11 minutes for an opening presentation and 160 minutes for
12 witness testimony, and CDTFA would have 30 minutes for
13 their presentation. And then each party would have 10
14 minutes for any closing remarks that they would like to
15 make before we conclude.

16 Does that sound -- is that accurate for you,
17 CDTFA?

18 MR. SUAZO: That's accurate.

19 JUDGE KWEE: Okay. And for Appellant, is that
20 accurate for you too?

21 MR. MATHER: Yes, I think so. I'm not sure that
22 we really want much of an opening statement. We'd rather
23 just kind of get into the presentation.

24 JUDGE KWEE: Okay. And there's just one thing I
25 was going to ask. Are you -- the 160 minutes estimate for

1 the witness testimony, are you anticipating using the full
2 160 minutes, or are you thinking it might be shorter than
3 that?

4 MR. MATHER: I think it will be shorter.

5 JUDGE KWEE: Okay. Because if it's going to go
6 that far, we would have to call a recess at some point to
7 allow our stenographer time to take a rest. But if -- how
8 about I will go for 2 hours and at the 2-hour mark if it
9 sounds like, looks like, feels like we're going to be
10 continuing longer, then I will call a recess.

11 MR. MATHER: Yes. I think we'll be done in two
12 hours.

13 JUDGE KWEE: Okay. Great. With that, I believe
14 we are ready to move on to the parties' presentations.
15 I'll just double check. Are there any questions from
16 either party?

17 CDTFA, do you have any questions before we get
18 started.

19 MR. SUAZO: No questions.

20 JUDGE KWEE: Okay. And for Appellant, did you
21 have any questions before we turn it over to you for your
22 opening statement and witness testimony?

23 MR. MATHER: No questions. Well, I guess the
24 only question is, are we going to just do our statement
25 and testimony now and then have CDTFA do their

1 presentation? Is that kind of the revised schedule?

2 JUDGE KWEE: Yes. So I was thinking that I would
3 start with you. You would do your opening presentation,
4 and then we would have your witness testimony. He could
5 either testify in the narrative, if you didn't want to ask
6 him questions. That's fine too. And I'll swear him in
7 before we get started.

8 And then at that point, because there is
9 testimony under oath, CDTFA would have an opportunity to
10 have questions for the witness. And then I would allow
11 the panel here to ask questions. At that point we turn it
12 over to CDTFA for their 30 minutes once questions are
13 concluded. And then each party would have their 10
14 minutes for closing remarks.

15 MR. MATHER: Okay.

16 JUDGE KWEE: Okay. Then, Mr. Arik, would you
17 raise your right hand.

18 MR. ARIK: Yeah.

19

20 D. ARIK,

21 produced as a witness, and having been first duly sworn by
22 the Administrative Law Judge, was examined and testified
23 as follows:

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25 JUDGE KWEE: Okay. Thank you. You may proceed

1 with your presentation followed by witness testimony.

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PRESENTATION

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MR. MATHER: All right. Again, just to repeat for the record, there are two issues that have been raised previously that have been ruled upon that I wanted to be clear that we're continuing to pursue and maintain. First was the granting of the rehearing motion, which just for the record's sake of discussion of history, there was a -- the taxpayer previously had a hearing with the Board of Equalization in November of 2017, and there was a determination, a vote at that hearing on the day that, five to nothing, that the petition was going to be upheld, and the audit determination was going to be reversed in its entirety.

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And there was also a vote of 4 to 1 to determine that all of the refund claims that the taxpayer claimed to have submitted were, in fact, found to have been submitted and, therefore, the refund would be determined to be fully allowed. After that hearing, I had conversations with the CDTFA, if that's even what they were called at the time. I can't remember.

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And it became apparent that they were deliberately refusing to finalize the determination of the Board because they could drag this out long enough so that

1 the Board would lose its authority on December 31st, of
2 2017, and create the -- and the Office of Tax Appeals took
3 over.

4 So that deliberate refusal or enter or recognize
5 the decision of the Board in that case was successful
6 because this -- then in March the -- the Department filed
7 a request for rehearing based on nothing that was
8 different than what had happened at the Board hearing.
9 And this agency granted it, which we continue to maintain
10 was a gross miscarriage as particularly because the
11 Department we believe was acting in a fraudulent fashion
12 with respect to deliberately withholding the finalization
13 of the decision in the case. So that was five years ago.
14 We're back here now still talking about the same issues
15 with different faces, but we don't believe we should be
16 here.

17 Secondly, the other kind of set-aside issue was
18 Judge Kwee had authored the opinion granting the rehearing
19 motion which in its terms -- by its terms was,
20 essentially, we believe prejudging the record in the case
21 which was necessary to finding on several of the issues
22 that are the more immediate issues we're going to talk
23 about today in which the opinion of the agency is written
24 by Judge Kwee was that there was no substantial evidence
25 to support the taxpayer's position, which certainly sounds

1 like prejudging the evidence based on no hearing at that
2 time.

3 And so therefore, we had asked that Judge Kwee
4 recuse himself, and he has declined that invitation. So
5 that is another issue that we continue to maintain as
6 being erred on the part of the agency. So that aside, the
7 more substantial or the issues that go more to the merits
8 today, the first one is the Department's determination of
9 unreported taxable sales. I have been in practice inside
10 and outside the government for 40 years, and I can say
11 with a great deal of certainty this is the single worse
12 audit I have seen in my career.

13 This was the most -- it was the most unsupported,
14 most inappropriate use of an estimation that I've ever
15 seen. And as there -- just to kind of repeat or go over
16 some of the exhibits that we have that have been admitted
17 into the record the -- in fact, the determination in the
18 audit was that all of the taxpayer's books and records, in
19 fact, tied out completely and there was nothing to
20 indicate that there was anything wrong with those records.

21 Our Exhibit 6 is the -- is, essentially, the
22 proof of the reconciliation of the sales tax returns to
23 the federal income tax -- I'm sorry -- to the general
24 ledger. Again, the reconciliation is almost exact. It's
25 off by a minor, minor percent, not even a single percent.

1 Our Exhibit 7 shows the Department reconciled the sales
2 tax returns to the federal income tax returns, which again
3 left a discrepancy of approximately 1 percent.

4 There was also a test of invoice on a quarterly
5 basis, the actual taxpayer invoices. That's in Exhibit 8,
6 and that resulted in a determination that the invoices
7 matched the general ledger, which matched the sales tax
8 return, which matched the federal income tax return. So
9 every single reporting by any measure all tied out. And
10 so -- and further, I'd say -- I'd point out that Exhibit 8
11 or 9, pardon me, is also evidence that the Department had
12 audited this taxpayer for a later period and a related
13 taxpayer for the same period, and in both cases had
14 determined that the no changes were appropriate.

15 So we basically have a taxpayer that has
16 complete, accurate, and totally sufficient records and
17 yet, we end up with what the Department came up with in
18 this case, which is reflected primarily in one page from
19 the Department's work papers, which I have as Exhibit 10,
20 which is the manner in which a markup method was computed
21 in this case. And so this -- this method basically broke
22 the taxpayer's sales down into six components and
23 estimated without foundation a markup in five components
24 that were not particularly taxable categories.

25 And in essence what that did is by estimating

1 what the cost of goods sold or the cost of sales was in
2 each of those five categories and then pulling that amount
3 out of the total cost of sales from the federal income tax
4 returns, which of course matched the sales tax returns.
5 But pulling out those five categories of cost to sales
6 basically left no cost of sales left for taxable retail
7 sales in California.

8 And based on subtraction of those five estimated
9 amounts, the Department then determined a markup on that
10 taxable, you know, that clearly taxable California retail
11 sales of 120 percent, which was just crazy. I mean, it
12 was 100 percent more than any rational markup. And
13 this -- and so really what this was, this audit was
14 tantamount to just picking a number out of the air. It
15 was backing into a number that they -- it was clear that
16 they wanted to have a 100 percent markup because some
17 jewelry store someplace has a 100 percent markup. And
18 they just did whatever they needed to do to come up with
19 100 percent plus markup.

20 And so that's the basis of the unreported taxable
21 sales in essence is this six-factor estimate to come up
22 with a markup that is just totally bizarre and not
23 grounded in reality whatsoever. The one issue that was
24 not as fully resolved in the audit was the reconciliation
25 of the bank deposits. And so I believe it was after the

1 hearing of the Board of Equalization because that was an
2 issue that was raised.

3 We had further audit discussions, at least, with
4 the auditor in an effort to explain why the bank deposits
5 were more than the sales tax return, the general ledger,
6 and the federal income tax return. The result of that is
7 that, you know, most of those -- most of that excess was
8 conceded by the auditor in this kind of reaudit, if you
9 will. And the rest of them are establish to be loans made
10 to the taxpayer which was a frequent phenomenon and why --
11 an easy reason why those deposits exceeded the report --
12 the reported income.

13 And in Exhibit 13 in our materials, that --
14 there's a summary or a documentation and declarations of
15 all those -- supporting all of those loan amounts, which
16 then fully reconciled the bank deposits to the tax
17 returns, the sales tax returns, the income tax returns,
18 and the general ledger. So we've got every single
19 possible measure of determining whether these records are
20 accurate all tying out to about \$26 million during the
21 audit period.

22 So -- but nevertheless, we're here with this
23 six-factor estimate instead of auditing the taxpayer's
24 actual records. I believe that in the prehearing
25 conference it was determined that the Department had

1 conceded the negligence penalty in the case, so I don't
2 need to address that issue any further, I don't believe.
3 There were also a couple of issues concerning claimed
4 resale and claimed out-of-state sales. The out-of-state
5 sales were sales largely following up a conference in
6 Nevada, in Las Vegas where after the show, sales or
7 jewelry was shipped to an out-of-state seller.

8 The Department found the documentation of the
9 shipments to be insufficient, you know, three or
10 four years after the fact, and ended up with this tiny
11 little error factor, which we do not concede. And then
12 the resale was -- most of the resales that the Department
13 identified were resales to a known wholesaler or known
14 retailer that actually was the person that had sold the
15 taxpayer the Newport Jewelers location.

16 He knew he was in business and knew him
17 personally and knew that he was still in business and
18 still is selling in a different location. And the
19 Department picked those up because there was apparently
20 some lapse of the resale certificate at some point in time
21 in the process. But these were clearly wholesale sales to
22 another retailer that was actively in business. And so we
23 also do not concede those issues.

24 And then I believe that touches all of the issues
25 that are before us today.

1 JUDGE KWEE: Just a quick follow up on that. I
2 believe there was also an issue. The final issue was the
3 refund claims.

4 MR. MATHER: Yes, you're right. Thank you. Not
5 an insignificant issue.

6 So, yeah. The refund claims are kind of a
7 mystery to us because we have in our files refund claims
8 that correspond to every single payment. The process as
9 it started -- you know, again, to explore the history of
10 this case a little bit. There was a petition in response
11 to the Notice of Determination that was filed one day
12 late. So that meant that the amount -- the bill went
13 final. The petition was accepted as an administrative
14 protest and the case went forward, but collection ongoing.
15 And it was being pursued very aggressively.

16 And, in fact, there were a number of levies that
17 were served in the case that resulted in payments. And,
18 in fact, in our Exhibit 14 is the summary of all the
19 payments that were made issued by the Department, every
20 single one of the uneven dollar amounts, and that was a
21 levy payment. And there were multiple levy payments.

22 And then to avoid the constant levy with the
23 collection officer for the Department, the taxpayer
24 setup -- essentially agreed to a continuing levy, if you
25 will, or an automatic debt of \$10,000 to be taken from the

1 accounts, which were in our view product of an enforcement
2 procedure which give us a three-year period of
3 limitations, now six-year period -- or six-month period of
4 limitations for these claims. And based on that and our
5 claim records, we believe all of the claims are timely.

6 And I think that's it.

7 JUDGE KWEE: Okay. Then if you wanted to move
8 over to the witness testimony before we do questions from
9 the Panel?

10 MR. MATHER: Okay.

11 JUDGE KWEE: Okay.

12 MR. MATHER: Oh, you had already sworn him in,
13 right?

14 JUDGE KWEE: Yes, I already swore him in, so you
15 may proceed when he's ready.

16 MR. MATHER: Okay. Great.

17

18 DIRECT EXAMINATION

19 BY MR. MATHER:

20 Q So, Danny, could you explain how the Newport
21 Jewelers location came about and what your history in the
22 business had been before that?

23 A Yeah. So my father moved here into the country
24 from Turkey where we did manufacturing over there. And we
25 started out in the jewelry manufacturing business in

1 Los Angeles, which we still currently have. And we moved
2 into the retail space about 20 years after that where we
3 still have a store currently right now in Fullerton,
4 California. And then when I came to of age, about 18 or
5 19 years old, my father opened up the store Newport
6 Jewelers by Gabe Arik, which Gabe Arik is my brother.

7 So we have a long history of jewelry in the
8 business, but we came originally from the wholesale
9 business. And when we opened up the Newport store, which
10 as well as our Fullerton location, we -- our pricing was
11 always wholesale to the public. We never did high margin.
12 We always do low margin, high volume was our model.

13 Q And so what was the difference with the Fullerton
14 store and Newport store?

15 A The Fullerton store was in a jewelry mart. So it
16 was -- I don't know if you guys ever been to, like, the
17 jewelry mart in Los Angeles. It's essentially, like, a
18 lot of different vendors in the same building. It's the
19 same concept but in Orange County. But it is the same.
20 It was the same thing, I mean, just high volume, low
21 margin.

22 Q So the Newport store was not in a jewelry mart;
23 is that right?

24 A No. It was in a private location.

25 Q And did that have any impact on how much markup

1 you could charge or did charge?

2 A Not at all.

3 Q And why was that?

4 A Because I mean, look, with online and the
5 internet today, you can't over charge clients. There's
6 nothing like that. I mean, you have stores like Zales and
7 Jareds and those kinds of companies that, yeah, I'm sure
8 they have 100 percent, 150 percent markup. But their
9 whole business model is finance, right. Customer walks
10 in. They do self-financing. Customer has poor credit,
11 good credit, it doesn't matter. And now the client is
12 just looking at the financing.

13 We don't -- we didn't have that. We didn't do
14 in-house finance. And especially with that type of crowd,
15 they're constantly going online. They're constantly doing
16 price matching. We're not going to be doing that kind of
17 volume at that kind of a markup. Nobody would buy from
18 us, and we'd go out of business in a couple of years.

19 Q So is your customer base the same type of
20 customer in Newport as it had been in Fullerton?

21 A No.

22 Q How are they different?

23 A It was just, I guess, a little bit more affluent
24 customers. I mean, it's just a different city, different
25 client.

1 Q How did that effect the inventory and the
2 business model for the Newport location?

3 A It was tougher. I mean, we started from scratch.
4 So we had to, you know, build our name, build a reputation
5 in new city, new business. So, you know, we had to build
6 our name, build our customer base over there. But
7 business model, like profit margin, it didn't change. It
8 was the same concept.

9 Q So what was the nature of the jewelry that you
10 sold? Was it buying a piece and selling the same piece?
11 Or how did it -- how did it get done?

12 A No. We're in the manufacturing business. So we
13 don't -- we're not buying from wholesalers who are going
14 to sell the piece completed. We're A, my dad is casting
15 the piece. So we're taking the mold. We're casting it
16 into gold. We're buying the diamonds from our suppliers
17 directly, you know, whether it was in India, Israel, or
18 wherever we're buying the stones from.

19 So we would source the diamond separately. We
20 would cast the gold separately. We would give to one of
21 our diamond centers. And so it was -- I mean, there was
22 maybe 4 to 5 companies involved in a single piece.

23 Q And so there wasn't any way for you to track this
24 specific purchase to a specific sale. Is that fair?

25 A Yeah. I mean, we can -- we could track it with

1 the invoices. But, no, it's not going to be like, oh, you
2 sold this ring for \$1,000, and you purchased that ring
3 from Company B for, you know, \$900. It's impossible. You
4 can't.

5 Q But could you -- did you buy gold and diamonds
6 for one piece at a time, or did you buy, kind of, in bulk
7 and then make them from that inventory?

8 A We bought it in bulk.

9 Q And what of the jewelry sales what percentage of
10 those sales were that type of manufactured jewelry?

11 A I would say about 90 to 95 percent.

12 Q Now you also had watch sales; correct?

13 A Yes.

14 Q So you also had sales of watches; correct?

15 A Yes.

16 Q And was that different in terms of the ability to
17 identify the purchase and the sale?

18 A Yes. Totally different.

19 Q And how is that?

20 A Because you buy a watch with a model number,
21 serial number, and you sell the watch as the same watch
22 with the model number and serial number. So you can trace
23 the watch exactly to the sale from where you purchased it.

24 Q And so during the audit you did a shelf test I
25 believe, of specific sales. And what was the result of

1 that shelf test -- of your own shelf test?

2 A As in like profit margin or --

3 Q Yeah. For profit margin, yeah, or markup?

4 A For like average for all?

5 Q Yes.

6 A It was about 12 percent. Was it 10? It was like
7 10 to 12 percent, I believe. Right.

8 Q And is that -- was that the same for watches or
9 were watches a little higher or lower?

10 A Lower.

11 Q Watches were lower?

12 A Yes.

13 Q And why is that?

14 A Because depending on the brand, especially with
15 the competition out there, watches are very difficult to
16 make money on but the turnover is much higher. As in with
17 jewelry, you're going to sit on an item much longer. You
18 might make a little bit more money. But with watches,
19 margins are sometimes 2 or 3 percent, 4 percent, but the
20 lifelong of the item is not going to last long. So
21 sometimes you can move the same money, you know, 5 or 6
22 times in a month whereas the margin is a lot smaller, if
23 that makes sense.

24 Q And so why were you not competing with a Zales or
25 shopping center jewelry store?

1 A We're a completely different business.

2 Q Describe that?

3 A So Zales are, you know, somewhere in the shopping
4 center. You know, there's a jewelry store and there's a
5 watch store. For us we build relationships. So when a
6 customer comes in one time, we want to capture that
7 customer. We don't want it as a one-time sale. We're a
8 family business. We're not a chain shore. You know,
9 we're not looking at, you know, every single number.
10 We're not looking at -- you know, we see a customer as a
11 relationship and as a lifelong client.

12 If I sell the customer one piece, and I make a
13 300, 400 percent markup, and the guy goes online, and he
14 sees that I overcharged him, he's never going to come back
15 to me again. So I don't want to keep chasing for a new
16 client every single time. When I sell somebody a piece, I
17 want to make a small margin, you know, 8 to 12 percent.
18 No business is going to be in business making no money,
19 but I want that person to know that he got charged a fair
20 price and to come back to me in the future.

21 Q And sometimes do you get more than 12 percent?

22 A Of course. I mean, sometimes it's more than
23 12 percent. Sometimes it's less, but the average is about
24 that number.

25 Q And that's the target for you? Is that your

1 goal? Have you done a financial model to see how that
2 works?

3 A Yeah. I mean, our end goal is always to be at
4 that number. It's not like, oh, my god, it's set in stone
5 we have to make X amount of money, but it always falls in
6 that range.

7 Q And do you lose money sometimes?

8 A Of course. Yeah.

9 Q And what kind of circumstance is that typically?

10 A Sometimes you'll buy a watch at -- you know,
11 let's say you bought a watch for \$10,000. The watch has
12 been sitting there for, you know, 3 or 4 months, 5 months.
13 It's not as popular. It's not as hot. There's not that
14 many clients looking for it. And if you have a client
15 walk in and say, hey, I'll give you \$8,000, you're going
16 to sell that piece so that you can take that money and be
17 able to afford the next item and turn a profit and, you
18 know, use your money. But, yeah, many times. There's a
19 lot of times where we lose money on pieces.

20 Q So in this case on Exhibit 10, the method that
21 the Department used to come up with a markup or a profit
22 margin on the jewelry for sale in California resulted in a
23 markup of about 120 percent. What would you say about
24 that markup for your sales?

25 A It's impossible. I mean, if it's -- I mean, if I

1 was making that much money, I wouldn't be in the store
2 every single day working, you know, 6 days a week,
3 14-hour days. I mean, I'd be on vacation.

4 Q So with manufactured jewelry, how do you
5 determine --

6 A Actually can I --

7 Q Yeah.

8 A Also for that kind of volume and that kind of
9 markup, especially, at that time, you know, this is
10 like -- how many years ago? 10 or 12 years ago, right?

11 Q Yeah.

12 A For that kind of volume for a jewelry store --
13 obviously, money isn't the same today with inflation and
14 everything. The numbers that we were doing were very
15 high. And for a jewelry store to be making that kind of
16 margin doing that volume, it's impossible. I mean, you
17 can ask anybody in the business, you know. A Jareds and a
18 Zales was doing maybe a 10 or 15 percent of the sales that
19 we were doing in jewelry.

20 Q Wait. I'm not following that. So a Zales is
21 doing --

22 A So like say we were doing -- I'm just throwing
23 numbers out. It's not exact numbers, right.

24 Q Right.

25 A Let's say we were doing a million dollars in

1 sales and a Zales and a Jareds at 120 percent markup,
2 they're doing like \$100,000 in sales. They do very low --

3 Q Oh, you mean an individual store, for example?

4 A Yes, like an individual store. They're doing,
5 you know, low production but very high margin where we're
6 the opposite. We want high volume, low margin. It's
7 impossible to sell that amount of jewelry at 120 percent
8 markup. There's not going to be that many people in the
9 world that are going to overpay for it.

10 Q And -- and you said that there was a difference
11 in financing as well; correct?

12 A Of course. I mean, they run their business on
13 financing which until even today. I mean, you walk into
14 your Robbins Brothers, before they even show you a piece
15 of jewelry, they're going to ask you to get financed, you
16 know. You walk in and they say, hey, let's pre-approve
17 you for financing because they do in-house financing. So
18 at that point you're not really looking at, oh, what the
19 price is. It's, like, what can I buy?

20 Q Right. What the monthly is?

21 A Yeah.

22 Q I guess --

23 A And they'll make their money off interest.
24 They're essentially a bank. They're not a jewelry store
25 anymore.

1 Q But then they still have a high markup?

2 A Well, they have to have a high markup, right,
3 because they're approving everybody for financing. So if
4 they're selling an item for \$10,000, and their cost is
5 \$2,500 and they're taking a \$2,000 deposit, now they're
6 only risking \$500. Whereas a store like ours, if our cost
7 on an item is \$9,000 and we're selling it for \$10,000, we
8 would go out of business if we finance. Because if, you
9 know, 20 or 30 percent of the people defaulted, you --
10 you're out of the business. So they have to have high
11 margins.

12 Q And do stores like that, like Zales, they have a
13 lot of defaults on their payment? You're aware?

14 A I'm not aware of that.

15 Q Okay. All right. So in the -- you remember
16 testifying at the hearing before the Board of
17 Equalization; correct?

18 A Yes.

19 Q And one of the issues that was raised in the
20 Board hearing was the -- was the apparent discrepancy
21 between the bank deposits in the company's bank accounts
22 and the amount -- the \$26 million amount that was reported
23 in the general ledger and the sales tax returns and the
24 federal income tax return. Do you recall that?

25 A Yes.

1 Q So what process did we engage in then after that?

2 A We went through every single, sale, every bank
3 deposit, and we just -- it was essentially whether it was
4 transfers from our own company. Because, you know, we had
5 jewelry stores. We had a jewelry store in Fullerton, and
6 we had one in Newport. So we would transfer money back
7 and forth. A lot of times, you know, when one account
8 didn't have enough money to cover something.

9 Or, you know, we did a lot of business with a lot
10 of friends in the business that we built relationships
11 with where sometimes, you know, if you're 30, 40, \$50,000
12 short, you would call that person to wire you,
13 essentially, as a loan. You know, hey, you know, I need
14 \$40,000 before noon so that I can cover these payments.
15 Can you wire it to me? And then they would wire it and
16 then -- for a couple days and then you'll repay the money
17 back. Which we would do the same thing for them as well.
18 Because, you know, every business has cash flow, you know.

19 Q And so I'd like to point out just one aspect of
20 this in exhibits -- our Exhibit 2, 3, 4, and 5. And can
21 you explain what those exhibits are?

22 A Yes. So these are all our sales from 2009, 2010,
23 2011, and 2012, literally, every single one of them. I
24 went through every single invoice, and I put it on an
25 Excel sheet and I did before tax -- the tax amount and the

1 total amount.

2 Q So was this a record that was done at the time of
3 the sales, or was it done after the fact?

4 A After.

5 Q Okay. And what information did you use to
6 prepare this from?

7 A My invoices.

8 Q And so did every sale have an invoice?

9 A Yes.

10 Q And how did you make sure that happened, that
11 there was an invoice for every sale?

12 A I went through all the bank deposits and all the
13 invoices.

14 Q No. I'm sorry. I mean, on a daily basis how did
15 a sale get done so that there was an invoice? I mean what
16 was the process to make a sale back in this day for
17 Newport Jewelers?

18 A Oh, it was with -- we had invoice books. So
19 customer came in, bought an item, customer would -- or the
20 employee would write it on an invoice book, or I myself
21 would write it on the invoice book, and we would decipher
22 whether it was, you know, if it was wholesale -- a
23 wholesale transaction. But every item that was sold had a
24 paper invoice with it.

25 Q Okay. So were there remote sales? Did you ship

1 things?

2 A Of course. All the time.

3 Q And was there an invoice for that? Or how did
4 that get done?

5 A Yes, of course, there was an invoice for that as
6 well.

7 Q And who would do that then? The store employee?

8 A The store employee, yeah.

9 Q And how many employees were there for Newport?

10 A We had about, I believe, 10 to 12 employees at
11 that time.

12 Q And are you highly confident that everybody was
13 preparing an invoice for every sale?

14 A Of course, because the customer needs an invoice,
15 right. If they are buying an expensive item, they're not
16 going to buy it unless they get an invoice or some type of
17 history receipt of the purchase. I mean I know if I was
18 buying a 20 or \$30,000 piece, I would want the invoice
19 with the details of what I'm buying.

20 Q Okay. And so what process or where were these
21 invoices so that you were able to prepare these Exhibits 2
22 through 5?

23 A They were stored in our storage facility in our
24 L.A. office.

25 Q In L.A. So they weren't in Newport?

1 A No.

2 Q And just to be clear, the L.A. business and the
3 Fullerton business are not in the same corporate entity as
4 Newport; right?

5 A No.

6 Q So Newport just was for what? It just handled
7 store sales out of the Pacific Highway location?

8 A Yes.

9 Q And what happened to that location?

10 A We closed it down.

11 Q And why was that?

12 A Essentially from the audit. I mean, it put us
13 out of the business. I mean, it was really, really
14 difficult, you know, multiple times being levied, amounts
15 being taken out. And it got to the point where we were
16 selling merchandise out of the cases to cover the
17 payments.

18 Q Now the other aspect of the bank deposit analysis
19 was tracing each deposit. Do you recall doing that?

20 A From the bank statements; right?

21 Q Yeah, from the bank statements.

22 A Yes.

23 Q And so our Exhibit 11 was a document package that
24 I sent to the auditor for this purpose in October of 2019.
25 So it was obviously after the Board hearing. Could you

1 just take a brief look at that package and describe what
2 you did to prepare those documents?

3 A Okay. For the online transfers between
4 ourselves, right, and like the checks that got refunded
5 and everything?

6 Q Yes. Yes.

7 A Yeah. So I mean, I literally went through every
8 single invoice for the 3 -- it was three or four years,
9 right. And I essentially found every single invoice for
10 it. I mean, I found every single reason for the -- what
11 do they call it? Like the over sales or something like
12 that for the sales that are missing -- the invoices that
13 are missing.

14 Q Well, I mean, were you trying to find sales in
15 the process or were you looking for things that weren't
16 sales?

17 A I was looking for things that weren't sales. So
18 I mean, like, you could see on page 15 you're going to see
19 on 4/20, it's going to say, "Online transfer." This is
20 \$6,000. That's from our own account. That's not a sale.
21 That's literally just to help cover a charge.

22 Q Describe that again. You kind of touched on it
23 briefly, but why is there this money kind of ping-ponging
24 back and forth between you and other vendors or other
25 sellers?

1 A Yeah. So I mean in the jewelry and the watch
2 business it's a very tight-knit relationship, and you do a
3 lot of business going back and forth, and it's high value,
4 high dollar. So there's many times where, you know,
5 you're buying on terms, right. You buy a, you know,
6 package of diamonds for let's say 300 grand, and you tell
7 the person you're going to pay them in a three-month
8 period.

9 So you're paying them every two to three weeks.
10 There are sometimes you write checks and you know the
11 money is going to go through, but you're short. So you're
12 either going to transfer from your own account so
13 obviously you don't bounce the check. Or you're going to
14 ask a friend within the business to lend you the money for
15 a week.

16 Q Okay. And so there was a piece of paper
17 typically that would evidence that loan?

18 A Yes.

19 Q And what kind of paper was that? Was it a
20 promissory note with five pages and notarization or --

21 A No. No. No. It was just -- it was an invoice
22 with us to show the sale, and it was a promise back to the
23 person. I mean, it's all trust, you know. In the diamond
24 and jewelry business, until even today, you buy from a
25 handshake. You're not buy off a contract.

1 There's never been in my life where I bought, you
2 know, a half-a-million-dollar package of diamonds. I've
3 never signed anything. I've never, you know, like signed
4 a contract or anything like that. It's all based off word
5 and trust off a handshake.

6 Q Right. But typically with some piece of paper
7 just to show that --

8 A Yes. Of course.

9 Q -- that had been done?

10 A Of course.

11 Q And that's what is largely in this package for --

12 A Yeah. For every single one of them, actually.

13 Q There's transfers from other companies and --

14 A Of course.

15 Q -- invoices for these notes --

16 A Yes.

17 Q -- these loans, I guess? Not notes.

18 A Yes. And they were all provided for them.

19 Q Right. Right.

20 A Yes.

21 Q And in that -- let's see. Let me see what page
22 number it is. Starting on page 5 there's something that's
23 written at the top", corrections find."

24 A Yes.

25 Q So that was after the initial review by the

1 auditor. And what were these items specifically then in
2 these pages?

3 A Yeah. So you're going to have reversal of
4 overdraft fees. That's obviously like from the bank
5 giving us money back from reversals. You're going to have
6 \$1,495 for a bounced check. So that money, you know,
7 essentially went out or came back in. You have a \$500
8 rebate check. I mean, that's from a company. And then
9 you're going to have the bottom ones which is -- which is
10 going to be most of it, right?

11 Q Right.

12 A You're going to have \$6,000, which is an online
13 transfer from Eternity. Eternity is our other company.
14 You're going to have \$6,550, which is an online transfer
15 from personal. So that's coming from my personal account.
16 And the list goes on. I mean it's an online transfer from
17 Eternity. Loan \$40,000, it's going to be a loan from
18 invoice, and we provided the invoice with signatures of
19 the promissory note.

20 Q So those are the types of things. And then
21 there's handwritten numbers in there and they reference
22 the backup documents that are behind them?

23 A Yes. Yeah.

24 Q And so you personally went through the bank
25 statements and --

1 A Every one of them. Literally, I went through
2 every single bank statement, every single line item. I
3 think I spent maybe like two to three weeks on this going
4 through every single statement line by line and finding
5 exactly what it was and showing it and providing it.

6 Q And do you remember at the end of the day when we
7 found all these items what was -- did it reconcile with
8 the general ledger then?

9 A Yes. Literally to the T.

10 Q And I believe -- let's see. We have that. So
11 this is in that same Exhibit 11. It's pages 3 and 4, and
12 I believe this shows the final reconciliation after the
13 corrections. Is that what you recall?

14 A Yes.

15 Q And so that column for corrections found, which
16 is the second column from the right, corresponds to that
17 schedule we were just looking at that was also called
18 "corrections found;" right?

19 A Yes.

20 Q And the result -- the difference if there -- you
21 know, if there is any, is in the right column which tends
22 to be more deposits than general ledger some months and --

23 A Yes.

24 Q -- less the other; right?

25 A Yeah.

1 Q Back and forth?

2 A Because sometimes it's a timing issue, you know.

3 Q All right. Now we -- I mentioned in my opening
4 statement Exhibit 9, which was some letters from the
5 Department. Can you describe what the circumstances of
6 those were?

7 A Oh, yes. So one of them was for our other
8 company, Happy Jewelers. And the other one was for, I
9 believe the three years after the Newport Jewelers, right?
10 We got audited for Newport Jewelers again for the years
11 after while we were going through this, and for our other
12 jewelry store Eternity Jewelers, and they both came back
13 as zero.

14 Q And were those audits fairly complete audits
15 where the auditors came out and did the same sort of
16 analysis as they had done for the audit that we're here on
17 today?

18 A Yes.

19 Q So the other issues in the case involve some
20 smaller amounts that are attributable to resales -- or
21 wholesale sales and to out-of-state sales. And can you
22 describe your familiarity with those rules, like, from
23 that time when you were running Newport?

24 A For like out of state?

25 Q Yeah. Did you understand what the rules were or

1 how -- and if so, how?

2 A Yeah, of course. An out of sale was with no
3 sales tax as long as it was being shipped, the item,
4 through UPS, FedEx, or USPS. And, you know, wholesale was
5 a wholesale transaction being sold to another jewelry
6 store. And when they sell it, they're going to collect
7 the sales tax.

8 Q And so what did you do to ensure that you were
9 properly tracking those?

10 A We would have invoices in for every single sale.
11 We would take resale certificates, and we would ship every
12 single item. And we would make sure that the person
13 actually owned the home.

14 Q Okay. And in the -- let's see.

15 A We were very strict for out of state, but we did
16 a lot of trade shows for out of state. So we had a lot of
17 out-of-state customers. You know, we did a lot of ASD
18 shows, which are like gift shows. You know, we used to do
19 a lot in Las Vegas. We used to do in Tucson. We used to
20 go, essentially, all over the U.S.

21 I mean once we used to do about 8 to 10 shows a
22 year. So we accumulated a lot of out-of-state clients
23 because a lot of people from the U.S. would go to these
24 shows, but, you know, it wasn't just jewelry. These shows
25 were everything, you know, gifts, jewelry, watches. I

1 mean, pretty much you name it, they had it over there.

2 Q So did they just buy whatever they bought from
3 the show, or did they become customers and buy stuff after
4 you were back home?

5 A They became customers, and they would buy stuff
6 after we got home.

7 Q And so there were -- in the Department's work
8 papers they did a sampling that found a few -- a few
9 out-of-state -- claimed out-of-state sales, which had out
10 of state addresses but the notation was appropriate
11 shipping documents were not provided. What do you think
12 the problem was on those?

13 A You know, sometimes we did USPS sales -- sorry --
14 USPS shipping where we couldn't find -- because USPS
15 wasn't like a FedEx and UPS, right. UPS and FedEx is like
16 a computer system. You could look up the customer's name
17 years down the road and you could find it. Whereas USPS
18 was papers.

19 Q Right. Or at least back then there was papers.

20 A Back then. Yes.

21 Q Is it better now or do you use USPS now?

22 A I personally -- oh, no. Yeah. We do use USPS
23 for our website, and it is a computer now because it's run
24 through our third-party company.

25 Q So if it was U.S. if was a post office, what did

1 you need to do if you wanted to prove that you shipped it
2 out of state?

3 A You need that little, like, receipt that they
4 give you. It's almost like a piece of paper, which we
5 found a lot of them. I mean, we were pretty organized. I
6 mean, we kept all of our paperwork. But, you know,
7 sometimes it's like when you're having a busy day,
8 employee runs across the street to ship a bunch of items
9 and then they go to the bank, then they go somewhere else.
10 I mean, things can happen, right. Everyone is human.
11 They can misplace paperwork or a little receipt.

12 Q But you actually, in your Pacific Coast Highway
13 location, you were almost literally across the street from
14 the post office; isn't that right?

15 A Yes.

16 Q Now on the resales, again, the Department did a
17 sample and came up with a few that they considered to be
18 not active resale certificates. And three of them, I
19 believe from this work paper -- 12 D-1 in the Department's
20 work papers -- three of them are from a company called
21 Newport Watch and Jewelry at 1860 Newport Boulevard. Can
22 you explain what you knew about that customer?

23 A Yes. So he's a really good friend of us. We
24 actually bought our store from him, which he's a jewelry
25 store and a pawn shop. And he moved down to Newport

1 Boulevard right before the 55 Freeway, which he's actually
2 still there, still in business. So I mean, in selling him
3 items, we knew he was in the business because he sold us
4 his physical jewelry store, which was our physical jewelry
5 store. And he moved about a mile and a half to two miles
6 down the road.

7 Q So was there ever any time that you were aware of
8 when he was not in business?

9 A Never.

10 Q And then the other buyer that was listed as not
11 having a current permit was J8/J8 Jewelry Website Circle
12 in Huntington Beach? Are you familiar with them?

13 A I am familiar. I mean, she was a customer that I
14 know sold things privately to a lot of her customers. She
15 wasn't selling, like, in a physical store, but she would
16 do a lot of private showings like trunk shows, you can
17 kind of say. But she was in the business. I mean she
18 would do trunk shows all the time, take merchandise, sell,
19 make custom items, wax. I mean there was no reason to
20 believe she wasn't in the business.

21 Q And so because of the nature of your business,
22 did you typically know your customer?

23 A Yes, of course.

24 Q And so in addition to just asking for a resale
25 certificate, you would be familiar with their business

1 often; is that correct?

2 A Of course. The jewelry business is a small
3 industry.

4 Q And did you have a lot of sales to other
5 retailers or --

6 A Yes.

7 Q And why was that? Why would that make sense for
8 them? Were you getting a similar markup on that, or how
9 did that work?

10 A Yeah. I mean, we were -- we -- how can I say it?
11 We needed the -- I mean, we needed cash flow, you know.
12 So selling to other jewelry stores and other vendors kept
13 the cash flow coming in and out, and it kept the
14 merchandise fresh for when new customers walk in, they are
15 consistently seeing new product in the store.

16 Q So what was the guideline for keeping inventory?
17 I mean, how quickly did you want to turn it over?

18 A Within I would say 20 to 30 days.

19 Q And that would be the same for the manufactured
20 jewelry as well as like a watch that was purchased?

21 A No. Watch is 20 to 30 days. Jewelry is going to
22 be -- I mean, we have some jewelry that's just there for
23 three or four years.

24 Q And is that -- why would you have a difference,
25 or why would you treat those differently?

1 A What do you mean? Like --

2 Q Well, I mean, if you have a watch for over
3 30 days, do you discount it or how does --

4 A Of course. Yeah, yeah. Same with jewelry. I
5 mean, you know, if you have a, let's say, a tennis
6 necklace that has a really big or crazy design that you
7 invested \$35,000 into and the item has been sitting there
8 for two years, three years, and it's essentially dead
9 money, you're going to want to turn it very quick.

10 And if you're trying to get \$40,000 in the
11 beginning and a customer walked in and offered you
12 \$30,000, even though you're taking a \$5,000 hit, you're
13 going to sell it in hopes that you can roll it into
14 something else and make a profit.

15 Q So -- again, for a manufactured piece, like the
16 tennis necklace or bracelet you just mentioned, do you
17 have a sense of how much it cost you or how do you --

18 A Of course.

19 Q And where does that come from? I mean you
20 don't -- are you adding up six ounces of gold and -- or
21 how do you do that?

22 A Of course. So you're going to weigh the item.
23 You're going to see how much it weighs in gold. And
24 within that you're going to know the scrap metal price,
25 and the manufacturer charges you a certain amount of labor

1 to cast that item. So if scrap metal gold is \$30, the
2 manufacturer is most likely going to charge you about \$40,
3 and that's going to cover their cost of taking the, wax,
4 casting it, polishing it, cleaning it.

5 And then after that you're going to take the
6 carat weight of diamonds, which you're going to know
7 exactly how many carat weight it is, because you're going
8 to weigh the diamonds before you give it to the setter.
9 If he asks you for 500 pieces of 2-pointers, it's going to
10 come out to, let's say, 10 carats of diamonds. And from
11 those 10 carats of diamonds if you paid, let's say, \$500
12 per carat, that comes out \$5,000 plus let's say you have
13 \$1,000 in gold. That's \$6,000. And then the \$500 a
14 carat, if your setter charges you \$40, that's \$2,000. So
15 you're at \$8,000 so far and the polish, rhodium, and all
16 that stuff, it's going to cost you about \$8,300. So yes,
17 you will know the cost.

18 Q And you could -- it sounds like from your
19 description that you could look at a finished piece and
20 basically know exactly what that cost you to put together?

21 A Yes, of course.

22 Q And that would be within a very --

23 A To the exact.

24 Q -- margin? I mean --

25 A To the exact money.

1 Q Yes, so within 5 percent one way or the other?

2 A Yes.

3 Q Or even closer?

4 A Even closer. Probably within 1 percent.

5 Q So when you say that you're selling that for a
6 profit margin of 10 percent or so, then you have a really
7 good idea that that's 10 percent?

8 A Yes. I mean, if I didn't know my cost on items,
9 I would go out of business.

10 Q Now one of the issues in the case is the refund
11 claims. And can you describe again how -- what the
12 process was or how you came to be making all these
13 payments -- these individual payments? I mean, there's 30
14 or 40 payments?

15 A Yeah. They would just take it straight out of my
16 account.

17 Q So but go back to the beginning and what the
18 process was with the collection people at the Department?

19 A The day that we turned the item in one day late,
20 we woke up in the morning and our account was zero
21 dollars. Literally, they flushed everything out. They
22 flushed the credit card merchant account. Any money that
23 was incoming, whether it was wires, checks, zeroed out.
24 So we obviously went to the bank and asked them what it
25 was, and they told us it was a levy.

1 And they essentially wanted all the money, so we
2 had to go on a payment plan. So every month they would
3 take \$10,000 out on the exact date, and if we missed the
4 payment, they would levy the account again. It was -- it
5 was tough.

6 Q So how did you miss a payment? If the Department
7 was taking the money, you know, automatically, how did you
8 miss?

9 A If there wasn't money in there. If there wasn't
10 money to cover it.

11 Q So your process throughout this period was -- I
12 mean, you knew which day and you tried to make sure there
13 was money? Is that how it worked?

14 A Yes.

15 Q And so in this Exhibit 14 that we've provided,
16 there's several payments that are -- of uneven dollars and
17 lots of \$10,000 payments.

18 A Yes.

19 Q So can you describe how those two categories of
20 payments would be made?

21 A Yeah. \$10,000 was the ones that we obviously --
22 every month they would take it on the exact date, and the
23 uneven numbers were most likely levies that they pulled
24 out, whether it was from the bank account, from the
25 merchant account.

1 Q So explain to me what the difference is between
2 the bank account and the merchant account and wherever you
3 decided to get money?

4 A Yeah, of course. So the bank account is what
5 you're going to essentially have in your Wells Fargo or
6 Bank of America. That's liquid ready for you to use.
7 Merchant account is, you know, let's say you come to me.
8 Let's say I have 10 customers that come in that day and
9 they spend \$100 each. I'm going to have \$1,000 in that
10 merchant account which is either going to come the next
11 day or 48 hours later. The State Board of Equalization
12 intercepted it before it went into my account and made
13 sure that it didn't come in and they took it.

14 Q So that's credit card sales then? That's what
15 makes it a merchant account?

16 A Yes.

17 Q And that account doesn't have money in it for
18 very long, I guess, or --

19 A No. It's maximum 48 hours. Like, American
20 Express is 48 hours. Everything else is 24 hours.

21 Q But you regularly had credit card sales?

22 A Daily. Of course, I mean, if -- at any day we
23 had credit card sales. Yeah.

24 Q Okay. So you knew that the Department was
25 levying and was drawing money from your bank account for

1 this payment. What did you attempt to do to make sure
2 that you -- I mean, you didn't agree with that balance at
3 the time, did you?

4 A No.

5 Q And so what did you make sure -- what did you do
6 to make sure that you had -- preserved your right to get
7 the money back?

8 A We would make the refund claims.

9 Q And who helped you with that?

10 A It was Terry Stept and myself.

11 Q Okay. Describe what the process was as if -- you
12 know, if you knew a payment got made, what did you do?

13 A We would most likely most of the time, we would
14 do it either, you know, a month after. Or sometimes we
15 would accumulate it where it was 2, 3 and we would send it
16 in at the same time. But we made sure -- I mean,
17 obviously, right, if I'm paying the money and I feel like
18 I don't owe the money, I want to make sure to put the
19 refund claims in. I mean, it's a piece of paper sending
20 it in. It's not difficult.

21 Q And where did you send the claims? Do you
22 recall?

23 A We sent it to the State. I mean, it was like
24 eight or nine years ago. So we sent it to like the State
25 Board of Equalization, I believe.

1 Q So did you send it to the collector, or did you
2 send it someplace else?

3 A No. We sent it to the address that was on the
4 paper. Yes.

5 Q Okay. And if there were 50 payments or 40
6 payments here total, so you prepared a claim for every
7 single one?

8 A Yes.

9 Q And then did you -- so you attempted to send it
10 in every single time there was a payment?

11 A Yes, of course.

12 Q And was there ever a time where you fell behind
13 farther or sent another set of claims? Or do you recall?

14 A No, not past the six months, or not past what
15 they said was the deadline. We sent it in a timely manner
16 every single time. There was no reason for us not to.

17 Q And, you know, the Department claims that they
18 don't have records of every one of these claims in their
19 file. What do you attribute that to?

20 A I have no idea. I mean, there's sometimes during
21 that time -- I don't know if you recall -- we called
22 multiple times, and one day they said, "Yes, you're fine.
23 Don't worry all your refund claims are in."

24 Some days they would say no. I believe it was
25 like four or five different occasions where we called in

1 and the person on the phone gave us a different number.
2 Maybe they didn't get it on time. Maybe they didn't see
3 it. I -- I have no idea.

4 Q If I can have a minute? Thank you. A couple of
5 more items before I'm finished, Danny. Now I'm looking at
6 Exhibit 13 now. And, again, this goes back to the kind of
7 the bank deposits analysis, but I forgot to bring it up at
8 the time. Can you take a look at that and describe what
9 that is.

10 A Yes. This is the schedule for the loans that we
11 took from people within the business.

12 Q Okay. And documents that are behind this summary
13 are --

14 A Yes. These are signed and sworn affidavits by
15 the people that we took the money from that you can even
16 see in the bank deposits would most likely match saying
17 that they lent us this money on those exact dates.

18 Q And so describe who these people are so we get a
19 better idea of why they were loaning you money. I mean,
20 these aren't banks; right?

21 A No. These are other dealers and other vendors
22 within the business, within the diamond and jewelry
23 business and the watch business that we regularly did
24 business with.

25 Q So who are -- just go through the list. It's

1 only half a dozen or so, and describe who those people
2 are.

3 A Yeah. Meta is Nick and Jay. They own a diamond
4 business in Los Angeles, California. They're very close
5 friends of ours. We've been doing business with them for
6 about 25 years. His whole family came to my wedding.
7 John Mitchum is the person that I bought my store from who
8 I regularly did business with.

9 Q Now which store was that? Was that --

10 A Oh, this was Newport Watch and Jewelry.

11 Q Oh, Mitchum was Newport Watch?

12 A Yes.

13 Q Oh, okay.

14 A Yeah. And then you're going to have Burdeen's
15 Jewelry, which is in Chicago. They own a really big
16 retail store over there who we still until today we
17 manufacture a lot of their jewelry and their custom
18 jewelry. You're going to have Misha Mottale who has a
19 place in San Diego. He's in the watch and jewelry
20 business and also in antiques. Mike Bekdas Anderson is my
21 cousin who is also in the watch and jewelry business that
22 I do a lot of business with.

23 And then you're going to have Burdeen again.
24 You're going to have Mike Bekdas again. All the other
25 ones are the same. And then you're going to have John

1 Dekker. John, I still until today do business with. He
2 has a store in Newport Beach today which is called the
3 Greenwich Time. We would -- I mean, we still we do a lot
4 of watch business together. And then you're going to have
5 the same names, Burdeen, Bekdas, Burdeen, Burdeen. And on
6 the following pages you're going to have their sworn
7 affidavits.

8 Q So describe this process to me again. I mean,
9 how does this come about. I mean, describe when you need
10 the money, let's say, and what you do to get it?

11 A Yeah. So when you wake up in the morning and you
12 realize you're 40 or \$50,000 short in your account and one
13 of your vendors put in a check in; so you don't bounce the
14 check, you're going to call that person and say, hey, you
15 know, send me \$40,000 for a couple days, and I'll return
16 it.

17 Q And so this group of half a dozen of people or so
18 would just do that pretty much at any time you asked?

19 A Yes.

20 Q And did you reciprocate then?

21 A Of course. There's many times where they would
22 call me as well. Hey, you know, I need 40, \$50,000, and
23 if we had it, we would send it instantly. No questions
24 asked.

25 Q And would it be ever as long as a week or two

1 weeks or a month, or was always very short term?

2 A Always very short term. I mean, max, max would
3 be maybe two weeks. But other than that, it was very
4 short term within a couple of days.

5 Q All right. Now the other exhibit, I think maybe
6 about the only one that we provided that we haven't talked
7 about is Exhibit 1, which is the transcript from the
8 hearing before the Board of Equalization. Do you recall
9 that hearing?

10 A Yes.

11 Q And how was that -- I mean, how did that go?
12 What's your recollection of that?

13 A So we present our case, and the Board was in
14 favor of us because they looked through all the documents.

15 Q And, in fact, the Board members had done work on
16 their own in the case; isn't that right?

17 A Yes. They went through the whole case and looked
18 at it.

19 Q And what ruling do you recall they made with
20 respect to the refund claims?

21 A They ruled it in our favor that they were all in
22 a timely manner.

23 Q And what evidence, if any, did the Department put
24 on at that time that they hadn't received the claims?

25 A None.

1 MR. MATHER: I don't believe I have any further
2 questions.

3 JUDGE KWEE: Okay. Thank you.

4 I will turn it over to CDTFA. If CDTFA has any
5 questions for the witness, now is your opportunity.

6 MR. SUAZO: No questions.

7 JUDGE KWEE: Okay. I will start Judge Wong.
8 Judge Wong, did you have any questions for the witness?

9 JUDGE WONG: Yeah. Actually, I do have a few
10 questions mainly just background about your business. So
11 you described your business model as low margin and high
12 volume; is that correct? But your family has related
13 businesses in Los Angeles and also in Fullerton. How did
14 you decide to enter the Newport Beach market?

15 MR. ARIK: Yeah, of course. So our store in
16 Los Angeles is a manufacturer, so we only wholesale over
17 there. We don't do retail business. So John was actually
18 a client of my dad's, the person I bought the store from,
19 the Newport Watch and Jewelry. So when he was moving to
20 his new location, because he actually bought the building
21 he was in, he said, "Hey, you know, I know your son."

22 I was working with my dad at the time. "He's
23 coming of age. I know he's 19, 20 years old." I was
24 young at that time. "I have a great location. It's in
25 Newport Beach. It's right on the marina. You should

1 think about taking it over."

2 And, you know, my dad and my brother went and
3 looked at that location at the time and they liked it, and
4 that was how it came about.

5 JUDGE WONG: Did you operate it differently than
6 the other two businesses, the one in Newport Beach?

7 MR. ARIK: In regards of like separate business
8 or business model?

9 JUDGE WONG: I guess business model.

10 MR. ARIK: No. It was essentially wholesale to
11 the public, and that's still how we operate our business
12 now.

13 JUDGE WONG: Is there -- your competitors, are
14 there competitors that operate the business similar to you
15 where they do manufacturing as well as wholesale and
16 retail, diamonds, watches, jewelry?

17 MR. ARIK: Yeah, of course. So in the jewelry
18 business a jeweler is one thing and a watch dealer is one
19 thing. We were one of the very few that actually had
20 both. But in that regard, yes. I mean, all of the
21 downtown jewelry mart is essentially wholesale to the
22 public. You are going to have in the watch business there
23 was people that were within a one-mile radius of us.

24 You're going to have Winston's Jewelers. You're
25 going to have Jewelers On Time. I mean, there was a lot

1 of competition in that area. You have the Tustin Jewelry
2 Exchange. It was huge. They're right off the 55. They
3 do commercials all the time. They would sell at wholesale
4 pricing.

5 JUDGE WONG: So the reason I'm asking is that
6 looking through the record it looks like CDTFA was
7 expecting a markup -- a retail markup around -- they had a
8 range, like, from 100 percent to 250 percent. But it
9 looked like your businesses markup was substantially less
10 than that. So I was wondering if, like, your business was
11 kind of like a unicorn, or do your competitors have
12 similar -- competitors who have a similar business model
13 have similar markups, if you're aware? Just curious.

14 MR. ARIK: Well, I mean, we were -- we were a
15 completely different business. Because in terms of
16 volume, I mean, to a single store, not a -- I don't want
17 to say Robbins Brothers in general, right, with their 100
18 stores. But at that time, like a Kay's single store, just
19 their one store, yeah, we were probably 10 to 15 times the
20 amount of sales that they were doing out of a single store
21 than they were.

22 So yeah, we're -- we're a totally different
23 business than them. I mean, there's no way that you're
24 going to do that volume and you're going to find that many
25 people in a single month to do a markup like that. It's

1 just impossible. We didn't do any marketing. We didn't
2 spend, you know, hundreds of thousands of dollars in
3 marketing. It was all word of mouth.

4 JUDGE WONG: Okay. Just moving onto a different
5 topic, the refund claims. Did you sign every one of those
6 retail claims, or did your representative sign the retail
7 claims -- the refund claims?

8 MR. ARIK: Yes, I believe we signed them.

9 JUDGE WONG: Do you have copies of those signed
10 refund claims? Because it looks like in the record there
11 are copies of refund claims, but they're not signed.

12 MR. ARIK: I believe they're signed, right,
13 Steve?

14 MR. MATHER: Yeah. No.

15 MR. ARIK: They're not signed?

16 MR. MATHER: We didn't have signed copies.

17 JUDGE WONG: Okay. Thank you. That's all the
18 questions I had for now.

19 JUDGE KWEE: Judge Brown, did you have any
20 questions for the witness?

21 JUDGE BROWN: Yes, thank you.

22 Let me start by asking to go back to your
23 testimony about resale certificates.

24 MR. ARIK: Yes.

25 JUDGE BROWN: You indicated that you did collect

1 resale certificates. That was part of what you did for
2 your record keeping to keep track of the sales for resale?

3 MR. ARIK: Yes.

4 JUDGE BROWN: Okay. But for the sales that
5 are -- the sales for resale that are in dispute here, you
6 did not have any resale certificates; correct?

7 MR. ARIK: We did.

8 JUDGE BROWN: Oh, you did?

9 MR. ARIK: We did.

10 JUDGE BROWN: All right.

11 MR. ARIK: I believe they were expired. It was
12 just like an error. It was human error. I mean, we
13 didn't realize that they were expired, but I mean the
14 people that we were doing business with, we knew they were
15 in business. I mean, yeah, he had a physical store. He
16 still has a physical store until today.

17 JUDGE BROWN: So you're saying that he gave you
18 like a blanket resale certificate?

19 MR. ARIK: He probably just gave us the old one,
20 and we didn't -- we just kind of overlooked it. It was
21 just a mistake on our end. You know, we overlooked it.
22 But I'm sure he has a current resale license. Or I know
23 he has a current resale license. There's no way he's
24 still doing business without a current resale license.

25 JUDGE BROWN: And I'll just say this can also go

1 to your attorney as well that if there's something you
2 want to clarify about the taxpayer's position on this,
3 feel free to jump in.

4 MR. MATHER: Sure.

5 JUDGE BROWN: I also wanted to ask about the
6 request for relief of the finality penalty. So the, you
7 know, there's this extra penalty involved in the case, and
8 it's one of the issues. I think it's Issue 4 on the
9 minutes and orders. One second. Yes, it's Issue 4. And
10 again, I'll say this applies to both. I'll ask the
11 witness and the attorney, whoever is more knowledgeable
12 can respond. Did you ever submit a request for relief of
13 the finality penalty to our office?

14 MR. MATHER: I don't recall. This case been
15 going on for a really long time and, obviously, the
16 basis of the -- the only reason this is final, quote,
17 unquote, at this point is we missed the filing deadline by
18 a day. So that would be the basis of our claim is that it
19 was really a mistake by the representative at the time,
20 and they paid dearly for that. You know, all of this
21 collection action that was forced on them would not have
22 occurred if they had filed the petition one day earlier.
23 We'd still be here fighting over an un-final
24 determination.

25 JUDGE BROWN: And let me ask the witness. Is

1 that your recollection as well that -- do you know why the
2 petition for redetermination was filed one day late?

3 MR. ARIK: It was exactly what Steve said. The
4 person that was representing us before filed it one day
5 late.

6 JUDGE BROWN: Okay. One second. I'll say that's
7 all my questions for right now.

8 JUDGE KWEE: I'd just follow up on that because
9 that's -- the finality penalty is an issue, and I think
10 our statute requires written statements, a declaration in
11 order to be eligible for relief of the finality penalty.
12 So -- and I don't have in our record a written request for
13 relief of the finality penalty. If that's something that
14 you wanted to request, perhaps if subject to an objection
15 from CDTFA, the Appellant could make an oral statement
16 during the hearing as to the basis of why it's a day late.

17 And then you could just provide a statement
18 either after the hearing today just saying that the
19 testimony provided for requested the finality penalty is
20 the basis for our request, or I provided an accurate
21 statement during the hearing requesting relief of the
22 finality penalty for the reasons stated there, or
23 something very simple like that if that's something you
24 wanted to pursue. If you don't, that's, of course, up to
25 you too.

1 MR. MATHER: Yes, I guess I would like to pursue
2 that. I -- you know, in looking at the account statement,
3 it wasn't that it had not been removed already. Even
4 though it was listed as an issue, it seemed like on the
5 account statement, which is our Exhibit 14, that all the
6 penalties had been removed. But maybe -- maybe I'm
7 misreading the statement.

8 JUDGE KWEE: Okay. I'll check with CDTFA.

9 CDTFA, did you have any objections or concerns to
10 what was just discussed?

11 MR. BACCHUS: No. We don't have any objection to
12 having him, Mr. Arik, testifying as to why the petition
13 for redetermination was filed late. As you mentioned, we
14 would still need that form, CDTFA Form 735 to be signed
15 and submitted before we could consider relieving the
16 penalty. And to be clear this is just the finality
17 penalty. As we discussed, the negligence penalty has
18 already been removed.

19 JUDGE KWEE: Okay. Yeah. So how about we do
20 that then. And, of course, just to clarify, you know,
21 this is so that OTA can consider granting relief of the
22 finality penalty. I'm not making any decision today on
23 the dais. It's just that it's a procedural requirement
24 that if you wanted us to consider relief, that's something
25 that, you know, we would require. And if you wanted to

1 provide just a brief explanation today why it was -- what
2 was the reason for -- the witness wanted to provide an
3 explanation for what the reason was for it being one day
4 late, and then we could consider that.

5 And I think as CDTFA was saying that they -- just
6 for them to consider it also, they would need that.
7 There's a form number that they had cited. And I think I
8 had attached it and summarized it in the minutes and
9 orders sign that he would just have to sign that form, and
10 he could state on the form that the testimony accurately
11 summarizes the basis for the request.

12 And then the next step would be for the CDTFA to
13 consider that, and if they -- depending on the outcome
14 there, the next step is for OTA to consider that in the
15 written opinion as to whether or not that's sufficient to
16 provide relief or contingent relief if it hasn't been paid
17 yet.

18 MR. MATHER: Okay. Well, we can -- I'll ask a
19 few questions and then we can submit the statement -- the
20 form after the hearing to CDTFA, right, not to the OTA?

21 JUDGE KWEE: Oh, I'm sorry. It's the Form 735.
22 But that's something that would be submitted to OTA with a
23 copy to CDTFA so that everyone would have a copy of it.
24 And two weeks or one week? How much time would you need
25 to do that?

1 MR. MATHER: One week is fine.

2 JUDGE KWEE: Okay. And CDTFA, is that fine if we
3 held the record open for a week to allow -- actually, I
4 guess it would be more than one week. We'd allow them one
5 week to submit it. And then CDTFA, how much time would
6 you need to consider that form?

7 MR. BACCHUS: We would request about the same
8 time, about a week to consider it.

9 JUDGE KWEE: Okay. So then we'd probably hold
10 the record open for two weeks to allow Appellant to submit
11 their request, the Form 735, and for CDTFA to consider
12 that request. But yeah, so we'd start with you asking the
13 question so we can get it on the record.

14 MR. MATHER: One other procedural point is can I
15 submit that electronically?

16 JUDGE KWEE: You could file the Form 735, yes,
17 through the portal. I think you're a portal user, so you
18 can submit it through --

19 MR. MATHER: Through the portal. Yeah.

20 JUDGE KWEE: Actually, I'm sorry. We like the
21 evidence after the hearing to be submitted to our email
22 address, evidence@ota.ca.gov. But, yeah, electronic
23 submission is fine.

24 MR. MATHER: Okay. Thank you.

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Q All right, Danny. So kind of describe how the audit ended up and how you ended up hiring Terry Stept?

Q So had Terry handled the audit?

Q So he was interfacing with the Department during
-- at least part of the audit?

Q And so were you aware of when the Notice of Termination was issued which meant the audit was over?

Q So what -- how did you expect the petition to get
d then?

Q And did he ever give an indication that he wasn't to handle that?

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1 Q What did he represent to you about his
2 familiarity with the rules for audits and appeals?

3 A I mean, he represented that he was an expert and
4 he knew everything about it. That's why we hired him to
5 represent us.

6 Q And did he ever acknowledge why he had -- he's no
7 longer alive; is that right?

8 A Yeah. I mean, God rest his soul.

9 Q Did he ever offer an explanation of why he didn't
10 file on time?

11 A Terry was an interesting guy. He -- his thing
12 was he's just -- I mean, I forgot, pretty much. He was
13 extraordinary but, I mean, yeah. That -- that was his
14 reason.

15 Q And how did you find out that there was something
16 that should have been done that wasn't done?

17 A I believe it was because the accounts got levied.

18 Q And so what was your reaction to that?

19 A I freaked out.

20 Q So you understood that there shouldn't be levies
21 if he had done what he was supposed to do?

22 A Later on, yes, I found that out.

23 Q So were you expecting levies?

24 A No, not at all.

25 Q But you thought you were challenging the results

1 of the audit determination?

2 A Yeah, of course. I had no idea that the audit
3 was decided on, and that they were going to start
4 collecting. I mean, I had no clue. I mean, I have never
5 experienced anything like that, you know.

6 Q And had you ever appealed an audit before or --

7 A Never.

8 Q So you weren't personally familiar with the
9 rules?

10 A No, I was not.

11 Q And did your family members, were they familiar
12 with the rules?

13 A No. This was the first audit we've ever been
14 through.

15 MR. MATHER: I don't have any further questions.

16 JUDGE KWEE: Okay. Thank you. I did have a
17 couple of questions for the witness, and I guess just one
18 thing. I believe the witness had mentioned the business
19 has since terminated. Is that -- was that a correct
20 understanding?

21 MR. ARIK: Yes.

22 JUDGE KWEE: And my understanding is the
23 liability here is not a responsible person liability.
24 This is just a corporate liability. Is that also your
25 understanding?

1 MR. ARIK: I didn't understand the question.

2 JUDGE KWEE: Oh, my understanding is that the
3 appeal currently before the OTA is just the corporate
4 liability. Is that accurate?

5 MR. ARIK: Like the liability was on the
6 business, not me personally; right?

7 JUDGE KWEE: I guess, yeah. My understanding was
8 that we don't have a 6820, a responsible person appealing
9 before us today?

10 MR. MATHER: No. This is actually a refund
11 because before the company went out of business --

12 JUDGE KWEE: Oh, that's right.

13 MR. MATHER: -- it paid the liability.

14 JUDGE KWEE: Oh, okay. I get it. That's a good
15 point. And as far as the refund claims that we did have,
16 my understanding is we have refund claims, but then the
17 dispute there is that some of the refund claims weren't
18 signed, but they're not being accepted as valid. Is
19 that -- or I guess maybe that's a question for CDTFA.

20 Was that -- because like CDTFA, have you reviewed
21 the exhibits provided by the taxpayer, which is
22 Exhibit 14. It's a summary of their refund claims. And I
23 believe the contention was they had refund claims for all
24 of the periods. Is the CDTFA's position there that the
25 refund claims aren't valid because they weren't signed?

1 Or was there a different issue with the refund claims?

2 MR. SUAZO: I believe 5 of them were late, and 10
3 of them were unsigned.

4 JUDGE KWEE: Okay.

5 MR. SUAZO: And it's 11 unsigned. It's in
6 Exhibit F as an additional brief. There's a whole
7 synopsis on it.

8 JUDGE KWEE: Okay. And some other questions on
9 the loans for -- actually, Appellant, you had been
10 discussing, you know, how certain businesses that even
11 you, you know, that work closely within some of your own
12 businesses, like the Fullerton location,] from my
13 understanding, would make transfers, like loans when
14 needed. And that was some of the reasons for the
15 discrepancy between the bank deposits and the reported
16 taxable sales. And my question there is, in looking at
17 the audit, it looks like CDTFA made allowances for just
18 over \$2 million in loans.

19 And my question is were you contending that there
20 were more loans that should be accounted for? Was that a
21 concern that CDTFA didn't make enough adjustments for
22 loans, or was that just an explanation for why there was a
23 discrepancy, and your position is that CDTFA should have
24 accepted the returns as filed and this is, you know, part
25 of the reason for the discrepancy.

1 MR. ARIK: It was an explanation for the
2 discrepancy. We found all the ones that weren't being
3 allowed as loans and transfers from within our continue.

4 JUDGE KWEE: Okay.

5 MR. MATHER: So I think, because I was involved
6 in this process. I was involved by that time. And so
7 what it was is we submitted a batch of information to the
8 auditor that we thought basically reconciled the bank
9 deposits to the general ledger. And in the course of
10 reviewing that, the auditor did not allow all of the
11 nontaxable or non-sales deposits that we claimed.

12 And so we then followed up and provided
13 additional information, which is mostly this Exhibit 13 to
14 kind of explain the loans that had not been allowed in the
15 first go around.

16 JUDGE KWEE: Oh, so there are, if I'm
17 understanding correctly, there are still additional loans
18 that were not allowed by CDTFA then?

19 MR. MATHER: Yes. Well, I think our position at
20 least is set forth on pages 3 or 4 of Exhibit 11, which --
21 with the schedule of individual loans, we think completely
22 reconciles to the sale -- to the general ledger. And
23 whether or not CDTFA -- whether the Department ultimately
24 allowed them or not, I'm not 100 percent sure. But this
25 wasn't a bank deposit-based method of determining the

1 unreported sales. So it was really more of a test than it
2 was a method for determining the adjustment.

3 JUDGE KWEE: Okay. I won't ask CDTFA that now,
4 but I would ask at some point if they could address
5 whether allowances were included in the audit for all of
6 the loans. Or if not, on what basis the loans were -- or
7 the documented loans were not made -- given an allowance
8 for loans provided by taxpayer in the audit.

9 And so one other question, so I understand, you
10 have the L.A. location, the Fullerton location, and the
11 Newport location. And I think you had mentioned Eternity
12 was the name of -- was that the Fullerton location or was
13 that an unrelated business?

14 MR. ARIK: That was the Fullerton location.

15 JUDGE KWEE: Okay. So Fullerton was Eternity.
16 And what was the L.A. location? And what was the
17 wholesale location called?

18 MR. ARIK: Yes. That one is Arik Mounting.

19 JUDGE KWEE: Okay. And those are entirely
20 unrelated to Newport, like, they have a separate permit, I
21 guess?

22 MR. ARIK: Yes.

23 JUDGE KWEE: Or if they are wholesale then maybe
24 not but -- oh, yeah. Okay. So then that's not at issue.
25 That's just incidentally related in explaining the, for

1 example, transfers or --

2 MR. ARIK: Yes.

3 JUDGE KWEE: Okay.

4 MR. MATHER: And I think also is Eternity called
5 Happy?

6 MR. ARIK: Yes. It's Eternity Jewelers D.B.A.
7 Happy Jewelers.

8 JUDGE KWEE: Okay. Thank you. Okay. I believe
9 that was all the questions I had at this moment. I'd just
10 double check with -- before we move on, Judge Wong did you
11 have any additional questions for the witness at this
12 time?

13 JUDGE WONG: I do not. Thanks.

14 JUDGE KWEE: And Judge Brown, did you have any
15 questions for the witness?

16 JUDGE BROWN: Not at this time. Thank you.

17 JUDGE KWEE: Okay. I just realized there was one
18 additional question that I had because you were
19 mentioning, like, when you were talking about the pricing
20 how if you made a sale a certain way, the customer might
21 default. So I was just wondering, was there any bad debts
22 on -- did you have any bad debts, like, sales were -- you
23 weren't paid during the audit period?

24 MR. ARIK: I mean, of course, there were some
25 customers that didn't pay. But that was more like on the

1 chain stores is the way they would charge like the high
2 markup. They would do like the high markup, you know,
3 three- or four-times skew, is because they were offering
4 the financing, and they needed those kinds of markups to
5 offer financing because of the risk.

6 JUDGE KWEE: Okay. So I guess the reason I was
7 asking is I just wanted to make sure that you weren't
8 claiming or asserting maybe a reduction for bad debts,
9 like a bad debt deduction of off the liability?

10 MR. ARIK: No.

11 JUDGE KWEE: Okay.

12 MR. ARIK: No. No. Sorry.

13 JUDGE KWEE: Thank you.

14 Then I would like to call -- is 15 minutes -- do
15 you think 15 minutes is a good recess amount? -- 15-minute
16 recess just for us to stretch our legs and take a bathroom
17 break.

18 MR. ARIK: Yeah.

19 JUDGE KWEE: It's 2:39 right now. So how about
20 we come back at 2:55. Okay.

21 And we'll go off the record. I'll see everyone
22 in 15 minutes.

23 (There is a pause in the proceedings.)

24 JUDGE KWEE: Let's go back on the record.

25 I believe where we left off, we we're just about

1 to turn it over to CDTFA for their 30-minute opening
2 presentation.

3 Are you ready to proceed, CDTFA?

4 MR. SUAZO: Yes.

5 JUDGE KWEE: Okay. Then you have 30 minutes
6 starting now. I'll turn it over to you.

7

8 PRESENTATION

9 MR. SUAZO: Newport Jewelers by Gabe Arik
10 Corporation operated a jewelry store located in Newport
11 Beach, California. Appellant sold both pre-made and
12 custom jewelry. Appellant made in-state and out-of-state
13 retail and wholesale sales of diamonds, jewelry and
14 watches. Appellant also accepted trade-ins of jewelry.
15 Appellant claimed nontaxable sales of interstate and
16 foreign commerce, resales, labor, and sales tax included.

17 Comparison of federal income tax returns, the
18 sales and use tax returns for 2009, 2010, and 2011
19 disclosed an overall difference of \$120,000 for the
20 three-year period; Exhibit E, page 198. The Department
21 conducted a one-quarter block test on sales for the period
22 from July 1st, 2011, through September 2011. The
23 Department examined both claimed resales, Exhibit E, pages
24 185 to 192, and out-of-state retail and wholesale sales,
25 Exhibit E, pages 177 to 183.

1 The Department determined that items not
2 supported -- the Department determined that items not
3 supported by proper documentation should be disallowed.
4 The Department calculated percentages of errors and
5 applied those to the respective claimed nontaxable sales
6 to arrive at disallowed resales of almost \$423,000,
7 Exhibit E, page 184, and disallowed interstate commerce
8 sales of just over \$139,000, Exhibit E, pages 175 and 176.

9 The Department also determined that the overall
10 book markup for the period from 2009 through 2011 of only
11 13.28 percent was very low in comparison to jewelry
12 industry standards, Exhibit E, page 197. To verify the
13 validity of the recorded markup, the Department conducted
14 a shelf test. The shelf test was conducted by the
15 Appellant and was segregated into wholesale and retail
16 markups. The wholesale markup of 11.06 percent,
17 Exhibit D, pages 74 through 77 and the retail markup was
18 8.79, Exhibit D, page 70 to 73.

19 The Department accepted the wholesale markup and
20 the retail markup of 23.32 percent on watches, Exhibit D,
21 page 73, which the Department was able to verify.

22 However, the Department did not accept the retail markup
23 on remaining items because it was lower than wholesale
24 markup, well below industry average, and sales items were
25 not adequately supported with complete sales and cost

1 information, Exhibit A, page 10.

2 Because markups could not be obtained for retail
3 jewelry, the Department applied an industry low of 100
4 percent to the out-of-state retail sales of jewelry. To
5 determine the retail markup for California sales, the
6 Department conducted a cost accountability review which
7 was used to calculate cost of goods sold of Californian
8 retail sales, Exhibit A, page 34.

9 The Department then removed the cost of goods
10 sold of watches in California, Exhibit A, page 33, to
11 arrive at a cost of goods sold at California jewelry
12 retail sales. The Department compared reported taxable
13 sales for 2009 to audited cost of goods sold -- to audited
14 jewelry cost of goods sold and calculated 120.94 percent
15 markup on taxable sales, Exhibit A, page 34. The overall
16 markup for 2009 of 87.68 consisting of 120.94 percent
17 markup for jewelry and 23.23 percent for watches
18 established from the Appellant's records for 2009 were
19 accepted.

20 However, the overall California retail markups of
21 3.08 percent -- negative 3.08 percent for 2010, negative
22 15.51 percent for 2011, and negative 19.37 percent for
23 2012 were not, Exhibit A, page 33. The Department
24 determined the cost of goods sold available for retail
25 sales in California for 2010 and 2011 and 2012 and applied

1 the markups to cost of goods sold to calculate California
2 retail sales of jewelry for 2010, '11, and '12 of more
3 than \$3.6 million.

4 The watch sales of almost \$2.6 million was added
5 to the jewelry sales to arrive at roughly \$6.2 million in
6 California retail sales. The California retail sales were
7 compared to reported taxable sales of about \$3.4 million,
8 which showed a difference of just under \$2.8 million,
9 Exhibit A, page 33. Based on these differences, the
10 Department calculated percentages of error, Exhibit A,
11 page 33, which were applied to reported taxable measure
12 for the years 2010, 2011, and 2012. The underreported
13 taxable measure was determined to be almost \$2.8 million.

14 The Department's review of sales invoices from
15 which the Appellant conducted their shelf test revealed
16 three retail sales totaling \$8,364 included trade-ins as
17 part of the sale, Exhibit F, page 247, Invoice Numbers
18 2415, 2417, and 2440 with trade-in values on Exhibit F,
19 pages 252, 253, and 256. The invoices show sales tax was
20 computed net of the trade-in values. Therefore, the items
21 were not properly taxed. The trade-in values were also
22 not properly recorded in the sales register as they are
23 recorded net of trade-in value.

24 The value of the merchandise received by the
25 Appellant in trade-ins is not included in the purchase

1 journal and therefore, not included in the cost of goods
2 sold. Based on the one month provided documentation, the
3 projected liability from these transactions total over
4 \$400,000 for the four-year audit period, Exhibit F,
5 page 235. The trade-ins would also need to be added back
6 to the bank -- added to the bank deposit analysis thereby
7 increasing the amount of compensation received over the
8 monies deposited.

9 The Department also found a trade-in totaling
10 \$10,500 on one of the wholesale documents, Exhibit F, page
11 249. The sale was reported on November 2012 sales
12 register as Invoice Number 2360, Exhibit F, page 264, and
13 Exhibit N, page 918. The projected amount for the
14 four-year audit period would be \$504,000. Again, the
15 projected trade-in amount would need to be added back to
16 the bank deposits. The traded items did not appear to be
17 included in the purchase journal and, again, not included
18 in the cost of goods sold.

19 The Department determined the combined value of
20 the trade-ins to add to the bank deposit difference would
21 amount to more than \$905,000. Adding that to the bank
22 deposit differences of more than \$855,000, Exhibit F,
23 page 237 to 239, totals over \$1.6 -- \$1.7 million of
24 compensation received above reported gross amounts. The
25 \$855,000 in this case was after adjustments were made in

1 2019 after the Board hearing for the bank deposit
2 analysis.

3 It should again be noted that the combined
4 \$900,000 was not accounted for in the Appellant's
5 purchases and is not included in the audited cost of goods
6 sold. If this is correct, the amount of liability will
7 increase significantly as all of the exempt sales have
8 already been accounted for and the additional \$900,000
9 would apply only to unreported taxable transactions. With
10 respect to any potential claims for refund, pursuant to
11 Revenue & Taxation Code, in order to constitute a valid
12 claim for refund, the claim must be in writing, signed,
13 and states specific grounds upon which the claim is
14 founded.

15 A claim for refund filed prior to January 1st,
16 2017, cannot be considered valid with respect to any
17 payments that are made after the date of that claim -- of
18 that refund claim. The failure to file a timely and valid
19 claim for refund constitutes a waiver of any demand
20 against the State on account of an overpayment. As
21 relevant here, in order to be timely, a claim must be
22 filed no later than six months from the date of payment.
23 No refund maybe approved after six months from the date of
24 overpayment.

25 As an exception in the case of an overpayment due

1 in a lien or levy, a timely claim for refund may be filed
2 within three years of the date of overpayment. Here,
3 there are over 5 payments which did not have proper claim
4 for refund documentation, and 11 payments in which no
5 claim for refunds were filed. The 5 late filings for
6 refunds were not received within the six-month time frame
7 for the Appellant to properly secure a refund, Exhibit F,
8 page 247.

9 The 5 payments with late claims for refunds
10 totaled \$50,000. The 11 payments where no claim for
11 refund was filed amounted to \$104,000. The combined total
12 of \$144,000 is considered by the Department to be out of
13 statute, and the Appellant is not entitled to a refund.

14 The Appellant disagrees with the use of the
15 markup procedure used by the Department. The Appellant
16 contends that the recorded sales should be used to
17 determine the accuracy of reported amounts on sales and
18 use tax returns. The Department contends that based on
19 the information, i.e., source documents that came into its
20 possession, the reported sales amounts on the sales and
21 use tax returns for the audit period were incorrect.

22 The Department used the Appellant's record to
23 determine the cost of goods sold, the breakdown of retail
24 sales of watches, jewelry, and diamonds for in-state and
25 out-of-state retail and wholesale sales, the markup of

1 wholesale sales, the markup for watches and to compute the
2 retail markup of jewelry and diamonds. The out-of-state
3 retail sales markup is actually less than that of the
4 in-state jewelry and diamond sales, which is to the
5 Appellant's benefit when performing the type cost
6 accountability test performed to obtain unreported taxable
7 sales.

8 The Appellant has had time to review the testing
9 procedures and corrections were made when the Appellant
10 provided documentation to support their contention.
11 Revenue & Taxation Code Section 7054 authorizes the
12 Department to examine books, papers, records, and
13 equipment of any person selling tangible personal
14 property, and the Department may investigate the character
15 of the business to verify the accuracy of any return.

16 Moreover, Revenue & Taxation Section 6481 states
17 that if the Department is not satisfied with the return or
18 returns of the tax or the amount of the tax or other
19 amount required to be paid to the State by any person, it
20 may compute and determine the amount required to be paid
21 upon the basis of facts contained in the return or returns
22 or upon the basis of any information within its possession
23 or that may come into its possession.

24 California courts have upheld the Department's
25 rights to investigate beyond a taxpayer's books and

1 records to calculate a tax deficiency. In Maganini versus
2 Quinn, the court held Section 6481 and 7054 contemplate an
3 examination behind the books in which original records,
4 such as purchase invoices, sales slips, cash register
5 tapes, and inventory records may be audited and analyzed.
6 Similarly, in Riley B's versus Board of Equalization, the
7 court reaffirmed the holding in Maganini, even when a
8 taxpayer's books and records are comprehensive and in
9 agreement with each other.

10 The court in Maganini also found that where the
11 Department has established that its determination is
12 reasonable, the burden of proof shifts to the taxpayer to
13 explain any disparity between taxpayer's books and records
14 and the results of the audit determination. Here, the
15 Department examined Appellant's books and records. And
16 even though it found them to be complete and in agreement,
17 the Department was within its rights under Section 7054
18 and 6481 to examine behind the books.

19 Accordingly, the Department's use of an
20 alternative method to compute and determine the taxable
21 sales and the applicable sales tax that should have been
22 reported for the audit period was reasonable. Based on
23 the Department's review, the Appellant's records in
24 relation to taxable sales appears to be unreasonable. The
25 drop from a recorded taxable markup in 2009 from 87.68

1 percent to negative markups in 2010, 2011, and 2012 is not
2 logical and has never been explained by the Appellant.

3 The Appellant's shelf test, not including design
4 or production cost, for complete documentation in the
5 markups is not credible. The wholesale markup being
6 higher than the retail markup is not practical. The bank
7 deposit analysis, not including trade-ins, is inaccurate.
8 The premise by Appellant that tax was paid correctly to
9 the State when it has been shown that sales related to
10 taxable transactions were not properly accounted for is
11 not realistic.

12 Appellant's assertion that the recession cut into
13 sales is misleading. Appellant's total sales increased
14 every year from 2009 to 2011. The sales more than doubled
15 from 2009 to 2010 and increased over 75 percent from 2010
16 to 2011, Exhibit D, page 60. This is contrary to what the
17 Appellant stated at the Board hearing on November 16th,
18 2017. The recession did not drag down sales. In fact,
19 sales grew at a phenomenal rate. Analysis of reported
20 taxable sales to reported gross sales shows that taxable
21 sales accounted for 27.6 percent of total sales in 2009.

22 This is the year the Department accepted taxable
23 sales. In 2010, 2011, and 2012 taxable sales as a
24 percentage of total sales made up only 12.67 percent,
25 10.19 percent, and 19.76 percent respectively. This

1 drastic reduction and reported taxable sales further
2 explains the understated taxable amounts. When unreported
3 taxable sales are added to reported taxable sales, based
4 on the audit findings for the period from 2010
5 through 2012, the overall percentage of taxable sales
6 increase to 25.5 percent of total sales.

7 Based on the foregoing, the Department has shown
8 that its determination is reasonable. The Appellant has
9 not provided sufficient evidence or other documentation to
10 provide otherwise. In addition, Appellant has not
11 submitted -- which we discussed already. Appellant has
12 not submitted a CDTFA Form 735 for request of relief
13 penalty. Therefore, at this point, no relief has been
14 granted.

15 This concludes my presentation. I'm available to
16 answer any questions you may have.

17 JUDGE KWEE: Yes. This is Judge Kwee. I had a
18 quick follow up. At the start of CDTFA's presentation,
19 you had referred to page 264 in your exhibit binder, which
20 was the three trade-in transactions. So -- and I'm just
21 trying to understand why CDTFA is bringing that up. Was
22 CDTFA asserting that to the extent Appellant, you know,
23 prevail and say a resale transaction, they're asserting an
24 offset for those three transactions that weren't accounted
25 for? Is that why you're bringing that up? Or I just --

1 if it wasn't asserted, I guess I'm just not clear why it
2 was raised.

3 MR. SUAZO: I'm bringing it up for reasonableness
4 in one case.

5 JUDGE KWEE: Okay. So CDTFA is not asserting an
6 offset, then, to the extent Appellant prevailed in any
7 adjustments?

8 MR. SUAZO: No.

9 JUDGE KWEE: Okay. Great. And I would like to
10 also like to circle back to the other question that I had
11 about the taxpayer's Exhibits 11 through 13, which was the
12 documentation to support the non-sales revenue,
13 specifically loans from other entities. And I did see
14 that CDTFA made an allowance for a little over \$2 million
15 for, you know, non-sales revenue or non-sales transaction
16 or it looked like allowances were made.

17 And I'm just wondering, did CDTFA accept all of
18 the, I guess, loans made by the taxpayer? Or if there
19 were any that were not accepted and an allowance wasn't
20 made, therefore, could you explain basically or I guess
21 respond to Appellant's contention that there was a
22 significant amount of non-sales revenue for loans.

23 MR. SUAZO: On Exhibit E, page 196, the original
24 difference between bank deposit analysis and total sales
25 was \$2.238 million. I don't know if you're there yet.

1 JUDGE KWEE: What page number was that?

2 MR. SUAZO: Exhibit E, page 196.

3 JUDGE KWEE: Okay.

4 MR. SUAZO: Okay. So that was the original
5 difference prior to everything happening before the Board
6 hearing. The Appellant then made a new attempt at
7 lowering the amount. And if you go to Exhibit F, there's
8 a -- the auditor redid the reconciliation for bank deposit
9 analysis, taking into account the Appellant's findings
10 that were emailed to her that same month, I believe, or
11 maybe a month earlier. And she made allowances for an
12 additional \$1.7-something million.

13 So there was still a difference, according to the
14 auditor, of \$856,000. And that's on page -- Exhibit F,
15 pages 237 to 246. The meat of it is going to be on 237
16 to 239. And you'll see the auditor's comments regarding
17 as to why she allowed or did not allow certain items that
18 the Appellant was contending for it to be loans. But she
19 did lower it down quite a bit on that. However, as
20 explained in our presentation, there were trade-ins that
21 were accepted that aren't included in this. So the
22 trade-ins would be value that should be added back into
23 this.

24 JUDGE KWEE: Right. But you said that CDTFA is
25 not asserting an offset to the extent --

1 MR. SAUZO: No, no. Well, this isn't -- this is
2 only for -- this isn't the actual audit. The audit is
3 based on a markup.

4 JUDGE KWEE: Right.

5 MR. SAUZO: So this is just a secondary source.

6 JUDGE KWEE: Okay. Oh. Oh, okay. I see what
7 you're saying.

8 MR. SAUZO: Yeah.

9 JUDGE KWEE: Oh, and this was only just looked at
10 to verify the reasonableness. I see what you're saying.
11 Okay. And I think Appellant's representative mentioned
12 that too. Okay. And this is listed as bank
13 statement and -- okay. Got it. Thank you.

14 Judge Wong, did you have any questions for CDTFA?

15 JUDGE WONG: Just a couple of questions. There's
16 reference to, like, the estimated or the expected markup
17 about, I guess, 100 percent or range of 100 percent to
18 250 percent, and you'd referenced like the jewelry
19 industry standards. I'm just wondering how -- what
20 references -- or how was that estimate -- expected
21 estimated markup, how did CDTFA arrive at that? Because
22 Mr. Arik had testified regarding different types of
23 sellers in the jewelry industry including, like, a trunk
24 show seller or a jewelry store slash pawnshop? So I'm
25 just curious how CDTFA came up with this expected range

1 markup for the jewelry industry.

2 MR. SUAZO: Based on historical experience of our
3 audits on jewelry stores.

4 JUDGE WONG: Retail? Just retail?

5 MR. SUAZO: Yes.

6 JUDGE WONG: Okay.

7 MR. SUAZO: If you remember correctly, we did
8 accept the 11 percent markup on the wholesale and the very
9 low 23 percent on watches which was extremely low on that
10 as well.

11 JUDGE WONG: Yeah. I'm just curious about what
12 the standard was and how it was established for
13 comparative purposes. The second question I had, and I
14 think it's the last one. During the Board hearing back in
15 2017, there was testimony about Appellant making --calling
16 different -- making several calls to CDTFA regarding their
17 claims for refund, and some had said their claims for
18 refund were all valid and other calls were not. And the
19 Board members had asked CDTFA to maybe look into it and
20 see if there was any record whether written or verbal or
21 some record of that type of interaction.

22 I'm just curious if that investigation or that
23 inquiry had been made and, if so, what was the result of
24 it? Were there anything in CDTFA's records showing any
25 written or verbal communication as to the validity of

1 their claims for refund?

2 MR. SUAZO: We don't have any written notes after
3 that on that particular issue.

4 JUDGE WONG: Okay. Thank you. No further
5 questions at this time.

6 JUDGE KWEE: Judge Brown, did you have any
7 questions for CDTFA?

8 JUDGE BROWN: I do. Thank you.

9 Let me start by picking up on Judge Wong's line
10 of questioning about how CDTFA came to estimate the
11 100 percent markup for jewelry stores. And I understood
12 your response about that it's based on CDTFA's experience
13 in auditing jewelry stores. My next question is do you
14 know if this accounts for differences among different
15 types of jewelry stores? For example is, Mr. Arik was
16 describing just in a general knowledge sort of way, my
17 understanding that jewelry stores from experience do
18 differ. A mall jewelry store will be different -- have a
19 different kind of markup than a, you know, a small
20 hole-in-the-wall kind of jewelry store.

21 MR. SUAZO: Well, they manufacture -- as they
22 said earlier, they design and manufacture their own stuff.
23 So that's totally different than a mall jewelry. Okay.
24 Actually, you would sort of expect it higher because they
25 are in -- they don't have to pay for the already added on

1 cost of the labor that would be embedded in a finished
2 product. And if you remember correctly, when the
3 Appellant was speaking, he said that --

4 JUDGE BROWN: And I will say if you could speak
5 into the microphone.

6 MR. SUAZO: I believe the Appellant stated early
7 on in his presentation the markup could not be performed
8 because of all the various factors that were going into
9 the -- that were in play when he was trying to get a
10 markup established on pricing versus cost. This was early
11 on in his discussion. So the cost accountability test,
12 what that does is it takes all the knowns because we know
13 the wholesales. We know the watch, and we gave an
14 industry a very low amount on the out-of-state retails.
15 So we took out all the knowns, and the only one left would
16 be the unknown which is the retail sales in California.

17 Based on 2009, the retail sales in California was
18 120 percent based on the taxpayer's very own records. So
19 this was not what we created. This is something that is
20 based on the taxpayer's own records. The taxpayer is the
21 person who did the markup on the wholesales. The taxpayer
22 is the person who did the markup on the watches. We did
23 estimate a 100 percent markup. But, again, that's
24 industry low for the out-of-state retail.

25 So the only thing that was unknown at this factor

1 retail was the retail sales in California. And when we
2 compared the 2009 taxable sales, less the watches, in
3 comparison to the cost of goods sold, we saw a 120 percent
4 markup. The taxpayer has never explained how you go from
5 120 percent to negative 3 percent, negative 15 percent,
6 and negative 19 percent, especially when sales were
7 increasing year after year after year.

8 JUDGE BROWN: And then I also wanted to ask about
9 the March 2020 -- you know, the Department went back in
10 March of 2020, actually, I believe when we were talking
11 after the Board hearing the Department -- the auditor went
12 back and made adjustments based on additional
13 documentation that the taxpayer had provided. And I
14 wanted to ask whether in light of that, whether the
15 Department's calculations also took into consideration the
16 documentation that the taxpayer provided in the briefing
17 for this appeal. It was Appellant's -- taxpayer's second
18 supplemental brief in April of 2020 where the taxpayer
19 accounted for the loans, and that was also covered in
20 Mr. Arik's testimony.

21 My question is just how does that factor in? Was
22 it already taken into consideration? Or has the
23 Department -- has the Department already responded to that
24 in our -- in the consideration of how these additional
25 deposits should be considered? Or is this in addition?

1 MR. SUAZO: Briefing that would have occurred
2 after March 11, 2020, would not be considered in the
3 Department's additional brief. So if he had something
4 afterwards, it wouldn't be included in this.

5 JUDGE BROWN: Then I suppose my question is what
6 is the Department's position regarding the Appellant's
7 explanation for these additional deposits that Appellant
8 explains were based on loans? And I understand that this
9 was not a bank deposits audit, but just how -- in terms of
10 how are we supposed to be considering this. Does the
11 Department want to respond?

12 MR. SUAZO: Well, we're not entirely sure.
13 Because this is not a bank deposit audit. Okay. This is
14 a markup audit. This is only secondary information.
15 Okay. The other thing is we don't know if he deposited
16 everything into the bank to tell you the truth. Because
17 if you look at page -- Exhibit E, page 226, there's a sign
18 on the window and -- because he buys a lot of scrap gold.

19 If you look at the purchase journals, especially
20 in 2010, '11 and '12, you'll see a lot of scrap gold in
21 there that he's paying with a check. But on the window,
22 it says, "Scrap Gold Paid with Cash." So I don't know --
23 we don't know if he's depositing everything into the bank,
24 or he's also buying scrap gold and it's going into the
25 purchases but not showing up.

1 MR. BACCHUS: And just to kind of clarify the
2 position. The bank deposit analysis has been already
3 explained was used to show that the determination that the
4 markup method was reasonable. So even if -- and so now
5 our position -- the Department's position is that even if
6 all the bank deposits were shown to have been loans, we
7 also have these trade-ins and other items like Mr. Suazo
8 just explained, the cash for gold, that should be in bank
9 deposits. That would still show that the bank deposits
10 were in excess and which show that the audit determination
11 was reasonable. So either way it shows that the
12 determination was reasonable.

13 JUDGE KWEE: I'm sorry where did you reference
14 where you saw the scrap gold sign? And could you --

15 MR. SUAZO: Exhibit E, page 226.

16 JUDGE KWEE: Thank you.

17 JUDGE BROWN: I'll say that's all that I have at
18 this time.

19 JUDGE KWEE: Okay. At this time I believe we are
20 ready to move onto closing remarks. I will turn it over
21 to Appellant's representative. You have 10 minutes for
22 closing remarks.

23 MR. MATHER: Thank you.

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10 And what they did is this, our Exhibit 10, which
11 is what he referred -- what the Department referred to as,
12 I think, the cost allocation -- or maybe I didn't have the
13 term right -- and suggested that these were all numbers
14 based on our records. Well, that's just not true. All of
15 the -- every one of the numbers on this schedule that is
16 encircled was based on an estimate. It's an estimated
17 markup on a different category of different types of
18 sales.

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1 percentage, but they're not. They are not an audit of all
2 of the sales in the year or even in an entire -- beyond a
3 single quarter.

4 So you know, a markup is an estimate. It's not
5 using the taxpayer's records. A markup estimation is an
6 estimation, and every single one of those categories is an
7 estimation. And what the effect of estimating in every
8 one of those categories, as I indicated before, is that it
9 literally pulls all of the cost of sales away out of the
10 category that they're really going to guess on, which is
11 the California retail sales.

12 That's how they justified or rationalized their
13 100 percent-plus markup when the actual markup reported in
14 the books and the federal income tax returns and the
15 invoices and everything is under 20 percent. It's under
16 15 percent. So you got 130 percent determined by using 6
17 estimate versus books and records that tie out in every
18 which way that show 15 percent, maybe. So if we're
19 talking about the taxpayer's records, that's 15 percent.

20 And more specifically -- I mean, in the pick and
21 choose category, as the Department indicated, they did the
22 shelf test and the shelf test on retail was 4 percent.
23 Oh, no. Well, that's not 100 percent, so we got to toss
24 that. We'll keep all the other ones because those work
25 for us in our 6-factor removal equation here. So we'll

1 keep all the ones that work for us, and we'll toss out the
2 ones that don't.

3 Well that's not a reasonable method. It's not a
4 method at all. It's literally picking and choosing. It's
5 basically coming up with a that they knew that had to be
6 in advance and figuring out and just playing with the
7 numbers until they come up with something that computes to
8 that. It doesn't -- it's not based in fact. It's not
9 based in the taxpayer's records. It's just picking a
10 number out of the air.

11 With respect to the bank deposit analysis, I
12 think Judge Brown was right on. Our Exhibit 13, which was
13 I believe included in that April 2020 supplemental brief,
14 shows an additional million dollars of deposits that were
15 not income. My recollection -- and it's been a while --
16 but my recollection is that we specifically put together
17 that package, which is Exhibit 13 because they were not
18 allowed by the Department.

19 So if we've got a million and three on
20 Exhibit 13, that means the bank deposits analysis
21 basically reconciles to the general ledger to the sales
22 tax returns and to the federal income tax returns. So
23 there's nothing in the taxpayer's records to suggest that
24 there's any mistakes in their reporting on the sales tax
25 returns at all.

1 And, you know, here we were, you know, ten years
2 after the fact and now speculating that there were cash
3 sales. Speculating. I mean, no evidence. I mean, that's
4 even worse than even trying a computation just to back
5 into your number. It's just idle speculation years after
6 the fact and arguments that basically recognize that the
7 audit didn't work. I mean, they took liberties in this
8 audit. They just made up a number because it was the
9 number that they thought it should be, and there is no
10 rational foundation for it.

11 And that's why we haven't disproved it because
12 how do you disprove a made-up number? You don't. And the
13 legal authorities at the Department cite, you know,
14 basically, you've got to have some rational basis for this
15 number, or you don't have the burden, or you don't enjoy
16 the burden of proof, and there's no rational basis here.
17 There is this one page on Exhibit 10 that justifies the
18 entire audit, and it's nothing but guesses and estimates.

19 And I think that concludes our remarks.

20 JUDGE KWEE: Okay. Thank you.

21 And CDTFA you have 10 minutes for your final or
22 any final remarks before we conclude today.

23 MR. SUAZO: No additional remarks.

24 JUDGE KWEE: Okay. Thank you everyone for coming
25 in. We will be holding the record open for two weeks,

1 one week for Appellant to submit a request for relief of
2 the finality and then an additional week for CDTFA to
3 review that request. I will send out a post-hearing order
4 detailing the time frames summarizing the scope of the
5 additional briefing, and I will mention the form number,
6 which I believe was the CDTFA 735 that they had asked for.

7 Are there any questions before we conclude today?

8 MR. MATHER: I don't believe so.

9 JUDGE KWEE: Okay. Then thank you everyone. The
10 record is being held open, and we will issue a decision in
11 100 days after we close the record, which is the close of
12 the additional briefing period.

13 This concludes the hearings for today, and we are
14 ready to go off the record. Thank you.

15 (Proceedings adjourned at 3:38 p.m.)
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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for
the State of California, do hereby certify:

That the foregoing transcript of proceedings was
taken before me at the time and place set forth, that the
testimony and proceedings were reported stenographically
by me and later transcribed by computer-aided
transcription under my direction and supervision, that the
foregoing is a true record of the testimony and
proceedings taken at that time.

I further certify that I am in no way interested
in the outcome of said action.

I have hereunto subscribed my name this 21st day
of February, 2023.

ERNALYN M. ALONZO
HEARING REPORTER