

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:	)	OTA Case No.: 20035926
	)	CDTFA Case ID: 092-045
<b>MUTUAL MEDICINAL COLLECTIVE</b>	)	
	)	
	)	

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**OPINION**

Representing the Parties:

For Appellant:	Lina Devera, Representative C. Macias, CEO
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For Respondent:	Randy Suazo, Hearing Representative Christopher Brooks, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.
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For Office of Tax Appeals:	Craig Okihara, Business Tax Specialist III
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J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Mutual Medicinal Collective (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)<sup>1</sup> ordering a reaudit but otherwise denying appellant’s petition for redetermination of the Notice of Determination (NOD) dated September 26, 2017. The NOD is for tax of \$414,575.55, applicable interest, and a penalty of \$41,457.57, for the period July 1, 2014, through June 30, 2017 (audit period).

CDTFA performed the reaudit using an average sale per person of \$50, which reduced the total measure of tax from \$5,209,235<sup>2</sup> to \$4,859,078 and will result in reductions to the determined tax and penalty.

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

<sup>2</sup> The NOD is based on an audit report dated September 12, 2017, in which CDTFA had determined that appellant had unreported taxable sales measuring \$5,208,688. Later, CDTFA confirmed that the correct measure, based on the audit working papers, was \$5,209,235. CDTFA subsequently performed a reaudit that reduced the unreported taxable measure by \$350,157 therefore this discrepancy is moot.

Office of Tax Appeals (OTA) Administrative Law Judges Eddy Y.H. Lam, Michael F. Geary, and Josh Aldrich held an oral hearing for this matter in Cerritos, California on October 11, 2022. At the conclusion of the hearing, the record was held open to allow CDTFA to respond to appellant's Exhibits 5 through 8. The record closed on November 9, 2022.

### ISSUE

Whether additional adjustments to the amount of unreported taxable sales are warranted.

### FACTUAL FINDINGS

1. Appellant, a California corporation, operated a medical marijuana dispensary located in Santa Ana, California, selling cannabis products and smoking accessories. Appellant obtained a seller's permit effective June 1, 2012, and it was closed out effective September 30, 2017.
2. During the audit period, appellant reported total and taxable sales of \$185,522 on its sales and use tax returns (SUTR). Upon audit, appellant failed to provide any books and records. Appellant's reporting method is unknown.<sup>3</sup>
3. On July 3, 2017, CDTFA mailed appellant an audit engagement letter to appellant's mailing address. CDTFA requested a response by July 13, 2017.
4. On July 19, 2017, CDTFA's auditor went to appellant's business location since no response was received. CDTFA's auditor observed that the business was still active and selling products. Appellant's CEO was not available at the time, but a sealed copy of the audit engagement letter was provided to a person who self-identified as the business manager. An employee provided CDTFA's auditor with the CEO's phone number.
5. On July 26, 2017, CDTFA's auditor called the phone number that was provided but the CEO was not available. CDTFA's auditor indicated that he would come to the business the following day to discuss sales tax matters.
6. On July 27, 2017, CDTFA's auditor went to appellant's business location. Appellant's CEO was not available according to appellant's security guard. Appellant's employee indicated that appellant's CEO would call CDTFA by the next day.
7. CDTFA did not receive a response. On August 2, 2017, CDTFA issued a follow up audit engagement letter requesting appellant's response by August 12, 2017.

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<sup>3</sup> The evidence does not indicate whether appellant reported sales net of any potentially exempt sales.

8. CDTFA sent appellant a request for information or documentation on August 9, 2017.
9. Because CDTFA had not received a response to the request for information or documentation, CDTFA's auditor phoned appellant's CEO on August 17, 2017. According to the audit notes, the CEO "was not cooperative. He was not willing to provide information regarding the business operations, sales and delivery services except he confirmed that the taxpayer has been providing delivery services."
10. Because appellant did not provide business records upon which an audit could be based, and to avoid the expiration of the statute of limitations, CDTFA prepared the audit with the available information as discussed below.
11. For audit, CDTFA learned from the website Weedmaps.com (Weedmaps)<sup>4</sup> that appellant's business hours were from 9:00 a.m. to 11:00 p.m., Monday through Sunday. Weedmaps also indicated that appellant provided delivery services.
12. CDTFA divided appellant's reported taxable sales by the number of days in each quarter and calculated average reported daily sales of \$167.
13. CDTFA did not have average sales data for Orange County dispensaries, so it used data from audits of two comparable Los Angeles County dispensaries, which had average sales per customer of \$53.39 for 2014 and 2015, and \$53.55 in 2016. Using these amounts, appellant reported an average of about three customers per day for the audit period, which CDTFA considered incredibly low and an indication that appellant was not reporting a significant percentage of its sales. On that basis, CDTFA decided that additional investigation was warranted.
14. CDTFA conducted an observation test from outside appellant's business on two days.<sup>5</sup> Appellant's business shared the same building with an unrelated business and each business had a separate entrance. CDTFA counted the number of people who entered appellant's business.<sup>6</sup>

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<sup>4</sup> Weedmaps is a website that allows users to search for marijuana dispensaries by location. The website provides information about marijuana dispensaries, such as business location, business hours, menus, pricing, and customer reviews.

<sup>5</sup> Prior to the audit period, CDTFA through its Statewide Compliance and Outreach Program visited appellant's business on Tuesday, January 15, 2013, and observed seven people inside the business during a 10- minute period.

<sup>6</sup> CDTFA reports that it observed the business from across the street, where the auditor had a clear view of the entrance.

- a. On Monday, August 7, 2017, CDTFA observed 40 people enter the business from 10:00 a.m. to 2:00 p.m.
- b. On Friday, August 11, 2017, CDTFA observed 69 people enter the business from 9:00 a.m. to 5:00 p.m.

For the two days combined, CDTFA observed 109 people entered the business over 12 hours and computed an average of 9 people per hour entered the business.

15. CDTFA estimated appellant's sales based on the average purchase data and the two observation tests.
16. CDTFA recognized that some of those who entered the business may not have made a purchase. Therefore, CDTFA estimated that two-thirds (66.67 percent) of the people entering the business made a purchase and one-third (33.33 percent) did not make a purchase. Based on this estimate, CDTFA found that appellant made six sales per hour (i.e., two-thirds of the average number of people entering the business per hour) during a typical 14-hour business day. In total CDTFA calculated 84 in-store sales per day (6 customers per hour  $\times$  14 hours per day).
17. Since appellant's CEO confirmed that it offered delivery services but did not provide any information about its delivery sales, CDTFA reviewed additional information. For example, CDTFA submitted an article that reports a delivery driver using Eaze<sup>7</sup> could make 20 to 40 deliveries during an eight-hour shift. CDTFA estimated that appellant made eight delivery sales per day. CDTFA added the 84 audited in-store sales per day and the 8 audited delivery sales per day to find an average of 92 audited taxable sales per day.
18. Using the sales prices of comparable dispensaries of \$53.39 for 2014 and 2015, and \$53.55 in 2016, CDTFA computed average daily taxable sales of \$4,912 (92 customers  $\times$  \$53.39) for 2014 and 2015, \$4,927 (92 customers  $\times$  \$53.55) for 2016, and \$4,927 (92 customers  $\times$  \$53.55) for the first two quarters of 2017. CDTFA multiplied these average daily taxable sales by the number of days in each quarter to calculate audited taxable sales of \$5,391,757 for the audit period. CDTFA compared audited taxable sales for the audit period to appellant's reported taxable sales and found unreported taxable sales of

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<sup>7</sup> According to CDTFA, Eaze is an online marketplace that connects users to marijuana dispensaries providing delivery services.

- \$5,209,235 for the audit period. Under this analysis, the average audited measure per quarter is \$449,313.
19. CDTFA concluded that the estimated sales were within the expected range.<sup>8</sup>
  20. CDTFA issued the NOD to appellant on September 26, 2017, with a tax liability of \$414,575.55, applicable interest, and a negligence penalty of \$41,457.57.
  21. On May 22, 2018, CDTFA discovered that appellant ceased operating. CDTFA closed appellant's seller's permit effective September 30, 2017.
  22. Appellant filed a timely petition for redetermination disputing unreported taxable sales. Appellant did not dispute the penalty.
  23. During CDTFA's appeals process, appellant asserted that the average sale price per customer was \$50 during the audit period. In its decision dated July 23, 2019, CDTFA accepted appellant's representation and used the \$50 average purchase amount to reduce the average sale price per customer but otherwise denied appellant's petition.
  24. CDTFA performed a reaudit using average sale per customer of \$50 which resulted in a reduction to the taxable measure of \$350,157 from \$5,209,235 to \$4,859,078.
  25. Appellant timely appealed to OTA.

### DISCUSSION

Issue. Whether any additional adjustments to the amount of unreported taxable sales are warranted.

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax unless the retailer can prove otherwise. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481,

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<sup>8</sup> CDTFA found that the audit results were supported by its own knowledge of the dispensary industry, which estimates that a similar business would make sales between \$150,000 and \$450,000 per quarter.

6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) That means that the taxpayer must prove both: (1) the tax assessment is incorrect, and (2) the correct amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, appellant was, at first, nonresponsive to CDTFA's request for cooperation and business records, and later outright refused to provide records for the audit. To protect the State's interest for the expiring period (3Q17),<sup>9</sup> CDTFA decided to observe the business from the outside. Using the available information, CDTFA completed the audit report and sent appellant the NOD based thereon. In light of these circumstances, CDTFA's decision to observe the business from outside, counting the number of patrons entering the dispensary, was reasonable. (*Appeal of AMG Care Collective, supra.*) However, CDTFA's observations require additional scrutiny because they totaled just 12 hours and did not include all of appellant's business hours.

The observations occurred on a Friday and a Monday. The Monday observation, between 10:00 a.m. and 2:00 p.m., showed that 10 individuals entered per hour. The Friday observation, between 9:00 a.m. and 5:00 p.m., showed that 8.6 individuals entered per hour. CDTFA then compared the observation tests with the January 15, 2013 Statewide Compliance and Outreach Program (SCOP) data.<sup>10</sup> Moreover, CDTFA's ability to perform additional observations was limited by appellant's refusal to sign a waiver extending the statute of limitations for CDTFA to issue a determination, limiting CDTFA's ability to perform more observations. CDTFA's ability to perform additional observations was also limited by the cessation of appellant's business activities in 4Q17. Furthermore, in the reaudit CDTFA excluded one-third of those observed entering the business from its calculation, thereby accounting for the fact that it could not verify whether appellant made a sale to each person that

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<sup>9</sup> Generally, there is a three-year statute of limitations for CDTFA to issue an NOD. (R&TC, § 6487.) The statute of limitations begins to run on the last day of the calendar month following the filing period, quarterly or annually, for which the amount is proposed to be determined. Appellant reported quarterly. Thus, for 3Q14 the statute of limitation would have run on October 31, 2017 or about a month after the NOD date.

<sup>10</sup> OTA notes that the Form CDTFA-1164, referenced in the audit workpapers, is not in evidence (see footnote 5).

CDTFA observed entering. In light of the foregoing, OTA finds that CDTFA's use of the observation test to be reasonable and rational.

Appellant confirmed that it provided delivery services during the August 17, 2017 telephone conference. Thus, CDTFA's conclusion that appellant provided delivery services is reasonable and rational.

To calculate the measure of taxable sales, CDTFA used pricing information obtained from audits of similar businesses in the Los Angeles area. During the reaudit, CDTFA agreed to reduce the per sale price from \$53.39 for 2014 and 2015, and \$53.55 for 2016 and 2017 to \$50 per sale. This reduction is based solely on a contention by appellant, which was not supported by any documentation. Accordingly, OTA finds that the price per sale (as adjusted during the reaudit) is based on appellant's own figures.

Taken with the fact that appellant failed to provide any books and records and otherwise refused to meaningfully participate in the audit, CDTFA's initial burden of showing that its determination was reasonable and rational is met. Accordingly, the burden of proof shifts to appellant to show errors in the audit. (*Appeal of Talavera, supra.*)

On appeal, appellant raises several contentions. Regarding the observation test, appellant asserts that not every person entering the business made a purchase and, in some cases, up to 50 percent of those entering consisted of vendors, merchants, and other guests. Appellant also asserts that CDTFA improperly relied on "best in industry" figures to calculate appellant's audited taxable sales. Appellant has not provided any support for these contentions.

Concerning delivery sales, appellant argues that although it was listed on the "app" as having a delivery service, it never utilized it because they did not have the manpower for it. Alternatively, appellant asserts it did not make deliveries for a long enough period to include them in the taxable measure. Appellant also asserts that the audit measure is overstated because CDTFA based its estimate on information obtained from Eaze, a marijuana delivery service. While the Eaze article showed that a delivery driver could make between 20 and 40 deliveries per 8-hour shift, CDTFA estimated that appellant made only eight deliveries per 14-hour day. In other words, CDTFA's estimate of appellant's daily deliveries is significantly less than the information obtained from Eaze. As noted above, appellant confirmed during the audit that it made deliveries. OTA again notes that none of the daily sales journals or other related

documents were ever provided.<sup>11</sup> Appellant has not provided any documentation to show that it made less than eight deliveries per day; that it discontinued delivery service during the audit period; or that it did not make delivery sales. Thus, appellant has not met its burden of proof regarding its delivery sale contentions.

Regarding the audit methodology, appellant asserts that CDTFA did not take into account days that the business was closed. Despite these contentions, appellant has not provided any evidence to show adjustments are warranted for additional days on which it was closed. Thus, we find appellant's contention to be without merit.

Appellant claims that the IRS performed a thorough audit on the same years as in the case before us here and identified a \$65,000<sup>12</sup> discrepancy in sales from a review of bank account statements which appellant concurs with. Appellant provided a copy of the IRS Report of Income Tax Examination Changes (Form 4549) dated October 7, 2019, which indicates that the audit was on C. Macias' (appellant's CEO) personal individual income tax returns (Form 1040) for 2016, 2017, and 2018. Here, however, OTA notes that appellant, a corporation, would have to file a U.S. Corporate Income Tax Return (Form 1120).<sup>13</sup> The audit of appellant's corporate officer's personal income tax returns has little bearing on the sales reported by appellant on its SUTR. OTA finds that the assertion of an alleged discrepancy of \$65,000 by the IRS on appellant's CEO personal returns is not persuasive here.

Finally, appellant provides evidence that appellant's CEO worked other jobs, including a full-time position as a phlebotomist, and as a Lyft driver during the audit period to show that the business was not successful and that the audited measure is overstated. However, this evidence merely shows that appellant's CEO earned outside income. This evidence does not demonstrate that adjustments are warranted.

In sum, appellant has failed to provide any documentation or other evidence from which a more accurate determination could be made. In conclusion, appellant has not met its burden of establishing that a reduction to the measure of unreported taxable sales is warranted.

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<sup>11</sup> According to appellant's argument, it accurately recorded its daily sales in a sales journal which it submitted to its tax preparer; in turn, the tax preparer used the information to complete appellant's SUTR.

<sup>12</sup> Appellant's opening brief stated the discrepancy was \$30,000 while its reply brief stated the discrepancy was \$65,000.

<sup>13</sup> CDTFA's Report of Discussion of Audit Findings (Form CDTFA-836) dated January 16, 2016, states that appellant provided its U.S. Corporate Income Tax Return (Form 1120) for 2015, and 2016.



HOLDING

Appellant has not shown that further adjustments to the measure of tax is warranted.

DISPOSITION

CDTFA’s action in recommending that the determined measure of tax be reduced to \$4,859,078, as computed in CDTFA’s reaudit, but otherwise denying the petition is sustained.

DocuSigned by:  
*Josh Aldrich*  
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Josh Aldrich  
Administrative Law Judge

We concur:

DocuSigned by:  
*Michael F. Geary*  
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Michael F. Geary  
Administrative Law Judge

DocuSigned by:  
*Eddy Y.H. Lam*  
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Eddy Y.H. Lam  
Administrative Law Judge

Date Issued: 2/8/2023