

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
PREMIER WHEELS/PRO TIRES, INC.,) OTA NO. 20096668
)
APPELLANT.)
)
)

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, September 13, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
12900 Park Plaza Dr., Cerritos, California,
91401, commencing at 9:34 a.m. and concluding
at 11:10 a.m. on Wednesday, September 13, 2023,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ ANDREW WONG

Panel Members: ALJ LAUREN KATAGIHARA
ALJ JOSHUA ALDRICH

For the Appellant: MARC BRANDEIS

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

NALAN SAMARAWICKREMA
RANDY SUAZO
CHRISTOPHER BROOKS

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I N D E X

E X H I B I T S

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OPENING STATEMENT

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By Mr. Samarawickrema	25

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1 Cerritos, California; Wednesday, September 13, 2023

2 9:34 a.m.

3

4 JUDGE WONG: Let us go on the record.

5 This is the Appeal of Premier Wheels/Pro Tire,
6 Inc., before the Office of Tax Appeals, OTA Case Number
7 20096668. Today is Wednesday, September 13th, 2023. The
8 time is 9:34 a.m. We're holding this hearing in person in
9 Cerritos, California.

10 I am lead Administrative Law Judge Andrew Wong
11 and with me today are Judges Lauren Katagihara and Josh
12 Aldrich.

13 Individuals representing the Appellant taxpayer
14 please identify yourselves.

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

17 JUDGE WONG: Thank you.

18 And individuals representing the tax agency, the
19 California Department of Tax and Fee Administration or
20 CDTFA, please identify yourselves.

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

23 MR. SUAZO: Randy Suazo, Hearing Representative
24 for CDTFA.

25 MR. BROOKS: Good morning. Christopher Brooks,

1 attorney for the CDTFA.

2 JUDGE WONG: Thank you.

3 Originally Judge Teresa Stanley was to be a
4 member of this panel, but she's unavailable. So
5 Judge Aldrich is subbing in for her. Does either party
6 object to this substitution?

7 Mr. Brandeis?

8 MR. BRANDEIS: No objection.

9 JUDGE WONG: Thank you.

10 CDTFA?

11 MR. SAMARAWICKREMA: No objections.

12 JUDGE WONG: Thank you.

13 So this will be the panel hearing and deciding
14 this case.

15 We are considering two issues today. The first
16 is whether the amount of unreported taxable sales should
17 be reduced, and the second is whether Appellant was
18 negligent or intentionally disregarded relevant legal
19 authorities.

20 Mr. Brandeis, is that a correct statement of the
21 issues?

22 MR. BRANDEIS: Yes.

23 JUDGE WONG: Thank you.

24 CDTFA?

25 MR. SAMARAWICKREMA: Yes, Judge.

1 JUDGE WONG: Thank you.

2 As far as exhibits go, Mr. Brandeis, you have not

3 submitted or proposed any exhibits; is that correct?

4 MR. BRANDEIS: That's correct.

5 JUDGE WONG: And you have no additional exhibits

6 you wanted to submit; is that right?

7 MR. BRANDEIS: That's correct.

8 JUDGE WONG: Okay. Thank you.

9 And CDTFA has identified and submitted proposed

10 Exhibits A through P.

11 And, CDTFA, you had no other documents; is that

12 right?

13 MR. SAMARAWICKREMA: Yes, Judge. No other

14 exhibits.

15 JUDGE WONG: Okay. Mr. Brandeis, did you

16 object to -- did you have any objections to CDTFA's

17 proposed Exhibits A through P?

18 MR. BRANDEIS: No objections.

19 JUDGE WONG: Okay. Thank you.

20 CDTFA's Exhibits A through P will be admitted

21 into the record as evidence.

22 (Department's Exhibits A-P were received in

23 evidence by the Administrative Law Judge.)

24 JUDGE WONG: And, Mr. Brandeis, you had no

25 witnesses today?

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MR. BRANDEIS: No witnesses.

JUDGE WONG: And, CDTFA, no witnesses?

MR. SAMARAWICKREMA: No witnesses.

JUDGE WONG: Thank you.

All right. It was anticipated that this oral hearing would take approximately 70 minutes.

Mr. Brandeis, you've asked for 25 minutes total to be divided between your opening, your main presentation, and your closing and rebuttal.

And CDTFA asked for 30 minutes total.

Mr. Brandeis, is that correct?

MR. BRANDEIS: That's correct.

JUDGE WONG: And, CDTFA, is that right?

MR. SAMARAWICKREMA: Judge, we are requesting 40 minutes.

JUDGE WONG: 40 minutes. Okay. Just a second. Okay. Since I budgeted 10 minutes for this opening matter, I don't think that will be a problem.

Okay. Any questions before we get started.

Mr. Brandeis?

MR. BRANDEIS: No questions.

JUDGE WONG: CDTFA, any final questions?

MR. SAMARAWICKREMA: No judge.

JUDGE WONG: Okay. Mr. Brandeis, please proceed with your presentation. You have 25 minutes.

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1 does, and the law doesn't support that. The regulation
2 doesn't support that and neither does the Audit Manual.

3 In fact, if you read -- if you read the Audit
4 Manual Section -- Audit Manual Section 0409.50, that
5 section specifically states with regards to a resale test
6 that an auditor may exercise personal knowledge or -- or
7 other sources that they may come into, both public and
8 non-public sources of information, in order to determine
9 whether or not a transaction is, in fact, a sale for
10 resale. But she simply just said well, they don't have a
11 resale certificate so, therefore. It's disallowed.

12 So clearly, she's not exercising the policies in
13 the Audit Manual. Audit Manual, when it talks about
14 auditors in the Chapter 1 Section 0101.20, it says that
15 they're called upon to exercise their highest skill and
16 best judgement throughout the performance of their
17 official duties. That section goes on to state some
18 professional judgment must be exercised in making tests
19 that are representative of the actual business operations
20 during the audit period.

21 So she didn't do that here. You know she -- in
22 fact, if you look at the details of her tests -- and I
23 have just filtered the transactions that she's
24 disallowing -- looking at the first -- the first
25 disallowed set of transactions, it's to Buena Park Service

1 Center. There's four transactions. So she tested one
2 month and came up with a percentage of error basis in that
3 one month.

4 But the first one, Buena Park Service Center --
5 so, first of all, you've got to ask yourself, they have
6 four tractions to Buena Park Service Center in this one
7 month period. So one of the things that a professional
8 auditor would look at is, even if they don't have a resale
9 certificate, are the number and scope of the purchases --
10 the sales in this case -- indicative of a sale for resale
11 or a retail sale?

12 So, you know, I used to be an auditor myself.
13 And when I went through training, one of the things that
14 my trainer said when we talking about resale tests is that
15 don't be that guy that has an invoice -- say, you're
16 auditing a widget company, a company that makes widgets.
17 And you have an invoice to a widget supply company from
18 the widget manufacturer that you're auditing for 10,000
19 widgets, but you don't have a resale certificate. I mean,
20 it's absurd to pick that transaction up and call it a
21 retail sale. 10,000 widgets sold XYZ Widget Supply
22 Company just because they don't have a resale certificate.
23 That's absurd. But that's what she's doing here.

24 So, again, the first transaction -- the first
25 disallowed customer, Buena Park, four sales transactions

1 the in one month test, and her comment is, "Auditor
2 contacted owner Michael. He stated no resale certificate
3 issued."

4 Now, sometimes what happens when an auditor
5 contacts a taxpayer to ask what they did, as far as did
6 you buy this for resale, they get scared. Oh, my gosh,
7 you know, are they going to come after me? What if I say
8 something are they going to start looking at my records?
9 So sometimes they just say that they didn't do it, or they
10 don't recall it, or I didn't happen. But four
11 transactions in a one month period, I think a reasonable
12 and prudent person would say that that's more indicative
13 of a sale for resale than a retail sale to this service
14 center, Buena Park Service Center. So a service center,
15 this is most likely an automobile service center. What
16 would they be doing with tires or wheels that they're
17 buying, four transactions in a one-month period? It seems
18 pretty evident that they would be buying it for resale and
19 not for their own consumption.

20 The other thing to consider is the standard of
21 proof that the auditor should be using. And what the
22 auditor should be exercising is the preponderance of the
23 evidence standard. And that standard says what's more
24 likely than not to have happened here. And so, again,
25 she's clearly not applying that standard.

1 The next one is Caliber Collision. There's three
2 transactions to Caliber Collision, and she says that she's
3 disallowing them because she spoke to an office manager
4 whose name -- apparently, they had a resale certificate,
5 and the manager states that she did not sign this form.
6 She'd like to report it as fraudulent. She says,
7 "Ms. Marquez says she searched her system, and Caliber
8 Collision does not do business with Premier Wheels.
9 Auditor questions the authentication of the resale
10 certificate."

11 So I went online and there is more than one
12 Caliber Collision. We found two of them. So is it
13 possible she called the wrong one, spoke to the wrong
14 person. Or, again, sometimes people just don't want to
15 deal with the auditors. They say we didn't do business
16 with them or what not because they're scared. But three
17 transactions to Caliber Collision, again, in a one-month
18 period?

19 The next one is California Auto Body. There's no
20 comments there. Again, one, two, three, four transactions
21 in a one-month period to California Auto Body, but she
22 makes no comment. Why? She just needs a resale
23 certificate.

24 The next one is Cannillo's Tires. This one she
25 says that the resale certificate is for -- so I guess the

1 name was wrong, or it's possible -- these are handwritten
2 resale certificate. Everybody handwrites them. I rarely
3 see one that's typed out. So it's possible that
4 somebody -- somebody's handwriting is hard to read or what
5 not. And it says that they are a used car dealer, not I
6 tire shop. Well, okay.

7 I've audited plenty of used car dealers in my
8 days as an auditor. And oftentimes they'll buy a used
9 car, and it needs new wheels, new tires, new this, new
10 that. But again, one, two, three, five transactions in a
11 one-month test period. It seems highly unlikely to me
12 that they're for self-consumption.

13 Then we have a number of others that, again,
14 there's no comment from the auditor. So the schedule I'm
15 looking at is what was ordered by the Appeals Bureau after
16 they told her she can't just simply disallow transactions
17 because they don't have a resale certificate. So, again,
18 Fast Road Service we have one, two transactions, GM
19 Specialist, four transactions, good Auto Repair, one
20 transaction, Hai Tech, three transactions. No comments
21 whatsoever.

22 We were able to find Hai Tech on the internet
23 using Google. Fast Road Service we found on the internet
24 using Google, but she doesn't -- I don't even know that
25 she looked at those. But again, there are multiple

1 transactions, the name of the company, the frequency of
2 the transactions leads a reasonable and prudent auditor to
3 conclude that those are more likely than not for resale.

4 Next one Kurtis Tires, Kurtis spelled with a K. I
5 couldn't find Kurtis Tires with a K, but I could find a
6 Curtis Tires with a C. So again, I don't think she just
7 exercised a lot of care there.

8 Then we have Long Beach Truck Sales. I located
9 them on -- no comment -- but I located them on Yelp. They
10 are at 1531 West Cal Street in Long Beach, California. I
11 found a phone number for them, but she has no comments.
12 So I can only assume that just is disallowing it because
13 they don't have a resale certificate. But we have
14 transactions there.

15 Lozano's Tires, four transaction. No comment.
16 But, again, we found them on Google, 900 Vermont Avenue in
17 Los Angeles.

18 Elmore Toyota, there's two transactions. She's
19 disallowing it because there's no signature on the resale
20 certificate. Again, it's required. It's a flawed resale
21 certificate. But again, I would ask the auditor to
22 exercise judgment -- reasonable judgment. What is Elmore
23 Toyota likely doing with tires or wheels that they've
24 purchased from my client? Two in the one month test.

25 Norwalk Auto, we have one, two, three, four,

1 five, six, seven transactions to Norwalk Auto in this one
2 month test. Her comment is, "Taxpayer provided a resale
3 certificate without a valid seller's permit number.
4 Norwalk Auto is an auto auction house."

5 So, again, they're selling used cars, but they're
6 probably buying tires or wheels for the used cars that
7 have bald tires and need to be replaced. The fact that
8 they received a resale certificate that's not valid, the
9 number is not valid, is not -- it's not the taxpayer's job
10 to verify a resale certificate. In fact, a lot of them
11 don't even know how to do it using the CDTFA website.
12 It's their job to accept a resale certificate in good
13 faith.

14 If somebody puts a bad number on there, they can
15 still be considered to be accepting it in good faith, and
16 there are several annotations that support that
17 conclusion. But, again, Norwalk Auto Auction, seven
18 transactions in a one-month period being disallowed.

19 PCH Auto, three transactions. Taxpayer provided
20 a resale certificate with one number. The name on the
21 permit is different. Therefore, it's disallowed.

22 You know what she doesn't seem to ask any of them
23 when she does contact them? She doesn't seem to ask any
24 of them, "Did you resell the items that you purchased from
25 Premier Wheels and Tires?" That's the most important

1 questions. She doesn't document that anywhere inn any of
2 these when she contacts the taxpayer.

3 Perfect Auto, we found them on the internet. Two
4 locations, one in La Habra, on in Placentia. They
5 probably did business at the one in La Habra since it's
6 the closer one. She disallowed it because sales invoice
7 doesn't have purchase information, such as address or
8 phone number. So we got one, two, three, four, five,
9 transactions to Perfect Auto that she's disallowing.

10 The next is Smog Pros, two transactions. She
11 says it was accepted as a resale from the prior audit.
12 However, no permit number was recorded for auditor to
13 validate if customer is still in business. Well, first of
14 all, there's no requirement that -- you know, a sale for
15 resale is a sale for resale. So, for example, if you had
16 a taxpayer, let's just assume they did not have a seller's
17 permit, but they made purchases of wheels or tires for
18 resale.

19 Again, we're talking about somebody operating
20 without a permit. And they gave a resale certificate with
21 either a bad number or what not or even no number, or they
22 gave no resale certificate. That doesn't mean it's a
23 taxable sale from Premier Wheels to the unpermitted [sic]
24 retailer. It simply means that the Board has likely found
25 somebody that's unpermitted [sic], and they should be

1 going after that person by making audit memorandum notes,
2 but they shouldn't be picking it up against the wholesale
3 transaction between Premier Wheels and the unpermitted
4 retailer. So this auditing 101. Why she's picking it up
5 at the wholesaler is just beyond me.

6 So Star Auto, same thing. We have two
7 transactions there. She says that resale certificate
8 provided. Started on 4/12/18. So, in other words, the
9 date that the permit started and the date of the
10 transaction between my client and Star Auto falls outside
11 of the date that the taxpayer had a valid seller's permit
12 number. So, again, I would be contacting them and
13 wondering did the date that you opened the permit, was
14 that after the date that you actually started? This is
15 what an experienced knowledgeable prudent professional
16 auditor would do, not pick it up at the wholesale
17 transaction at Premier Wheels.

18 And the last one is Tamazula Tires which, again,
19 we found in -- on the internet in Torrance using Google.
20 She says that this one they didn't have a valid resale
21 certificate. Auditor used non-public source to search for
22 this business. There's no valid permit during the testing
23 period, November 2015. Hence, the transaction is not a
24 sale for resale. That's -- so what she's saying there is
25 if you don't have a seller's permit, you can't be a

1 retailer. That's not true. That is a false statement.

2 There's -- if you look up the definition of a
3 retailer, there's nothing in the law that says you must
4 have a seller's permit to be a retailer. You're a
5 retailer if you're making retail sales of tangible
6 personal property in the state. That's what makes you a
7 retailer. There's nothing in the law that says you have
8 to have a seller's permit. Actually, let me take that
9 back. There's nothing in the law that says you -- in
10 order to be a retailer, you must have a seller's permit.
11 There is something in the law that says retailer are
12 required to hold seller's permits.

13 But the question here is, did they sell to
14 somebody who was a retailer? And her response is, no
15 seller's permit, can't be a retailer. I mean, this is --
16 this is absurd. It's just absurd. This issue actually
17 came up in another case V.A. Auto Sales that we presented
18 in front of this body back in 2019. In that case we
19 provided no resale certificates. We provided no XYZ,
20 letters, but we won the case unanimously at OTA. Why did
21 we win unanimously? Because we simply asked the panel to
22 exercise common sense.

23 If you read the opinion on the V.A. Auto Sales,
24 page 5 of the opinion, paragraph -- second paragraph it
25 says, "In the instant case, it is undisputed that

1 Appellant did not obtain resale certificate or XYZ letters
2 from the purchaser. Nevertheless, Appellant appeals to
3 common sense."

4 So what the Panel recognized, they looked at the
5 big picture, the number of transactions. So we had a
6 few -- a number of buyers who made a significant number of
7 purchases of -- in this case it was wrecked vehicles. The
8 Department was saying that those people -- that those were
9 retail sales. Common sense would tell you I'm buying
10 hundreds of wrecked vehicles for my own use. No, for
11 resale. We won that case unanimously, and they even cited
12 the more likely than not standard of proof. What was more
13 likely to have happened here.

14 So the auditor is not exercising that standard of
15 proof, and she even explicitly states that in a memorandum
16 dated October 25th, 2019, that she wrote to Cindy Feng,
17 the tax counsel in the Appeals Bureau. So in that -- and
18 then I'm quoting. She says, "We" -- there's some
19 grammatical writing that has some errors. So I'm going to
20 read it as wrote it. "When examined the exempt sales for
21 resale, the auditor must base on the law and regulation,
22 not on the auditor's experience or personal knowledge."

23 So what she's saying there is she's not allowed
24 to exercise -- she's basing it on the part of the law that
25 says if you -- in order to exempt a sale for resale, a

1 taxpayer must obtain a resale certificate. But even if
2 you read that regulation, that's not what it says in the
3 regulation. If you read Regulation 1668, Sales For
4 Resale, subdivision (e), other evidence to rebut
5 presumption and taxability, subsection little (e)(4) --
6 I'm sorry -- subsection little (e)(4), it says when
7 there's no response to an XYZ letter -- and presumably
8 there's no resale certificate, that's why they're sending
9 out an XYZ letter -- the Board staff should consider
10 whether it is appropriate to use an alternate method to
11 ascertain whether the seller should be relieved from tax
12 under the subdivision with the respect to the questioned
13 or unsupported transaction.

14 So even in the regulation it provides for the
15 Department to use professional judgment, look at a number
16 of transactions and scope and simply not be that person
17 that's going to pick up 10,000 widgets sold from XYZ
18 widget manufacturer to XYZ widget supply, simply because
19 they don't have a resale certificate.

20 JUDGE WONG: Mr. Brandeis, you have about three
21 minutes left in your total.

22 MR. BRANDEIS: I'll submit the balance of my
23 time.

24 JUDGE WONG: Okay. Thank you.

25 All right. I'll now turn to my co-panelists to

1 see if they have any questions for Appellant, starting
2 with Judge Aldrich.

3 JUDGE ALDRICH: No questions at this time. Thank
4 you.

5 JUDGE WONG: Thank you.

6 Judge Katagihara?

7 JUDGE KATAGIHARA: No questions at this time.
8 Thank you.

9 JUDGE WONG: Thank you.

10 I just have one question. During the prehearing
11 conference I'd asked the parties to address the case in
12 Micelle and a footnote in Micelle. It's M-i-c-e-l-l-e,
13 Laboratories, Inc., OTA Case No. 2020-OTA-290P,
14 specifically, pointing them to a footnote, Footnote 20
15 there. I just wanted to see if you had any response to
16 that question.

17 MR. BRANDEIS: Well, I read the opinion, and I
18 didn't watch the hearing. But it seems to me that the
19 question -- what's in question here is whether -- so
20 there's a -- what it says is we cannot deviate from the
21 formula set forth in Regulation 1595, which is
22 reorganization sale of business. There's no provision in
23 that regulation which permits CDTEFA to rebut or reject
24 this presumption.

25 As such we -- so what I think they're saying here

1 is that they want to use some formula that differs with
2 what's outlined in the regulation. And if that is what is
3 in the regulation, then I agree. I don't think that they
4 can. It's the regulation's -- or it's the Board's
5 interpretation of the law, and they carry the same weight
6 and effect as the law. There's a hierarchy of authority.
7 The law being at the top, regulations being the Board's
8 interpretation of the law -- above the law, and then
9 carrying the same weight and effect as the law. And then
10 below that are opinions, Audit Manual, annotations, prior
11 cases, hearings, and so forth.

12 And, you know, there's so many different ways.
13 Sales and use tax is an incredibly complicated field.
14 They can't write the law, the regulations to adequately
15 describe every single conceivable type of transaction.
16 The laws are written to -- and the regulations are written
17 to give the auditors and the public guidance on how they
18 should be applying the law to their businesses. And so
19 that's why, you know, they make the Audit Manual available
20 on the public on their website. They have annotations and
21 other court rulings to help the public understand how the
22 Board interprets the law and, therefore, how they should
23 be interpreting the law.

24 So here it seems like this footnote is saying
25 that the Audit Manual has not been gone through some

1 rule-making process, I guess, is an underground regulation
2 and, therefore, has no bearing on the appeals process. I
3 don't -- I don't agree with that. There's a number of
4 things that are not detailed in the Audit Manual -- I'm
5 sorry -- in the law or the regulations, but are detailed
6 in the Audit Manual. And those are effectively become the
7 Board's policy on how the law should be applied.

8 In addition, the agency is looking to -- for
9 uniformity in how the law is applied. And you can't have
10 uniformity if you don't have the Audit Manual or other
11 authority to look upon and to try and have the law applied
12 uniformly to every taxpayer. There's just too many -- too
13 many variations of how transactions can occur. You just
14 can't do it.

15 I'll give an example. We have a lot of
16 restaurant clients. And one of the audit approach that
17 auditors would frequently use is an observation test. And
18 we have problems where auditors would come in and do an
19 observation test for just a few hours and then make a
20 conclusion based on three-years of sales on what they
21 observed in just a few hours. And we said that's not
22 representative. I mean, you have happy hour. You have
23 weekends. On weekends people behave differently than
24 during the weekday. Everybody knows that weekends at
25 certain restaurants are busy and maybe a weekday is not as

1 busy.

2 And so we -- in the Audit Manual, they spelled it
3 out. If you're going to do an observation test, you've
4 got to do three days. One day has to be a weekday. One day
5 has to be -- it doesn't say that in the regulation. It
6 doesn't say that anywhere. Yet, that became the Board's
7 policy. So I think the CDTFA Audit Manual has relevance
8 in these hearings and proceedings. It's there to try and
9 maintain uniformity in how the law is being applied.

10 JUDGE WONG: Thank you.

11 All right. We'll now turn to CDTFA for your
12 presentation. You've requested 40 minutes. Please
13 proceed.

14 MR. SAMARAWICKREMA: Thank you, Judge.

15

16 PRESENTATION

17 MR. SAMARAWICKREMA: Appellant is a California
18 corporation that operates four retail tire stores selling
19 new and used tires, wheels, rims and mufflers at retail
20 and for resale in Norwalk, California. Appellant also
21 offered related services, such as installation, alignment,
22 balancing, and repairing tires. In addition, Appellant
23 makes online sales to eBay and its websites.

24 The Department audited Appellant's business for
25 the period of January 1st, 2013, to September 30th, 2017.

1 Appellant has been previously audited twice for the
2 periods of April 1st, 1997, through March 31st, 2000, and
3 April 1st, 2006, through March 31st, 2009. During the
4 audit period, Appellant reported around \$12 million as
5 total sales and claimed various types of deductions,
6 resulting in reported taxable sale of around \$2.4 million.
7 And that will be on Exhibit A, pages 25 and 26.

8 During our presentation, we will explain why the
9 Department rejected Appellant's reported taxable sales;
10 why the Department used an indirect audit approach; how
11 the Department determined Appellant's unreported sales tax
12 for the audit period; and why the Department recommended a
13 10 percent negligence penalty. Appellant stated its sales
14 and use tax returns were prepared by its outside
15 accountant using sales invoices and eBay sales reports.
16 During the audit, Appellant failed to provide complete
17 sales records.

18 Appellant did not provide complete sales
19 documents of original entry, such as sales invoices for
20 the audit period, nor did Appellant provide complete sales
21 report or sales journals. In addition, Appellant failed
22 to provide complete purchase invoices and purchase
23 journals for the audit period. Due to lack of reliable
24 records and negative reported book markups, the Department
25 did not accept Appellant's reported total and taxable

1 sales.

2 The Department also determined that Appellant's
3 record was such that total and taxable sales could not be
4 verified by a direct audit approach. Therefore, the
5 Department used an indirect audit approach to estimate
6 Appellant's taxable sales. The Department completed four
7 verification methods to verify the reasonableness of
8 Appellant's reported total and taxable sales. First, the
9 Department compared reported total sale of around
10 \$25 million reflected on Appellant's federal income tax
11 returns with the reported total sale of around \$12 million
12 for the period July 1st, 2012, through June 30th, 2017,
13 and calculated an overall difference of around
14 \$13 million. And that will be on your Exhibit A, page 97.

15 The Department also compared reported total sale
16 of around \$12 million to the cost of goods sold of around
17 \$22 million reflected on Appellant's available federal
18 income tax returns and calculated an overall negative
19 reported book markup of around 44 percent. And that will
20 be on your Exhibit A page 97. Based on the negative
21 reported book markup, Appellant would have been losing
22 money every time it made a sale. Accordingly, the
23 Department did not accept Appellant's reported total sales
24 for the audit period. However, based on the analysis of
25 available selling prices and related cost, the audited

1 weighted markup was around 11 percent. And that will be
2 on your Exhibit B, page 164.

3 Second, the Department conducted a bank
4 reconciliation comparing Appellant's net bank deposits to
5 its reported total sales. From January 2013 through
6 June 2017, it deposited around \$15.7 million but only
7 reported total sale of around \$11.2 million. Thus,
8 Appellant deposited around \$4.5 million going into his
9 bank account, then reported sales for sales and use tax
10 returns. And that will be on your Exhibit A, page 96.

11 Third the Department compared recorded total sale
12 of around \$15 million reflected on Appellant's income
13 statements with a reported total sale of around \$7 million
14 for the period July 1st, 2012, through June 30th, 2014,
15 and July 1st, 2015, through June 30th, 2016, and
16 calculated an overall difference of around \$8 million for
17 these periods. And that will be on your Exhibit A,
18 page 98.

19 Fourth the Department also compared Appellant's
20 sales reflected on its monthly sales work sheets with
21 sales reflected on its federal income tax returns and
22 income statement and calculated material differences. And
23 that will be on your Exhibit A, page 95.

24 Appellant was unable to explain the significant
25 federal income tax return, sales differences, net bank

1 deposits differences, and income statement differences,
2 and negative reported book markups. Therefore, the
3 Department conducted further investigation by analyzing
4 Appellant's product mix, pricing policies, and purchases.
5 To understand Appellant's product mix, the Department
6 segregated Appellant's available purchase invoices for
7 November 2016 into four categories and calculated purchase
8 ratio of around 73 percent for tires, 21 percent for
9 wheels, 4 percent for mufflers, and 2 percent for
10 miscellaneous items. And that will be on your Exhibit B,
11 pages 165 through 172.

12 To understand Appellant's pricing policies, the
13 Department performed a shelf test on August 4tht, 2017.
14 Appellant's president assisted in the shelf test by
15 selecting the most popular item and providing selling
16 prices for the tested items. The Department compared the
17 selling prices provided by the Appellant's president, and
18 the cost shown on purchase invoices for November 2016 to
19 calculate audited markup of around 13 percent for tires,
20 11 percent for mufflers, and 5 percent for wheels. And
21 that will be on your Exhibit B, pages 173 through 175.

22 The Department then weighted the audited markups
23 using the purchase ratios for the corresponding product
24 categories and calculated an audited weighted markup of
25 around 11 percent. And that will be on your Exhibit B,

1 page 164. It should be noted the Department did not
2 calculate an audited markup for miscellaneous items, even
3 though miscellaneous items were included in the purchase
4 segregation. And that will be on your Exhibit B, page
5 164.

6 The typical markup for these miscellaneous items
7 are higher than the main items that Appellant sells.
8 Therefore, by not including markup for these miscellaneous
9 items, the Department gave a benefit to Appellant.
10 Appellant's president stated that Appellant's markup are
11 the same for its retail sales, sales for resale, and sales
12 in interstate and foreign commerce. Appellant claimed
13 around \$8 million as its sale for resale and around
14 \$715,000 as its sale sin interstate and foreign commerce.
15 And that will be on your Exhibit A, page 26.

16 To verify the reasonableness of sales for resale
17 and sales in interstate and foreign commerce deductions,
18 the Department reviewed resale invoices and eBay sales
19 reports for November 2015 and the prior audits to
20 determine allow customer names. And that will be on your
21 Exhibit A, pages 80 through 94.

22 The Department allowed resale transactions
23 supported by a valid resale certificate on file or the
24 prior audit as valid sale for resale and sales through
25 eBay shipped to out-of-state destination as shown on

1 shipping documents as valid interstate and foreign
2 commerce sales. And that will be on your Exhibit B, pages
3 144 through 146.

4 The Department also allowed sales for a resales
5 where it could determine that the buyer was in the
6 business of selling the typed of items it actually
7 purchased from Appellant. And that will be on your
8 Exhibit A, pages 80 through 94. For questionable resale
9 transactions, the Department gave Appellant an opportunity
10 to send XYZ letters to the purchasers to support its
11 recorded sales for resale, but the Department received no
12 response from the purchasers. Appellant has not provided
13 any documentation, such as payment information to
14 substantiate the sales made to the other customers who
15 failed to respond to XYZ letters.

16 For the remaining claimed sales for resales, the
17 Department determined that Appellant did not provide any
18 reliable shipping, information, contact information, or
19 any other useful information that could be used to verify
20 the nature of the transactions. The Department compared
21 the allowable sales for resales with the recorded sales
22 for resales from November 2015 to calculate an audited
23 resale ratio of around 72 percent. And that would be on
24 your Exhibit A, page 94.

25 The Department then used a claim for resale of

1 around \$7.7 million and audited resale sales ratio of
2 around 72 percent to calculate audited sales for resale of
3 around \$5.6 million for the period January 1st, 2013,
4 through June 30th, 2017, which the Department will refer
5 to as the test period. And that will be on your Exhibit
6 A, page 79. Similarly, the Department calculated the
7 audited sales and interstate and foreign commerce ratio of
8 around 99 percent using Appellant's eBay sales report for
9 November 2015. And that will be on your Exhibit B,
10 page 146.

11 The Department then used the claims of sales in
12 interstate and foreign commerce of around \$700,000 and
13 audited interstate and foreign commerce sales ratio of
14 around 99 percent to calculate audited sales in interstate
15 and foreign commerce of around \$688,000 for the test
16 period. And that will be on your Exhibit A, page 79. In
17 total, the Department calculated the nontaxable sales for
18 resales and interstate and foreign commerce sales of
19 around \$6.3 million for the test period. And that will be
20 on your Exhibit A, page 79.

21 The Department then divided the \$6.3 million by
22 the audited weighted markup factor to calculate the cost
23 of goods sold in the nontaxable sales for resales and
24 interstate and foreign commerce sales transactions of
25 around \$5.7 million for the test period. And that will be

1 on your Exhibit A, page 79. Appellant did not provide
2 complete purchase invoices or monthly purchase journals
3 for the audit period. Therefore, the Department used the
4 cost of goods sold reported on the federal income tax
5 returns to calculate Appellant's taxable sales. And that
6 will be on your Exhibit A, page 78.

7 The Department considered half of the cost of
8 goods sold reported on the federal income tax return for
9 fiscal year ending June 30th, 2013, to represent the cost
10 of goods sold for the first six months of year 2013. And
11 that will be on your Exhibit D, page 78. In total, the
12 Department determined federal income tax return cost of
13 goods sold of around \$20 million for the test period. And
14 that will be on your Exhibit A, page 78. The Department
15 reduced the cost of goods sold of around \$20 million by
16 the cost of goods sold in nontaxable sales for resales and
17 interstate and foreign commerce sales transaction of
18 around \$5.7 million to calculate the cost of goods sold at
19 retail of around \$13.9 million for the test period. And
20 that will be on your Exhibit a, page 78.

21 The Department then used the calculated cost of
22 goods sold at retail and the audited weighted markup
23 factor to determine the audited taxable sales of around
24 \$15.4 million for the test period. And that will be on
25 your Exhibit A, page 98. Audited taxable sales were

1 compared with reported taxable sales of around
2 \$2.1 million to determine unreported taxable sales of
3 around \$13.3 million for the test period. And that will
4 be on your Exhibit A, page 77.

5 The Department then compared the unreported
6 taxable sales with the reported taxable sales of around
7 \$2.1 million to calculate the error rate of around
8 620 percent for the test period. And that will be on your
9 Exhibit A, page 77. The Department also calculated the
10 error rate of around 318 percent using unreported and
11 reported taxable sales for the period July 1st, 2016,
12 through June 30th, 2017. And that will be on your
13 Exhibit A, page 77.

14 The Department used the low error rate of around
15 318 percent and the reported taxable sales to determine
16 unreported taxable sales of around \$934,000 for the period
17 July 1st, 2017, through September 30th, 2017. And that
18 will be on your Exhibit A, page 77. In total, the
19 Department determined unreported taxable sales based on
20 the markup method of around \$14.2 million for the audit
21 period. And that will be on your Exhibit A, page 76.

22 In addition, Appellant noted that the --
23 Appellant had income from selling scrap metals, recycling
24 materials, rebates from vendors, which were not passed
25 down to customers and fabrication labor. Based on

1 Appellant's own records, the Department determined the
2 income from selling scrap metals, recycling materials,
3 rebates. And that will be on your Exhibit B, page 137.

4 The Department accepted the claimed nontaxable
5 labor as valid nontaxable labor charges. The Department
6 combined the audited taxable sale of around \$15.4 million
7 with the audited exempt sale of around \$6.3 million
8 audited nontaxable other income and claimed nontaxable
9 labor to calculate total audited sale of around
10 \$22.6 million for the test period of January 1st, 2013,
11 through June 30th, 2017. And that will be on your
12 Exhibit A, page 75.

13 Audited taxable sales for this period were
14 compared with the audited total sales to calculate audited
15 taxable sales percentage of around 68 percent. And that
16 will be on your Exhibit A, page 75. The Department noted
17 that the total sales reflected on Appellant's federal
18 income tax return were more than the audited total sales
19 for the periods January 1st, 2013, through June 30th,
20 2015, and July 1st, 2016, through June 30th, 2017. And
21 that will be on your Exhibit A, page 73.

22 A comparison of sales reflected on Appellant's
23 federal income tax returns and audited total sales
24 resulted in a credit difference for the period July 1st,
25 2015, through June 30th, 2016. And that will be on your

1 Exhibit A, page 73. The Department did not accept the
2 federal income tax return gross sales for the period
3 July 1st, 2015, through June 30th, 2016, because of low
4 reported book markups for this period. Therefore, the
5 credit differences were not allowed. And that will be on
6 your Exhibit A, pages 73 and 97.

7 The unaccounted sales based on the federal income
8 tax returns and the audited taxable sales percentage of
9 around 68 percent were used to determine unreported
10 taxable sales of around \$341,000 for the period
11 January 1st, 2013, through June 30th, 2015, and July 1st,
12 2016, through June 30th, 2017. And that will be on your
13 Exhibit A, page 73. In total, the Department combined
14 unreported taxable sales based on the markup method and
15 federal income tax return differences to determine total
16 unreported taxable sales of around \$14.5 million for the
17 audit period. And that will be on your Exhibit A,
18 page 72.

19 The Department then compared the total unreported
20 taxable sales with the reported taxable sales of around
21 \$2.4 million to calculate the error rate of around
22 610 percent for the audit period. When the Department is
23 not satisfied with accuracy of the sales and use tax
24 returns filed, it may rely upon any facts contained in the
25 return or upon any information that comes into the

1 Department's position to determine if any tax liability
2 exist.

3 Taxpayer shall maintain and make available for
4 examination, on request by the Department, all records
5 necessary to determine the correct tax liability under the
6 sales and use tax laws and all records necessary for the
7 proper completion of the sales and use tax returns. When
8 a taxpayer challenges a Notice of Determination, the
9 Department has the burden to explain the basis for that
10 deficiency. When the Department's explanation appears
11 reasonable, the burden of proof shifts to the taxpayer to
12 explain why the Department's asserted deficiency is not
13 valid.

14 To verify the reasonableness of total unreported
15 taxable sales, the Department uses an alternative audit
16 approach. This alternative audit approach used the sales
17 reflected on Appellant's federal income tax returns and
18 audited taxable sales percentage of around 68 percent to
19 determine total unreported taxable sales for the audit
20 period. And that will be on your Exhibit A, pages 100 to
21 103. Unreported taxable sales determined from this audit
22 approach were compared with the total unreported taxable
23 sales, as it is in this audit, and immaterial differences
24 were noted. And that will be on your Exhibit A, page 100.

25 The audit calculation of unreported taxable sales

1 based on the best available information was reasonable.
2 However, Appellant disputes the unreported taxable sales
3 and making four arguments in his opening brief.

4 First, the Department failed to analyze
5 Appellant's cost of goods sold to determine purchases of
6 tangible personal property versus fabrication labor.
7 Appellant claimed that the cost of goods sold reported on
8 his federal income tax returns included intangible items,
9 such as fabrication labor for grilling and polishing.
10 Second, the Department did not exercise professional
11 judgment when conducting the resale test. Third, the
12 Department did not make an adjustment for inventory for
13 shrinkage and sale consumption when estimating cost of
14 goods sold available for retail sales.

15 Finally, the Department did not allow an
16 adjustment for taxable bad debts. Appellant failed to
17 provide any evidence that the cost of goods sold amounts
18 reflected on his federal income tax return include other
19 intangible purchase item. Absent complete and reliable
20 documentary information, Appellant is unable to support
21 that the cost of goods sold reflected on Appellant's
22 federal income tax returns include other intangible
23 purchase items not related to cost of merchandise sold.
24 Therefore, the Department rejected this argument.

25 The Department determined the validity of sales

1 for resales based on the resale certificate on file as
2 well as audit staff judgment and other resources. As to
3 Appellant's contention that the Department did not
4 exercise professional judgment in accordance with the
5 policies with the Department in examining sales for
6 resale, Appellant referenced an October 25th, 2019,
7 memorandum from the audit staff in which the audit staff
8 stated, "The auditor must base on the low end regulation
9 and not on the auditor's experience or personal
10 knowledge." And that will be on your Exhibit E, pages 253
11 through 260.

12 Despite what the audit staff stated in the
13 memorandum, the audit staff had actually exercised
14 professional experience, personal knowledge, and other
15 resources to verify the exemption status of recorded sales
16 for resale during audit and upon appeal because the audit
17 staff considered other circumstantial evidence in addition
18 to available resale certificates.

19 Regarding Appellant's contention that the
20 Department should accept sales for resales to customers
21 whose name suggest that the customer is in the business of
22 selling tires and related items. The Department finds
23 that the lacking essential information of the customer,
24 merely the customer's name is not sufficient for the
25 Department to identify the true purchaser. And thus, the

1 Department has no way to verify exemption status of such
2 sales.

3 When a customer cannot be identified, the
4 frequency of volume of sales to the customer are not
5 sufficient to determine that sales to the customer are, in
6 fact, for resale. Appellant failed to provide its method
7 of payment, like, wire transfers or copy of the check from
8 the customer for its disallowed resales to support that it
9 made the sales to another retailer or wholesaler and
10 received payment from such retailers or wholesalers. The
11 Department found some discrepancies that cause it to
12 question the authenticity of the resale certificates. And
13 that will be on your Exhibit A, page 82, Items 86, 87 and
14 88. Therefore, the Department rejected Appellant's second
15 argument.

16 Appellant is in the business of selling tires and
17 related auto parts, and its inventories are imperishable.
18 And thus, in order to support the presence of shrinkage
19 for such business, Appellant needs to provide accounting
20 records to show it wrote off obsolete inventories, or
21 police reports, insurance claims to support inventory
22 theft or casualty loss. Appellant has not provided any
23 such evidence to claim any additional adjustment. And
24 that will be on your Exhibit F, pages 264 through 267.

25 Appellant also argued that the allowance for

1 self-consumption should be allowed. Appellant has not
2 afforded any basis for any self-consumption allowance.
3 For instance, Appellant has not identified any particular
4 inventory items that were purchased for self-consumption
5 or were removed from his resale inventory for
6 self-consumption or information as to the vehicle on which
7 alleged self-consumed items were used. And that will be
8 on your Exhibit F, pages 264 through 267. The Department
9 thus, has no basis upon which to adjust for
10 self-consumption allowance. Therefore, the Department
11 rejected Appellant's third argument.

12 Also, a retailer may be entitled for an allowance
13 for bad debts, insofar, as the measure of the tax is
14 represented by accounts that have been found to be
15 worthless and charge offs for income tax purposes. But a
16 retailer must support any allowance for bad debts by
17 providing the required records to support its bad debts.
18 Appellant has not provided any records to support alleged
19 bad debts. And that will be on your Exhibit F, pages 264
20 through 267. Therefore, the Department rejected
21 Appellant's fourth argument.

22 Appellant also cite V.A. Auto Sales, Inc., in his
23 argument, which is an Office of Tax Appeals opinion for a
24 different business, for a different audit period, with
25 different set of facts. Opinions made on different set of

1 facts, different audit procedures, in a different business
2 are not evidence and have no procedural value in this
3 appeal.

4 According to the minutes and orders from the
5 prehearing conference, this Panel request the Department
6 address Footnote 20 in the Appeal of Micelle Laboratories,
7 Inc., and what, if any, role the Audit Manual has in an
8 appeal before Office of Tax Appeals. The Audit Manual has
9 no force of law. It is an advisory publication, and it is
10 a guide to the Department's audit procedures and
11 techniques. Therefore, the Audit Manual is not binding on
12 Office of Tax Appeals. During an appeal, the parties may
13 point to provisions of the Audit Manual, and Office of Tax
14 Appeals may take them into consideration as guidance
15 regarding the Department's general procedures and
16 techniques. Beyond this, the Audit Manual does not have
17 persuasive value in an appeal before the Office of Tax
18 Appeals.

19 As such, it is our position that neither the
20 Government Code nor the precedential opinion in Micelle
21 Laboratories bar the Office of Tax Appeals from
22 considering Department's Audit Manual as evidence and
23 weighing whatever probability of value it may have in a
24 particular appeal. However, Office of Tax Appeals should
25 not disregard any applicable statutes or regulations in

1 favor of the Audit Manual. If there's a conflict between
2 the Audit Manual and the law, the decision should be based
3 on the law, not the Audit Manual.

4 Finally, the Department imposed a negligence
5 penalty based upon its determination that Appellant's
6 books and records were incomplete and inadequate for sales
7 and use tax purposes and because Appellant failed to
8 accurately report his taxable sales. The Department also
9 notes that Appellant had two prior audits which found an
10 assess similar to this. Specifically, the Department
11 noted that Appellant provided limited records for this
12 audit period, and Appellant failed to provide documents of
13 original entry to support its reported sales tax
14 liability. As a result, the Department had to compute
15 Appellant's taxable sales based on Appellant's federal
16 income tax return information and marking up cost of goods
17 sold available to sell at retail.

18 In addition, the audit examination disclosed
19 unreported taxable sales of around \$14.5 million which,
20 when compared with reported taxable sales of around
21 \$2.4 million for the audit period, resulting in an error
22 rate of around 610 percent. This extremely high error
23 rate is additional evidence of negligence.

24 In conclusion, when Appellant did not provide
25 complete source documentation, the Department was unable

1 to verify the accuracy of reported sales tax using a
2 direct audit method. Therefore, an alternative audit
3 method was used to determine unreported sales tax.
4 Accordingly, the Department determined the unreported
5 sales tax based upon the best available information. The
6 evidence he shows that the audit produced fair and
7 reasonable result. Appellant has not provided any
8 reasonable documentation or evidence to support an
9 adjustment to the audit findings. Therefore, the
10 Department requests the appeal be denied.

11 This concludes our presentation. We are
12 available to answer any questions the Panel may have.
13 Thank you.

14 JUDGE WONG: Thank you.

15 All right. I'll now to turn to my Co-Panelists
16 for questions, starting with Judge Aldrich.

17 JUDGE ALDRICH: Good morning. Good morning,
18 Mr. Brandeis. I have a question for you, and after you
19 answer, I'll ask the same question of CDTFA. But you
20 indicated that many taxpayers do not know how to verify a
21 seller for purposes of resales or resell certificates.
22 How would you go about verifying a seller?

23 MR. BRANDEIS: There's no requirement in the law
24 or the regulation for a taxpayer to verify a seller's
25 permit number at all. The requirement of the law is that

1 a taxpayer accepts a resale certificate in proper form and
2 in good faith. That's the only requirement. A taxpayer
3 may go to the CDTFA website if they're familiar with the
4 website and verify a permit number, but there's no
5 requirement under the law that they do so.

6 And to be honest with you, I don't really know of
7 any -- I've represented, I don't know, 300 clients over
8 the last 10 years. I don't know any that -- maybe one or
9 two that go to the website and verify, but that's an
10 extremely uncommon thing for them to do. And what I have
11 noticed -- I have been dealing with this agency as either
12 an employer or a consultant for about 25 years. The
13 verification of a seller's permit on the website has been
14 degraded. Sometimes it just gives the name of the
15 taxpayer, and it doesn't give the start date or the close
16 date. So, I mean, I don't know how you would even know.
17 It'll say if it's valid or invalid but, I mean, if you're
18 dealing with a transaction, it's important to note that
19 the dates that it was open and/or possibly closed. So
20 that's been degraded.

21 Some permits that have been closed don't even
22 show up. It just says, "Permit number is invalid." So it
23 doesn't even give you -- and, again, I'm not an IT
24 specialist. There are some times where it will give you
25 information on a closed-out permit, including the name and

1 the open date and the close date, but there are also times
2 where it gives no information.

3 JUDGE ALDRICH: Thank you.

4 And, CDTFA, would you like to respond?

5 MR. SAMARAWICKREMA: California imposes sales on
6 a retailer's retail sales in this state of tangible
7 personal property measured by the retailer's gross
8 receipt, unless the sale is specifically exempt or
9 excluded from taxation by statute. All retailer's gross
10 receipt are subject to tax unless the retailer can prove
11 otherwise. That's Revenue & Taxation Code 6091. During
12 the audit process, if it is a sale for resale, then we
13 recognize that's a sale for resale. But for this
14 taxpayer --

15 JUDGE ALDRICH: Mr. Samarawickrema, I'm going to
16 cut you off there. I don't think you're answering my
17 question. So if I were a seller or if I were a taxpayer
18 and I wanted to verify a seller's permit, how would I go
19 about that?

20 MR. SAMARAWICKREMA: The first step, if I'm the
21 seller I would request to get that information for like a
22 permit number, name of the taxpayer, and whether they
23 specifically buy for resale. So once the retailer has the
24 seller's permit, they can go to the CDTFA website and
25 verify whether the purchaser has a valid seller's permit

1 and whether they are selling the same type of item that
2 the seller sells.

3 And if the seller took that resell certificate in
4 good faith, then it's exempt. Or when you don't have a
5 resell certificate and during our audit process, we
6 give -- generally, the Department gives an opportunity for
7 taxpayer to prove that transaction is exempt by offering
8 or requesting them to do XYZ process. Also, in addition
9 that, you know, the audit staff will review all the
10 available information to see whether it was exempt.

11 JUDGE ALDRICH: Thank you.

12 Okay. Back to Mr. Brandeis. With respect to the
13 disallowed sales for resales, you indicated you were able
14 to find various businesses online; is that correct?

15 MR. BRANDEIS: That's correct.

16 JUDGE ALDRICH: Okay.

17 MR. BRANDEIS: One other thing I might add is
18 sometimes a permit -- permittee has multiple locations.
19 So even if you were to go the CDTFA's website and run the
20 permit number, it's probably just going to give you the
21 main permittee's address. But there could be seven
22 sub-locations under that permit. So --

23 JUDGE ALDRICH: I understand. So you found the
24 businesses online, and were you able to go and verify any
25 of those businesses?

1 MR. BRANDEIS: Well, I didn't call them up if
2 that's what your question is because really what the --
3 it's the auditor that should have been contacting these
4 businesses and making verifications because what I say
5 they would have to verify anyways. But one of the things
6 that I would note in some of the cases, because this
7 reaudit was done years after the audit, so when she calls
8 some of these businesses up and says, you know, the resale
9 certificate was signed by Bob Smith and the person says we
10 don't have a Bob Smith well, you know, they're calling in
11 2020 or 2019. I don't remember the date that the reaudit
12 was prepared.

13 But the audit period covers from '13 to, I
14 believe, sometime early in '17. I mean, that person could
15 have worked years ago, and this person might not know who
16 they are. So it's not -- it's not indicative that a
17 resale certificate was issued. But more tellingly is that
18 in these instances she doesn't even ask the question or at
19 least she doesn't document it in her reaudit schedule.
20 She doesn't ask the question, "Did you purchase these
21 items and for resale?"

22 She doesn't ask that question at all. That's the
23 most important question, and it's not documented.

24 JUDGE ALDRICH: Thank you. So if I understand
25 you correctly, we don't have anything in evidence that

1 shows that the businesses that you researched online are
2 verified as sellers with a seller's permit?

3 MR. BRANDEIS: Well, so the Department said
4 earlier that there are some resale -- some sales invoices
5 were -- so these are handwritten. They have employees
6 handwriting these out, and there are many examples in the
7 exhibits that are provided. Sometimes the employees
8 didn't write the name of the person that they were selling
9 to. And you notice we're not questioning -- we're not
10 asking for relief on any of those because we cannot say
11 who the purchaser is.

12 We're simply saying on the transactions that were
13 identified where we do know they did write down the name
14 of the purchaser. When you look at the name and the
15 number of transactions, the only conclusion that you can
16 come to, if you agree with them, is that they fraudulently
17 misnamed these customers to give them a name that sounds
18 like a business that would normally resell those items.
19 That's not what's happening here. That's -- that would be
20 indicative of fraud, and that's not what's happening here.
21 He's been audited many times.

22 One other thing I would like to say. There is a
23 large underreporting here. And again, we didn't address
24 that, but I'm going to just briefly address that.

25 JUDGE ALDRICH: If you can hold off on that?

1 MR. BRANDEIS: Okay.

2 JUDGE ALDRICH: I'm sure you will have that
3 opportunity, but your comment kind of led me to another
4 question. So what evidence, if any, is there that those
5 businesses were retailers as opposed to consumers of the
6 tangible personal property.

7 MR. BRANDEIS: Well, when you look at the name
8 and -- remember, this is a one-month test. You know,
9 there are four or five, six purchases happening in one
10 month. The only -- using the preponderance of the
11 evidence standard, the preponderance of the evidence
12 suggest that this person is purchasing for resale and not
13 for their own consumption.

14 JUDGE ALDRICH: So a collision center, for
15 example, is more likely to engage in a retail sale of
16 brakes or tires, rather than use it for the rehabilitation
17 of the vehicle?

18 MR. BRANDEIS: Well, they sell wheels as well.
19 So, again, I don't know specifically what transaction
20 you're referring to, but they could have been replacing
21 wheels that were damaged in a collision.

22 JUDGE ALDRICH: Okay. I guess this question is
23 going to be for both parties. But so with respect to
24 Regulation 1668(f) and (f)(4), it contemplates alternative
25 methods to the XYZ letters. What methods, if any, were

1 involved in this audit?

2 MR. SAMARAWICKREMA: The payment method, like a
3 wire transfer a check, like, to show that, you know, the
4 Appellant sold PHC Auto and got a payment. And that's one
5 other documents we requested, and also we received that
6 kind of information and we allowed some transactions. But
7 whatever the transaction that the Department did not
8 allow, we -- Department didn't receive any information to
9 support the exempt status of the transaction. And there
10 are certain transactions the Department did not have any
11 contact information to verify, and we requested XYZ
12 letters and the Department did not receive any.

13 And basically the easiest way, you know, the
14 taxpayer Appellant has the bank statements. They could go
15 to that particular test month and pull that method of
16 payment and show us, okay, yeah. The Appellant sold it to
17 PHC Auto or Norwalk Auto Auction. And if it can -- if the
18 Appellant can support method of payment like a check or a
19 wire transfer, the Department will -- can go back and have
20 a look.

21 JUDGE ALDRICH: So I understood the Department
22 had used -- from your argument, that the Department used a
23 verification method of the payment with respect to the
24 retail certificates. But you're saying they also used
25 them in consideration with the XYZ letters or lack of

1 letters?

2 MR. SAMARAWICKREMA: That's correct, Judge.

3 JUDGE ALDRICH: Okay. Same opportunity to
4 respond.

5 MR. BRANDEIS: I find that completely
6 disingenuous. If you go schedule -- the reaudit Schedule
7 R1-12B-3, there are a number -- a number of customers that
8 they allowed, that they accepted as being sales for
9 resale. It appears clear to me that they allow it when
10 they can locate a seller's permit number for purchaser.
11 In those cases, they're not questioning A Lux -- I don't
12 know who A Lux is, but they found a seller's permit
13 number, Permit No. 100684859. But why aren't they saying
14 well, wait a second. How do we know that's the A Lux?
15 How do we know that's not someone else?

16 So they are only applying this, we're questioning
17 now whether or not the name on the invoice is, in fact,
18 that customer when they can't locate a resell certificate
19 or they didn't get an XYZ response. So they're completely
20 inconsistent here.

21 JUDGE ALDRICH: Okay. Thank you.

22 That was clarifying from both parties. At this
23 time, I'm going to refer it back to Judge Wong.

24 JUDGE WONG: Thank you.

25 Judge Katagihara, do you have any questions?

1 JUDGE KATAGIHARA: I do.

2 Appellant for the business information that you
3 were able to find, did you share that contact information
4 with Respondent?

5 MR. BRANDEIS: There's been so many emails back
6 and forth, I can't honestly say for certain whether or not
7 we shared that. But, I mean, we just used the internet,
8 Google searches. I mean, I don't have access to the
9 CDTFA's internal records. They have access to more
10 information than I do. But an auditor should -- this is
11 just being prudent work on the behalf of the audit
12 department. They should also be doing research using the
13 internet, using Google, whatever information they find in
14 addition to the information that they -- the non-public
15 information that they have within their database.

16 JUDGE KATAGIHARA: Thank you.

17 Respondent, do you know if you are able -- or if
18 you received that information from Appellant? And if you
19 did, now and what actions did you take or did you -- what
20 actions did you take?

21 MR. SAMARAWICKREMA: Exhibit D, page 253 through
22 260, we -- during the appeal process, the Appellant
23 provided the information for some, and we verified and we
24 allowed whatever the information that supports that
25 particular section is a sale for resale. So that is our

1 Bate number 253 through 260.

2 MR. BRANDEIS: Can I interject? That's when we
3 were able to locate either a resale certificate or an XYZ
4 response. But, again, if you go 12B -- R1-12B-3, the only
5 time they are questioning whether or not the sale is, in
6 fact, to that customer is when we can't locate a resale
7 certify or an XYZ response. That's the -- well, they're
8 not questioning that information when we are able to
9 provide either an XYZ or resell certificate. So to say
10 we're disallowing it because we don't know that that's the
11 buyer, they're not applying equal weight here.

12 JUDGE KATAGIHARA: Thank you.

13 JUDGE WONG: Any other questions?

14 JUDGE KATAGIHARA: No, thank you.

15 JUDGE WONG: Thanks.

16 Okay. All right. I had no questions for the
17 parties at this time. So we will turn it over to
18 Mr. Brandeis for your closing and rebuttal. You have
19 three minutes. And can you also address the negligence
20 penalty during that time. Please proceed. Thanks.

21

22 CLOSING STATEMENT

23 MR. BRANDEIS: Okay. I wasn't the original
24 representative on this case. The original
25 representative -- I'm not going to say his name he has

1 since passed away. He brought the case to me. I had a
2 couple of meetings with him. And the reason why there's a
3 large underreporting is because the taxpayer -- the
4 taxpayer is a relatively young man. He inherited the
5 business from his father, from his parents. And the
6 accountant in question that they used was probably the
7 same accountant that the parents used. And so when he
8 took over, he just continued using the same accountant.

9 What happened here, he started to get into this
10 polishing and drilling business for wheels. So he would
11 get blank wheels that needed drilling of holes and
12 polishing, in essence, fabrication labor. And for
13 whatever reason, he did not generate sales invoices for
14 those types of transaction. And I asked the accountant
15 about that because the accountant -- and actually, the
16 Department earlier said that they didn't get any sales
17 journals. That's not entirely true.

18 The taxpayer would give these handwritten sales
19 invoices to the accountant. The accountant then created
20 an Excel spreadsheet. What the accountant didn't get are
21 these polishing and drilling because there were no sales
22 invoices created. The accountant, I asked him. I said,
23 "Well, why didn't you press the taxpayer for creating
24 records for those polishing and drilling?"

25 And he says, "I did. And, you know, he kept

1 saying he was going to do it, and he never did it."

2 If it were me and I were that accountant, I would
3 have walked away from him. I would have sent him a letter
4 saying, "You either do this, or I'm walking away as your
5 accountant."

6 Because as the accountant, you should be guiding
7 the taxpayer on proper recordkeeping. That's one of the
8 key elements of being an accountant. You shouldn't be
9 just making journal entries with no documentation. At any
10 rate he didn't do it. But if you look at what he
11 provided, the handwritten journals, they match the
12 reported taxable measure essentially to the dollar.
13 Essentially to the dollar. So in effect what they did is
14 they did a pretty good job documenting the normal sales
15 through the -- for the selling tires, selling wheels, you
16 know, rebalancing tires, the other work that they do with
17 tires and wheel.

18 What they did a lousy job of is recordkeeping
19 with respect to the polishing and the finishing and the
20 drilling. They didn't -- they didn't create sales
21 invoices for it. That's why there's a large discrepancy
22 in gross receipts. Now, so I asked the taxpayer well,
23 what -- it sounds to me like it would be considered
24 taxable fabrication labor. But, again, applying common
25 sense, what he was doing was buying -- and actually, in

1 some cases he wasn't even buying them.

2 Other companies brought him the wheels. He did
3 the taxable fabrication to bring the wheels to completion,
4 and that's it. So he just did fabrication labor. And
5 those folks then resold -- presumably resold those wheels.
6 He should have gotten a resale certificate. I think what
7 happened in his mind is that, "I don't have to worry about
8 these. These are not nontaxable labor." That's what I
9 think happened in his mind.

10 The evidence, it also shows, if you look at the
11 purchase segregation for a cost of goods sold, they did a
12 one-month or two-month test. I don't remember. But if
13 you look at the amount that they came up with and the way
14 they segregate it, and you compare that to the cost of
15 goods sold on the income tax returns, there's a large
16 discrepancy. What I mean by that? So you can take that
17 one month and you make a presumption here.

18 You make a presumption that purchases are evenly
19 spaced throughout the year. So let's take that one month
20 to multiply it times 12 to come up with an estimate for
21 what we would expect to see as cost of goods sold on the
22 income tax returns. It's way below what actually showed
23 up on the income tax returns. Why? Well, what I think he
24 did -- and this actually would be -- would be acceptable
25 accounting principals, is he took the fabrication labor

1 and he put it into the cost of goods sold.

2 But no analysis was done to say, hey, do we have
3 fabrication labor? And, in fact, if you read the
4 auditor's comments on her schedule where she does this --
5 I believe it is in the original auditing working paper
6 12(B)(4)(a). I'll read them to you right now. She says,
7 "Based on the above computation, it appears incomplete
8 records were provided for 11/16, November of 2016, the
9 one-month test."

10 However, that's all the records that were
11 available for the audit review based on the auditor's
12 observation the majority of the sales are tires and
13 wheels, and they're in line with purchase segregation. So
14 in other words, she's -- what she's saying is I don't
15 think I got all the records here. Why? Because she
16 probably did the same calculation I just did and said
17 we're -- if this a one-month test and they've got
18 \$2.9 million based on aggregating out on one-month test
19 versus \$4.5 million that showed up on the income tax
20 returns, either the cost of goods sold are not evenly
21 placed in each monthly period, or there's missing
22 invoices.

23 Well, the missing invoices I theorize are the
24 fabrication labor that didn't occur. So he's not a big
25 cheat. The problem with us in trying to defend that is we

1 don't have the records. So that's why you don't hear me
2 talking about hey, you know, you should be knocking this
3 thing down, it's a no change, because we don't have the
4 records. I can't tell you who those companies are that he
5 was polishing wheels for, and I don't have any checks or
6 payment information. He just did a lousy job in
7 documenting that.

8 As a result, you don't hear me arguing that there
9 should be an adjustment for that. I noted it in my
10 opening brief, but you didn't hear me raising that
11 argument here at the hearing. What I am placing an
12 objection is the way they did this resale test. They're
13 clearly not exercising reasonable judgement. One of the
14 things that Nalan said is that they even used the prior
15 audit, and that's not true. If you look at the -- again,
16 that schedule of disallowed transactions, one of them Smog
17 Pros Line No. 357 and 357, she says that was accepted in
18 the prior audit, Case No. 741143. However, there is no
19 permit recorded for the auditor to verify the customer is
20 still in business.

21 So if we're not questioning whether or not the
22 name on the resale certificate is, in fact, the actual
23 purchases for the other transactions, and we're only doing
24 it when we don't have a resale certificate or an XYZ
25 letter, my response to that is you probably -- if you

1 can't locate a permit number, I would have contacted Smog
2 Pros. But probably what you may have here is an
3 un-permitted retailer. So again, we shouldn't be picking
4 it up at the wholesale level.

5 If the -- the Board should have investigated and
6 said, "Is this an un-permitted retailer or not?" They
7 have the internal records that I don't have.

8 JUDGE WONG: Mr. Brandeis, I gave you a little
9 leeway on your closing because --

10 MR. BRANDEIS: I'm sorry. The negligence
11 penalty, is that what you want me to address next?

12 JUDGE WONG: I would just ask you to wrap it up.
13 I gave you a little leeway because they asked for an extra
14 10 minutes, and we are running out of the time. So --

15 MR. BRANDEIS: Okay. So I would say on the
16 negligence penalty is yes, there are prior audits.
17 However, this the son taking over from the parents, and I
18 don't -- I've met the son. I've had several meetings with
19 him. I don't know his educational background. I don't
20 get the feeling he's gone to school, studied business,
21 studied taxation, studied accounting. I don't even know
22 that he's gone to college. He's just a young man that's
23 taken over the business from his parents.

24 So this is, in effect, his first audit. He's
25 made a huge mistake with not keeping the records on the

1 polishing and the drilling. The rest of the findings --
2 you know, I've been an auditor for almost 30 years. I've
3 audited companies big and small. None of have them
4 perfect records. None of them have perfect resale
5 certificates. So in that respect, he wasn't negligent.
6 He's just doing things like any other business would do.
7 His big mistake was this drilling and polishing stuff.

8 JUDGE WONG: Thank you.

9 All right. For the final time, I will turn to my
10 co-Panelist to see if they have any last questions for the
11 parties.

12 Judge Aldrich?

13 JUDGE ALDRICH: No questions. Thank you.

14 JUDGE WONG: Judge Katagihara?

15 JUDGE KATAGIHARA: No questions.

16 JUDGE WONG: Okay. This concludes the hearing.
17 The record is closed, and the case is submitted today.

18 The judges will meet and decide the case based on
19 the exhibits presented and admitted as evidence. We will
20 send both parties our written decision no later than 100
21 days from today.

22 This oral hearing is now adjourned.

23 We will recess for 15 minutes until the next
24 hearing. Thank you.

25 Off the record, please.

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(Proceedings adjourned at 11:10 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 2nd day of October, 2023.

ERNALYN M. ALONZO
HEARING REPORTER