

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:)
)
J. PADILLA,)
) OTA NO. 21037383
)
) APPELLANT.)
)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Thursday, February 16, 2023

Reported by:

SHELBY K. MAASKE
Hearing Reporter

Job No. :
40542 OTA(A)

BEFORE THE OFFICE OF TAX APPEALS

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J. PADILLA,)
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TRANSCRIPT OF PROCEEDINGS, taken at
12900 Park Plaza Drive, Suite 300, Cerritos,
California, commencing at 9:30 a.m. and
concluding at 10:34 a.m. on Thursday,
February 16, 2023, reported by Shelby K. Maaske,
Hearing Reporter.

1 APPEARANCES:

2
3 Panel Lead:

HON. JOSHUA ALDRICH

4
5 Panel Members:

HON. MICHAEL GEARY
HON. ANDREW KWEE

6
7 For the Appellant:

DAVID PIDAL

8
9 For the Respondent:

NALAN SAMARAWICKREMA
Hearing Representative

10
11 CHRISTOPHER BROOKS
Tax Counsel

12
13 JASON PARKER
Hearing Representative

I N D E X

E X H I B I T S

(Appellant's Exhibits were received at pages 7)

(CDTFA's Exhibits were received at page 7)

1 Cerritos, California; Thursday, February 16, 2023

2 9:30 a.m.

3
4 ADMINISTRATIVE LAW JUDGE ALDRICH: This is Judge
5 Aldrich. We are opening the record in the appeal of
6 J. Padilla before the Office of Tax Appeals, OTA Case
7 No. 21037383. Today's date is Thursday, February 16,
8 2023, and it is approximately 9:30 a.m. This hearing is
9 being conducted in Cerritos, California, and is also being
10 live streamed to OTA's YouTube channel.

11 This hearing is being heard by a panel of three
12 administrative law judges. My name is Josh Aldrich. I'm
13 the lead judge for purposes of conducting the hearing.
14 I'm joined by Judges Michael Geary and Andrew Kwee.
15 During the hearing, the panel members may ask questions or
16 otherwise participate to make sure we have all of the
17 information needed to decide the appeal. After the
18 conclusion of the hearing, we three will deliberate and
19 decide the issues presented.

20 As a reminder, the Office of Tax Appeals is not a
21 court, it is an independent appeals body. The Panel does
22 not engage in ex parte communication with either party,
23 and our opinion will be based on the parties' arguments,
24 admitted evidence, and the relevant law.

25 We have read your submission, and we look forward

1 to hearing your arguments. Who's present for the
2 Appellant?

3 MR. PIDAL: Myself, David Pidal.

4 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you.
5 For the Department?

6 MR. SAMARAWICKREMA: Nalan Samarawickrema for the
7 Department.

8 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. I may
9 be using the term "Department," but that refers the
10 California Department of Tax and Fee Administration.

11 So with respect to the substitution, OTA made
12 substitutions to the panel. On February 3rd, 2023, we
13 sent the parties a notice of tax appeals panel revised,
14 and I have taken the lead role and Judge Kwee has been
15 added to complete the panel.

16 Department, any objections to the revision of the
17 panel?

18 MR. SAMARAWICKREMA: No objections.

19 ADMINISTRATIVE LAW JUDGE ALDRICH: And Mr. Pidal?

20 MR. PIDAL: No objections.

21 ADMINISTRATIVE LAW JUDGE ALDRICH: So next, we
22 will address issues. According to the January 20, 2023,
23 Minutes and Orders as distributed to the parties, the
24 issues are whether adjustments are warranted to the
25 determined measure of tax and whether Appellant was

1 negligent.

2 Does that sound correct to you, Mr. Pidal?

3 MR. PIDAL: Yes. Very simple.

4 ADMINISTRATIVE LAW JUDGE ALDRICH: Department?

5 MR. SAMARAWICKREMA: Yes.

6 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you.

7 Regarding exhibits, the Department's exhibits are
8 identify alphabetically as Exhibits A through K. And
9 according to the Minutes and Orders we previously
10 referenced, Appellant had no objections to admitting the
11 Department's exhibit into evidence during the prehearing
12 conference.

13 Do you have any objections now, Mr. Pidal?

14 MR. PIDAL: No, I don't.

15 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay.

16 Appellant submitted two exhibits, Exhibits 1 and
17 2.

18 Department, did you have any objections to
19 admitting those into evidence?

20 MR. SAMARAWICKREMA: No objections.

21 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you.

22 So the exhibits for Appellants, 1 and 2, and the
23 exhibits for the Department, A through K, are submitted
24 into evidence.

25 (All exhibits were received in evidence.)

1 ADMINISTRATIVE LAW JUDGE ALDRICH: And that is in
2 the same order we referenced earlier provided that the
3 hearing would proceed as follows: Appellant's opening
4 presentation, which we estimated at 20 minutes, then the
5 Department's combined opening and closing, we estimated at
6 30 minutes, and then the Panel will ask questions for 5 to
7 10 minutes, and, then, finally, the Appellant or his
8 representative will have 10 minutes for closing remarks or
9 a rebuttal statement.

10 Like we indicated in the Minutes and Orders,
11 these are estimates and made for our calendaring purposes.
12 If you need additional time, please make the request, and
13 we can reassess at that time. Okay?

14 MR. PIDAL: I didn't catch that. I'm sorry.

15 ADMINISTRATIVE LAW JUDGE ALDRICH: So if you need
16 additional time, more than what we have allotted, just
17 ask, and we can determine whether or not we can
18 accommodate it at that time. Okay?

19 MR. PIDAL: Thank you.

20 ADMINISTRATIVE LAW JUDGE ALDRICH: And with
21 respect to witness testimony, my understanding is that
22 there are no witnesses today; is that correct, Mr. Pidal?

23 MR. PIDAL: That is correct.

24 ADMINISTRATIVE LAW JUDGE ALDRICH: Department?

25 MR. SAMARAWICKREMA: Yes, that is correct.

1 ADMINISTRATIVE LAW JUDGE ALDRICH: Great. Any
2 questions from either party before we transition to
3 statements?

4 MR. PIDAL: No questions.

5 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. So
6 Mr. Pidal, we are ready to hear your argument when you are
7 ready to proceed.

8 MR. PIDAL: Okay.
9

10 OPENING STATEMENT

11 MR. PIDAL: Well, basically, as you indicated,
12 there's -- whether or not an adjustment is warranted to
13 the taxable sales or measure of tax and whether the
14 Appellant was negligent. So there's two issues. I want
15 to preface, basically, by stating this audit was started
16 back in June of 2014. Since the initial beginning of the
17 audit when I got involved, I've dealt with four auditors,
18 and every auditor had their own methodology of performing
19 the sales and use tax audit.

20 The final auditor assessed tax based on the
21 credit card ratio. And I don't know if we need to explain
22 that, but credit card ratio -- the Respondent came up with
23 a credit card ratio of around 40-some percent. And the
24 credit card ratio is based on two premises, number one,
25 the credit card receipts and the ratio. So you have the

1 credit card receipts, and if the ratio is 50 percent, then
2 they're saying the result is 50 percent are card sales and
3 50 percent are cash sales. So there's two components to
4 the credit card ratio.

5 The Department -- well, I should say the
6 Respondent. When I say Department --

7 ADMINISTRATIVE LAW JUDGE ALDRICH: I understand
8 what you mean. Feel free to use Department.

9 MR. PIDAL: Okay. I might use the term Board of
10 Equalization because that's what they were when they
11 started the audit. Anyway, but the auditor -- the final
12 auditor or the last auditor, I should say, assessed
13 understated sales of \$6,369,246.00. Again, that was based
14 on credit card receipts and the credit card ratio.

15 It went through an appeals conference, and it was
16 determined that the Department overstated the credit card
17 receipts. The Department erroneously included credit card
18 receipts from another business that the Appellant held,
19 thereby overstating the taxable sales by \$3,275,176.00.
20 In other words, the Department overstated the sales by
21 51.43 percent, which I believe is a pretty egregious
22 error.

23 And the reason I'm bringing that up is that is
24 part of the negligence -- whether or not the Appellant was
25 negligent. The Appellant's second language is English.

1 Okay. So they or he didn't understand requirements. The
2 Department will argue that this is Appellant's second
3 audit. The Appellant had another business, more like a
4 market grocery store, and that's where the Department
5 errored in picking up the credit card receipts from that
6 store, from that business. Okay.

7 The business, as I said, was a market grocery.
8 This audit is a restaurant bar operation. Two different
9 entirely operations. As a matter of fact, the audit
10 manual has two sections, one for grocers and one for bars
11 and restaurants. So they're totally different. The
12 Department will argue that Appellant had a prior audit.
13 Well, the prior audit had nothing to do with the
14 restaurant bar operations.

15 Audit Manual Section 0506.4 talks about
16 negligence penalties and taxpayer's first audits, and they
17 give examples in the audit manual. They talk about
18 whether or not the taxpayer or the Appellant had prior
19 experience in being audited, or they had prior experience
20 in running a restaurant. Obviously, the Appellant did not
21 have any prior experience in the restaurant. So in our
22 view, this is the Appellant's first audit. Okay.

23 And given all of the facts that they understated
24 their sales -- the understatement was around 42 percent,
25 okay, and that was after the adjustment that was made in

1 the appeals conference, which the Department overstated
2 their sales by 51.65 percent.

3 There was an appeals conference held on a similar
4 audit, or I should say on a similar business restaurant.
5 It had the sale percent of error, 42 percent. It had the
6 same things that's going on in this particular audit, and
7 the appeals auditor writes up all of the court cases
8 stating they are negligent -- blah, blah, blah -- stating
9 the Revenue and Taxation Code. But I just want to read
10 verbatim here what the report said.

11 It said, "However, since this is Petitioner's
12 first audit, Petition is entitled to leniency because
13 there is no evidence to show Petitioner did not have a
14 bona fide and reason to believe that her bookkeeping and
15 reporting practices were not sufficiently compliant with
16 requirements of the sales use and tax law."

17 We conclude the negligence penalty should be
18 deleted under these circumstances. And that -- excuse me.
19 And that is based on a first audit, which again, we argue
20 or we state the facts that this is the taxpayer's first
21 audit with a restaurant.

22 The two businesses are going on concurrently,
23 okay, and that's how the Department errored in picking up
24 the credit card sales from the groceries and including it
25 in the audit of the restaurant and bar and overstating

1 their liability by 51 percent. So that is why we believe
2 the negligence penalty should be abated. This is the
3 taxpayer's, basically, first audit, and there should be
4 leniency based on the fact that this is his first audit.

5 The other argument is whether or not there's an
6 adjustment to the credit card ratio. I have submitted --
7 which is in Respondent's Exhibit J. Exhibit J is what I
8 had submitted to discuss the adjustment and the credit
9 card ratio itself. Exhibit J, this is something that I
10 had submitted. But I had to resubmit it because it's
11 already in the Respondent's exhibits.

12 Exhibit J discusses in length the contentions as
13 to why the credit card ratio should be adjusted.
14 Basically, the revenue and taxation code basically says
15 that the Department can make any adjustments that they get
16 access to any information if they find the returns are not
17 correct or reasonably correct.

18 So when the appeals conference was held, the
19 appeals attorney requested a May 2020 report. That was
20 access to the Board of Equalization -- the CDTFA, and I
21 wanted to incorporate that I am recommending that this
22 be -- I'm suggesting that this be incorporated into
23 recalculating the credit card ratio.

24 Now, May 2020, unfortunately, was the time of the
25 pandemic when the restaurants were closed and businesses

1 were down and all of that. The Department said, "Well,
2 this is not represented." Well, I understand and the
3 Respondent understands it's not representative because of
4 the weighting factor. I believe the Department's suggests
5 that it's five times less than what it was that was used
6 for March, April, and May, to compute the original credit
7 card ratio. So I suggested take an average. Okay?

8 They pointed out -- the Department pointed out
9 that is not representative, you can't take an average.
10 Well, if it's five times less than what it was back when
11 they took the original ratio, then if you multiply that by
12 five, you can weight it for the sales correctly or
13 estimate, and it comes out pretty close to the average.
14 They are listed in Exhibit J. So that, at least, make an
15 adjustment to the credit card ratio.

16 Of course, the Department will argue that saying,
17 "Well, 42 percent is based on similar restaurants in the
18 area." Okay. Well, that's when I submitted Exhibit 1 and
19 2. If you look at Exhibit 1 and 2, Exhibit 1 is
20 demographics of two restaurants -- the same restaurants
21 here. Mexican restaurants. They're four miles apart, and
22 the demographics are 90 percent Hispanic, the credit card
23 ratio on that audit -- and that's Exhibit 2 -- is around
24 60 percent.

25 So when I originally looked at this, I figured

1 the ratio would be 60 percent. I have been an -- I'm an
2 ex-employee of the Board of Equalization. I worked for
3 them for 34 years, and I retired in 2009. I have been
4 doing this since 2009, in addition to the 34 years I have
5 of board experience.

6 The 42 percent that the Respondent used is the
7 lowest I have ever seen. I have done fast food
8 restaurants, and it was never 42 percent. This is the
9 lowest. To support that is the lowest, I'm pointing out
10 that a restaurant, similar operation, four miles down the
11 road, the demographics are the same, 60 percent, and
12 that's what CDTFA used.

13 So because May 2020, the report, that should be
14 incorporated to at least give the Appellant a reasonable
15 and more fair adjustment in recalculating the credit card
16 ratio. The Department already made the adjustment for the
17 credit card receipts through the appeals process. So
18 that's basically where the Appellant is seeking adjustment
19 to the credit card ratio and the abatement of the
20 negligence penalty. And if you have any questions, I'll
21 be glad to answer any.

22 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you,
23 Mr. Pidal. Does that conclude your opening presentation?

24 MR. PIDAL: Yes, it does.

25 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. I think

1 we are going to reserve questions for after the
2 Department's combined opening and closing, but we will get
3 back to you on that. I know I have a couple of questions.

4 So, Department, are you ready to proceed with
5 your combined opening and closing?

6 MR. SAMARAWICKREMA: Yes, Judge.

7 ADMINISTRATIVE LAW JUDGE ALDRICH: Go ahead when
8 you are ready.

9
10 OPENING STATEMENT

11 MR. SAMARAWICKREMA: Appellant operates a
12 full-service Mexican restaurant with a bar in Baldwin
13 Park, California. Appellant's restaurant and bar provides
14 entertainment such as live music, DJ, dancing, and
15 karaoke. Appellant also offers catering services.

16 The Department audited Appellant's business for
17 the period April 1st, 2011, through March 31, 2014.
18 During the audit period, Appellant reported taxable sale
19 of around \$7.4 million, and that will be on Exhibit A,
20 page 16. During our presentation, we will explain why the
21 Department rejected Appellant's reported taxable sales,
22 why the Department used an indirect audit approach, and
23 how the Department determined Appellant's unreported sales
24 tax for the audit period, and why the Department
25 recommended a 10 percent negligence penalty.

1 During the audit, the Appellant did not provide
2 complete sales records. Appellant failed to provide
3 complete documents of original entry such as his actual
4 POS download with all folders, POS sales receipts, credit
5 card sales receipts, guest checks, and copies of catering
6 contracts for the audit period.

7 In addition, Appellant failed to provide complete
8 purchase invoices or purchase journals for the audit
9 period. Appellant used a Matre d' point of sale system to
10 record his sales. Appellant stated he combined sales from
11 his POS sales reports into handwritten sales worksheet,
12 which was used to prepare the sales and use tax return for
13 the audit period. While Appellant provided copies of the
14 handwritten worksheets to the Department, he did not
15 provide copies of POS sales report for the audit period.
16 Appellant failed to provide POS sales data and POS folders
17 for the audit period.

18 Appellant stated he was unable to provide POS
19 data for the audit period because his POS system crashed
20 in April 2014, a month before the Department sent its
21 audit engagement letter to him. The Department did not
22 accept Appellant's reported taxable sales due to lack of a
23 reliable report, low reportable book markups, and high
24 credit card sales ratio.

25 The Department also determined that the

1 Appellant's record was such that sales could not be
2 verified by a direct audit approach. Therefore, the
3 Department relied upon an indirect audit approach using
4 Appellant's credit card sales ratio to determine audited
5 sales for the audit period.

6 The Department completed three verification
7 methods to evaluate the reasonableness of Appellant's
8 reported taxable sales. First, the Department had mailed
9 an engagement letter to Appellant on May 6, 2014, to
10 inform the Appellant that his account has been selected
11 for an audit, and that will be on your Exhibit A, page 27.

12 In the three subsequent orders, Appellant finds
13 sales and use tax returns which show his average reported
14 daily sales increased from the average daily sales during
15 the audit period. The Department ordered average reported
16 daily sales of around \$6,700.00 ranging from as low as
17 \$3,600.00 to as high as \$8,900.00 for the audit period.
18 However, those values increased to around \$10,500, and
19 that would be on your Exhibit A, pages 67 and 68.

20 In addition, based on May and June 2014 POS
21 reports, Appellant's reported average daily sales of over
22 \$30,000.00, and that would be on your Exhibit A, page 17.
23 This is an indication that not all of Appellant's sales
24 had been reported in the sales and use tax returns.

25 Second, the Department compared reported taxable

1 sale of around \$3.8 million and with the cost of goods
2 sold of around \$1.6 million reflected on Appellant's 2011
3 and 2012 federal income tax returns, and calculated an
4 overall reportable markup of around 134 percent, and that
5 would be on your Exhibit C, page 165.

6 However, based on the items sold, menu prices,
7 customer base, services provided, and the location of the
8 restaurant, the Department expected to see higher book
9 markup than the reported bookmark for a full-service
10 restaurant with live entertainment and a license to sell
11 alcoholic beverages.

12 Third, the Department did not provide complete
13 sales information for the audit period. Therefore, the
14 Department obtained the Appellant's credit card sales
15 information for the audit period from his internal
16 sources, and that would be on your Exhibit A, pages 62
17 through 66.

18 The Department compared the reported total sales
19 to the credit card sales and calculated an overall credit
20 card sales ratio of around 62 percent, ranging from as low
21 as 51 percent to as high as 93 percent for the audit
22 period, and that will be on your Exhibit A, page 69.

23 Based on his experience in audit of a similar
24 restaurant in Appellant's area, the Department viewed this
25 as a high credit card sales ratio for a restaurant selling

1 alcoholic beverage and providing entertainment. This is
2 an indication that not all of Appellant's cash sales
3 transactions had been reported in the sales and use tax
4 return for the audit period.

5 In contrast, based on May and June 2014 POS
6 reports, the calculated credit card sales ratio was around
7 44 percent, which is, the Department determined, to be a
8 more reasonable credit card sales ratio, and that would be
9 on your Exhibit A, page 70.

10 Appellant was unable to explain the low average
11 reported daily sales, the low reported book markup, and
12 the high reported credit card sales ratios, therefore, the
13 Department conducted further investigation by analyzing
14 Appellant's credit card sales and credit card sales
15 ratios.

16 Appellant did not provide any POS information for
17 the audit period, however, Appellant provided his POS
18 report for May and June 2014, and that will be on your
19 Exhibit C, pages 167 and 168. Therefore, the Department
20 used the available POS reports to determine the credit
21 card sales percentage of around 44 percent, and that will
22 be on your Exhibit A, page 70.

23 The Department also noted the average daily sales
24 of around \$13,300.00, and that will be on Exhibit A, page
25 17. Appellant did not provide any evidence such as credit

1 card information that in May and June 2014 was
2 significantly different than the condition during the
3 audit period. In fact, the May and June 2014 sales
4 information were within two months of the audit period.

5 During the field work, Appellant failed to
6 provide credit card merchant statements or 1099(k) forms
7 to calculate credit card sales for the audit period.
8 Therefore, the Department obtained Appellant's credit card
9 sales information for the audit period from the
10 Department's internal sources, and that would be on your
11 Exhibit A, pages 62 through 66.

12 If the Department used total credit card sales of
13 around \$5.5 million, the audited credit card sales ratio
14 of around 44 percent, credit card tip ratio of around 10
15 percent, and the applicable sales tax rate factors to
16 determine audited taxable sale of around \$10.5 million,
17 and that would be on your Exhibit A, page 57.

18 The Department then compared the audited taxable
19 sales to the reported taxable sales of around \$7.4 million
20 to calculate unreported taxable sales of around \$3.1
21 million, and that would be on your Exhibit A, page 55.
22 The Department then compared the unreported taxable sales
23 with reported taxable sale of around \$7.4 million to
24 calculate their rate of around 42 percent for the audit
25 period.

1 Had the Department used the audited average daily
2 sales of \$13,300.00 without adjusting for the annual
3 growth, then the audited taxable sales would have been
4 increased by around \$4 million, from \$10.5 million to
5 \$14.5 million for the audit period, and that would be on
6 your Exhibit A, page 70.

7 The Department also analyzed Appellant's
8 available sales and business expense information to verify
9 the reasonableness of the audit finding. Since Appellant
10 did not provide complete sales information, purchase
11 invoices, wage information, insurance information, utility
12 bills, and other business expense details for the audit
13 period, the Department relied on reported expenses on
14 Appellant's federal income tax returns, and that would be
15 on Exhibit A, page 73.

16 Those federal income tax returns show that
17 Appellant did not report enough daily sales to cover his
18 daily expenses. The ratio of reported daily expenses to
19 report a daily sales was 93 percent, and that would be on
20 your Exhibit A, page 73. Therefore, Appellant's reported
21 daily sales are not sufficient to cover his actual daily
22 expenses for these years, and this is an indication that
23 Appellant did not report all of his sales on its sales and
24 use tax return for these years.

25 A similar analysis was made comparing the

1 reported daily expenses to average audited daily sales.
2 In 2012, the ratio of daily expenses audited daily sales
3 71 percent, and that would be on Exhibit A, page 73.
4 Based on this analysis, the Department concluded that the
5 audited taxable sales was reasonable, and that would be on
6 your Exhibit A, page 73.

7 The audit calculation of unreported taxable sales
8 based on the credit card sales ratio approach was
9 reasonable and was in Appellant's since favor since it was
10 the lowest of the differences determined. Appellant
11 contends that the audited credit card sales ratio of
12 around 44 percent is not reasonable and claims that his
13 credit card sales ratio is close to 60 percent.

14 In support, Appellant provided a worksheet from a
15 similar restaurant, and that would be on your Exhibit 2.
16 This worksheet listed its office ATM deposits, electronic
17 payment deposits, adjusted total deposits, online
18 transfers from business checking, and total deposits based
19 on that similar restaurant's bank statement for the period
20 April 2011 through July 2011, and that would be on your
21 Exhibit 2.

22 Using this worksheet, Appellant calculated a
23 credit card ratio of around 60 percent, that would be on
24 your Exhibit 2. Therefore, Appellant argued that the
25 Department should increase its credit card sales ratio

1 from 44 percent to 60 percent to determine Appellant's
2 audited sales for the audit period, and that would be on
3 your Exhibit 2.

4 The Department analyzed this information on this
5 worksheet and ultimately rejected it, and the Department
6 ordered that Appellant computed the proposed 60 percent
7 credit card sales ratio using other business credit card
8 sales ratio and its adjusted total bank deposits based on
9 bank statements from that similar restaurant, and that
10 would be on your Exhibit 2.

11 This, however, will not be equal to an audited
12 credit card sales ratio for this restaurant. Instead,
13 this is just a recorded credit card ratio which is based
14 on a similar restaurant's bank statements. The worksheet
15 is inaccurate because it cannot establish that 100 percent
16 of the similar restaurant's cash sales were deposited into
17 his bank account.

18 But in his audit, the Department used the
19 Appellant's own May and June 2014 POS sales information to
20 determine his credit card sales percentage. Therefore, it
21 is not necessary to rely upon projections from a similar
22 restaurant in Appellant's area to determine Appellant's
23 credit card sales ratio.

24 Appellant also provided a POS sales report for
25 the period of May 1st, 2020 through May 31, 2020, and that

1 would be on your Exhibit J, page 301 through 305. Using
2 the reports, total and credit card sales for that month,
3 Appellant calculated a credit card sales ratio of around
4 52 percent, and that would be on your Exhibit J, page 300.

5 Therefore, before the period in question, the
6 Appellant argued that the combined credit card sales ratio
7 should be increasing from 44 percent to 46 percent, and
8 that will be on your Exhibit J, page 300.

9 The Department also reviewed and analyzed this
10 information and ultimately rejected it. Upon examination
11 of Appellant's May 2020 POS sales information, the
12 Department noted that Appellant did not provide actual POS
13 download with all folders, POS sales receipts, and credit
14 card sales receipt to the corroborate the figures listed
15 in his May 2020 POS reports. Therefore, the Department
16 was not able to verify the completeness and recordkeeping
17 activities of the Appellant's May 2020 POS sales
18 information.

19 However, the Department reviewed Appellant's May
20 2020 POS report and ordered that Appellant need not
21 calculate the combined credit card sales percentage
22 correctly, and that would be on your Exhibit J, page 300.
23 Based on the three months of POS reports, the Department
24 calculated the combined credit card sales percentage of
25 44 percent and not 46 percent, and that would be on your

1 Exhibit A, page 70 and Exhibit J, page 300.

2 Therefore, the Department continues to find that
3 Appellant's credit card sales ratio of 44 percent to be
4 representative and reasonable. Based on this new May 2020
5 sales information, the Department can also use this May
6 2020 POS sales information to verify the reasonableness of
7 the audit finding.

8 Since the Department now has two different credit
9 card sales ratio of around 44 percent for year 2014, and
10 52 percent for year 2012, it is now able to mathematically
11 determine Appellant's credit card sale ratios for years
12 2011, 2012, and 2013, using compound annual growth rate
13 formula, and that would be on your Exhibit A, page 72.

14 Based on the compounded annual growth rate
15 formula, the Department mathematically determined the
16 credit card sales ratio of 40 percent for year 2011,
17 41 percent for year 2012, and 42 percent for year 2013,
18 and that would be on your Exhibit A, page 72.

19 If the Department used its credit card sales
20 ratios, this would increase the audited taxable sales by
21 around \$400,000.00, from \$10.5 million to \$10.9 million
22 for the audit period, and that would be on your Exhibit A,
23 page 71.

24 At this time, the Department will not assert an
25 increased account for the additional taxable sale of

1 around \$400,000.00, that would be on your Exhibit A,
2 page 71. Therefore, the Department finds that the
3 estimated amount as is in this audit is not only
4 reasonable, but a benefit to Appellant.

5 Finally, the Department imposed an increased
6 penalty based upon its determination that Appellant's
7 books and records were incomplete and not accurate for
8 sales and use tax purposes, and because Appellant failed
9 to accurately report his taxable sales. The Department
10 knows that although this may be Appellant's first audit on
11 the subject account, he was previously audited under a
12 different permit which is asserted in a determination of
13 unreported sales tax.

14 This indicates that Appellant had the experience
15 and knowledge to sufficiently understand his sales and use
16 tax compliance of the obligation. Specifically, the
17 Department ordered that Appellant provided a record for
18 the audit period, and Appellant failed to provide
19 documents of original entry to support his reported sales
20 tax liability.

21 As a result, the Department had to calculate
22 Appellant's taxable sales based on the credit card sales
23 ratio method. In addition, the audit examination
24 disclosed unreported taxable sales of around \$3.1 million,
25 which when compared with the report of taxable sale of

1 around \$7.4 million for the audit period, resulted in an
2 error rate of 42 percent. This high error rate is
3 additional evidence of negligence.

4 The Department understands that Appellant may
5 have language barrier. The Department also knows that the
6 Department offers its information and assistance in
7 Spanish, both in writing and speaking, and, therefore, it
8 must not be of complete value. Thus, the Department finds
9 Appellant's argument that he was not knowledgeable of the
10 recordkeeping requirements because English is his second
11 language, lacks merit.

12 As stated earlier, the audit calculation of
13 unreported taxable sales, based on the credit card sales
14 and two months' sale information was reasonable and was in
15 Appellant's favor since it was the lowest of the
16 differences determined. Ultimately, the Department used
17 an audit method which yielded the lowest deficiency
18 measure to give a benefit to Appellant.

19 Appellant did not provide complete source
20 documentation such as POS download, POS sales receipt,
21 catering contract information, and credit card sales
22 receipt. Appellant did not provide complete purchase
23 invoices. Appellant failed to provide documentary
24 evidence to support his taxable sales for the audit
25 period. The Department was unable to verify Appellant's

1 reported sales tax using the direct audit method.
2 Therefore, an alternate audit method was used to determine
3 unreported sales tax.

4 Accordingly, the Department determined the
5 unreported sales tax based upon the best available
6 information. The evidence shows that the audit produced
7 fair and reasonable results. Appellant has not provided
8 any reasonable documentation or evidence to support an
9 adjustment to the audit finding, therefore, the Department
10 requests the appeal be denied. This concludes our
11 presentation. We are available to answer any questions
12 the Panel may have. Thank you.

13 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you.

14 I was going to start with a couple of questions
15 for Appellant's representative if that's fine. So
16 Exhibit 2 appears to be a schedule that you submitted.
17 Could you tell me what the source of it is? Is that
18 something that BOE or the Department generated?

19 MR. PIDAL: This is an audit done by CDTFA, the
20 same time this audit was done. Just to give you a
21 brief -- without divulging any confidential information.
22 They are related in blood, okay, but they have bad blood
23 between them. So when CDTFA started the audit, they were
24 doing them together as a related accounts, per se, so I
25 had to point out to CDTFA that you have two individuals,

1 two parties that don't get along, but they're related by
2 blood. So I didn't want one person knowing what the other
3 person is doing and vice versa. I represented them both,
4 so I was in a funny situation, for lack of a better term.

5 But to answer your question, that was from an
6 actual audit done by the same auditor, and it's -- I find
7 it intriguing that auditor will say this is the current
8 credit card ratio that I find in similar audits, yet, he
9 concurrently doing another audit, or has -- you know, but
10 they are totally different.

11 The auditor says that the markup should be X
12 amount, 300 percent, so based on the projected sales. And
13 as the Respondent was reading the markups -- I mean, the
14 adjustments that were made after the credit card receipts
15 were adjusted accordingly, the markup is around 270
16 percent, yet the Department will say we expected
17 300 percent. That was before the egregious error
18 including the credit card receipts from the grocery store
19 in the restaurant.

20 Now I know I went off track. To answer your
21 original question, that is an actual audit that was done
22 concurrently with this audit, and they are related by
23 blood, but they are not related.

24 ADMINISTRATIVE LAW JUDGE ALDRICH: So I have a
25 follow-up question. I guess you mentioned there was some

1 confidential information, and it looks like you attempted
2 to redact some of that.

3 MR. PIDAL: Yes.

4 ADMINISTRATIVE LAW JUDGE ALDRICH: But at the
5 bottom of the page, there's a workbook and then what
6 appears to be the name of the other restaurant. Did you
7 intend to have that redacted?

8 MR. PIDAL: If it said it, I intended to redact
9 it. I apologize.

10 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. So
11 follow-up question. You know, for the Appellant's
12 business at issue, it's a bar and grill?

13 MR. PIDAL: Yes.

14 ADMINISTRATIVE LAW JUDGE ALDRICH: I guess I'm
15 wondering, is there anywhere in the evidence that shows
16 that the restaurant that you are comparing here is also a
17 bar and grill?

18 MR. PIDAL: They're very similar. They have a
19 night club. As the Respondent was describing the business
20 operations, they're the same. One might be a little
21 larger.

22 ADMINISTRATIVE LAW JUDGE ALDRICH: The question
23 is -- I'm sorry. I'm not asking to argue what they may
24 be. Will I find something in the evidence that shows,
25 like, how comparable they are, like, the business models

1 or whether they're both bar and grills? Do you understand
2 what I'm saying?

3 MR. PIDAL: Well, I guess to answer your
4 question, I don't think you will find it in the exhibits.
5 Because as I said, I tried to redact that info and I
6 screwed up.

7 ADMINISTRATIVE LAW JUDGE ALDRICH: And would it
8 be your request to redact that information now?

9 MR. PIDAL: Yes, that should be redacted. I
10 apologize. Please redact it if it's going to be public.
11 And I guess it is.

12 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay.

13 MR. PIDAL: The reason I was pointing this out is
14 part of the argument is that the Department always says,
15 "Well, based on my experience, or based on similar audits
16 in similar businesses, we think 42 percent is reasonable,
17 or based on similar audits, we think the markup is
18 reasonable."

19 Well, they've been making that comment ever since
20 auditor one started the audit. Remember, I went through
21 three or four auditors. Every time they make a change,
22 the current markup right now, after adjusting for the
23 sales, is about 270 percent. I think there's a letter
24 signed by Mr. Parker saying they expected a 300 percent
25 markup, so they did an indirect audit approach. Well, the

1 indirect audit approach, after adjusting for the correct
2 or more reasonable credit card receipts, resulted in about
3 a 270 percent overall markup.

4 I kind of tried to point this out in Exhibit J --
5 I can't find it here -- but I had a markup showing what
6 the markup would be based on the adjustments, and I'm
7 estimating that using the overall 271 percent and using
8 the different market for bar and restaurant just to show
9 how reasonable or unreasonable it would be to use the
10 amounts. It's a Schedule J. I can't pull it up here on
11 my laptop.

12 ADMINISTRATIVE LAW JUDGE ALDRICH: That's okay.
13 We have a copy of Exhibit J.

14 MR. PIDAL: It's Exhibit J, but I don't remember
15 the page number.

16 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay.

17 MR. PIDAL: But in there is my calculation of the
18 -- okay. Let me quickly try to find it here.

19 ADMINISTRATIVE LAW JUDGE ALDRICH: So while you
20 are looking for that, I'm going to also pose another
21 question.

22 MR. PIDAL: Okay

23 ADMINISTRATIVE LAW JUDGE ALDRICH: It looked like
24 in Exhibit J that you were arguing for an average to
25 include the May 2020 credit card ratio, but in your

1 opening argument, it sounded like you were arguing for a
2 weighted average.

3 MR. PIDAL: Well, the reason my first submission
4 was an average, because recognizing the fact that May 20th
5 is one fifth of the two months' use in the audit, so if
6 you weighted them, you know, it would not be weighted
7 correctly as the Respondent pointed out. You can't say,
8 okay, these are 50 percent and 50 percent, and this one
9 has about one-fifth of the sales of these months, so if
10 you try to weight them out, it wouldn't weight correctly.
11 So my best guess -- and I'm sure that Respondent has done
12 it -- take an average. Okay. So that's what I did.

13 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. So
14 that's your position?

15 MR. PIDAL: That was my position initially. It
16 is -- here's the position, either take an average or if
17 you want to weight it correctly, multiply that, increase
18 it by five times, and then you take the weight of the two
19 months plus May, and it comes close. So either one is
20 going to change the credit card ratio, which is going to
21 be more reasonable -- closer to 50 percent, 60 percent,
22 which I believe it still is -- unfortunately, this is the
23 best information that we have.

24 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. Thank
25 you. And for the Department, I did have a couple of

1 questions. So there's reference to a prior audit from an
2 unrelated business. Will I find information in the
3 Department's exhibits regarding that prior audit?

4 MR. SAMARAWICKREMA: No.

5 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. So we
6 just have notes saying that one occurred, but no --

7 MR. SAMARAWICKREMA: In the decision it
8 specifically says, but the Department did not include any
9 working papers relating to that audit with the
10 Department's exhibits. But if the judges want, then we
11 can provide that.

12 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you. At
13 this time I'm going to refer to my colleagues.

14 Judge Geary, did you have any questions for
15 either party?

16 ADMINISTRATIVE LAW JUDGE GEARY: I do not. Thank
17 you.

18 ADMINISTRATIVE LAW JUDGE ALDRICH: Judge Kwee, do
19 you have any questions for either party?

20 ADMINISTRATIVE LAW JUDGE KWEE: Hi, this is Judge
21 Kwee. Yes, I will start with CDTFA. I think in your
22 opening combined presentation you had mentioned that if we
23 increased the credit card ratio that you would have to
24 increase additional taxable sales by \$400,000.00. Did I
25 hear that correctly? I guess I'm not understanding how

1 increasing the credit card ratio would result in
2 additional taxable sales.

3 MR. SAMARAWICKREMA: So in 2014, we have one
4 credit card ratio based on May and June sales information.
5 Close to 44 percent. Then based on the May 2020, the
6 credit card ratio was close to 52 percent, so there is a
7 six-year gap. So if you use that information and use the
8 annual growth rate formula -- it's page 72.

9 So, basically, we use 2014 and 2020, and use that
10 two numbers and estimated 2010, 2011, 2012, and 2013
11 credit card ratio. So if you use that tool credit card
12 ratio based on the growth rate formula from 2011, 40
13 percent, 2012, like, 41, and like 43 for the other year --
14 and it's also listed on page 71. And if you use the
15 credit card ratio based on the May and June, 44 percent,
16 and May 2020, 52 percent, there's a difference of
17 \$400,000.00, showing on page 70.

18 ADMINISTRATIVE LAW JUDGE KWEE: So if I
19 understand you're factoring in the growth weight?

20 MR. PARKER: Judge Kwee, I just wanted to add a
21 little clarification. The credit card ratio did not go
22 up, it went down, which meant -- based on the annual
23 growth rate factor, which increases the cash sales which
24 makes the overall assessment go up. It's not that the
25 credit card ratio went up, it went down based on the

1 growth rate factor.

2 ADMINISTRATIVE LAW JUDGE KWEE: I understand. I
3 didn't realize you were factoring in the growth rate
4 factor. So that explains my confusion. Thank you.

5 And another question for the Department. On the
6 audit working papers that we do have in the file, it
7 references that there were three related accounts. So I
8 guess it seems that one of those accounts had a prior
9 audit, which was mentioned in the decision, and my
10 question was for the prior audit that was referenced, is
11 that the same type of entity as was here? It's also a
12 sole proprietorship grocery store, or is there an issue
13 where it is a different type of business or different type
14 of entity?

15 MR. SAMARAWICKREMA: It's a different type of --
16 based on the Appellant's argument, it appears that it's
17 not a restaurant and bar, but the taxpayer had the
18 experience and had the knowledge on the reporting
19 requirements.

20 ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

21 MR. SAMARAWICKREMA: And, also, the percentage
22 that we have, 42 percent, if he uses that actual audited
23 sales using the growth rate formula, or the daily sales
24 approach, the percentage of error is more than 80 percent.
25 If you use the growth rate formula and compare the

1 original sales to the reported, the percentage of error is
2 82 percent, but in this audit, it's only 42 percent.

3 We give a huge break to the taxpayer by using
4 this audit approach. Even if you use the daily sales
5 approach and give an annual adjustment, then the liability
6 is \$593,00.00, more than what we have today -- I mean,
7 more than what we have in this audit. We have, like,
8 three different approaches and we went with the lowest
9 number.

10 ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you.

11 And for the Appellant, I did just want to clarify
12 my understanding. So with the decision, the CDTFA had
13 deleted some of the credit card sales based on 1099 (k)
14 info and that was from a different business. Am I correct
15 in understanding that you no longer dispute that there are
16 erroneous credit card sales or erroneous 1099(k) info in
17 the current audit, you are only looking at the 43 percent
18 credit card ratio, you agree with the amount of credit
19 card sales that were used?

20 MR. PIDAL: Yes. The credit cards are reasonably
21 correct. It's just the ratio, because I -- we still
22 believe the ratio should be closer to 60 to 50 percent,
23 and that's why I submitted Exhibit 1 or Exhibit 2. And I
24 just want to add -- if I can add, the prior audit that
25 they're referring to was a grocery store. The audit

1 methodology was a markup analysis which is totally
2 different. The requirements for reporting are totally
3 different, that's why there is an audit manual section for
4 grocers and that's why there's an audit manual section for
5 bars and restaurants. So they're totally different
6 operations owned by the same individual.

7 And, again, the audit manual talks about prior
8 audits, and when they say negligence should apply to prior
9 audits, they are saying that, hey, if Mr. Padilla operated
10 a restaurant and was prior audited and then opened up
11 another restaurant, okay, he was negligent. You know, it
12 was not his first audit. Or if he incorporated, his audit
13 as an individual and an audit as a corporation, similar
14 business -- the exact same business, but they're reference
15 to -- they are putting a lot of weight on other than the
16 fact that, you know, the error is this and then they
17 didn't have the books and records.

18 Well, obviously, there's a lot of businesses that
19 don't have all of the books and records. Okay. Whether
20 or not they were negligent or fraudulent, you know, is not
21 the case here. And, again, when I read that decision and
22 recommendation, that was on that audit that I gave you
23 referring to Exhibit 1 and 2, that was the same
24 circumstance. That was the decision and recommendation on
25 that audit where the appeals attorney or appeals auditor

1 recommended that the negligence penalty be deleted because
2 it was the taxpayer's first audit.

3 ADMINISTRATIVE LAW JUDGE KWEE: Okay. Thank you
4 for the clarification. I don't have any further
5 questions, so I will turn it back to the lead judge.
6 Thank you.

7 ADMINISTRATIVE LAW JUDGE ALDRICH: Thank you. So
8 at this time, Mr. Pidal, would you like to make a closing
9 statement or rebuttal to the Department's argument?

10 MR. PIDAL: Well, I think already rebutted, and
11 maybe not in the form. But just in summary then, the
12 adjustment that we are seeking is the credit card ratio
13 should be increased, because even though there's -- you
14 know, when I first took this case, I knew something was
15 wrong. Part of it was they had the wrong credit card
16 receipts.

17 And, I mean, you can go through my initial
18 meeting with the appeals attorney, my discussion is in
19 there. And, I mean, the unreasonableness of their
20 estimate. You know, they talk about how reasonable it
21 was -- well, I don't know how they come up with those
22 numbers. So the credit card ratio should be increased.
23 Okay. Very minimal, but you are talking thousands of
24 dollars here. And the penalty should be abated because,
25 really, this is the taxpayer's first audit. That's it.

1 ADMINISTRATIVE LAW JUDGE ALDRICH: Okay. Well,
2 I'd like to thank everyone for their time. We are ready
3 to conclude the hearing. The record is now closed. The
4 Panel will meet and decide the case based off the evidence
5 and arguments presented today. We will send both parties
6 a copy of our written opinion within 100 days.

7 While this hearing is concluded, there are more
8 hearings today. We will take a 15-minute recess before we
9 proceed to the next hearing. Which will resume, I guess,
10 at 10:50. So please cut the live stream and have a great
11 day.

12 (The hearing concluded at 10:34 a.m.)
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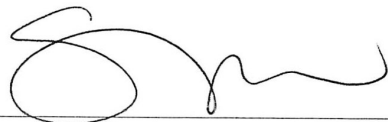
1 HEARING REPORTER'S CERTIFICATE

2
3 I, Shelby K. Maaske, Hearing Reporter in and for
4 the State of California, do hereby certify:

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

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

14 I have hereunto subscribed my name this 9th day
15 of March, 2023.

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19 _____
Shelby Maaske,
Hearing Reporter

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