OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeals of: **A. JAFARI,** **dba Corona Motors,** **CORONA MOTORS, INC., and** **A. JAFARI,** **dba First Auto Center**	OTA Case No. 19034469 CDTFA Case ID 560002 OTA Case No. 19034467 CDTFA Case ID 560000 OTA Case No. 19034470 CDTFA Case ID: 561320

OPINION

Representing the Parties:

For Appellant:	Joseph A. Vinatieri, Attorney Patricia Verdugo, Attorney
For Respondent:	Joseph Boniwell, Tax Counsel III Stephen Smith, Tax Counsel IV Kimberly Wilson, Hearing Representative

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, A. Jafari (Jafari), dba Corona Motors (appellant 1), Corona Motors, Inc. (appellant 2), and Jafari, dba First Auto Center (appellant 3)[1] appeal from a Decision and Recommendation (Decision) and a Supplemental Decision (collectively, Decisions) issued by the California Department of Tax and Fee Administration (respondent)[2] denying appellants' petitions for redetermination of Notices of Determination (NODs) issued on December 13, 2010, to appellants 1 and 2, and on December 10, 2010, to appellant 3.[3] The NOD issued to

[1] This Opinion will refer to all appellants, collectively, as "appellants."

[2] Prior to July 1, 2017, sales and use taxes (and other business taxes and fees) were administered by respondent's predecessor, the State Board of Equalization (BOE). When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to BOE.

[3] Respondent asserts that the petition filed on behalf of appellant 3 was untimely. However, respondent accepted the petition as a late protest. Respondent consolidated the two petitions and the late protest for respondent's internal appeals process, and the three appeals remain consolidated before the Office of Tax Appeals (OTA).

appellant 1 was for $209,404.22. in tax, plus applicable interest, and a 25 percent fraud penalty of $52,351.07 for the period July 1, 1999, through January 31, 2000 (period 1).[4] The NOD issued to appellant 2 was for $1,660,816.03 in tax, plus applicable interest, and a 25 percent fraud penalty of $415,202.14 for the period February 1, 2000, through June 30, 2004 (period 2).[5] Respondent issued an adjusted Field Billing Order (FBO) to appellant 2 dated September 14, 2012, which increased appellant 2's tax liability to $1,683,679.95 and increased the fraud penalty to $420,920.10.[6] The NOD issued to appellant 3 is for $400,665.90 in tax, applicable interest, and a 25 percent fraud penalty of $100,166.52 for the period November 5, 2003, through December 31, 2004 (period 3).[7]

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Suzanne B. Brown, and Michael F. Geary held an oral hearing for this matter in Cerritos, California, on October 11, 2022. At the conclusion of the hearing, the parties submitted the matters, and OTA closed the record.

[4] This NOD is based on an August 20, 2008 report of an audit that determined appellant 1 had recorded but failed to report taxable sales of $2,662,990. The determined tax due also includes excess tax reimbursement (district taxes) that appellant 1 had collected from customers in connection with sales totaling $1,836 but failed to remit to the state (or refund to customers) during period 1. (See Cal. Code Regs., tit.18, § 1700(b)(1), (2).)

[5] This NOD is based on a June 11, 2008 Field Billing Order (FBO), which documented respondent's determination that appellant 2 had failed to report $21,299,460 in taxable sales during period 2. Specifically, respondent determined: (1) a taxable measure of $19,694,761 based on the difference between taxable sales recorded and taxable sales reported; (2) unreported taxable sales of $1,590,018, estimated for periods for which appellant 2 did not provide adequate records; and (3) an additional taxable measure of $14,681 for excess tax reimbursement.

[6] The increase was based on an increase to the measure of unreported taxable sales estimated for periods for which appellant 2 did not provide adequate records from $1,590,018 to $1,880,784 and an increase to the measure of excess tax reimbursement from $14,681 to $14,882.

[7] This NOD is based on a January 10, 2007 FBO, which documents respondent's determination that appellant 3 had recorded but failed to report $5,081,271 in taxable sales during period 3.

ISSUES[8]

For all appellants:[9]

1. Has respondent proved appellants' fraud or intent to evade the payment of taxes by clear and convincing evidence?[10]
2. Are appellants, or any of them, entitled to a reduction to the measure of unreported taxable sales?

For appellants 1 and 2, only:

3. Are appellants 1 and/or 2 entitled to a reduction to the measure of excess tax reimbursement?[11]

For appellant 2, only:

4. Is appellant 2 entitled to a reduction to the measure of unrecorded taxable sales?

FACTUAL FINDINGS

1. Jafari has been in the business of selling used automobiles since at least 1988, when he would sell used cars to supplement his income from his gas station business.
2. Jafari's seller's permit to engage in the business of buying and selling used cars as appellant 1 was effective on May 10, 1999.
3. On January 27, 2000, Jafari incorporated appellant 1 as appellant 2 but did not obtain a seller's permit for the corporation or otherwise inform respondent about the

[8] In the NOD issued to appellant 3, respondent imposed a penalty under R&TC section 6565 for failure to pay the liability before the NOD went final 30 days after issuance (finality penalty). Respondent granted conditional relief of this penalty in its Supplemental Decision and Recommendation. While appellant 3 has stated that the penalty remains at issue, it has not made an argument or offered evidence to show that respondent incorrectly imposed the penalty. Consequently, this Opinion will not further address the issue.

[9] Because the fraud/evasion issue is potentially dispositive, and because the material facts, with the exception of the dollar amounts, and arguments are essentially the same for all appellants, the Opinion will address the issues common to all appellants first.

[10] Prior to the hearing, OTA identified a related issue as to each appellant, as follows: if respondent does not prove fraud or intent to evade the payment of taxes by clear and convincing evidence, are respondent's NODs barred by the statute of limitations? However, respondent conceded in its argument that each NOD will be time-barred unless the fraud allegation is sustained as to each appellant. Therefore, the effect of respondent's failure to prove fraud is not at issue.

[11] When a retailer collects more sales tax reimbursement from a customer than is actually due, that amount is excess tax reimbursement. (Cal. Code Regs., tit.18, § 1700(b)(1).) Retailers are required to either refund the excess to the customer or pay it to the state. (Cal. Code Regs., tit.18, § 1700(b)(2).)

incorporation. Jafari, as appellant 1, continued to file sales and use tax returns (SUTRs) for the business until after the periods at issue.

4. For period 1, appellant 1 reported total sales and taxable sales of $380,491.[12]

5. For period 2, appellant 2 reported total sales and taxable sales of $4,603,711.

6. For period 3, appellant 3 reported total sales and taxable sales of $1,604,885.

7. Respondent attempted a first contact with Jafari in late July 2002, and spoke with Jafari's authorized representative, K. Walsh, CPA, (Walsh) on July 30, 2002. By letter dated August 22, 2002, respondent formally notified Jafari that his business had been selected for a routine audit. By September 2002, respondent had begun the audit and soon thereafter learned for the first time that Corona Motors had been incorporated.

8. For the audit, Walsh provided business records that reconciled with reported amounts. The records included what purported to be SUTR worksheets,[13] sales journals, approximately 450 copies of Department of Motor Vehicles (DMV) Report of Sale (ROS) forms, a 1999 federal income tax return (FITR) purportedly filed by Jafari, and documents pertaining to Jafari's purchase of approximately 49 automobiles from various auto auction operators.

9. The DMV informed respondent that it had issued sequentially numbered wholesale and retail (used) ROS forms to Jafari. According to the audit work papers, DMV issued 75 wholesale ROS forms and 650 retail ROS forms to Jafari during period 1, and 350 wholesale ROS forms and 4,000 retail ROS forms to Jafari during periods 2 and 3, which partially overlap.[14] In addition, five auto auction operators informed respondent that Jafari purchased a total of 572 vehicles.[15] On the basis of its investigation, respondent suspected that Jafari was attempting to evade tax.

10. In late November 2002, respondent opened a criminal investigation of Jafari and others.

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[12] Corporations and other business entities act through their owners, officers, or other employees. There does not appear to be any dispute that the person who acted, or failed to take action, for appellants was Jafari, with or without the advice or assistance of others.

[13] Here, the worksheets consisted of adding machine tapes.

[14] DMV records also showed that Jafari used the same dealer number for all appellants.

[15] The record does not indicate the period of time during which these alleged purchases occurred.

11. In the course of the fraud investigation, respondent obtained search warrants for various locations, including appellants' business locations, banks where appellants had accounts, Jafari's residence, Walsh's office, financing companies used by appellants, and the DMV.

12. Among the items seized from Jafari's home pursuant to the search warrant were at least one computer and many boxes of business records, including copies of appellants' SUTRs with supporting worksheets, profit and loss (P&L) statements, general ledgers, a 1999 FITR for Jafari that was substantially different from the FITR provided by Walsh,[16] bank and inventory records, and deal jackets.[17] Respondent was able to make a copy of a hard drive (from a seized computer), which contained a detailed record of appellants' sales from May 16, 1999, through February 27, 2004.[18] That record, which this Opinion will refer to as the "electronic sales journal," included sales date, stock and vehicle identification numbers, ROS form number, sales price, purchaser information, and taxes and fees collected for each sale.

13. By comparing the deal jackets with the electronic sales journal, respondent confirmed that the electronic sales journal was consistent with information contained in the deal jackets, but it did not include all of the sales shown in the deal jackets. Consequently, respondent also identified and scheduled sales that Jafari had not recorded in the electronic sales journal.

14. The seized records showed recorded taxable sales of $3,043,481 for period 1. Respondent deducted reported taxable sales of $380,491 to compute unreported taxable sales of $2,662,990 for period 1, which is audit item 1. Respondent also found from its review of the seized records that appellant 1 collected excess tax reimbursement based on the San Bernadino local tax rate from customers who registered their vehicles in other

[16] For example, the FITR provided by Walsh showed purchases and gross receipts of $464,970 and $383,765, respectively, while the FITR seized by warrant showed purchases and gross receipts of $2.218,551 and $2,477,540, respectively.

[17] Deal jackets are typically manila folders or envelopes that contain all documents that pertain to a vehicle in (or formerly in) a dealer's inventory, including purchase, repair, and reconditioning invoices, sales and financing contracts, and DMV documents.

[18] There was also one resale transaction in April 2004.

counties that had lower tax rates. The taxable measure of this excess tax reimbursement, which is audit item 2, is $1,836.

15. For period 2, the seized records documented taxable sales totaling $23,908,870. Respondent deducted reported taxable sales of $4,214,109 to calculate unreported taxable sales of $19,694,761, which is item 1 on the September 14, 2012 adjusted FBO issued to appellant 2. Respondent estimated[19] additional unreported taxable sales of $1,880,784 ($569,895 for 1Q04 and $1,310,889 for 2Q04) based on its actual examination of transactions shown in dealer jackets but not recorded in the electronic sales journal.[20] Item 3 was excess tax reimbursement, determined as explained above, measured by $14,882.

16. For period 3, the seized records showed recorded taxable sales of $6,495,090. Respondent compared the journal with a sample of deal jackets to spot-check the journal for consistency with source documents and found that as a result of various recording errors, taxable sales for period 3 were 2.9417 percent greater than recorded taxable sales.[21] It thus applied that factor to recorded taxable sales to calculate total taxable sales of $6,686,156 for period 3. Respondent then subtracted reported sales of $1,604,885 to calculate unreported taxable sales of $5,081,271 for period 3.

17. Respondent also compared bank deposits to reported sales. For 2003, appellant 1 deposited $7,217,224, recorded sales totaling $8,357,432 ($5,026,093 in taxable sales and $2,431,339 in nontaxable sales for resale), and reported sales of $1,165,534. For 1Q04 through 3Q04, bank deposits totaled $5,073,212, audited taxable sales totaled $4,739,410, and reported sales totaled $1,108,369. According to appellant 3's P&L statement for 2003 and 1Q04 through 3Q04, sales for those periods totaled $502,968 and $4,774,066 (rounded), respectively.

[19] The audit work papers characterize this taxable measure as "estimated sales due to inadequate records," but respondent determined the measure by an actual examination of deal jackets, so it would appear that the measure is an estimate only in that it may not reflect all unrecorded sales.

[20] For the June 11,2008 FBO, respondent incorrectly calculated a measure of $1,590,018 for this item by subtracting reported taxable sales of $290,766 for 1Q04 when it had already subtracted that amount for its calculation of item 1, discussed above. Respondent corrected this error in the adjusted FBO.

[21] Respondent performed a similar analysis for periods 1 and 2 but found that no adjustments were necessary.

18. On an unknown date, respondent referred the criminal investigation to the California Attorney General's office for consideration of a felony prosecution. On January 5, 2010, the Attorney General's office declined to prosecute.
19. On December 10, 2010, respondent issued the NOD to appellant 3.
20. On December 13, 2010, respondent issued the NODs to appellants 1 and 2.
21. Appellants 1 and 2 filed timely petitions for redetermination. Appellant 3 filed a petition for redetermination, which respondent deemed to be untimely but accepted as an administrative protest.
22. Appellants' designated expert witness, Wade Downey (Downey), was hired to assist Jafari, first in connection with the criminal investigation and later in connection with the civil tax appeal. Downey testified that he first reviewed the seized business records in 2005, and later reviewed them again, along with the audit work papers. Downey testified, in part, that in his expert opinion:
    - The seized business records were complete, meticulously maintained, and consistent with the electronic sales journal.
    - The seized business records are sufficiently detailed to support a comprehensive audit of appellants.
    - A comprehensive audit of appellants is required to determine whether the returns filed by Jafari on behalf of appellants were accurate.
    - A duplicate set of records would include multiple sales journals with inconsistent recording of transactional information, of which Downey saw no evidence during his review.
    - The methodology used to complete SUTRs is unclear, except that deductions were netted (i.e., deducted from total sales and reporting the remainder).
    - Because there were no deductions on appellants' SUTRs (for bad debts, sales for resale, tax-paid purchases (of fuel) resold, etc.) appellants probably netted those deductions, thereby reporting on a taxable measure basis, as allowed by respondent's Audit Manual.

- The primary purpose of respondent's audit program is to determine the correct tax and thus ensure that taxpayer's do not pay more or less that what the law requires.
- Despite the fact that respondent probably expected appellants to have legitimate deductions, it based its determinations on the difference between sales recorded and sales reported and did not consider deductions to which appellants were entitled.[22]

23. On March 13, 2014, the parties participated in an appeals conference as part of respondent's internal appeals process.

24. On April 22, 2015, respondent issued its Decision, which recommended an increase to the taxable measure of appellant 2's unreported taxable sales (from $1,590,018 to $1,880,784) in accordance with a September 14, 2012 adjusted FBO, and otherwise recommended that the petitions for redetermination and administrative protest be denied. The Decision also recommended that the finality penalty imposed on appellant 3 not be relieved because appellant 3 had not filed a request for relief.

25. Appellant 3 subsequently filed a request for reconsideration and for relief of the finality penalty. In its October 8, 2015 Supplemental Decision, respondent recommended conditional relief of the finality penalty but otherwise affirmed its Decision.[23] These timely appeals followed.

DISCUSSION

Preliminary Matter

There is a matter that warrants some discussion before an analysis of the issues identified above. It pertains to appellants' desire to litigate here, before the OTA, what they view as respondent's multiple violations of their rights, including, but not necessarily limited to, the alleged: unwarranted inclusion of Jafari and his businesses in the criminal investigation; abusive treatment of Jafari and his spouse at the time the search warrants were executed; and respondent's failure to provide potentially exculpatory evidence, despite an Information

[22] Downey stated that it is not uncommon for vehicle dealerships to "hold back" deductions (i.e., not claim them on their SUTRs), asserting them only in the event of an audit.

[23] In this instance, conditional relief means that respondent will relieve the finality penalty imposed on appellant 3 if the tax due is paid in full within 30 days of the notice to appellant 3 of a final decision in this appeal.

Practices Act request for same. The matter was brought to the foreground during a prehearing conference (PHC) when appellants requested that the issues for hearing include the alleged violations of appellants' rights. After the PHC, OTA issued its Minutes and Orders declining to include the issue requested by appellants and explaining OTA's view that the requested issue was outside of OTA's jurisdiction. Among other things, OTA explained that: OTA is not a court (Govt. Code, § 15672(b)); it is an administrative tribunal whose jurisdiction is specifically delineated by statute and regulation; that OTA's primary responsibilities are to process and decide taxpayers' administrative appeals (Govt. Code, §§ 15672(a), 15674); OTA does not have the jurisdiction to consider whether respondent violated the Information Practices Act, the Public Records Act, or any similar provision or law (Cal. Code Regs., tit. 18, § 30104(c)); responsibility for the investigation of alleged violations of taxpayers' rights rests with respondent's Taxpayers' Rights Advocate; and OTA does not have jurisdiction to decide whether a taxpayer is entitled to a remedy for respondent's actual or alleged violation of any substantive or procedural right to due process under the law, unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal (Cal. Code Regs., tit. 18, § 30104(d)).

The parties were given the opportunity to file briefs regarding OTA's authority to (1) consider such matters, and (2) provide a remedy in the event it was determined that some remedy was warranted. Appellants filed a timely supplemental brief. Respondent did not.[24] Ultimately, OTA affirmed its view that it was without jurisdiction to consider the alleged violations and issued an Order confirming the issues identified in its PHC Minutes and Orders. Accordingly, although appellants spent considerable time at the hearing talking about the alleged violations of their taxpayer's rights, this Opinion will make little, if any, reference to those claims.

Issue 1: Has respondent proved appellants' fraud or intent to evade the payment of taxes by clear and convincing evidence?

R&TC section 6485 states that, "[i]f any part of the deficiency for which a deficiency determination is made is due to fraud or an intent to evade this part or authorized rules and regulations, a penalty of 25 percent of the amount of the determination shall be added thereto."

[24] OTA did not consider respondent's untimely brief.

Fraud or intent to evade must be established by clear and convincing evidence. (Cal. Code Regs., tit. 18, § 1703(c)(3)(C).) The parties agree that burden is on respondent. (See also *State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1240-1241).

Direct evidence of a taxpayer's fraudulent intent or intent to evade the payment of taxes due is not required. (*Rau's Estate v. Commissioner* (9th Cir. 1962) 301 F.2d 51, 54-55.)[25] The required intent can be proved through circumstantial evidence. (*Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307.) An understatement alone may not be sufficient to warrant a finding of fraud, but repeated understatements in successive years, combined with other circumstances showing intent to conceal or misstate taxable income, provides a sufficient basis for a finding of fraud. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P [citing *Rau's Estate*, *supra*].) Other "badges" of fraud include inadequate records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealment of assets, failure to cooperate with tax authorities, and a taxpayer's lack of credibility. (*Ibid*.)

Here, respondent alleges the following as evidence of appellants' fraud:

- Jafari had extensive knowledge regarding the used car business and a clear understanding of appellants' obligation to pay sales tax measured by the price of the vehicle sold (including some mandatory fees), as evidenced by Jafari's decades of experience selling used cars, by his receipt of copies of informative publications and applicable regulations when he applied for seller's permits, and by the content of the deal jackets and other business records maintained by Jafari at his home.
- Jafari meticulously maintained accurate business records, which included an electronic, double-entry accounting system that was supported by deal jackets containing detailed information regarding each vehicle sold, but Jafari did not provide those records for audit.
- Jafari also maintained copies of SUTRs filed by appellants, every one of which reported only a fraction of actual taxable sales and at least some of which were accompanied by worksheets purporting to show the sales

[25] Because there are few cases that discuss R&TC section 6485, OTA considers, by analogy, the standards that apply under Internal Revenue Code section 6633, the federal income tax fraud penalty.

price, sales tax collected, and, in some cases, the ROS form number used for each sale included in reported amounts.

- Despite the availability of source documents (i.e., the contents of the deal jackets) evidencing sales during the audit periods, Jafari, through his authorized representative, Walsh, provided for audit incomplete and inaccurate records, including the SUTRs and worksheets described above and what was represented to be Jafari's 1999 FITR, all of which were fraudulently constructed to be consistent with reported sales.
- Over a period of five and one-half years, Jafari[26] reported only a small percentage of appellants' taxable sales (14.288 percent for period 1, 21.337 percent for period 2, and 31.584 percent for period 3) while failing to report taxable sales of $29,319,806 and thus evading taxes totaling $2,277,032.[27]

Appellants argue that respondent has not proved fraud or intent to evade the payment of taxes by clear and convincing evidence and that, as a consequence of that failure, the NODs issued to all appellants are barred by the statute of limitations. They contend that it was Walsh, not Jafari, who provided the allegedly falsified records and that there is no evidence to prove that Jafari was personally involved in the audit. Appellants claim that Walsh calculated their sales tax liability and told Jafari what to report for taxable sales on a net basis, meaning that Jafari assumed Walsh had already taken appropriate deductions, and at least implying that if there was any fraud, it was not Jafari who perpetrated it. Appellants spent considerable time and effort arguing that Walsh was the person responsible for providing questionable records and underreporting, pointing to the revocation of Walsh's CPA license and asserting that these licensing issues support their accusations against Walsh.[28]

Appellants further assert that respondents' audits were not in compliance with respondent's Audit Manual, at least in part because they failed to take into consideration

[26] Jafari signed the SUTRs filed on behalf of appellants.

[27] This amount does not include the $16,718 in excess tax reimbursement that appellants 1 and 2 collected from their customers but failed to refund those amounts or remit them to the state.

[28] Appellants' implication was that Walsh duped Jafari and other motor vehicle dealers into committing tax fraud without their knowledge.

deductions to which appellants were entitled; appellants specifically refer to buy-backs, repossessions, bad debts, and tax-paid purchases (of fuel) resold deductions.[29] Appellants also contend that the determined deficiencies, which respondent uses to prop up its otherwise unsupported fraud allegations, have not been proved by clear and convincing evidence, and they at least suggest that the absence of such evidence explains why Jafari was not charged with a crime.

There is clear and convincing evidence of appellants' fraud and intent to evade payment of taxes he knew were due. Jafari had extensive experience in the used car business and obviously understood his obligations to maintain and provide for audit complete and accurate records and to accurately report taxable sales. Jafari's detailed records, including source documents, establish taxable sales in excess of $29 million during a period for which Jafari reported less than 23 percent of appellants' taxable sales. He had in his possession copies of SUTRs that had been filed for appellants, and attached to those SUTRs were calculator tapes that purported to show details (including sales prices and sales tax reimbursement collected) regarding the reported taxable sales. Those reported taxable sales represented only a small fraction (14.3 percent to 31.58 percent) of actual taxable sales, as shown not only by the detailed deal jackets maintained by Jafari, but also by P&L statements, bank records, and the copy of Jafari's 1999 FITR that was not provided for audit. All of these records were found in Jafari's possession. Appellants' fraud is also evident from his authorized agent's production of obviously falsified documents for respondent's audit. Finally, appellants' fraud was of such a magnitude that their denial of knowledge of and participation in it is not credible. All the evidence points clearly and convincingly to fraud and directly at Jafari, the owner and operator of appellants' businesses; and on the basis thereof, OTA finds that respondent has established appellants' fraud and intent to evade the payment of taxes by clear and convincing evidence.[30] Consequently, none of the NODs are barred by the statute of limitations. Although this finding is dispositive, this Opinion will address some of appellants' arguments below.

[29] The term "buy-back" has various meanings, but in this context, it appears appellants use the term to refer to appellants' obligations to buy back recourse loans made to appellants' customers by third-party lenders, in effect repaying the lender and taking back the right to collect the amounts due from the borrower or repossess the vehicles.

[30] The finding that Jafari misrepresented appellants' taxable sale with the intent of evading taxes that were due is not based on any imputation of Walsh's intent to Jafari and through Jafari to appellants, though it could be, given the probability that Walsh and Jafari acted with the same intent and for the sole benefit of appellants.

Appellants' efforts to shift all blame to Walsh find no real support in the evidence. The evidence regarding the status of Walsh's license is a mere distraction and not material. The only evidence that Walsh actively participated in the planning or execution of the fraud are the fact, apparently undisputed, that he delivered the fraudulent 1999 FITR to respondent and the probability that he knew – or at least should have known – that the FITR was falsified because he prepared Jafari's income tax returns.[31] In any event, the result would be the same regardless of Walsh's participation in the fraud.

There is no question that Walsh was appellants' authorized representative, that Walsh gave the falsified records to respondent, that Jafari, not Walsh, signed the SUTRs, and that the SUTRs and worksheets were in Jafari's possession when seized pursuant to a search warrant. While it is not clear who created the fraudulent 1999 FITR that was provided for the audit – neither party called Walsh as a witness, and Jafari did not testify – it is clear Jafari was the only person who stood to benefit from appellants' underreporting, from the falsification of records, or from the presentation of those falsified records to respondent in an attempt to misrepresent the facts and thereby evade the payment of taxes that were due.[32] Under these circumstances, where clear and convincing evidence establishes that Jafari knowingly filed fraudulent SUTRs with the intent of evading the payment of taxes due, Walsh's possible involvement in the scheme changes nothing.

Appellants argue that they reported sales after netting (i.e., deducting but not reporting) exemptions and deductions, a methodology that respondent recognizes in its Audit Manual, and that had respondent done a proper audit and given appellants the deductions and exemptions to which they were entitled, the liability would be substantially less and not enough to count as evidence of fraud. This argument, too, lacks evidentiary support. There is no evidence to explain how appellants decided what to report on their respective SUTRs. While appellants argue that SUTRs were prepared by netting deductions and exemptions, there is no testimony or other evidence to prove that was done.[33] On the contrary, and as found above, the evidence

[31] Notwithstanding respondent's belief, stated in its internal memorandum dated April 14, 2014, that Walsh advised Jafari how to evade taxes, there is no evidence that Walsh told appellants what to report in taxable sales.

[32] The Opinion need not consider whether Walsh was a willing participant in, or even an architect of, the fraud.

[33] This Opinion will later address appellants' designated expert witness's conclusion that appellants reported only taxable sales after netting deductions and exemptions.

shows that appellants reported only a small fraction of their taxable sales, and how Jafari decided which sales to report is known only to him.

Appellants' designated expert witness did not shed much light on whether appellants filed fraudulent SUTRs or intended to evade the payment of taxes due. Downey agrees that the seized records were detailed and meticulously maintained. He testified that those records appear to be sufficient for sales and use tax purposes; but he was not able to testify that appellants' SUTRs were accurate. That opinion, Downey testified, would require an audit, and that is not what he was hired to do. Downey's testimony that there was no evidence that Jafari kept a second set of records because there were not two sets of sales journals with inconsistent entries elevates form over substance and conveniently ignores the evidence that appellants' authorized representative presented false SUTR worksheets in support of SUTRs that grossly and knowingly misrepresented appellants' taxable sales. Finally, Downey's suppositions that the fraud was Walsh's only, and that any underreporting was minimal are not based on facts established by the record. There is nothing in Downey's testimony or other evidence to suggest that Downey ever spoke with Jafari or Walsh; and while Downey could have audited the seized records and expressed an informed opinion regarding the extent of appellants' underreporting, appellants did not ask him to do that. Consequently, Downey's opinion about what Jafari knew, intended, did, or failed to do is not entitled to much weight.

Appellants' argument that respondent was required to but did not prove the asserted deficiencies by clear and convincing evidence is based on a false premise. Appellants have not cited any authority for the proposition that respondent is required to prove every factual component that contributes to the finding of fraud by clear and convincing evidence, and OTA is not aware of any such authority. The rule is that respondent must prove fraud by clear and convincing evidence. The Ninth Circuit Court of Appeals cites to *Colorado v. New Mexico* (1984) 467 U.S. 310, 316 (*Colorado*) [defining clear and convincing evidence] and *Sophanthavong v. Palmateer* (9th Cir.2004) 378 F.3d 859, 866 [citing *Colorado*] in support of a jury instruction that states: "When a party has the burden of proving any claim or defense by clear and convincing evidence, it means that the party must present evidence that leaves you with a firm belief or conviction that it is highly probable that the factual contentions of the claim or defense are true. This is a higher standard of proof than proof by a preponderance of the evidence, but it does not require proof beyond a reasonable doubt." (See *Manual of Model Civil*

Jury Instructions for the District Courts of the Ninth Circuit, 2017 Ed. (updated 2022); see also, Judicial Council of California Civil Jury Instruction, No. 201 [p.42].) It is the totality of the evidence favoring a finding of fraud that must be clear and convincing. Nevertheless, in this case, respondent established the deficiencies by clear and convincing evidence.

Respondent 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.) There does not appear to be any question that respondent reasonably relied on the meticulously maintained and detailed records maintained by Jafari and kept at his home to establish gross receipts from sales. Even appellants' designated expert concluded that those records were reliable. All gross receipts are presumed subject to tax, and the seller has the burden of proving the contrary unless it timely and in good faith takes from the purchaser a certificate that the property is purchased for resale. (R&TC, §§ 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).) Therefore, clear and convincing evidence, Jafari's own detailed records, established appellants' gross receipts from sales, and respondent correctly presumed those gross receipts were subject to tax.

Appellants' argument that in order to prove fraud by clear and convincing evidence, respondent cannot rely on the presumption that all gross receipts are from taxable sales, but must also allow appellants the benefit of exemptions and deductions, ignores the law and the evidence. It ignores the law because the burden of proving entitlement to exemptions and exclusions belongs to appellants, not respondent. (*Owens-Brockway Glass Container, Inc.*, 2019-OTA-158P.) It ignores the evidence because the audit work papers indicate that respondent considered possible exemptions and exclusions and allowed some.[34] According to their designated expert witness, appellants possess evidence to prove their entitlement to adjustments. They have had ample opportunity to prove valid sales for resale, tax-paid purchases resold, bad debts, and any other deduction to which they claim entitlement, but they have not even attempted to do that. A logical inference from that failure is that the records do not support appellants' argument.

Finally, the Attorney General's (AG's) opinion declining to pursue a criminal prosecution of Jafari has no real bearing on the question of whether Jafari's failure to correctly report

[34] According to the evidence, respondent examined and allowed, or at least did not include in the deficiency, sales for resale and sales in interstate or foreign commerce; and it examined possible bad debts but allowed none because it did not appear that appellant qualified for the exclusion pursuant to California Code of Regulations, title 18, section 1642.

appellants' tax liability was due to fraud. Even if the reasons and rationale for the AG's decision were in evidence, which they are not, the decision constitutes an opinion based on circumstances, such as the requirement of proof beyond a reasonable doubt, that are not present in these appeals. For these reasons, the AG's opinion is of little evidentiary value in these appeals.

Because respondent has established fraud by clear and convincing evidence, none of the NODs at issue are barred by the statute of limitations. Consequently, OTA will address the remaining issues.

Issue 2: Are appellants entitled to a reduction to the measure of unreported taxable sales?

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When respondent is not satisfied with the amount of tax reported by the taxpayer, it 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.) In the case of an appeal, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, respondent established appellants' unreported taxable sales using Jafari's detailed records of sales to establish appellants' gross receipts, all of which were presumed subject to tax until appellants proved otherwise. The burden is on appellants to prove that adjustments are warranted and the amount of such adjustments. As already stated, above, appellants have detailed records with which they should be able to prove any adjustments to which they are entitled, but they made no effort to do so. Given that appellants failed to carry their burden of

proof, no adjustments are warranted to any of the determined measure of unreported taxable sales.

Issue 3: Are appellants 1 and/or 2 entitled to a reduction to the measure of excess tax reimbursement?

Pursuant to R&TC section 6901.5 and California Code of Regulations, title 18, section 1700(b)(1), when an amount represented by a retailer to a customer as constituting reimbursement for sales taxes due is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the retailer, the amount so paid is excess tax reimbursement. Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when tax reimbursement is computed on an amount in excess of the amount subject to tax, when tax reimbursement is computed using a rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the tax reimbursement on a billing. (Cal. Code Regs, tit. 18, § 1700(b)(1).) When respondent ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax to the customers from whom it collected the excess tax reimbursement. (Cal. Code Regs, tit. 18, § 1700(b)(2).) In the event of failure or refusal of the retailer to make such refunds, the retailer must pay the excess tax reimbursement to the state. (R&TC, § 6901.5; Cal. Code Regs, tit. 18, § 1700(b)(1).)

The audit work papers show that appellants 1 and 2 collected excess tax reimbursement by calculating sales tax based on the San Bernadino local tax rate for customers who registered their vehicles in other counties that had lower tax rates, thus collecting excess tax reimbursement totaling $1,836 and $14,882, respectively. Appellants 1 and 2 have not denied that they collected the excess sales tax reimbursement. They have not argued or provided evidence to show that they have refunded any of the excess to their customers or that they have paid the excess to respondent. Finally, appellants have not argued or established that respondent erred in connection with this determination or established a different measure. Consequently, no adjustment to this taxable measure is warranted.

Issue 4: Is appellant 2 entitled to a reduction to the measure of unrecorded taxable sales?

As explained above, the audit work papers show that appellant 2 did not record in the electronic sales journal all sales evidenced by deal jackets. The measure of these unrecorded

sales is $1,880,784. For the reasons already discussed above, OTA finds that the evidence establishes a reasonable and rational basis for respondent's calculation of this liability. The burden is on appellant 2 to prove that (1): the tax assessment is incorrect, and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Again, appellant 2 has not made an argument or provided evidence on this issue. Therefore, OTA finds that no adjustment is warranted.

HOLDINGS

1. Respondent proved appellants' fraud or intent to evade the payment of taxes by clear and convincing evidence.
2. Appellants are not entitled to reductions to the measure of unreported taxable sales.
3. Appellants 1 and 2 are not entitled to a reduction to the measure of excess tax reimbursement.
4. Appellant 2 is not entitled to a reduction to the measure of unrecorded taxable sales.

DISPOSITION

Respondent's actions increasing the measure of unreported taxable sales by appellant 2 from $1,590,018 to $1,880,784 and granting appellant 3 conditional relief from the finality penalty, but otherwise denying appellants' petitions for redetermination, are sustained.

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

We concur:

DocuSigned by:
Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
Suzanne B. Brown
47F45ABE89E34D0...
Suzanne B. Brown
Administrative Law Judge

Date Issued: 1/11/2023