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APPEARANCES:

Panel Lead: ALJ ANDREW WONG

Panel Members: ALJ SUZANNE BROWN
ALJ TERESA STANLEY

For the Appellant: JOHN TOUMA
DANI KHOURI

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

RAVINDER SHARMA
CHRISTOPHER BROOKS
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-4 were received into evidence at page 9.)

(Department's Exhibits A-D were received into evidence at page 8.)

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Cerritos, California; Tuesday, September 10, 2024

9:45 a.m.

JUDGE WONG: Let's go on the record.

This is the Appeal of Touma Smoke Incorporated, before the Office of Tax Appeals, OTA Case Number 230814072. Today is Tuesday, September 10th, 2024. The time is 9:45 a.m., and we're holding this hearing in Cerritos, California.

I'm lead Administrative Law Judge Andrew Wong, and with me today are Judges Suzanne Brown and Teresa Stanley.

The individuals representing the Appellant, could you please introduce yourselves.

MR. KHOURI: Dani Khouri, an accountant for the Appellant.

MR. TOUMA: John Touma, taxpayer.

JUDGE WONG: Thank you.

And the individuals representing the Respondent tax agency, the California Department of Tax and Fee Administration or CDTF, can you please introduce yourselves.

MR. SHARMA: Ravinder Sharma, Hearing Representative.

1 MR. PARKER: Jason Parker, Chief of Headquarters
2 Operations Bureau.

3 MR. BROOKS: Christopher Brooks, attorney for
4 CDTFA.

5 JUDGE WONG: Thank you.

6 We are considering two issues today:

7 Issue No. 1 is issue whether the amount of
8 unreported taxable sales should be reduced.

9 Issue No. 2 is whether Appellant was negligent.
10 Is that correct, Mr. Khouri?

11 MR. KHOURI: Yes, sir.

12 JUDGE WONG: Okay. And, CDTFA, is that correct?

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

14 JUDGE WONG: Thank you.

15 So we're going to go over preliminary matters, go
16 over exhibits, potential witnesses, and the time
17 allocation.

18 So, originally, Appellant Mr. Khouri, you
19 identified and submitted proposed Exhibits 1 and 2, but
20 today you submitted some additional documents.

21 MR. KHOURI: Correct. We -- it's some email
22 com -- proof of email communications between us and the
23 auditors. So there was no negligence in communicating
24 with her. And we submitted advertisement for certain
25 products, and some of those products we were losing money

1 on, so -- and to support the lower markup.

2 JUDGE WONG: Okay. CDTFA, do you have any
3 objections to these exhibits?

4 MR. SHARMA: Department has no objection because
5 if those are the document -- we don't know which documents
6 are those, if those are the documents which have been
7 submitted to the Department and auditor has reviewed it,
8 we have no objection. But as of now, the email is, yes,
9 we confirm we have no objection to the submission of the
10 email.

11 JUDGE WONG: And so the advertisements are not --
12 you're not sure whether they've been submitted to you
13 before, during the audit?

14 MR. SHARMA: That is correct.

15 JUDGE WONG: Mr. Khouri, did you submit these
16 advertisements to CDTFA during the --

17 MR. KHOURI: No. We -- we did not, as they did
18 not ask for it.

19 JUDGE WONG: Okay. CDTFA, do you have any
20 objections to admitting the advertisements as exhibits?

21 MR. SHARMA: As far as these documents are, we
22 have no objections because the shelf test was conducted
23 for the June 2021 invoices, and these are invoices from --
24 documents from September 2019, which doesn't refute the
25 shelf test. So as regards to that, we have no objection.

1 And, again, these are not supported by any purchase
2 invoices, sales receipts, or whether any manufacturing
3 rebate was involved. The Department is not aware of that.

4 JUDGE WONG: Okay. So no objection?

5 MR. SHARMA: Thank you. Yeah.

6 JUDGE WONG: Okay. In that case, we will admit
7 these documents into the record as well. The exhibits --
8 sorry. The emails will be admitted as Exhibit 3, and the
9 advertisements will be admitted as Exhibit 4.

10 CDTFA has identified and submitted proposed
11 Exhibits A through D as evidence.

12 CDTFA, did you have any additional exhibits?

13 MR. SHARMA: No additional exhibits. Thank you.

14 JUDGE WONG: Mr. Khouri, did you have any
15 objections to CDTFA's proposed exhibits?

16 MR. KHOURI: No, sir.

17 JUDGE WONG: Okay. And then CDTFA's Exhibits A
18 through D will be admitted into the record as evidence.

19 (Department's Exhibits A-D were received in
20 evidence by the Administrative Law Judge.)

21 JUDGE WONG: Oh, and just for the record, we' are
22 also admitting Appellant's proposed Exhibits 1 through 2.
23 So Exhibits 1 through 4 in their entirety will be
24 admitted.

25 ///

1 (Appellant's Exhibits 1-4 were received
2 in evidence by the Administrative Law Judge.)

3 MR. SHARMA: Judge Wong, may I add something?

4 JUDGE WONG: Yes.

5 MR. SHARMA: During the PHC, the Department
6 raised an objection as to the number of documents
7 Appellant -- Appellant claimed 220 pages for Exhibit 1.
8 Department has no way to verify those because those are
9 Excel worksheets, and Appellant confirmed that he will
10 submit PDF file. But as of now, Department has not seen
11 any PDF files for Exhibit 1.

12 JUDGE WONG: Okay.

13 MR. SHARMA: But as far as 24 Excel files, we
14 have no objections, but we cannot verify the pages as to
15 whether there are 220 pages or more or less.

16 JUDGE WONG: So are you maintaining that
17 objection, or are you withdrawing that objection?

18 MR. SHARMA: We are maintaining that objection as
19 to the number of pages, but we have no objection as to the
20 24 Excel files.

21 JUDGE WONG: Could you explain the objection to
22 the number of pages?

23 MR. SHARMA: Because we don't know. Appellant
24 claims 220 pages. So Excel files are, depending on how
25 you print, I don't know how they arrived at 220 pages. So

1 we have no idea. But Excel file is 24, we did receive,
2 and we have no objections.

3 JUDGE WONG: Okay. So the content you're not
4 objecting to. You're just objecting to the page numbers?

5 MR. SHARMA: That is correct.

6 JUDGE WONG: Okay. With that objection noted, I
7 think I'm still going to admit it since CDTFA is not
8 objecting to the substance of the Excel worksheets. Just
9 to reconfirm, Exhibits 1 through 4 will be admitted into
10 the evidence.

11 And, Mr. Khouri, did you have any witnesses
12 today?

13 MR. KHOURI: No, sir.

14 JUDGE WONG: Okay. No witnesses.

15 And, CDTFA, you also have no witnesses; is that
16 correct?

17 MR. SHARMA: That's correct. Thank you.

18 JUDGE WONG: Okay. It was anticipated that the
19 oral hearing would take approximately 75 minutes.

20 Mr. Khouri, you've asked for 30 minutes; is that
21 correct?

22 MR. KHOURI: Yes, sir.

23 JUDGE WONG: And that's going to be divided
24 between your opening presentation and your closing and
25 rebuttal; is that correct?

1 MR. KHOURI: Correct.

2 JUDGE WONG: Okay. And, CDTFA, you've also asked
3 for 30 minutes; is that right?

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

5 JUDGE WONG: Okay. All right. I think we're
6 ready to begin. We're going to start with Appellant.
7 They're going to have their opening presentation, and then
8 we're going to turn it over to CDTFA for their
9 presentation, and then the last word goes to Appellant.
10 Are there any final questions before we begin?

11 MR. SHARMA: No questions.

12 MR. KHOURI: No.

13 JUDGE WONG: No questions. Okay. All right.

14 Appellant, please proceed with your presentation.
15 You have 30 minutes.

16

17 PRESENTATION

18 MR. KHOURI: Good morning.

19 The audit we have in question is for fourth
20 quarter 2017 through third quarter 2020. The CDTFA used
21 two different methods of arriving to the liability, which
22 is a credit card ratio in fourth quarter 2017 through
23 third quarter 2018. And then they shifted to a markup
24 method for fourth quarter 2018 through third quarter 2020.
25 And then in their final calculation, the period from

1 fourth quarter 2017 through third quarter 2018, they
2 actually took the credit card ratio liability. And they
3 also did a markup liability on that same period.

4 So they used two methods for the same period,
5 which generated duplicate tax liabilities. So that's
6 issue number one in arriving to the liabilities that they
7 arrived to. So we think there's an over lapse for that
8 period, fourth quarter 2017 through third quarter 2018 as
9 they used two different methods for it. CDTFA was
10 provided with bank statements for the entire audit period.
11 We provided them with QuickBooks backups, which is usually
12 rare for an accountant or the taxpayer to provide. Then
13 they asked us for additional documents to provide in Excel
14 because they couldn't take a lot of the data out of the
15 QuickBooks. So we gave them Excels. We offer the auditor
16 to do as many days as she wants for observation test. She
17 declined due to COVID.

18 And then so a -- and then initially the dollar
19 amount they wanted was super high because the numbers had
20 no basis. And then we finally arrive to the number they
21 have here. And then looking at their percentages and
22 percentages of errors, we look at, for example the fourth
23 quarter of 2018, we have a 2 percent percentage of error.
24 That's even with if we use their own markup method, and
25 that's based on a \$466,000 reported sales. They're saying

1 that additional sales is \$10,000 for a quarter that has
2 \$466,000 in sales. So that's very, very, very minimal.

3 In terms of a liability for how large the sales
4 were, which does not justify a negligence penalty. And
5 then we'll look at their after -- the effective credit
6 card rate after they applied the markup method, which
7 yields a 63 percent for first quarter 2020. It gives a
8 69 percent credit card ratio for second quarter of 2020.
9 Given those periods where -- the COVID periods and the
10 credit cards runs between 80 to 90 percent for that period
11 as everybody was using touchless and a lot of government
12 benefits on EDD and other payments people were receiving
13 on the cards. So that credit card ratio should be a lot
14 higher.

15 And then we'll look right after the first audit
16 had finished -- and I know that CDTFA in their papers they
17 say it was done November 2017. But with appeals and
18 settlements, it wasn't really done until the end of 2018.
19 And that's when the taxpayer implemented a POS system,
20 implemented all the sales goes to the bank accounts, so he
21 does daily deposits. He even had an IRS audit, and the
22 guy said oh, this is perfect. Everything is -- is there.
23 Everything is paid from the bank account. All the
24 groceries are paid from the bank account. All the sales
25 goes to the bank account.

1 He has a topnotch POS system that sends him a
2 report every month. The POS system was offered to the
3 auditor, and she visited the location, and she had full
4 access to the POS system. But at the end of the day, the
5 CDTFA, they just wanted to calculate whether yields more
6 liability, and they weren't really interested in being
7 fair to the taxpayer.

8 Thank you.

9 MR. KHOURI: Did you want to say something?

10 MR. TOUMA: Yes.

11 Good morning. My name is John Touma.

12 During the audit period, every time I was asked
13 for anything, the amount of time it took me to provide to
14 the auditor was quick and easy because I had easy access
15 to my POS, to my bank statements, to the QuickBooks.
16 Everything was given to them immediately. Even when we
17 got to the supervisor and she started looking through
18 stuff, she informed me that everything that the auditor
19 asked to kind of like shift to the side and start looking
20 to me. I said, okay. No problem. And she said I need
21 this, this, and this. I said, okay. No problem.

22 I got back to my -- my office and everything was
23 provided to her within a half-hour period of her asking of
24 anything. Even -- even when she had issues with POS
25 systems -- with the POS system as far as not her

1 understanding how the sales balance with the credit cards,
2 right, I would get my POS guy on the phone, and he would
3 walk her through the process. And she would thank us, and
4 she would tell us how -- you know, how we were prompt with
5 presentation, how we gave her everything she wanted.

6 And then moving forward, everything that we gave
7 is now not good. Well, why? Why is it good to use
8 against me as far as the shelf test? The shelf test is
9 all these invoices here. And when they use it, it's --
10 it's okay. But when I want to use it to -- to go against,
11 it's not okay. So what -- then what's the point of having
12 invoices, and what's the point of having a POS if you're
13 just gonna use a markup theory every time moving forward?
14 That's not fair to me.

15 You asked me from the private audit to clean up
16 as far as POS system, as far as bank statements, as far as
17 everything else, and I moved forward doing everything.
18 And when the evidence is provided for you, you tell me
19 it's -- it's invalid. Okay. If it's invalid for me, then
20 it should be invalid for you. Then, therefore, your shelf
21 test is no good either.

22 JUDGE WONG: Anything else?

23 MR. KHOURI: No, sir.

24 JUDGE WONG: Okay. Thank you.

25 I'm going to turn it over to my Co-Panelists now

1 for any questions for Appellant, beginning with
2 Judge Stanley.

3 JUDGE STANLEY: No, since the reps here today are
4 not giving sworn testimony, I'm not going to ask any
5 questions.

6 JUDGE WONG: Judge Brown?

7 JUDGE BROWN: Is there any evidence in the
8 record, either in Appellant's exhibits or CDTFA's
9 exhibits, about what change -- how the COVID-19 pandemic
10 effected Appellant's business operations?

11 MR. KHOURI: Nothing in the record, but prior
12 audits during that same period at the same office, the
13 Irvine office, they allowed us 90 percent credit card
14 ratio.

15 JUDGE BROWN: And so the auditor allowed a
16 90 percent credit card ratio for --

17 MR. TOUMA: Similar businesses in the Orange
18 County area, similar area to the taxpayer's area.

19 JUDGE BROWN: Okay. But that's not in the
20 record?

21 MR. TOUMA: No, ma'am.

22 JUDGE BROWN: I wanted to ask about Appellant's
23 Exhibits 1 and 2. Can you explain how these exhibits
24 support Appellant's position?

25 MR. KHOURI: We provided POS reports to show that

1 the sales is reported as it happens in certain months the
2 credit card ratio versus the cash ratio, because it's part
3 of the this audit. It's 37 percent. Other month it's
4 25 percent. Other month is 20 percent. So the ratios are
5 all over the place, but at the same time the overall
6 picture justifies our argument that by them, for example
7 first quarter 2020 after they applied their markup method,
8 they arrived at 63 percent credit card ratio; which is a
9 lot lower than anything else they allowed on this audit,
10 which tells us clearly that markup method does not work in
11 this case.

12 So, basically, we're saying the POS system
13 justifies this sale, and it's a solid evidence once you
14 look at the POS system and the bank statements that all
15 sales were reported. And we're confident that they were
16 all reported.

17 JUDGE BROWN: And Exhibits 1 and 2 contain all
18 that evidence are things you're saying you've already
19 provided to the auditor during the audit?

20 MR. KHOURI: Yes, ma'am. But we have a feeling
21 that no one looked at them.

22 JUDGE BROWN: I think those are all my questions
23 for Appellant right now. Thank you.

24 MR. KHOURI: Thank you, ma'am.

25 JUDGE WONG: Thank you, Judge Brown.

1 So I just wanted to go over the additional
2 exhibits that you submitted today. Exhibit 3 were emails
3 between Mr. Touma and the auditor. And the purpose for
4 submitting these emails is to show -- is it against the
5 negligence penalty; is that correct?

6 MR. KHOURI: Yes, sir.

7 JUDGE WONG: Okay.

8 MR. KHOURI: That we provided the documents.

9 JUDGE WONG: Okay. And then could you also go
10 over again the purpose of Exhibit 4, what you hope
11 Exhibit 4 is going to show and how it supports your
12 position?

13 MR. KHOURI: Exhibit 4 shows the markup method
14 works if the client does not run promotions, does not run
15 specials. The prices are the same. The percentage of
16 profit is the same. But we all know businesses don't
17 operate that way. They run promotions. They run
18 specials. And in some cases, like some of those exhibits
19 we provided, Exhibit 4, he loses \$8.50 on the transaction
20 when he sells it. And those exhibits are advertised on
21 Mr. Touma's Instagram page, and he brings a lot of people
22 in when he advertise. So he has to offer a lower price as
23 there's a lot of other stores in -- in his area that he
24 has to compete with. So it doesn't always work out where
25 the same markup always applies.

1 JUDGE WONG: And on Exhibit 4, these images of
2 Mr. Touma's Instagram page, they're showing products. And
3 then there's in -- on the side there's written a cost; is
4 that right?

5 MR. KHOURI: Yes, sir. We have those invoices if
6 you want us to -- and -- and the auditor has those
7 invoices too. We gave her those invoices. All --

8 JUDGE WONG: Those were --

9 MR. KHOURI: All the invoice for the entire audit
10 period were given to the auditor, all the invoices. So
11 they can go back and reference the cost, and we wrote the
12 cost on there to just simplify it.

13 JUDGE WONG: Are they in the record? Are they in
14 the exhibits that CDTFA provided, the cost of these items?

15 MR. KHOURI: No, they are not in the exhibit, but
16 they had access to them.

17 JUDGE WONG: Okay. And you said you have these?

18 MR. KHOURI: We have them here with us.

19 JUDGE WONG: Okay. All right. Thank you for
20 that.

21 MR. KHOURI: Thank you.

22 JUDGE WONG: Okay. That's all the questions I
23 have for now for Appellant. We are going to turn it over
24 to CDTFA for their presentation.

25 You have 30 minutes.

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MR. SHARMA: Thank you.

PRESENTATION

MR. SHARMA: Appellant, a corporation, operated a smoke shop in Lake Forest, California, since July 1, 2011. The Department performed an audit examination for the period of October 1, 2017, through September 30, 2020. Appellant reported taxable sales of approximately \$5.5 million and claimed no deduction for the audit period; Exhibit A, page 13.

Records available for the audit: Federal income tax returns for years 2017 to 2020; bank statements and merchant statements for the audit period; point of sales monthly sales summary reports for the audit period, except September 2019; point of sales daily sales summary reports for July 13, 2021 through July 20, 2021; source documents for June 14th, 2021; and purchase invoices for second quarter 2018, fourth quarter 2020, and June 14, 2021 to June 29, 2021.

The Department obtained 1099-K data for 2018 and 2019. Appellant did not provide point of sales data downloads, cash register tapes for the audit period. Due to lack of source documents, such as point of sales data downloads, the Department could not verify the accuracy of point of sale sales summary reports and reported amounts. The Department's analysis of bank deposits revealed that

1 bank deposits exceeded reported total sales by
2 approximately \$81,000 for the audit period; Exhibit A,
3 page 37. The Department compared reported total sales
4 with the cost of goods sold and arrived at an average
5 markup of approximately 26 percent for 2018 to 2020;
6 Exhibit A page 43.

7 Based on the Department's experience, the markup
8 appeared to be low. The Department compared the current
9 audit findings with the prior audit findings and noted
10 that reported credit card sales ratio for the current
11 audit was significantly higher than the credit card sales
12 ratio established based on the observation test for the
13 prior audit. Based on the foregoing analysis, the
14 Department determined that Appellant's books and records
15 were not reliable and not adequate for sales and use tax
16 purposes.

17 In the absence of reliable books and records, the
18 Department used an indirect audit method to verify the
19 accuracy of reported amounts. The Department conducted a
20 shelf test using Appellant's sales invoices and supporting
21 purchase invoices for June 14th, 2021 to June 29, 2021.
22 Shelf test resulted in a weighted markup of approximately
23 37 percent; Exhibit A, pages 23 through 28. The
24 Department used Appellant's federal income tax returns
25 data to calculate cost of goods sold of a little more than

1 \$4.5 million for 2018 to 2020; Exhibit A, page 22.

2 The Department used the cost of goods sold of
3 \$4.5 million, self-consumption allowance of 2 percent,
4 pilferage allowance of 1 percent, and markup of
5 30 percent -- 37 percent to determine taxable sales of a
6 little more than \$6 million for 2018 to 2020. When
7 compared with the reported taxable sales, it resulted in
8 an overall error rate of 5 percent; Exhibit A, page 22.

9 The Department applied the error rates to the
10 reported taxable sales and determined audited taxable
11 sales of around \$5.8 million for the audit period.
12 Appellant reported taxable sales of approximately
13 \$5.5 million resulting in unreported taxable sales of a
14 little more than \$258,000 for the audit period; Exhibit A,
15 page 21. To verify the accuracy of the markup method, the
16 Department analyzed and performed a post-markup analysis
17 using merchant's deposits. This method revealed a credit
18 card sales ratio of 71 percent for fourth quarter 2017, an
19 average credit card sales ratio of more than 107 percent
20 for first quarter 2018 through third quarter 2018, and an
21 average credit card sales ratio of 70 percent for fourth
22 quarter 2018 to third quarter 2020; Exhibit A, page 18.

23 Further, this method revealed that Appellant did
24 not report any cash sales whatsoever for first quarter
25 2018 through third quarter 2018. Based on this analysis,

1 the Department determined that audited taxable sales based
2 on the markup method was not acceptable and representative
3 of the business activities for first quarter 2018 through
4 third quarter 2018. Then the Department applied credit
5 card sales ratio of 71 percent to merchant deposits of
6 around \$909,000 and determined unreported taxable sales of
7 around \$420,000 for first quarter 2018 through third
8 quarter 2018; Exhibit A, page 17. The Department used an
9 allowance of 2 percent and determined unreported
10 self-consumption of around \$86,000 for the audit period;
11 Exhibit A, page 19 and 20. Based on the stated audit
12 procedures, the Department determined unreported taxable
13 measures of a little more than \$773,000 for the audit
14 period; Exhibit A, page 16.

15 When the Department is not satisfied with the
16 amount of tax reported by the taxpayer, the Department may
17 determine the amount required to be paid based on any
18 information which is in its possession or may come into
19 its possession. In the case of an appeal, the Department
20 has a minimal initial burden of showing that its
21 determination was reasonable and rational. Once the
22 Department has met its initial burden, the burden of proof
23 shifts to the taxpayer to establish that a result
24 differing from the Department's determination is
25 warranted. Unreported assertions are not sufficient to

1 satisfy a taxpayer's burden of proof.

2 The Department used Appellant's books and records
3 and other best available information to determine the
4 audit liability. Doing so produced a reasonable and
5 rational determination. Appellant contends that the
6 Department ignored its point of sale sales summary
7 reports. In response, the Department submits that the
8 Appellant did not provide any source documents such as
9 cash register tapes or point of sales for data download so
10 that the Department could verify the accuracy and the
11 validity of point of sales reports.

12 Due to lack of source documents, the Department
13 rejected point of sale sales summary reports as unreliable
14 and unverifiable. For detailed comments, please refer to
15 Exhibit D, page 113, Line 20 to page 114, Line 8.

16 Further, on July 25th -- excuse me -- Appellant submitted
17 24 Excel files, Exhibit 1, and 24 sales summary reports in
18 PDF, format; Exhibit 2, pages 1 through 48, for
19 October 2018 through September 2020 to the Office of Tax
20 Appeals. Again, Appellant did not provide any source
21 documents, such as cash register tapes or point of sale
22 data downloads for the sales summary reports. In the
23 absence of source documents, the Department could not
24 verify the accuracy and validity of submitted documents.

25 JUDGE WONG: Mr. Sharma, sorry to pause you.

1 Could you repeat the last two sentences you said? I
2 didn't quite catch last part of your prior -- the sentence
3 to the prior.

4 MR. SHARMA: "Further on July 25th," or before
5 that?

6 JUDGE WONG: From there on, yeah.

7 MR. SHARMA: Okay. Further, on July 25th,
8 Appellant submitted 24 Excel files, Exhibit 1, and 24
9 sales summary reports in PDF format; Exhibit 2, pages 1
10 through 48, for October 2018 through September 2020 to the
11 Office of Tax Appeals. Again, Appellant did not provide
12 any source documents, such as cash register tapes or point
13 of sales data downloads for the sales summary reports. In
14 the absence of source documents, the Department could not
15 verify the accuracy and validity of submitted documents.
16 However, the Department examined and compared Excel files
17 with PDF file for each month of submission and noted
18 significant discrepancies between PDF sales summary
19 reports and Excel files.

20 To summarize, for 2019 PDF, sales summary shows
21 voided sales of a little more than \$70,000 for unknown
22 numbers of voided sales, whereas, Excel file for the same
23 period shows deleted sales of \$821,000 for a total of
24 17,360 sales. For second quarter 2020 through third
25 quarter 2020, PDF sales summary shows voided sales of

1 around \$26,000 for unknown numbers of voided sales,
2 whereas, Excel file for the same period shows deleted
3 sales of \$70 million for a total of 13,957 sales.

4 For October 2018 through September 2020, PDF
5 sales summary shows voided sales of around \$121,000 for
6 unknown numbers of voided sales, whereas, Excel files for
7 the sale period shows deleted sales of a little more than
8 \$146 billion for a total of 45,080 sales. As regards to
9 Appellant's claim of duplicate assessment for first
10 quarter 2018 through third quarter 2018, the Department
11 has made necessary adjustments for assessment based on the
12 markup method to arrive at unreported taxable sales based
13 on credit card sales ratio method' Exhibit A, page 17.

14 Based on the detailed examination, the Department
15 determined that the submission is incomplete,
16 unverifiable, and unreliable. As of now Appellant has not
17 provided any documentary evidence to show that the cost of
18 goods sold, the weighted markup, and the credit card sales
19 ratio used by the Department is not correct. In fact,
20 during the appeals process, Appellant did not dispute the
21 weighted markup of around 37 percent; Exhibit D, page 113,
22 Line 5 and 6, and conceded to the reporting errors for
23 first quarter 2018 through third quarter 2018; Exhibit B,
24 page 119, Line 15 and 16.

25 The Department assessed 10 percent negligence

1 penalty for the audit period. This is Appellant's second
2 audit with similar errors. Unreported taxable measure is
3 14 percent of the reported taxable sales, which is due to
4 negligence in maintaining necessary books and records as
5 required and mandated by Revenue & Taxation Code 7053 and
6 7054 and Regulation 1698, and Appellants failure to fix
7 the errors noted in the prior audit. The understatement
8 cannot be attributed to a bona fide and reasonable belief
9 that the bookkeeping and reporting practices was
10 sufficiently compliant with the requirements of sales and
11 use tax law. Therefore, Appellant was negligent and
12 penalty should be upheld.

13 Based on the foregoing, the Department has fully
14 explained the basis for the deficiency and proved that the
15 determination was reasonable based on the available books
16 and records. Further, the Department has used approved
17 audit methods to determine the deficiency. Therefore,
18 based on the evidence presented, the Department requests
19 that Appellant's appeal be denied.

20 This concludes presentation, and I'm available to
21 answer any questions you may have. Thank you.

22 JUDGE WONG: Thank you, Mr. Sharma. I'll now to
23 turn to my Co-Panelists for any questions for CDTEFA,
24 starting with Judge Stanley.

25 JUDGE STANLEY: Good morning. I have at least

1 one question. Mr. Touma or Mr. Khouri stated that the
2 Department used two different methods for the same
3 periods, fourth quarter 2017 through third quarter 2018.
4 Can you address that?

5 MR. SHARMA: That is correct. Because the first
6 method used was the markup method. Based on that,
7 Department determined liability of \$258,000 for the audit
8 period. But then post markup analysis shows that three
9 quarters, first quarter 2018 to third quarter 2018, that
10 credit card sales ratio was more than 100 percent. And
11 Appellant admitted that due do change in accounting --
12 accountant, there were errors in reporting. So that is
13 correct.

14 We used two separate methods to determine, but
15 when we determined the credit card sales ratio method
16 liability, the adjustment for the markup method was made.
17 So the net liability is after adjusting the error based on
18 the markup method. And to further support that,
19 Department has already did a reasonable test based on
20 credit card ratio method during the prior audit. We did
21 the observation test in September of 2017. That was just
22 month before startup audit. And credit card sales ratio
23 was 47 percent average. The Department used that and
24 determined that the liability would have been \$3.8 million
25 if we have used that credit card method. But Department

1 give him the benefit by using this combined method, which
2 resulted in a liability of \$773,000 only.

3 Thank you.

4 JUDGE WONG: Thank you.

5 And I believe this next question is probably for
6 more for Appellant.

7 Mr. Touma, you had mentioned that you provided
8 everything they asked for, but the Department is now
9 saying that no data downloads were ever provided.

10 MR. TOUMA: Everything they asked me for was
11 handed to them. As a matter of fact, Jen, which is the
12 supervisor of the audit, she asked -- first of all, she
13 said she wanted 15 days of every single transaction that
14 was made with every single customer. That was provided to
15 her one by one. And then they would ask me for further
16 sales. Everything was provided for them. The fact that
17 they're saying that I did not give them tape register,
18 false. Completely false.

19 Every time they asked for anything of the tape
20 register, it was provided for them promptly, within a week
21 at best. Which even Ms. Jen Kim -- I think is her last
22 name -- kept giving me praise for it. She told me you're
23 very good as far as giving me records, as far as doing
24 this, and what you're told to do. And I was -- I was --
25 give it to them immediately. So I don't know what they're

1 talking about.

2 JUDGE STANLEY: Well, I was just going to follow
3 up and you can answer, Mr. Khouri, if you want. But the
4 items, the document that you provided, it doesn't sound
5 like a data download was included with that. And I'm not
6 sure if it was requested during the audit or not.

7 MR. TOUMA: Data download of what, ma'am?

8 JUDGE STANLEY: Of the POS records, I believe.

9 MR. KHOURI: May I?

10 JUDGE STANLEY: Yes.

11 MR. KHOURI: The auditor went to the store, and
12 she had full access to the POS system. The conversation
13 of full download of transactions, it was just brought up
14 right now by the CDTFA, was never mentioned. They're more
15 than welcome to get whatever data they wanted if they ask
16 for it. And, like, the CDTFA just mentioned, data for
17 7/13 through 7/21 was requested. We provided it. Source
18 document from 6/14/21 through 6/29/21 we provided.
19 Anything the CDTFA ever requested was provided. So if a
20 data download was requested, we were more than welcome to
21 give them access. My client or me, we don't have the
22 technical support to download it. But if they ask for it,
23 we would have gotten it from the POS company with no
24 issues, zero problems.

25 Thank you.

1 MR. TOUMA: If -- if they're saying that no
2 documentation was presented to them, or nothing was given
3 to them from the POS system, how can they move forward
4 with a shelf test, which came to their conclusion if the
5 shelf test was provided from me. They came to my store,
6 and they went through my POS system, and they used my --
7 my purchase invoices. If the documents that I provide
8 that they claim were all false and -- and copied or
9 whatever they want to say, then how is it fair to use it
10 against me?

11 I mean, that's just the conclusion. I -- I'm so
12 frustrated when it comes to this -- this matter because
13 they keep saying I didn't give them this and I didn't give
14 them that. But when I -- when I give them everything,
15 everything they asked for was handed to them. Ms. Kim was
16 biased from the beginning. From the beginning, every time
17 she asked for something, let's start with your QuickBooks.
18 I gave her my QuickBooks. I don't trust your QuickBooks.
19 Give me your purchase invoices. I give her purchase
20 invoices. I don't trust your purchase invoices. Give me
21 your POS system. I give her the POS system. I don't
22 trust the POS system.

23 Ms. Kim, who do you trust? I trust the markup
24 theory. Why all of a sudden the markup theory is -- is
25 there and -- and efficient for you but not for me?

1 Nothing is efficient for me. All it was for me was strike
2 down. Strike down. Everything you're giving us is wrong.
3 It's false.

4 That means my employees are in on it. That means
5 Mr. Khouri is in on it. That means everybody I have in my
6 circle is in on me hiding from the CDTFA. That's not
7 fair. That's not a fair analysis. How can they come to a
8 conclusion like that when everything was given to them.
9 Everything. And I never denied them anything. Anything
10 they wanted was easy access. But now all of a sudden I
11 didn't give them nothing. This is not fair.

12 JUDGE STANLEY: Okay. Thank you.

13 JUDGE WONG: All right. I will now turn it to
14 Judge Brown for any further questions for CDTFA.

15 JUDGE BROWN: Yes. Thank you. All right. Let
16 me turn -- I'll pick up on this topic, and I'll start with
17 my question to CDTFA. I'm looking at CDTFA's exhibit
18 page 53. In the audit work papers there's an entry on
19 April 19th, 2022. It's towards the bottom of the page
20 where it says -- sorry -- not April 19th -- April 29th
21 where -- I'll wait. Mr. Sharma, let me know when you get
22 there.

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

24 JUDGE BROWN: Okay. So it says, "Requested the
25 taxpayer to provide the POS download for first quarter

1 2020 by 5/12/2022, meaning May 12th, 2022. Is that what
2 you're referring to when you talk about the data download?

3 MR. SHARMA: That is the starting point, yes. We
4 requested for first quarter 20, so they gave us a PDF
5 format. If you go further down, there are comments also
6 by auditors. They give us PDF files, but they don't give
7 us control numbers or anything for the Department to
8 verify the accuracy of those numbers.

9 JUDGE BROWN: Where does it say -- where is it?
10 Can we find that in the audit work papers that they
11 didn't -- the taxpayer didn't provide what the auditor was
12 asking for?

13 MR. SHARMA: Yeah. I'm just -- give me one
14 minute.

15 JUDGE BROWN: Certainly.

16 MR. SHARMA: If you go to page 54, auditors
17 comments on May 4, 2022, CAS processed sales data in PDF
18 format. So they provided PDF format and converted the
19 details to Excel files. And further down, please note
20 that no check figures or control totals were provided with
21 the sales PDF file. Therefore, auditor should take care
22 of verified records for completeness. Which auditor tried
23 to do that but could not do.

24 JUDGE BROWN: Okay. Thank you. And I -- I'll --

25 MR. SHARMA: Thank you.

1 JUDGE BROWN: I'm going to come back to questions
2 for CDTFA in a minute, but I will give Appellant an
3 opportunity to respond if you want to.

4 MR. KHOURI: Again, the answer from the CDTFA
5 does not really answer the question. The auditor went to
6 the business. She had full access to the POS system. We
7 offered it to her. We offered to her to set at the store
8 as many days as she wants. Everything she requested was
9 given to her. And like Johnny said, the supervisor asked
10 for transaction per transaction from the POS. He printed
11 transaction per transaction in it. He took it personally
12 to her and gave it to her. And there's no conversation of
13 her telling him, go download it in an Excel or any other
14 digital format where we can look at it. They asked him
15 for transaction per transactions. It was provided, and to
16 us that was the end of it.

17 JUDGE BROWN: All right. Thank you.

18 MR. KHOURI: Thank you.

19 JUDGE BROWN: I'm going to go back to questions
20 to CDTFA right now.

21 I want to ask CDTFA, so from my understanding
22 this is solely a brick and mortar location with no
23 internet sales. So -- but if I read the audit work papers
24 correctly, CDTFA's calculations reflect the highest amount
25 of additional taxable sales in first quarter of 2020

1 through third quarter of 2020. I guess I want to ask how
2 does that -- how do we interpret that in light of the
3 pandemic's effect on brick and mortar sales -- brick and
4 mortar stores in -- you know, with pandemic reducing
5 in-person shopping?

6 MR. SHARMA: The assessment for that period is
7 based on the markup method. It is not based on the credit
8 card sales method. But the credit card sales method we
9 calculated just to see if it is reasonable or not. So,
10 basically, what we used is we used Appellant's cost of
11 goods sold, and we marked it up after allowing the
12 pilferage allowance and self-consumption. So that is
13 based on the markup method. And during the appeals,
14 Appellant did not dispute the markup method, even though
15 now Appellant is submitting some additional information
16 for 2019. But to answer your question, that assessment is
17 based on the markup method, not on the credit card sales
18 method.

19 JUDGE BROWN: I understand that. I wasn't yet
20 asking about the credit card sales ratio, although, I'll
21 get to that in a minute. What I'm saying is just in a --
22 looking at the numbers, how do we reconcile that with the
23 fact that we know there must have likely been some
24 negative impact on Appellant's sales during the pandemic?

25 MR. SHARMA: Again, we used the best possible

1 information available to us, which was the cost of goods
2 sold, which was available to us, and we determined based
3 on the markup method. So Appellant has not given us
4 anything to prove that otherwise, as of now, to determine
5 that whether the sales was correctly assessed or not. So
6 we have whatever information was available to the
7 Department. We used that.

8 MR. PARKER: Judge Brown, can I --

9 JUDGE BROWN: Yes.

10 MR. PARKER: Can I add something?

11 JUDGE BROWN: Yes, please.

12 MR. PARKER: So we did use the cost of goods sold
13 for 2020 to markup their sales for 2020 for those three
14 quarters. If you look at their transcript, which I can
15 get you the exhibit number in a minute, their sales
16 reported were the three highest quarters ever in 2020.

17 JUDGE BROWN: I saw that.

18 MR. PARKER: Okay.

19 JUDGE BROWN: I was wondering about that too.

20 MR. PARKER: So obviously they reported more
21 sales. So they didn't have the impact from the COVID
22 pandemic that many other businesses may have had.

23 JUDGE BROWN: Or how do we know it isn't that
24 they were reporting more accurately in 2020 than they were
25 in 2018?

1 MR. PARKER: By us using the purchases in the
2 markup method. The reported markup for that period was
3 quite a bit lower than the other two years.

4 JUDGE BROWN: And this might be in the record,
5 but if you could point me to it, is there a calculation of
6 what we think the credit card ratio was for the quarters
7 in 2020?

8 MR. PARKER: Judge Brown, are you asking for
9 based off of what they reported or what our reflective
10 percentage was after we adjusted for the markup that was
11 in the --

12 JUDGE BROWN: After we -- after we adjusted.
13 What is CDTFA saying the credit card ratio was in 2020.
14 And if it's not in the record -- if it's in the record,
15 you can tell me that as well.

16 MR. SHARMA: It is in the record. That's based
17 on the post markup analysis. So that is Exhibit A,
18 page 18. And that's where the Department determined that
19 credit card ratio is.

20 JUDGE BROWN: Sorry. Exhibit A, page 18?

21 MR. SHARMA: Yeah. And as I said, it's a --
22 basically, what we did is we split into three different
23 areas, the fourth quarter '17, and then the 3 quarters;
24 first quarter '18 and the rest of the audit period. It
25 ranges from fourth quarter '18 from 75 percent, 75 to

1 63 percent. I hope that's your question, Judge Brown. Is
2 that --

3 JUDGE BROWN: Yes. I think your answer --

4 MR. SHARMA: I just want to make sure.

5 JUDGE BROWN: Yeah.

6 MR. SHARMA: Yeah. Because if that -- that is in
7 the audit working papers.

8 MR. PARKER: Judge Brown, if you look at page 17,
9 it has the three calculations for 2020; 63.1 percent in
10 the first quarter, 69.41 percent in the second quarter,
11 and 70.58 in the third quarter. So those are the
12 reflective after the additional taxable sales based on the
13 markup method.

14 MR. SHARMA: So page 17 and 18 contains --

15 JUDGE BROWN: Okay. Thank you.

16 MR. SHARMA: Thank you.

17 JUDGE BROWN: And then I just wanted to ask also
18 about the negligence penalty. Is it accurate to say -- or
19 looking overall at approximately a 14 percent error rate?

20 MR. SHARMA: That is correct for the audit
21 period, 14 percent.

22 JUDGE BROWN: Would you say that's on the low end
23 for imposing a negligence penalty?

24 MR. SHARMA: Depending upon Appellant's second
25 audit, and depending upon we did the observation test in

1 September 2017. And those three days of observation test
2 we did was one day was 34 percent credit card ratio. And
3 next date was September 23rd, 42 percent, September 27, 47
4 percent. That is in September 2017. So Appellant was
5 aware, but still the reporting is almost 27 -- or
6 28 percent more than that. So it means Appellant was
7 aware of the error but just decided not to fix it.

8 Thank you.

9 JUDGE BROWN: Thank you.

10 One minute. I think that's all the questions I
11 have right now. I'll turn it back over to Judge Wong.
12 Thank you.

13 JUDGE WONG: Thank you.

14 Does CDTFA have any comments regarding Exhibits 3
15 or 4 that were submitted and admitted today?

16 MR. SHARMA: Exhibit 4, as we stated earlier,
17 that because we did a shelf test for June 2021 and these
18 invoices are for September 2019, again, it doesn't refute
19 the shelf test of 37 percent. And further, the Department
20 has no information as to how did the Appellant arrive at
21 the cost. There is no purchase invoice he provided.
22 There's no cash register, actual sales receipts for this
23 period. And we are not aware if there was any
24 manufacturer rebate involved during this period when they
25 were selling at this price. So Department position is

1 that our 37 percent shelf markup is still correct, unless
2 proved otherwise.

3 Thank you.

4 JUDGE WONG: Thank you.

5 I also had a question about -- so the Department
6 determined that the Appellant's book markups were low for
7 businesses of its type. And you said it was based on
8 CDTFA's experience; is that correct?

9 MR. SHARMA: That's correct.

10 JUDGE WONG: Could you explain that a little bit
11 more?

12 MR. SHARMA: The Department whenever they do the
13 primary analysis, they have certain things they look at.
14 They look at the businesses in the surrounding area just
15 to see if the reported amount is correct. And, again,
16 there's a -- sometime it may be in the range of 35,
17 40 percent, depending upon the field office. And they
18 have certain -- it means sometimes they maintain certain
19 records in the field office to see if the markup is
20 reasonable or not. And when they see markup is low, then
21 they try to perform some additional testing to see if the
22 reported amount is correct.

23 JUDGE WONG: Is that the information that CDTFA
24 used to compare book markups to? Is that in the record
25 that you submitted?

1 MR. SHARMA: Yes.

2 JUDGE WONG: Could you point me to where those
3 are?

4 MR. SHARMA: I'm sorry. So your question was, is
5 that information in the records?

6 JUDGE WONG: Yes.

7 MR. SHARMA: No, no. There's no information in
8 the records. That's, as I said, it's the field office
9 that maintain certain information within their offices to
10 see if the reported markup is correct. And also, when
11 they do the primary analysis, they also look at that if
12 there's enough information to support the purchases and
13 other stuff. When they don't have, then the Department
14 determine to do an indirect audit method.

15 JUDGE WONG: Is that information from those other
16 businesses that the field office compared Appellant to, is
17 that available in the record?

18 MR. SHARMA: I'm not sure. I have to check with
19 the field office. They may have, they may not. As I
20 said, this is just some kind of information they use to
21 see if the markup is reasonable or not.

22 MR. PARKER: Judge Wong, I don't see anything in
23 the record that shows what they -- what businesses they
24 compared it to but based on -- they didn't use the other
25 businesses to actually make the assessment. They used the

1 actual taxpayer's own records to determine the assessment.

2 JUDGE WONG: Right. But they also used it to
3 determine that the book markups were low. So isn't that
4 kind of the entry point into the other audit methods that
5 they used? Like if the book markups shown weren't off --
6 weren't low, that they wouldn't proceeded on. Is that
7 fair to say?

8 MR. SHARMA: That is one of the criteria, not in
9 its entirety. As I said, they compare the bank deposits.
10 They find difference in bank deposits. They looked at the
11 sales summary reports. There were no supporting documents
12 provided, source documents. And they looked at the
13 overall markup, which was low. So all these factors
14 pointed to the Department that -- that provided documents,
15 books, and records may not be complete. So then they
16 decided to used indirect method. As Mr. Parker said, we
17 used Appellant's own books and records for the two weeks
18 period. They provided us the purchase invoices, sales
19 invoices, to determine 37 percent markup.

20 During the appeals process, Appellant also
21 submitted their own worksheets and decision talks about
22 that, and they calculated their own markup, ranges from
23 41 percent higher. And decision already explains about
24 that one why we still decided to accept 37 percent, which
25 was lower than their own calculation, which was submitted

1 to Department during the appeals process.

2 Thank you.

3 JUDGE WONG: Thank you.

4 Turning to the appeals process there was in the
5 decision under "Finding of Fact For" -- I'm just following
6 up on the low bookmark. There's a line that basically
7 talked about -- I'll just quote it. It says, "Appellant's
8 book markups were lower than expected. Lower than the
9 expected book markups for petitioner's type of business
10 establishment of 70 to 90 percent for vaping products, 100
11 percent for miscellaneous taxable accessories, and
12 10 percent to 15 percent for tobacco products.

13 I was just wondering where that information came
14 from. It was in the decision finding of fact for --

15 MR. SHARMA: Yeah. That's on page 110 of the
16 exhibits.

17 JUDGE WONG: So that would be Exhibit D.

18 MR. SHARMA: Again, that's based on the
19 information Department has, internal information. They
20 tried to just compare that, and we have not used that
21 information. So we decided to use the Appellant's books
22 and records to determine 37 percent. But that is the
23 internal raw data available to the Department, which they
24 can see whether it's reasonable or not. But that doesn't
25 mean it will apply to the Appellant's business. We do not

1 use those numbers. We actually use Appellant's books and
2 records to determine the shelf markup of 37 percent.

3 JUDGE WONG: But if OTA needs to make a valuation
4 of -- to determine whether CDTFAs has met its initial
5 burden of the determination being reasonable and rational,
6 shouldn't that information and the foundation for that
7 information be included in the records that you submit to
8 OTA so that we can actually make that evaluation?

9 MR. SHARMA: We can look into that one, and we
10 can see if something is available within the field office.
11 And as I said, we have not used -- generally when we use
12 the other businesses, we include those worksheets in the
13 audit working papers. But here, we decided not to use the
14 numbers. We actually used the Appellant's books and
15 records. That's the reason we didn't provide any
16 supporting documents. But we can look into that one to
17 see if there is something available.

18 JUDGE WONG: I think that would be helpful to
19 OTA.

20 MR. SHARMA: We can try, and we can let you know
21 if we find something.

22 MR. PARKER: Judge Wong, can I just add one
23 thing? As far as whether the determination is reasonable
24 and rational, you can tell basically from the markup
25 derived from their records it's 37 percent. And the

1 reflected markup based on what they reported was as low as
2 I believe, 20 percent -- 21 percent in 2020. So the
3 recorded markup is 21 percent. We did a test using their
4 own records and came up with 37 percent. So that's what
5 shows that their markup was not reasonable, and what we
6 came up with was.

7 JUDGE WONG: Got it. Thank you.

8 MR. KHOURI: May I?

9 JUDGE WONG: Sure.

10 MR. KHOURI: Just on the markup subject, and
11 that's what we tried to explain to the auditor and the
12 supervisor. With COVID that year, other stores opening up
13 in the area, Johnny panicked. He lowered the prices to
14 draft -- to bring in more business, which clearly explains
15 why his business survived. And he generated more sales in
16 '20 because his profit margin shrank. And then the shelf
17 test they keep referencing to, it was conducted in 2021.
18 So its invoices from 2021 compared to prices in 2021. So
19 it wasn't where the auditor would grab invoices from 2020
20 and say give me the receipts for those purchases. She
21 used 2021 data and took that and applied it, I guess, to
22 '18 through the 2020.

23 Thank you.

24 JUDGE WONG: Thank you.

25 That's all the questions I had for CDTFA at this

1 time. We're going to turn it over back to Appellant for
2 their final statements. But before we do that, I had a
3 question.

4 Mr. Touma, you have a box next to you. You've
5 referenced it earlier, like, that they're records. Have
6 you submitted those to CDTFa before?

7 MR. TOUMA: Yes, sir. I have over and over and
8 over again. The fact that they keep saying that my
9 documents -- they used my documents for the shelf test.
10 They used this against me. From the get go, they told me
11 that my documentation is not valid. It's not good. If
12 it's not good, then why are they using it? Why are they
13 using it? Why aren't they using the papers that I'm
14 giving them? They keep telling me no. But in here they
15 keep telling they're going to use it against me. It's not
16 fair. It's not fair.

17 I don't understand. All these documents and plus
18 more I gave over to them every time they asked for
19 anything. When Ms. Jen You, when she asked me for the
20 15-day transactions, every single transaction, I handed
21 her thousands of receipts. I kid you not. It was
22 thousands. And then even with Ms. Kim, every time she
23 asked me for something, I would hand it over to her. And
24 she would be shocked as to, wow, how -- how do you have
25 all this? How did you get all this?

1 So all of these things are forged, but now in
2 here, in appeals, they're good to use against me for the
3 shelf test. I -- I don't understand.

4 JUDGE WONG: Thank you, Mr. Touma.

5 Judge Brown has a question.

6 JUDGE BROWN: Okay. I have a question for
7 Appellant. In the Appeals Bureau decision that was based
8 on the appeals conference, if you remember that?

9 MR. KHOURI: Yes, ma'am.

10 JUDGE BROWN: Okay. In the decision it says
11 that, "During the appeals conference, petitioner confirmed
12 it did not dispute the audited shelf test markup ratio of
13 36.73 percent," is that correct?

14 MR. KHOURI: Yes, that is correct because it is
15 2021 prices to 2021 invoices. So there's -- I mean, it's
16 our information. There's no reason to dispute it. But
17 the dispute was 2020, is we lowered the prices so we can
18 bring in more business. So 2020 -- like, for example, you
19 go buy a bottle of coke at a Stater's. Today it's \$2. It
20 might be \$1.50 next week. So I can't use today's prices
21 and say, well, two years ago Stater's was making double on
22 that Coca-Cola bottle. It's the same concept.

23 JUDGE BROWN: So you're saying you don't dispute
24 that you -- what you told the appeals conference holder is
25 that you don't dispute the audited shelf test markup ratio

1 of 36.73 percent as it applies to 2021?

2 MR. KHOURI: It was conducted in 2021. So I
3 don't dispute it. It was 2021 prices he's generating. At
4 that date, at that moment, he's at 37 percent. But
5 doesn't --

6 JUDGE BROWN: But You're arguing --

7 MR. KHOURI: Yes. Go ahead.

8 JUDGE BROWN: I'm sorry. I didn't mean to cut
9 you off.

10 MR. KHOURI: I'm arguing that the markup is
11 right. I'm arguing using the method for 2020 is wrong.
12 Because if I look at other years -- and I know the State
13 keeps on saying it's 14 percent underreported, but
14 majority of it comes in 2018, which we agreed to 2018.
15 Even in appeals we said we know we had a problem, but
16 after 2018 things were fixed.

17 JUDGE BROWN: So you're arguing that that shelf
18 test markup ratio isn't accurate when it's applied to
19 2020?

20 MR. KHOURI: Correct.

21 JUDGE BROWN: Okay. Thank you.

22 MR. KHOURI: Thank you.

23 JUDGE WONG: Thank you.

24 I just had a follow-up question with CDTFA just
25 so I understand the methods used here. Because Appellant

1 had argued that they're being double taxed, essentially.
2 Is that correct? They're using two different audit
3 methods, and there's overlap. Is that what you're
4 arguing?

5 MR. KHOURI: Yes. In their worksheet at 12-C and
6 12-A, they're using both a credit card and markup for the
7 period of fourth quarter 2017 through third quarter 2018.
8 Double count.

9 JUDGE WONG: Thank you.

10 And so, CDTF, my understanding from your
11 position is that you used the markup method established
12 unreported taxable sales of X, but then determined that
13 testing it with a credit card ratio method that there was,
14 like, over 100 percent credit card ratio. So then you
15 apply the credit card ratio method, came out with
16 unreported taxable sales Y, and then subtracted X from it;
17 and then that's why we have two audit items?

18 MR. SHARMA: That is correct. And the credit
19 card is only for three quarters period when the Appellant
20 has change in reporting method, they changed their
21 accountant, and they admitted that they had reporting
22 errors. So those errors are only for three quarters,
23 first quarter '18 to third quarter '18. And if you look
24 at the schedule as I mentioned the page number, that
25 liability is net of -- as you explained -- Item 1, which

1 is markup method. It's not a duplicate assessment.

2 JUDGE WONG: Okay.

3 MR. SHARMA: Thank you.

4 JUDGE WONG: And just to clear something up
5 earlier, you had referenced CAS. Is that like a computer
6 audit specialist?

7 MR. SHARMA: That's correct.

8 JUDGE WONG: Okay. Thank you.

9 And then Judge Stanley had a question.

10 JUDGE STANLEY: Yes. Thank you, Judge Wong.

11 I just had a follow up for Appellant. You gave
12 us today Exhibit 4, which shows some discounts in 2019.
13 But now you're discussing discounts that were supposedly
14 provided to bring people in during the pandemic in 2020.
15 Did you provide those sales invoices to the auditors, such
16 that they could see that you had made special deals during
17 that time period?

18 MR. KHOURI: Sales -- it's the POS system that he
19 has. So like when the CDTFA reference cash register tape,
20 there's no cash register tape. It's a digital format.
21 The POS system is like a computer system that generates
22 transactions. We provided the CDTFA a detailed -- or,
23 actually, a sale per sale transaction for any period they
24 requested. So to answer your question, that period in
25 question was not can requested by CDTFA, and we did not

1 give them a sale -- a transaction for transaction for that
2 period. We gave them whatever period they requested. We
3 would give to them.

4 JUDGE STANLEY: Are they available?

5 MR. KHOURI: Yeah, they are available. Yeah.

6 JUDGE STANLEY: Okay. Thank you.

7 MR. TOUMA: The register tape I can go back as
8 far as I want. So anything you request I will have for
9 you within 45 minutes to an hour.

10 JUDGE STANLEY: The question that I have, though,
11 is I don't know if you can tie a register tape to a
12 particular cost of a product versus the sale price and
13 whether it was shelf price or discounted and those kinds
14 of things. So I'm not sure.

15 MR. TOUMA: We can just provide you with the
16 actual tape and -- as far as that period goes. And then
17 you can assess for yourself and you can come to the
18 conclusion on your own. But anything you need from me
19 from my tape register us accessible leading into -- I
20 think 2018 is when we purchased the POS system. As soon
21 as we purchased the POS system, I can go back as far as I
22 want and get anything you want.

23 JUDGE STANLEY: Thank you.

24 JUDGE WONG: Okay. What we're going to do right
25 now. Let us take a 10-minute break. There is something I

1 need to talk to my Co-Panelists about. So we're going to
2 take a 10-minute break. And then when we come back,
3 depending on what we decide, we'll see. But Appellants
4 still has their final statement to go. But let's go off
5 the record and take a 10-minute break. Come back at
6 11:05.

7 Thank you.

8 (There is a pause in the proceedings.)

9 JUDGE WONG: Let's go back on the record at.

10 So we're back on the record at 11:06 a.m.

11 So, Mr. Touma and Mr. Khouri, both of you had
12 made some factual statements, but you weren't sworn in
13 or -- as witnesses. In order for -- okay. In order for
14 either one, Mr. Touma to make -- in order for us to take
15 your statements as fact, we'd have to swear you in, and
16 you'd have to testify. You'd be subject to
17 cross-examination by CDTFA. Would you be willing to sworn
18 in and testify and affirm that the statements you've made
19 up to this point are factually true, and you're asserting
20 that they are true?

21 MR. TOUMA: Yes, sir.

22 JUDGE WONG: Okay.

23 MR. KHOURI: Sure.

24 JUDGE WONG: CDTFA, did you have any objections?

25 MR. SHARMA: Department has no objections.

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JUDGE WONG: Okay.

MR. SHARMA: Thank you.

JUDGE WONG: And, Mr. Khouri, were you involved in the audits of Appellant?

MR. KHOURI: Yes, sir, in terms of communication with the auditor and the supervisor. And some of the documents that was sent to the auditor, like the QuickBooks file is owned by my office. So we created a back up, and we send it to her. And then she asked us for an Excel format of the journal ledger, and we created it and we sent it to her. That typically shows all the detailed transactions one by one because we download the bank account ever since I started helping him later in 2018. That's what we've been doing. That's been the practice.

JUDGE WONG: Okay. Would you also be willing then to testify that the statements that you've made are factually true and be subject to cross-examination?

MR. KHOURI: Yes, sir.

JUDGE WONG: Okay. Then I will ask both of you individuals to raise your right hand.

J. TOUMA,

produced as a witness, and having been first duly sworn by the Administrative Law Judge, was examined, and testified

1 as follows:

2 D. KHOURI,

3 produced as a witness, and having been first duly sworn by
4 the Administrative Law Judge, was examined, and testified
5 as follows:

6

7 JUDGE WONG: Okay. Thank you.

8 I will just turn it over to CDTFA to see if they
9 have any questions on cross-examination for either of
10 these sworn witnesses.

11 MR. SHARMA: Department has no questions.

12 Thank you.

13 JUDGE WONG: Okay. Thank you.

14 All right. We're going to turn it over to
15 Appellant for their final rebuttal and closing remarks,
16 and then at the end we'll have last questions from the
17 Panel from either side.

18 Mr. Khouri.

19 MR. KHOURI: Thank you.

20

21 CLOSING STATEMENT

22 MR. KHOURI: Okay. So I know CDTFA started by
23 saying there's 14 percent underreported. If you look at
24 the year of 2019, even if I use their analysis, the
25 difference is the 1.6 percent based on their calculation

1 as a percentage of error. And then for 2020, which is
2 still the big year in question, they're showing
3 9.6 percent. And then in terms of the effective credit
4 card ratio rate after they applied their markup, that
5 shows 63 percent for 2020 first quarter.

6 And then, again, to the argument that no records
7 were provided, based on what the CDTFA rep said, there was
8 federal tax returns provided. There's bank statements
9 were provided. There's merchant statement. There is POS
10 monthly report -- summary report. There is detailed
11 transactions for July 13th through July 20th. There's
12 detailed transaction for 6/14 through 6/29. There is a
13 1099-K that was obtained from the State. So there is a
14 list of about seven, eight, nine items that CDTFA says
15 this is incomplete for accuracy because it's missing a
16 cash register tape or a download of the POS system.

17 JUDGE STANLEY: Mr. Khouri.

18 MR. KHOURI: Yes.

19 JUDGE STANLEY: Can you just slow it down a
20 little bit so our stenographer can keep up.

21 MR. KHOURI: I'm sorry.

22 So I just listed, and the CDTFA listed about
23 seven to eight items that we provided, and they are
24 extensive documents. And they like to state that I also
25 provided QuickBooks back up and Excel sheet of all of the

1 general ledgers showing all transactions, but yet the
2 seven, eight items that were provided still tells the
3 CDTFA that there was incomplete record because of one item
4 that we did not provide, given that it was never requested
5 from us. And the CDTFA auditor, if she wanted it the day
6 she came and visited the location, we were kindly provided
7 to her with no problem.

8 So, again, after I look at their credit card
9 analysis and the markup analysis, and I still 100 percent
10 confident that the period from first quarter 2018 through
11 third quarter 2018 was included in the audit twice. One
12 time using markup method, and one time using a credit card
13 method. We strongly agree that the taxpayer, once the
14 first audit was fully completed, and went through the
15 appeal process on the first audit and everything was
16 100 percent, the taxpayer did not an 80, 90 percent
17 improvement. He did 100 percent improvement by
18 implementing a POS system, by implementing that he takes
19 his bank deposits daily to the bank. And he made it
20 religiously. He goes to the bank. And some nights he
21 closes late with the risk taking cash to the bank. He
22 still goes at night and makes a drop deposit because he
23 doesn't take any of the sales with him home.

24 So it's not fair to the taxpayer to penalize him
25 after he made such a huge improvement. I've been doing

1 this for 17 years, and I can strongly say Touma has the
2 cleanest books and records. And I tell him sometimes, we
3 joke and I say, do you feel safe taking your deposits to
4 the bank at night?

5 And he says, you know, it's better than me taking
6 the money home. Let me deposit it. It goes to the bank.
7 I get my salary from the company. He's on payroll. He
8 gets paid. Even his wife that works the business gets a
9 check for her hours. Everything is 100 percent. The
10 State on one occasion through the supervisor, she made it
11 sound like it's a joke, but it's like, well, everybody
12 cheats. Not everybody cheats because we have a system.
13 And if the State uses their own system to be fair to the
14 taxpayer, they wouldn't put 63 percent credit card ratio
15 for 20 -- effective credit card ratio for first quarter
16 2020 when that same office in Irvine was given 90 percent
17 credit card ratio.

18 We're not asking for 90 percent. We're asking to
19 use the POS system that my client heavily invested in to
20 make sure all his paperwork is on track. Everything we
21 were asked was given. So we would like a second look at
22 that year. We acknowledge from early on in the audit that
23 2018 is -- is a problem. We were honest, faithful. We
24 told the auditor. We told the supervisor that 2018 had an
25 issue in it.

1 And this concludes my statement. Thank you.

2 JUDGE WONG: Thank you, Mr. Khouri.

3 All right. So for the final time, I will turn to
4 my Co-Panelists for any questions, and I believe I will
5 start with Judge Brown.

6 JUDGE BROWN: Thank you. I have a question, I
7 believe, for Mr. Touma about how the business operated
8 during the pandemic periods that began towards the end of
9 the first quarter of 2020, March 2020, through the end of
10 the audit period, which is the third quarter of 2020. Did
11 you -- did you have anything like curbside delivery or did
12 you have -- how did you manage to operate given the
13 limitations of the pandemic?

14 MR. TOUMA: In March of 2020 I was visited by the
15 Sheriff's Department. And they came in and they said that
16 their lieutenant had received some phone calls and, et
17 cetera, and they told me to start curbsiding. So we
18 complied, and we started curbsiding. The way we were
19 doing was they would call in, the customers, or they would
20 pull up in the parking lot, because a lot of them didn't
21 have the information. And we would use walkie-talkies to
22 call in to the inside, and they would get it ready for
23 them. They would go pick it up from the back. That's how
24 we did it for the majority of the pandemic.

25 So it was a lot of labor back and forth, back and

1 forth calling in on the walkie-talkie, or calling in on
2 phone and get the product ready. And when the customer
3 would come, we would have wireless touch credit card
4 machines that we would run out to them and, et cetera.
5 That's -- that's how it was conducted throughout the whole
6 pandemic.

7 JUDGE BROWN: But you never had to shut down
8 completely; correct?

9 MR. TOUMA: I did shut down for -- for about a
10 month.

11 JUDGE BROWN: When was that?

12 MR. TOUMA: That was in March when they visited
13 me.

14 JUDGE BROWN: Oh, okay. Is that reflected in any
15 of the evidence that we have?

16 MR. TOUMA: I'm not sure.

17 MR. KHOURI: No.

18 JUDGE WONG: I think that's all that I have right
19 now. Thank you.

20 MR. KHOURI: Thank you.

21 Judge Stanley.

22 JUDGE STANLEY: I don't have any follow-up
23 questions at this time. Thank you.

24 JUDGE WONG: Thank you.

25 I have just a had a few follow-up questions for

1 the parties.

2 So, Mr. Touma, during the pandemic, did your
3 sales increase? Did you see an increase in smoking?

4 MR. TOUMA: Yes, sir. Yes, sir, because there
5 was a lot of government money being pushed around. And a
6 lot of people would come in with their EDD cards and use
7 that for the majority of the time, given the fact that
8 there were some cash transactions here and there. But
9 yeah. I mean all businesses went up during the pandemic.
10 There was a lot of free money floating around.

11 JUDGE WONG: All right. Thank you.

12 And I wanted to have CDTFA address one thing.
13 Mr. Khouri had made an argument in his closing about,
14 like, Appellant is not a cheater, is not cheating. I
15 don't think CDTFA is saying that here.

16 Mr. Touma?

17 MR. KHOURI: I did not say they said it here. I
18 said they said it in a meeting with the supervisor. And
19 the problem -- and this is the problem I was having with
20 my client when we were downstairs on the break. The
21 problem is a lot of these cases don't get this far because
22 it cost money to hire an attorney or hire a forensic
23 accountant to fight the CDTFA. So the CDTFA in the last
24 few years they change the way they do business. And it's
25 now it's like, well, everybody takes it. We're giving you

1 a liability. Take it. The amount of appeals now is a lot
2 less than it used to be a few years back. People don't
3 see a point of fighting the CDTFA. They just say okay,
4 I'll pay it.

5 The reason we're fighting heavily here is we know
6 the system he implemented. We know what he's doing. We
7 know how he makes his deposits. Every night he takes his
8 money. Whatever is cash gets deposit in the bank account.
9 Everything that he pays gets paid out of that bank
10 account. It's 100 percent bank product. Everything is
11 through the bank. Everything paid in through the bank,
12 outside the bank. If he wants to cheat, it's very simple.
13 The way State Board wants to do it is you do a markup.
14 Well, buy half of your purchases outside from a cash
15 vendors. You don't show your invoices.

16 But my client does it -- after the first audit,
17 he learned that he has to be by the book. And he had not
18 IRS audit, and the IRS auditor in Laguna Niguel was
19 impressed with the paperwork. And one of years that was
20 audited for the IRS was '19 and '18. And he said you've
21 made such an improvement, and keep up the good work, and
22 this is how you do it. And that's how he's been doing it.

23 JUDGE WONG: Okay. So let me just explore the
24 context of that comment. You said you were meeting with a
25 CDTFA supervisor. She made a joke. Or was it he or she?

1 MR. KHOURI: Not every -- she. That everybody
2 cheats.

3 JUDGE WONG: So was she being serious or did
4 you --

5 MR. TOUMA: Yes.

6 MR. KHOURI: I don't know if she was being
7 serious, but it has no place. And I told her at that
8 time, it has no place in the conversation. We're focused
9 on the documents. This is the documents we have. Let's
10 argue the documents. If there is a liability, we'll pay
11 it. But if there's no liability, there is no reason for
12 us to -- to pay it because you're -- again, just like how
13 the state has similar businesses has that. Well, show me.
14 West Covina office has different similar businesses than
15 Irvine, than Riverside. There's no standards.

16 JUDGE WONG: Okay.

17 MR. KHOURI: Every office, it's a generic
18 statement. Everybody does this.

19 JUDGE WONG: Thank you, Mr. Khouri. Thank you.
20 I think I get your point.

21 I just wanted CDTFA to address that, if you
22 wanted to.

23 MR. SHARMA: I'm sorry. As to?

24 JUDGE WONG: They are testifying that during a
25 meeting with a CDTFA supervisor, she made a statement

1 about everybody cheating. One individual thinks she was
2 being serious. One individual is not sure whether it was
3 a joke or not.

4 MR. SHARMA: Department generally does not make
5 any comment on that. Because if there was serious issue
6 like that, they could have taken it up with the higher up
7 authority and done that. As of now, we don't have any
8 records. So we don't want to comment on that one, what
9 transpired at the time.

10 JUDGE WONG: Okay.

11 MR. SHARMA: Thank you.

12 JUDGE WONG: I will just note for the record
13 that -- okay.

14 Mr. Touma.

15 MR. TOUMA: When that comment was made the
16 following day, I made a phone call to the appeals officer,
17 and we were talking. And I asked her, I said does -- does
18 she have the right to call me a cheater? Because that's
19 how she closed the conversation. She said that everybody
20 cheats. Nobody reports the right way, and I'm sticking to
21 what I'm saying. So when I called the appeals officer the
22 following day and I said, ma'am, how is she allowed to
23 talk to me like that?

24 And she -- the appeals officer was -- she told
25 me, I -- I have no comment. I have no comment. I said,

1 yeah, but that -- that -- she's pointing her -- a
2 government gun on me. Why is she saying something like
3 that and -- when she has no proof. And everything she's
4 wanted I've handed over to her. She's going to call me a
5 tax cheat at the end. That's not fair.

6 JUDGE WONG: Thank you, Mr. Touma.

7 I just note for the record that there is no fraud
8 penalty in this case. So there's no -- there's no
9 allegation of any fraudulent intent or what not. So I
10 make that -- note that for the record.

11 MR. TOUMA: Yes, sir.

12 JUDGE WONG: Okay. So I had talked to CDTFA
13 earlier about additional information to be provided with
14 regards to comparable businesses that CDTFA had used to
15 compare Appellant to. I would like to request if CDTFA
16 provide those comps without any confidential taxpayer
17 information that they had used initially.

18 MR. SHARMA: As I stated earlier, we will look
19 into that one. And if we have something, we will
20 definitely provide without revealing any confidential
21 information.

22 JUDGE WONG: Okay. I will give you 30 days for
23 that. Be on the lookout for a post-hearing order for
24 that, and 30 days for Appellant to address those. Okay.

25 MR. SHARMA: Thank you.

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JUDGE WONG: All right. Thank you very much.

All right. So this concludes the hearing. The record is not closed. We're keeping it open. And so be on the lookout for the order.

Okay. All right. We're going to close the oral hearing in this case. The oral hearing in this case is now adjourned.

The next hearing will commence -- oh, sorry. We are taking a recess until 1:00 p.m. when the next hearing will commence at 1:00 p.m.

All right. Thank you to the parties for appearing. Be on the lookout for that order.

Let's go off the record.

Thank you.

(Proceedings adjourned at 11:23 p.m.)

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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 24th day of September, 2024.

ERNALYN M. ALONZO
HEARING REPORTER