

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
SERGIO COVARRUBIAS,) OTA NO. 230713841
)
APPELLANT.)
)
_____)

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, July 16, 2024

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken
at 12900 Park Plaza Drive, Suite 300, Cerritos,
California, 90703, commencing at 1:34 p.m. and
concluding at 2:18 p.m. on Tuesday, July 16, 2024,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ SHERIENE RIDENOUR

Panel Members: ALJ JOSHUA ALDRICH
ALJ ANDREW WONG

For the Appellant: NADER SHAHATIT

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

RAVINDER SHARMA
CHAD BACCHUS
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-2 were received into evidence at page 7.)

(Department's Exhibits A-E were received into evidence at page 7.)

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Cerritos, California; Tuesday, July 16, 2024

1:34 p.m.

JUDGE RIDENOUR: We are opening the record in the Office of Tax Appeals oral hearing for the Appeal of Sergio Covarrubias, OTA Case Number 230713841. Today's date is Tuesday, July 16th, 2024, and the time is 1:34 p.m. The hearing is being held at Cerritos, California.

Today's hearing is being heard by a panel of three Administrative Law Judges. My name is Sheriene Ridenour, and I am the lead judge. Judges Josh Aldrich and Andrew Wong are the other members of this tax appeals panel. All three of us will meet after the hearing and produce a written decision as equal participants. Although the lead judge conducts the hearing, any judge on this panel may ask questions or otherwise participate to ensure that we have all the information needed to decide this appeal.

For the record, will the parties please state their names and who they represent, starting with the representative for Appellant.

MR. SHAHATIT: Nader Shahatit. I'm representing Mr. Sergio Covarrubias.

JUDGE RIDENOUR: Thank you.

1 MR. SHARMA: Ravinder Sharma, Hearing
2 Representative with CDTFA. Thank you.

3 MR. PARKER: Jason Parker, Chief of Headquarters
4 Operations Bureau.

5 MR. BACCHUS: Chad Bacchus, attorney for CDTFA.

6 JUDGE RIDENOUR: Thank you.

7 As stated in my minutes and orders, dated
8 June 26, 2024, there is one issue in this appeal: Whether
9 further adjustments to unreported taxable sales are
10 warranted.

11 As for the exhibits, they are listed in the
12 exhibit log as provided in the exhibit binder. Appellant
13 originally did not submit exhibits. Since the prehearing
14 conference, Appellant has submitted Exhibits 1 through 3,
15 which includes a YouTube hearing that the parties and
16 panel watched before the hearing. As for the video, I'm
17 not allowing it in as exhibit for evidentiary purposes,
18 rather it was viewed for demonstrative purposes only. The
19 exhibits are not marked. However, I am going to have the
20 California resale packet be Exhibit 1 and what appears to
21 be an Excel printout as Exhibit 2. CDTFA do you have any
22 objections to Appellant's Exhibits 1 and 2.

23 CDTFA, do you have any objections to Appellant's
24 Exhibits 1 and 2?

25 MR. SHARMA: Department has no objection. Thank

1 you.

2 JUDGE RIDENOUR: Thank you.

3 Appellant's Exhibits 1 is 2 are hereby admitted
4 into evidence.

5 (Appellant's Exhibits 1-2 were received
6 in evidence by the Administrative Law Judge.)

7 JUDGE RIDENOUR: During the prehearing
8 conference, Appellant raised no objections to CDTFA's
9 exhibits being admitted into evidence. Therefore,
10 pursuant to my June 26, 2024, minutes and orders, CDTFA's
11 Exhibits A through E are admitted into evidence.

12 (Department's Exhibits A-E were received in
13 evidence by the Administrative Law Judge.)

14 JUDGE RIDENOUR: There will be no witness
15 testimony today; is that still correct?

16 MR. SHAHATIT: Yes.

17 JUDGE RIDENOUR: Yes.

18 MR. SHARMA: That is correct. Thank you.

19 JUDGE RIDENOUR: Thank you.

20 As a reminder to the parties, during our
21 prehearing conference, we decided that Appellant will have
22 30 minutes to make its presentation, followed by CDTFA who
23 will also have 30 minutes. Then Appellant will have 15
24 minutes to provide closing remarks, should you choose.
25 Each party is encouraged to monitor their own time.

1 Any questions before we begin presentations?

2 MR. SHAHATIT: Thank you.

3 JUDGE RIDENOUR: Okay. Hearing none.

4 Okay. The time is 1:37. When you're ready,
5 Mr. Shahatit, please begin your presentation.

6

7

PRESENTATION

8 MR. SHAHATIT: Yes. Let me start by saying
9 that --

10 JUDGE RIDENOUR: Mr. Shahatit, can you just move
11 the mic a little bit closer for the stenographer?

12 MR. SHAHATIT: Yes.

13 JUDGE RIDENOUR: Thank you.

14 MR. SHAHATIT: I got involved in this audit in
15 the beginning when there was a COVID. The auditor called
16 me, and they want the books and records. My client
17 provide all the books and records to the auditor, even
18 though in her report she said there's limited books and
19 record, but actually we have everything. We give her
20 federal income tax return for the audit period. We give
21 her for sales and use -- sales invoices. We give her the
22 bank statement. I mean, all the records that she
23 requested we provide her.

24 However, it took more than six months to a year
25 to conduct this audit. We went back and forth and trying

1 to tell her, like, what is the issues. Finally, she came
2 up with the report, which is the one on 12 -- R1-12A.
3 This is a summary of the -- of this audit. She basically
4 think that what my client report is not the amount that's
5 supposed to be, even though I believe this is the right
6 amount. Because if you look at the video or if you look
7 at the other evidence, this -- my client only do repair
8 and install for the semi-truck tires. And -- but I'm not
9 going to argue with this issue, but I'm going to argue
10 with -- with this form, which is R1-12A.

11 JUDGE RIDENOUR: Mr. Shahatit, can you please let
12 us know which exhibit that would be.

13 MR. SHAHATIT: Yeah. It's R1-12A, which is a
14 summary of the audit report. And I'm saying for Column H,
15 it says, "Audit Labor Ratio."

16 JUDGE RIDENOUR: Okay. Thank you.

17 MR. SHAHATIT: The auditor came up with
18 10.39 percent as labor ratio. I believe this is wrong
19 from the video or from common sense of changing, you know,
20 tires and make -- repair tires. This percentage should be
21 at least 50 percent and more. And if you apply this
22 percentage to the total -- to the number -- Column E,
23 which is total sales tax included. If you apply it, this
24 come up to almost to \$900,000 or more.

25 The auditor is trying to put tax on nontaxable

1 labor, and I think that is the major issue here. This is
2 nontaxable labor, and we are taxing my client almost
3 \$100,000 because of the -- this is how they calculate it.
4 That's number one issue with me.

5 The second one is the sale for resale, which is
6 the -- sale for resale is Column K, with is the same
7 R1-12A for \$352,000. That's why we bring -- I bring
8 the -- even though we give this to the taxpayer -- to the
9 auditor, she still did not -- like, she accept some and
10 she reject some. But now I just want to explain a little
11 bit about sale for resale. The law says when you sell
12 something for resale, you should get a resale card. My
13 client, when he get the resale card, he go online and
14 verify that the seller permit is valid. That's number
15 one.

16 Number two, as you can see from each one of them,
17 it has to be name and address of the person, the purchase
18 seller permit, the description of the property, the
19 statement describe the property, and then the signature
20 and the date. Every sale for resale that you have here
21 get verified and presented to the auditor. The auditor
22 say that this is not line of business, but my client deals
23 with all kind of businesses; construction contractors --

24 JUDGE ALDRICH: Excuse me, Mr. Shahatit.

25 MR. SHAHATIT: Yes, sir.

1 JUDGE ALDRICH: Were you referencing the specific
2 resale certificate or --

3 MR. SHAHATIT: No. All of them. It's the same
4 because resale certificate are the same. Like, it's like
5 a -- what do I call it? It's like a template. It's a
6 template that somebody has to fill it up. But the key is
7 not the issue. The key is to verify the information that
8 they have. And my client verify these, like, the seller
9 permit. If you have a seller permit, you can go online
10 and put the seller permit, and it will come up if it's
11 valid or closed or revoked or whatever.

12 And I, to make things easier, when you have like
13 mega-truck retail repair -- this is just an example. I
14 put resale number -- this is the resale number and that --
15 if you go to the seller permit on the top there is a
16 resale number. And this is -- should match with whatever
17 the amount that is there. If we apply all these with the
18 XYZ letter too, I think my client will be -- will owe only
19 the one that he reports.

20 JUDGE RIDENOUR: I'm sorry. Can you repeat that?
21 He would what?

22 MR. SHAHATIT: I said if we apply the 50 percent
23 labor and the valid resale card on file, my client will
24 not owe any money.

25 Thank you.

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JUDGE RIDENOUR: Thank you very much.

I'm going to see if any of my panel members have any questions.

Judge Aldrich, do you have any questions?

JUDGE ALDRICH: Yes, I do. One moment.

So did you have an opportunity to review CDTFA's Exhibit -- I think it's Exhibit 1. It's the reaudit and original audit work papers. I ask --

MR. SHAHATIT: Which one?

JUDGE ALDRICH: So it's Exhibit A, excuse me, reaudit and original audit work papers and related documents.

MR. SHAHATIT: Yeah, is there any page number?

JUDGE ALDRICH: Yeah. So if you go to the schedules there -- let me see. So it looks like starting on page 17 of the exhibit binder, there are, you know, different valid sales and resales and disallowed claim sales for resales.

MR. SHAHATIT: Yes.

JUDGE ALDRICH: And it looks like there's explanations with respect to claimed sales for resales that were disallowed. And are you disputing each of those or --

MR. SHAHATIT: Yes, I'm disputing each of them.

JUDGE ALDRICH: Okay. And is there -- the basis

1 for the dispute the same, that your client obtained a
2 resale certificate?

3 MR. SHAHATIT: Yeah. The reason -- I mean, let's
4 go back to the basic. What is sale for resale? The sale
5 for resale certificate is to verify that the product that
6 my client give them is not for the end use. It's for him
7 to resell it. And we try to see if you have the seller
8 permit for that client, and the State has -- you know,
9 issue the seller permit for them to do it, and he -- my
10 client do a due diligence for each seller -- for each sale
11 for resale certificate.

12 What does that mean? When he sell that products
13 and he receive information from his client, he make sure
14 that this is for resale. When he said, like, construction
15 contractors, like some of these comments saying that even
16 though there's a resale card but it's not for the end of
17 user because it's for construction contractors. But how
18 many construction contractors have semi-trucks and they
19 use these ones? So if they buy it from my client for
20 resale, my client should not be held responsible that they
21 may not be -- they may be the end user. Because they
22 issue a valid resale, certificate, and it was on file when
23 the auditor came to audit the business.

24 JUDGE ALDRICH: Thank you. I think I understand
25 your position.

1 MR. SHAHATIT: Thanks.

2 JUDGE ALDRICH: Thanks.

3 JUDGE RIDENOUR: Judge Wong, do you have any
4 questions?

5 JUDGE WONG: I did have a question. You had
6 mentioned that you estimated that the nontaxable labor
7 sales were about -- at least 50 percent.

8 MR. SHAHATIT: Yes.

9 JUDGE WONG: How did you estimate or calculate
10 that percentage?

11 MR. SHAHATIT: The -- it's definitely not
12 10 percent. Because you can see from the video what they
13 do is to replace the tires, and the major work that they
14 do is labor. It's nontaxable labor. What is taxable on
15 this transaction is the cost of the tire or the cost of
16 the patching. Or if it is a used tire, it's the cost of
17 the used tire. It is in this situation, when you say
18 \$2 million, the majority of this \$2 million are nontaxable
19 labor.

20 JUDGE WONG: So how are you figuring out majority
21 or at least 50 percent?

22 MR. SHAHATIT: When I said 50 percent, it is just
23 from my experience, not -- not for a specification issue.
24 Now, the other thing is the auditor got 100 percent of the
25 paperwork. And I don't know why she apply 10 percent,

1 even though she has -- she did, basically, bookkeeping for
2 my client. She register every single invoice, but she
3 choose to put 10 percent instead of going on an actual
4 basis for the labor. Because if she did the actual basis,
5 she would waive the audit.

6 JUDGE WONG: Okay. Is there any -- did you have
7 any specific reason why the auditor's 10 percent -- I
8 guess 10.39 percent is incorrect? Like, is there anything
9 specific you can point to in calculations or --

10 MR. SHAHATIT: Because -- because, you know, we
11 have -- we have 12 quarters in the audit. She choose only
12 one quarter instead of she have -- because she has an
13 actual basis. She did this audit on an actual basis. My
14 understanding, she should do the labor on an actual basis
15 too, not just to pick one quarter and then apply it to the
16 whole audit, if she's doing it on an actual basis.

17 JUDGE WONG: Were you involved with the audit, or
18 did you come in afterwards?

19 MR. SHAHATIT: No, I was involved in the audit
20 since the beginning because it was COVID. And I actually
21 deliver the books and records for her. And I tried to
22 explain to her that this is nontaxable labor. And even in
23 they had an explanation on that when she applied the
24 10 percent, if you read the comment on the bottom, she say
25 this is nontaxable labor, but she applied 10 percent

1 instead of the bigger percent. And I tried to do in the
2 appeal, I try to explain to them the same thing. But for
3 one reason or another, they just think that the nontaxable
4 labor is taxable, and they want to put money on my client.

5 JUDGE WONG: Thank you. That's all the questions
6 I have for now.

7 MR. SHAHATIT: Thank you, sir.

8 JUDGE RIDENOUR: Thank you.

9 At this time I don't have any further questions.
10 So thank you, Mr. Shahatit.

11 MR. SHAHATIT: Thank you.

12 JUDGE RIDENOUR: CDTFA, the time is currently
13 1:51. When you're ready, Mr. Sharma, please begin your
14 presentation.

15 MR. SHARMA: Thank you.

16

17 PRESENTATION

18 MR. SHARMA: Appellant operated a mobile service
19 business for big rig trucks specializing in sales and
20 installation of tires and automotive repair parts in
21 Rialto, California. The Department performed an audit
22 examination for the period of October 1, 2016, through
23 September 30, 2019. Appellant reported taxable sales of
24 approximately \$1.3 million and claimed deductions of
25 \$955,000 resulting in taxable sales of \$360,000 for the

1 audit period. Claimed deductions consisted of nontaxable
2 labor of around \$271,000, sales for resale of \$681,000,
3 and sales tax of \$2,000. Appellant reported around \$2,000
4 in purchases subject to use tax; Exhibit A, page 7 and 8.

5 Records available for the audit. Appellant
6 provided federal income tax returns for years 2016 to
7 2018, bank statements and sales invoices for the audit
8 period, purchase invoices, and repair orders for first
9 quarter 2019, and 1099-K data for 2017 and 2018. During
10 the audit process, Appellant informed the Department that
11 Appellant used summarized sales invoices to prepare and
12 file quarterly sales and use tax returns. But despite
13 various requests, Appellant did not provide any sales
14 summary reports for the audit period. Due to lack of
15 complete sales records, the Department could not verify
16 the accuracy of reported amounts.

17 The Department used purchases for federal income
18 tax return and reported taxable sales and sales to other
19 retailers per sales and use tax returns to calculate an
20 overall negative markup of 18.25 percent for the years
21 2016 to 2018; Exhibit A, page 80. Negative markup means
22 reported taxable sales and other retail sales were less
23 than the purchases. Due to lack of documents of original
24 entry and purchase invoices, the Department could not
25 verify the accuracy of purchases. Based on these

1 analysis, the Department determined that provided books
2 and records were incomplete, unreliable, and unverifiable.

3 The Department used an indirect audit method to
4 determine audited taxable sales. After detailed review of
5 available books and records, the Department determined
6 that the bank deposits method was the most appropriate
7 audit method to verify the accuracy of reported amounts
8 and determined audit taxable sales. The Department used
9 bank statements to calculate total deposits of
10 \$2.4 million and internal transfers and miscellaneous
11 deposits of \$62,000 for the audit period; Exhibit A, page
12 66 and 67.

13 The Department used sales invoices for first
14 quarter 2019 to calculate nontaxable sales such as tire
15 disposal fee and service call fee ratio of around
16 5 percent and nontaxable labor ratio of 10 percent;
17 Exhibit A, pages 39 to 43. The Department examines
18 Appellant's provided sales invoices on actual basis,
19 resale cards, XYZ responses, and other available
20 information to determine audited sales for resale of
21 \$353,000 for the audit period; Exhibit A, pages 13
22 through 32. Then the Department used total bank deposits
23 of around \$2.4 million adjusted for nontaxable sales for
24 tire disposal fees, service call fee, audited sales for
25 resale, and applicable sales tax rate to determine audited

1 taxable sales of \$1.5 million for the audit period.

2 Appellant reported taxable sales of around
3 \$360,000, resulting in unreported taxable sales of little
4 more than \$1.1 million for the audit period; Exhibit A,
5 page 12. When the Department is not satisfied with the
6 amount of tax reported by the taxpayer, the Department may
7 determine the amount required to be paid based on any
8 information, which is in its possession and may come into
9 its possession. In the case of an appeal, the Department
10 has a minimal initial burden of showing that its
11 determination was reasonable and rational.

12 Once the Department has met this initial burden,
13 the burden of proof shifts to the taxpayer to establish
14 that a result differing from the Department's
15 determination is warranted. Unsupported assertions are
16 not sufficient to satisfy a taxpayer's burden of proof.
17 Here, Appellant's records that were provided upon audit
18 revealed an overall negative markup of more than 18
19 percent, which is not reasonable.

20 Therefore, the Department determined that
21 Appellant's books and records were not sufficient for
22 sales and use tax purposes and used an alternative audit
23 method to estimate Appellant's unreported taxable sales.
24 The use of bank statements as an alternative audit method
25 is an accepted and reasonable approach. Accordingly,

1 Appellant bears the burden to establish that a result --
2 that a different result is warranted.

3 Appellant contends that the Department's
4 calculation of nontaxable labor ratio of 10 percent is not
5 correct. In response, the Department submits that it used
6 Appellant's provided sales invoices and repair orders for
7 first quarter 2019 to determine nontaxable labor ratio of
8 10 percent. As of now, Appellant has not provided any
9 documentary evidence to show that nontaxable labor ratio
10 should be higher than 10 percent.

11 As regards to Appellant's Exhibit Numbers 1 and
12 2, recently submitted, the Department has already reviewed
13 all these documents and have allowed the sales for resale
14 if warranted; and disallowed if not supported by resale
15 card, XYZ letter, or other best available information.
16 Refer to Exhibit -- some of these resale cards and XYZ
17 responses are taxed as Exhibit A, pages 341 to 351,
18 Exhibit E, 388 to 400. For detailed comments, Exhibit A,
19 pages 13 through 32.

20 Appellant contends that his books and records are
21 adequate and sufficient and auditor's use of bank
22 statements to reach the taxable sales was a wrong
23 approach. In response, the Department submits that it
24 used Appellant's records to calculate the overall negative
25 markup. This alone is proof that Appellant's records were

1 not adequate or sufficient, and the use of an alternative
2 method was necessary. It is Appellant's responsibility to
3 maintain and make available for examination on request all
4 records necessary to determine the correct tax liability,
5 including bills, receipts, invoices, or other documents of
6 reasonable entry supporting the entries in the books of
7 account.

8 As of now, Appellant has not provided any
9 documentary evidence to show that unreported taxable sales
10 of \$1.1 million is not correct. Based on the foregoing,
11 the Department has fully explained the basis for
12 deficiency and proved that the determination was
13 reasonable based on available books and records. Further,
14 the Department has used approved audit methods to
15 determine the deficiency. Therefore, based on the
16 evidence presented, the Department requests that
17 Appellant's appeal be denied.

18 This concludes my presentation, and I'm available
19 to answer any questions you may have. Thank you.

20 JUDGE RIDENOUR: Thank you.

21 Judge Aldrich, do you have any questions?

22 JUDGE ALDRICH: I have a quick question.

23 So page 26 of the exhibit binder, it corresponds
24 to the reaudit or associated audit work papers. Let me
25 see if I can pull up a schedule for you so we can double

1 check. So it looks like it's R1-12A-3A.

2 MR. SHARMA: Exhibit A -- I'm sorry.

3 JUDGE ALDRICH: 26.

4 MR. SHARMA: 26. Yes.

5 JUDGE ALDRICH: Okay. So I'm looking at a
6 company name and it says Vida Lease. And then to the
7 right there's comments and --

8 MR. SHARMA: I'm sorry. I'm not there. Just
9 give me one second. I'm looking at Exhibit A, page 25 --
10 or 26. Binder page 26. I'm sorry.

11 JUDGE ALDRICH: It's all right.

12 MR. SHARMA: Yes, I'm there.

13 JUDGE ALDRICH: But in the comments it says,
14 "Customer has a valid seller permit but not in the same
15 line of business. Disallowed sale for resale."

16 Will I find anywhere in the exhibits an
17 explanation of why it's not in the same line of business?

18 MR. SHARMA: That is based on the auditor's
19 review of the customer's business and everything. Because
20 it is possible that Vida Lease may be not charging tax on
21 that. They may be tax paid basis. So when the auditors
22 receive the XYZ or resale card, it's auditor's
23 responsibility. They review everything based on the
24 available information. It means response to XYZ. In some
25 cases they will call the customer to confirm. In other

1 cases they will look at the customer's permit and see if
2 they reported anything, taxable or not, so based on that,
3 in order to determine that they have not purchased this
4 for resale.

5 JUDGE ALDRICH: Okay. Thank you.

6 MR. SHARMA: Thank you.

7 JUDGE ALDRICH: And this question goes back to
8 Appellant's representative. But my understanding in your
9 presentation is that your client would obtain a resale
10 certificate ahead of time, generally; right?

11 MR. SHAHATIT: When the customer call to buy the
12 tires, they ask them for the resale card, if it's for
13 resale. And when they send them the resale card, they
14 verify the information that it they have a valid resale
15 number and then all the elements in the seller permit in
16 the resale card.

17 JUDGE ALDRICH: Okay. So, for example, in the
18 Vida Lease transaction; so it's Invoice No. 142, same page
19 number, page 26 of the exhibit binder. There's a note to
20 the right that says, "There's a valid resale card on file,
21 but it wasn't signed until after the transaction."

22 MR. SHAHATIT: After the transaction, I don't
23 know. I mean this is what the --

24 JUDGE ALDRICH: So his general practice was to
25 have it ahead of time, but it didn't always.

1 MR. SHAHATIT: They should -- they should have
2 it, yes. But, at the same time, you know, the key is this
3 product for resale or not. If it's for resale, usually
4 that's what he said. Like, you can call them and say, you
5 know, verify. Like the auditor can verify their own
6 information. But the idea is we -- my client is not like
7 an investigator to make sure that, you know, this is -- if
8 somebody -- or even the law says you accept it in good
9 faith.

10 You cannot just verify every single transaction
11 that it is for resale. You cannot do that. If somebody
12 offers you a resale card and all the information as ready
13 to go, and you try to do your due diligence, I think
14 that's sufficient for my client not to charge tax.

15 JUDGE ALDRICH: So the law that you're
16 referencing is that Regulation 1668 --

17 MR. SHAHATIT: Yes, that for resale account.

18 JUDGE ALDRICH: Okay. But isn't there a second
19 component there where you have to believe they are going
20 to be reselling it?

21 MR. SHAHATIT: They do. Yea, of course. But, I
22 mean, what can you do? I mean, if -- if everybody is
23 giving you everything, how can we challenge it? You know,
24 you still want to do business, right?

25 JUDGE ALDRICH: Sure. But --

1 MR. SHAHATIT: And he said that these are
2 construction contractors. Why you -- why the auditor
3 think the construction contractor cannot use a tire. It
4 doesn't make sense because they have their own tires -- I
5 mean, their own trucks.

6 JUDGE ALDRICH: But I'm sure a construction
7 contractor could use tires for their own business and
8 their own trucks. But don't you think it's less likely
9 that they would then resell tires?

10 MR. SHAHATIT: It depends. You know, this is
11 business. It depends. I agree with you but, at the same
12 time, they may sell tires. I mean, they don't sell --
13 resell the tires but you know.

14 JUDGE ALDRICH: Okay. All right. Thank you.

15 MR. SHAHATIT: You're welcome.

16 JUDGE RIDENOUR: Thank you very much. I do not
17 have any questions for CDTFA. Actually, I take that back.
18 I just want to confirm for the record that you had time go
19 over Exhibits 1 and 2, and CDTFA's position is the
20 documents provided don't warrant further adjustments?

21 MR. SHARMA: That is correct. We have reviewed
22 everything, and wherever the adjustments were warranted,
23 it has been made already. And the others one -- most of
24 these documents have been reviewed by the auditors during
25 the audit process or appeals process.

1 JUDGE RIDENOUR: Okay. Thank you. And also, as
2 for the audited labor ratio of 10.39 percent, can you
3 please ver -- like, explain how that percentage was
4 calculated.

5 MR. SHARMA: Auditor examined the sales invoices
6 and repair orders. That's only one quarter where
7 Appellant provided the repair orders. The auditors gone
8 through everything, and they determined how much was the
9 cost of the tires, how much are the tire disposal fees,
10 how much was the other transportation charges, and how
11 much was the actual charged for those first quarter 2019.
12 Again, we are not sure if every invoice was provided for
13 that quarter because there are a lot of missing serial
14 numbers.

15 But whatever they provided, the Department has
16 reviewed and basically scheduled each and every sales
17 invoice and repair orders. And based on that, they
18 determined that 10.39 percent was for the nontaxable labor
19 and some 4 percent was around for tire disposal fees and
20 other service calls.

21 Thank you.

22 MR. SHAHATIT: I have a question, if you don't
23 mind. Sorry. Go ahead.

24 JUDGE RIDENOUR: Hold on. Mr. Shahatit, you can
25 ask me the question, and I can decide whether or not to

1 ask CDTFA.

2 MR. SHAHATIT: The question is the amount that
3 they came up with, \$1,134,804 represent what? Is it like
4 a product that my client sell or what? What is it? They
5 have the information on an actual basis. They have every
6 invoice, and they spent probably a year doing this audit
7 and putting the information. Why didn't do it on the
8 actual basis and find out how much labor and how much
9 product?

10 Thank you.

11 JUDGE RIDENOUR: Thank you.

12 CDTFA, can you please clarify for the record.

13 MR. SHARMA: As explained earlier, due to lack of
14 books and records and direct books and records, which were
15 supplied but determined to be unreliable and unverifiable.
16 This audit method is a bank deposit method. Because to
17 determine the gross receipts and the Revenue & Taxation
18 Code 6091. So Department started with the gross receipts,
19 determined the gross receipts based on the bank deposits,
20 then they work backward. Whatever was allowable as
21 exempt, that could be service fees, tire disposal fees,
22 non taxables, labor, and basically sales for resale, and
23 sales tax included.

24 Actually, Department gave the benefit of doubt to
25 the Appellant by considering the entire amount of tax

1 included. They could have simply deducted \$2,000 and work
2 the number that could have basically more higher in
3 audited taxable sales. So that's how we came up with the
4 balance. And as of now, Appellant has not provided
5 anything to show that part of the bank deposits are
6 anything other than taxable sales.

7 Thank you.

8 JUDGE RIDENOUR: Thank you.

9 MR. PARKER: Judge Ridenour, I just wanted to add
10 one thing real quick. If you look at Exhibit A, page 7,
11 it has the gross sales that the taxpayer, the Appellant,
12 reported. They reported \$1.3 million in total sales. And
13 when you look at the bank deposits, after we made
14 adjustments for the transfers, they had \$2.3 million in
15 bank deposits. So there's obviously a discrepancy between
16 what the Appellant claims is their actual sales that
17 should have been basically reported -- or that they did
18 report to us and the \$1 million difference that actually
19 went into the bank.

20 JUDGE RIDENOUR: Thank you very much.

21 So I have a question as to CDTFA, one more. On
22 Schedule 414M, there is a list of use tax purchases
23 totaling \$1,580. Can CDTFA please confirm whether or not
24 that amount was deducted from the measure.

25 MR. SHARMA: I'm sorry.

1 JUDGE RIDENOUR: It would be Exhibit A, page 101.

2 MR. SHARMA: Okay. I'm sorry. Hold on one
3 second. Give me one second.

4 JUDGE RIDENOUR: Thank you.

5 MR. SHARMA: That is the purchase subject to use
6 tax. So, generally, that's not part of the bank deposits.
7 So that's why no adjustments were made for that because
8 that's not sale. So this audit is based on the gross
9 receipts. That's why no adjustment was made for that.

10 JUDGE RIDENOUR: Okay. I just wanted to clarify
11 for the record.

12 MR. SHARMA: Sure. Thank you.

13 JUDGE RIDENOUR: Thank you very much.

14 MR. PARKER: Also, can I add one thing real quick
15 on that?

16 JUDGE RIDENOUR: Yes, Mr. Parker.

17 MR. PARKER: Oh, sorry.

18 JUDGE RIDENOUR: That's okay.

19 MR. PARKER: So if we -- so we didn't make the
20 adjustment for the use tax that was reported, the measure.
21 So the reported taxable sales, what they actually reported
22 were their taxable sales, was actually lower than what we
23 have on that schedule, the R1-12A. If we reduce that
24 amount, the understated amount goes up. So by not
25 reducing the use tax amount, it actually benefits the

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Appellant.

JUDGE RIDENOUR: Okay. Thank you very much for clarifying for the record as well.

Mr. Shahatit, you have -- oh, I take that back.

Judge Wong has a question.

JUDGE WONG: Question for CDTFA about how the nontaxable labor sale percentage of 10.39 percent was calculated. It was based on a test period for first quarter '19. Is that my -- is that correct?

MR. SHARMA: That is correct.

JUDGE WONG: And that's because that was a quarter with the most complete sales invoices and books and records; is that correct?

MR. SHARMA: That is the only quarter Appellant provides sales work orders. Because that's the only way we can find -- determine the charges for the actual sales of tangible property. That means labor. That's the only quarter -- or whatever information they provided for that quarter, that's what we used as a test period.

JUDGE WONG: Okay. Question for Appellant's counsel. Did you provide work orders for any other quarters aside from the first quarter?

MR. SHAHATIT: My understanding is my client provide all the information that they have. I didn't know that this is the issue, otherwise we'll give him all the

1 quarters. He has all the books and records available.
2 And we provide, like, five, six boxes of books and records
3 to them. So I don't know why she picked only one quarter.

4 And you can see, like, 400 pages of the
5 information that she put. Why did she choose that one?
6 Why did she choose any other audit -- I mean, any other
7 quarters? But the idea is this 10 percent is really very
8 unreasonable. And I think the majority of this liability
9 is -- it belongs to nontaxable labor. And I think my
10 client is going to pursue this case further if this case
11 still the same.

12 JUDGE WONG: Okay. Thank you.

13 MR. SHAHATIT: Thank you, sir.

14 JUDGE RIDENOUR: Thank you.

15 Mr. Shahatit, you may make a statement in
16 response to CDTFA's argument or further address any
17 questions asked by the panel, but it is not required.
18 Would you like to make closing remarks?

19

20 CLOSING STATEMENT

21 MR. SHAHATIT: It's just very simple. I think
22 this is unreasonable result for a business, and I think
23 CDTFA -- I have a few cases. They are really pursuing to
24 squeeze the taxpayer, especially, small businesses and
25 putting a large liability that they will end up the only

1 way that the do it maybe file bankruptcy or do something
2 else instead of making more compliance and trying to work
3 out and understand.

4 This is the first time the taxpayer has an audit.
5 He is devastated. Like, what is going on? Why this
6 liability on me now? He's worried about his house and all
7 these other financial obligation. And that is not the way
8 it's supposed to be. We're supposed to educate the
9 taxpayer so we have more compliance, not just putting
10 liability and trying to inflate as much as possible and
11 trying to squeeze every penny from them.

12 This is not the right way to do the -- the agency
13 should change their mind and try to do the audit in a
14 different way. They spend on this one more than one year
15 and one taxpayer, and they left 100,000 taxpayers that
16 they can get more money and better result than just
17 emphasizing on one little guy.

18 Thank you.

19 JUDGE RIDENOUR: Thank you.

20 Judge Aldrich, do you have any final questions?

21 JUDGE ALDRICH: No questions. Thank you.

22 JUDGE RIDENOUR: Okay. Judge Wong, do you have
23 any further questions?

24 JUDGE WONG: No questions. Thank you.

25 JUDGE RIDENOUR: Okay. I want to thank everyone

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for participating in today's hearing.

 If there's nothing further, I'm now concluding the hearing. Today's hearing in the Appeal of Sergio Covarrubias is now adjourned.

 This concludes the hearing calendar for today. Hearings will resume tomorrow.

 And we will issue a decision within 100 days from today.

 Thank you everybody.

 (Proceedings adjourned at 2:18 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 8th day of August, 2024.

ERNALYN M. ALONZO
HEARING REPORTER