OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **AJAY BERI CORPORATION** **dba Subway #23933, 28347, 10108, 10278, and 44266**	OTA Case No. 19095230 CDTFA Case IDs: 238-037, 238-039, 238-040, 238-042, 238-043, 522120[1]

OPINION

Representing the Parties:

For Appellant: David Dunlap Jones, Attorney

For Respondent: Sunny Paley, Attorney
Stephen Smith, Attorney
Kimberly Wilson, Hearing Representative

For Office of Tax Appeals: Corin Saxton, Attorney IV

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Ajay Beri Corporation dba Subway #23933, 28347, 10108, 10278, and 44266 (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[2] denying appellant's respective petitions for redetermination of multiple Notices of Determination (NODs) collectively covering the period January 1, 2003, through December 31, 2010 (liability period), and related claims for refund of criminal restitution payments applied towards these NODs pursuant to R&TC section 7157.[3]

The NOD for the first period (first NOD) is dated December 8, 2017, and covers the period January 1, 2003, through December 31, 2005 (CDTFA Case ID 238-043). The first NOD

[1] The first five Case ID numbers listed replace legacy case numbers previously used by CDTFA during its internal appeals process. The superseded numbers are: 1044905, 1046274, 553937, 1006748, and 1034819. The sixth number listed is a legacy Case ID number because CDTFA did not provide an updated Case ID number.

[2] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts that occurred before July 1, 2017, "CDTFA" refers to the board.

[3] This Opinion uses the term "criminal restitution" to refer to amounts required to be paid pursuant to a restitution order imposed by a court of competent jurisdiction for a criminal offense, and which are due and payable to CDTFA.

is for $314,460.15 in tax, plus applicable interest. In addition, the first NOD includes a fraud penalty of $78,615.07. Absent fraud, the first NOD is untimely.

The NOD for the second period (second NOD), dated October 20, 2010, covers the next portion of the liability period: January 1, 2006, through December 31, 2009 (CDTFA Case ID 238-037). It is for $1,758,108.75 in tax, plus applicable interest. In addition, the second NOD includes two penalties imposed on different portions of the liability period covered by the second NOD: a negligence penalty of $42,343.83 for 2006, and a penalty issued pursuant to R&TC section 6597 (the 40 percent penalty) in the amount of $533,868.33 for the remaining three years covered by second NOD. The second NOD is timely irrespective of a finding of fraud because appellant executed a written waiver allowing CDTFA until October 31, 2010, to issue the second NOD.[4] (See R&TC, § 6488.)

On November 27, 2017, CDTFA asserted an increase to the second NOD of $3,993.07 in tax (which also increased the interest and 40 percent penalty). CDTFA also upgraded the $42,343.83 negligence penalty to a $105,882.44 fraud penalty. Absent fraud, the increase to the second NOD is untimely.[5] The parties dispute whether the Office of Tax Appeals (OTA) has jurisdiction over the amount asserted in the increase to the second NOD. Appellant contends that it does, and CDTFA contends that OTA does not have jurisdiction.[6] OTA will address jurisdiction as a separate issue if necessary for resolution of this appeal.

[4] Absent a waiver, the three-year statute of limitations would have expired for several quarterly reporting periods (i.e., January 1, 2006, through June 30, 2007.)

[5] For ease of analysis, this Opinion adopts the language of CDTFA's decision and refers to this as an increase to the second NOD. In doing so, this Opinion refers to the fact that CDTFA increased the liability; however, this is not intended to refer to a "Notice of Increase." In the case of fraud, there is no statute of limitations for CDTFA to issue either a Notice of Determination or a Notice of Increase. (R&TC, §§ 6487, 6563(a).) In the absence of fraud, CDTFA does not dispute that either document is untimely. In other words, under the facts of this case, it is immaterial for purposes of the timeliness of the notice document whether the underlying notice document was a notice of determination or increase.

The NOD for the third period (third NOD), dated September 5, 2017, covers the final year of the liability period: 2010 (CDTFA Case ID 238-040). The third NOD is for $88,941.12 in tax, plus applicable interest. In addition, the third NOD includes a 40 percent penalty of $35,576.46. Absent fraud, the third NOD is untimely.

The state Attorney General's office charged and criminally prosecuted appellant, appellant's president, A. Beri, and some related entities for tax evasion during the liability period. Appellant and A. Beri both pled guilty to felony tax evasion for the period covered by the third NOD. As part of a plea agreement covering 66 charges for most of the liability period, the Superior Court of California, County of Orange (Court) ordered A. Beri to pay criminal restitution of $3,021,059.00 to CDTFA. (See R&TC, § 7157.) A. Beri's criminal restitution payments satisfied appellant's tax portion of the determined liability in full, excluding the penalties and interest. The criminal restitution payments paid the tax as follows: (1) $314,460.15 towards the first NOD; (2) $1,758,108.75 towards the second NOD, and $3,993.07 towards the increase to the second NOD; (3) and $88,941.12 towards the third NOD.

After satisfying the criminal restitution order, A. Beri requested that his individual felony tax evasion charge be dismissed pursuant to the terms of the plea agreement, which the Court granted. In addition, appellant also timely filed claims for refund with CDTFA for the first NOD (CDTFA Case ID 238-039), the second NOD (CDTFA Case ID 238-037), and the third NOD (CDTFA Case ID 522120), requesting refund of A. Beri's criminal restitution payments on the basis that CDTFA failed to establish fraud and, as such, the NODs are untimely, in full (the first and third NODs) or in part (the increase to the second NOD).[7] The parties also dispute whether

[6] Footnote 31 of CDTFA's decision states that CDTFA asserted an increase to the second NOD pursuant to R&TC section 6563(a)(2). It is undisputed that appellant timely petitioned the second NOD. OTA would have jurisdiction over any increase asserted to the second NOD, due to the timely petition. However, in briefing dated March 9, 2023, CDTFA contends that the November 27, 2017 document is a notice of determination, and not an increase. Furthermore, CDTFA asserts that OTA lacks jurisdiction over the amount asserted pursuant to the notice because appellant did not timely petition the November 27, 2017 document, which is required to appeal a notice of determination. CDTFA incorrectly argues that the November 27, 2017 notice must be a notice of determination because CDTFA was statutorily prohibited from issuing a notice of increase due to expiration of the statute of limitations; however, the plain language of R&TC section 6563(a) expressly states that the statute of limitations to assert an increase does not apply when the fraud penalty is asserted pursuant to R&TC section 6485, and CDTFA's November 27, 2017 notice clearly explains that it is asserting a fraud penalty pursuant to R&TC section 6485. In any event, if the November 27, 2017 notice is a notice of increase, then OTA has jurisdiction; however, if it is a notice of determination then OTA lacks jurisdiction over the notice.

[7] In addition, appellant made three voluntary payments which CDTFA applied to the unpaid penalties in the second NOD pursuant to an Installment Payment Agreement; however, a claim for refund has not been filed in connection with those payments. Thus, OTA does not address those payments herein.

OTA has jurisdiction to address refunds of payments made in connection with the increase to the second NOD.[8] OTA will address jurisdiction as a separate issue if necessary for resolution of this appeal.

This matter was scheduled to be heard before OTA on September 30, 2022. The parties appeared on the scheduled hearing date but, at the start of the hearing, appellant requested to waive the oral hearing and the parties agreed to submit the matter to OTA for resolution based on the written record.[9]

ISSUES

1. Whether OTA has jurisdiction to refund criminal restitution payments.
2. Whether CDTFA timely issued the NODs.[10]
3. Whether appellant established that adjustments are warranted to the determined measure of tax.
4. Whether appellant's court-ordered criminal restitution payments precluded CDTFA from issuing NODs for the reporting periods covered by the plea agreement.

FACTUAL FINDINGS

1. Appellant, a California corporation, was an authorized franchisee of Doctors Associates, Inc. dba Subway (franchisor). During the liability period, appellant operated 21 Subway franchise locations in Southern California. Appellant held a seller's permit effective December 1, 2002, through December 31, 2016. Appellant had two corporate officers: a married couple, consisting of A. Beri (president), and R. Beri (vice-president), who were also the sole shareholders of appellant. The evidentiary record contains no evidence on

[8] It is undisputed that appellant timely filed a refund claim for the second NOD and that OTA has jurisdiction over the refund claim for the second NOD (CDTFA Case ID 238-037). Effective January 1, 2017, it is also not necessary for a taxpayer to file a refund claim for every payment made under a NOD, because the original refund claim is deemed a timely filed claim for all subsequent payments to the NOD. (R&TC, § 6902.6.) Thus, if the November 27, 2017 notice is a notice of increase, then OTA has jurisdiction; however, if it is a notice of determination then OTA lacks jurisdiction over any refund claimed in connection with the notice because appellant did not file any additional refund claims after issuance of that notice.

[9] Administrative Law Judge Daniel Cho presided over the discussions on September 30, 2022. Mr. Cho is no longer an OTA administrative law judge. By letter dated February 10, 2023, OTA notified the parties of a change in composition to the undersigned Panel, which added Judge Josh Lambert to the vacancy on the Panel.

[10] Absent a finding that the NODs are timely, issues 3 and 4 are moot with respect to the first NOD, third NOD, and increase to the second NOD.

the exact percentage ownership that A. Beri or R. Beri held in appellant, respectively, only that the total ownership between the pair is 100 percent.

2. Appellant's Point of Sale (POS) system generated two types of reports: Control Sheets (daily sales reports), which detailed daily sales information, and Weekly Inventory & Sales Receipts (weekly sales reports).
3. Appellant's franchise agreement required it to send the daily and weekly sales reports to the franchisor. The franchisor used these sales reports, in part, to calculate the applicable royalty fees that appellant owed to the franchisor.
4. During the liability period, A. Beri signed and filed appellant's sales and use tax returns as its president. The returns were not signed by a paid preparer.
5. In December 2008, CDTFA began an audit of appellant for the period covered by the second NOD.
6. For audit, appellant provided falsified daily sales reports for the third quarter of 2007 (3Q07). Appellant did not provide source documentation such as cash register Z-tapes.
7. CDTFA determined appellant's daily sales reports were falsified because appellant maintained two sets of books and records: one for reporting sales to its franchisor, and a different one for reporting sales to CDTFA. The first set of records, which appellant submitted to its franchisor, included recorded sales amounts, including sales tax reimbursement collected, that were substantially higher than the recorded sales amounts, including sales tax reimbursement collected, as reflected in the second set of records. Appellant reported sales and use tax returns to CDTFA based on the substantially lower amounts reflected in the second set of records.
8. Upon examination of appellant's computer hard drives, which had been seized by CDTFA in conjunction with law enforcement pursuant to a criminal investigation, CDTFA's forensic investigator determined that the daily data concerning "sales tax" amounts in the second set of records had been modified and replaced with a formula, which multiplied the original "sales tax" amount by a fractional percentage,[11] and which ultimately replaced the original "sales tax" values with the adjusted formula amounts, which were substantially less.

[11] Sales tax totals were listed by item category (e.g., drink sales, etc.) and the percentage applied to each category varied and, in some cases, was as low as 16.01 percent.

9. On December 31, 2009, after being notified of the audit, appellant transferred 16 of its 21 sublocations to related limited liability companies (LLCs) that were also wholly owned by the same individuals: A. Beri and R. Beri.[12] According to CDTFA, this alerted CDTFA because this tactic of breaking up one large entity into many newly formed corporations and LLCs is frequently used by tax evaders as a method to avoid paying tax liabilities and future audits.[13]

10. The evidentiary record contains no evidence documenting the precise percentage ownership that A. Beri or R. Beri respectively held in any of the LLCs which received the 16 Subway franchise locations; however, the total ownership between the pair was 100 percent.

11. The 21 Subway franchise locations that appellant owned on December 30, 2009, had an appraised value of $11,997,000,[14] and consisted of the following:

    1) Subway 28347 (Long Beach Blvd., South Gate, CA), appraised at $497,000.
    2) Subway 10108 (Easter Ave., Bell Gardens, CA), appraised at $706,000.
    3) Subway 27119 (Gaffey Street, San Pedro, CA), appraised at $427,000.
    4) Subway 23933 (Atlantic Blvd., Bell, CA), appraised at $676,000.
    5) Subway 10278 (Rosecrans Ave., La Mirada, CA), appraised at $709,000.
    6) Subway 36047 (E. Florence Ave., Los Angeles, CA), appraised at $720,000.
    7) Subway 22927 (Beach Blvd, La Mirada, CA), appraised at $312,000.
    8) Subway 2131 (W. Artesia, Lawndale, CA), appraised at $525,000.
    9) Subway 10122 (Painter Ave., Whittier, CA), appraised at $740,000.
    10) Subway 2637 (Imperial Hwy., Downey, CA), appraised at $725,000.
    11) Subway 2234 (7th St., La Puente, CA), appraised at $405,000.
    12) Subway 682 (Telegraph Rd, Whittier, CA) appraised at $675,000.[15]

[12] The ownership structure is attached as an exhibit to CDTFA's fraud memo, which CDTFA attached as Exhibit A.

[13] Eight appeals involving the other related entities and similar issues are currently pending before OTA. In addition, there are additional appeals pending for other periods and issues.

[14] The appraised values are listed in a document titled "Personal Financial Statement for Subway" which CDTFA obtained from appellant and submitted as its own exhibit for the instant appeal. There is no appraisal date in the record.

[15] This is also listed as: Telegraph Rd. #A. The store number is the same under both listings.

13) Subway 44031 (E. Imperial Hwy, Los Angeles, CA) appraised at $562,500.
14) Subway 44267 (W. Imperial Hwy, Los Angeles, CA) appraised at $676,000.
15) Subway 43706 (W. Florence Ave., Los Angeles, CA) appraised at $585,000.
16) Subway 43295 (Gage Ave., Bell Gardens, CA) appraised at $585,000.
17) Subway 42059 (South Broadway, Los Angeles, CA) appraised at $585,000.
18) Subway 40374 (E. Florence Ave., Los Angeles, CA) appraised at $675,000.
19) Subway 44266 (Imperial Hwy, Southgate, CA) appraised at $450,000.
20) Subway 28346 (Sepulveda Blvd., West Carson, CA) appraised at $312,000.
21) Subway 46383 (W. Florence Ave., Los Angeles, CA) appraised at $450,000.

12. On December 31, 2009, appellant transferred Subway locations 27119, 36047, 2131, and 682 (items 3, 6, 8, and 12, above), with an appraised value of $2,347,000 to Beri Enterprises, LLC, an entity wholly owned and controlled by the same individuals as appellant (A. Beri and R. Beri). This transfer represented 19.6 percent of the assets of appellant as of December 30, 2009 (the day before the transfer).

13. On December 31, 2009, appellant transferred Subway locations 22927, 10122, 2637, and 2234 (items 7, 9, 10, and 11, above), with an appraised value of $2,182,000 to Beri Development, LLC, an entity wholly owned and controlled by the same individuals as appellant. This transfer represented 18.2 percent of the assets of appellant as of December 30, 2009.

14. On December 31, 2009, appellant transferred Subway locations 44031, 43706, 43295, and 42059 (items 13, 15, 16, and 17, above) with an appraised value of $2,317,000 to Beri Ventures, LLC, an entity wholly owned and controlled by the same individuals as appellant. This transfer represented 19.3 percent of the assets of appellant as of December 30, 2009.

15. On December 31, 2009, appellant transferred Subway locations 44267, 40374, 28346, and 46383 (items 14, 18, 20, and 21, above), with an appraised value of $2,113,000 to Reliance Restaurants, LLC, an entity wholly owned and controlled by the same individuals as appellant. This transfer represented 17.6 percent of the assets of appellant as of December 30, 2009.

16. In total, in possibly four or more separate transactions,[16] appellant transferred 74.7 percent (i.e., 19.6, 18.2, 19.3, and 17.6 percent) of its assets to four separate LLCs under the same ownership as appellant.

17. Appellant's daily sales reports for 3Q07 disclosed a taxable sales percentage of only 23.8 percent, which CDTFA considered low for this type of business. CDTFA informed appellant that CDTFA was going to perform a one-day observation test, to verify the taxable percentage. However, during the observation test, CDTFA found it unusual that the same customers made purchases at different locations, and that the observed taxable percentage, and sales data, bore no relationship to the recorded data in the sales reports.

18. Ultimately, CDTFA was unable to use the data from the observation test. Based on a forensic analysis of a cellular telephone (cell phone) that CDTFA, in conjunction with law enforcement, subsequently seized from appellant's president, CDTFA discovered that appellant had intentionally interfered with CDTFA's observation test in order to influence the audit results in appellant's favor. CDTFA's forensic examination of the cell phone revealed text messages from A. Beri instructing appellant's employees to disguise themselves as customers and to make purchases of nontaxable items during the time that CDTFA was conducting an observation test at the Subway locations to determine the taxable percentage. For example, appellant's president sent the following text to multiple employees on February 22, 2010, prior to the observation test:

> "Just want to give you another advance notice on observation for Subway on Rosecrans and La Mirada. It will be tomorrow night (5pm-10pm) and Thursday (9am to 5 pm) can you personally line up 7 different people for each day. I will be coordinating the whole thing."

19. CDTFA also discovered text messages showing that A. Beri monitored the number of nontaxable sales made during the observation test, apparently with the intention of deflating the taxable sales ratio so it would more closely align with the reduced taxable

[16] Appellant did not provide the transfer document(s). As such, it is unclear whether the December 31, 2009 reorganization occurred through the use of 16, 4, 1, or some other number of separate and distinct transfers.

ratios contained in the falsified set of records that appellant used to report sales and use tax returns to CDTFA.[17]

20. CDTFA contacted appellant's franchisor and obtained appellant's sales and sales tax information for 2007 through 2009. CDTFA compiled audited taxable sales using this data.

21. In an audit report dated September 15, 2010, CDTFA identified an aggregate deficiency measure of $20,595,413. This liability represents unreported taxable sales based on the franchisor's information, and sales tax asserted in connection with the transfer of the Subway franchise locations to separate entities owned and controlled by appellant's president and vice president.[18]

22. On October 20, 2010, CDTFA issued an NOD to appellant for the liability disclosed by audit. Appellant timely petitioned the NOD.

23. On June 23, 2011, CDTFA, in conjunction with law enforcement, executed a search warrant at various locations associated with appellant and its owners and officers.[19]

24. CDTFA obtained appellant's daily and weekly sales reports for the period January 1, 2003, through December 31, 2010, from the franchisor pursuant to the search warrant.

25. CDTFA's forensic examination of seized computer hard drives disclosed detailed financial statements, including an income and expense analysis for 2007 through 2009 that compiled sales data for all but one of appellant's locations. The amounts listed on the income and expense analysis closely reconciled with the data obtained from the

[17] For example, on February 23, 2010, A. Beri texted an employee, "Let me know when you get done with your people . . . I'm monitoring numbers to make sure we are within the range."

[18] The fourth audit item consists of unreported taxable sales of fixed assets of $972,000, in connection with the transfer of business sublocations. To calculate the taxable sales of assets arising out of this transfer, CDTFA used an average estimated equipment setup cost of $60,750 per Subway restaurant, multiplied by 16 franchise locations transferred on December 21, 2009, to compute unreported taxable sales of fixed assets of $972,000.

[19] The following locations were searched: all the Subway franchise locations owned by appellant at the start of the audit (including those transferred to other entities during the audit); appellant's franchisor; the office of appellant's accountant; the residence of appellant's bookkeeper, A. Avina; a storage unit containing business records; Bank of America, where appellant maintained a bank account; and the residences and offices of appellant's two corporate officers, A. Beri and R. Beri. As a result of these searches, additional search warrants were obtained which resulted in the additional seizure of computers, a cell phone belonging to A. Beri, and over 400 boxes of records.

franchisor, except for one important difference: the sales tax reimbursement collected substantially exceeds the sales tax appellant reported to CDTFA.

26. CDTFA also found the second set of records containing electronic files of appellant's daily sales reports, in which the sales tax computation was overridden to show a lesser amount (discussed above). Some of the seized documents had the word "modified taxable" in the name of the file for the second set of sales and use tax records.

27. CDTFA also seized copies of sales and use tax returns and accompanying sales tax worksheets for appellant and some of appellant's related LLCs. Appellant's 2Q10 sales and use tax return and worksheet showed sales tax amounts substantially lower than the sales tax listed on the daily and weekly sales reports obtained from the franchisor, despite the fact that all other data on the seized worksheets matched that of the franchisor's daily and weekly sales reports. Additionally, CDTFA noted that some seized sales tax worksheets for other entities contain a reduced sales tax amount compared to the amount listed in an attachment to the worksheet (which contained the correct amount), and the worksheet also contained handwritten notations such as: "Ok per 11 am meeting on 01-27-11." In another example, a draft sales tax worksheet indicated a taxable sales ratio of 58 percent;[20] however, a handwritten notation on the draft sales tax worksheet states, "For [A. Beri] to Review" and "Per [A. Beri] ~ 46% Taxable ~ 54% Non taxable."

28. As a result of the criminal investigation, appellant and its president, A. Beri, were charged with 66 criminal counts including tax evasion allegedly occurring during the period January 1, 2007, through December 31, 2010.[21]

29. On November 1, 2016, A. Beri as an individual, and R. Beri on behalf of appellant, executed a plea agreement. A. Beri and appellant both agreed to plead guilty to tax evasion (Count 63) for filing false sales and use tax returns for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the tax due. This charge was punishable as a felony or misdemeanor.[22]

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[20] The draft worksheet lists sales net of tax of $47,000.09 and taxable sales of $27,340.10.

[21] CDTFA's exhibits indicate that appellant was not charged for earlier periods because the statute of limitations to initiate a criminal proceeding had lapsed. (See R&TC, § 7154.)

[22] A. Beri pled guilty to a misdemeanor, and appellant pled guilty to a felony.

30. As part of the plea agreement, A. Beri also pled guilty to Count 65 (felony tax evasion), which charged A. Beri with unlawfully filing false or fraudulent sales and use tax returns for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the tax due, in the amount of $25,000 or more.

31. A. Beri signed the plea agreement in the case against appellant and A. Beri under penalty of perjury, and asserted that "I declare under penalty of perjury everything on this form is true and correct. I understand the signing and filing of this form is conclusive evidence I have pled guilty to the charges listed." The plea agreement incorporates by reference the plea addendum, and the plea addendum for A. Beri and appellant lists the charges to which A. Beri and appellant, respectively, pled guilty. The plea addendum is also signed by A. Beri and a representative for appellant.

32. During and for the purposes of the criminal proceedings, CDTFA identified, in pertinent part, unpaid tax that appellant owed to CDTFA for the period January 1, 2003, through December 31, 2010, excluding interest and penalties, of $1,842,078. The total amount of restitution identified by CDTFA for five related entities, including appellant, was $3,021,059 in unpaid tax, excluding interest and penalties.[23]

33. As part of the criminal matter, A. Beri was ordered to pay criminal restitution to CDTFA. The plea agreement specified that the restitution represents unpaid sales tax for the years charged (2007 to 2010).

34. The plea agreement, paragraph 25(f), required A. Beri to "pay restitution on counts 1 – 66, even if any of these counts have been dismissed as part of a plea agreement, in the amount of $3,021,059." As part of the plea agreement, A. Beri also agreed to a sentence of 270 days in county jail. The plea agreement also set forth provisions for delayed sentencing on the felony tax evasion guilty plea, and it specified that delayed sentencing would be conditioned upon timely payment of the $3,021,059 in criminal restitution to the state prosecutor within 18 months of the guilty plea.

35. During sentencing, a freeze order was placed upon A. Beri's assets until such time as the criminal restitution was paid in full. The plea agreement included a provision that required the prosecutor to dismiss A. Beri's felony tax evasion charge upon timely

[23] The breakdown of the claimed criminal tax restitution was as follows: (1) appellant, $1,842,078; (2) B&L Diners, Inc. dba Denny's, $229,670; (3) Beri Restaurants Group, Inc., dba Subway, $760,281; (4) Beri Foods Group, Inc., dba Subway, $153,693; and (5) Delco Enterprises, Inc., dba Del Taco $35,337.

payment of the criminal restitution. The plea agreement did not contain any language addressing dismissal of A. Beri's misdemeanor tax evasion charge, or appellant's felony tax evasion charge.

36. A. Beri timely paid the $3,021,059 in court-ordered criminal restitution during the period November 1, 2016, through March 8, 2017. The Attorney General's office remitted the restitution payments to CDTFA.

37. On May 1, 2017, appellant timely filed a claim for refund of the criminal restitution payments.

38. On September 5, 2017, November 27, 2017, and December 8, 2017, respectively, which was after the criminal restitution payments were paid to the State of California, CDTFA issued the first and third NODs to appellant, and asserted an increase to the second NOD.

39. CDTFA subsequently applied $2,165,503.09 out of $3,021,059 of the criminal restitution towards the first, second (as increased), and third NODs, and these payments are the subject of the refund claims.[24] Appellant filed additional refund claims for these payments on December 12, 2017.

40. The liabilities asserted in the first and third NODs, dated September 5, 2017, and December 8, 2017, were calculated based on the weekly sales reports that CDTFA seized from the franchisor. The November 27, 2017 increase to the second NOD was based on the weekly sales reports that appellant seized from the franchisor pursuant to the search warrant. In addition, for periods for which the weekly sales reports documented the amount of sales tax reimbursement appellant collected from customers but did not remit to CDTFA, CDTFA upgraded the negligence penalty to a 40 percent penalty.

41. On August 15, 2019, CDTFA issued a decision denying appellant's petitions and related refund claims. This timely appeal followed.

42. After timely paying the required criminal restitution, A. Beri requested dismissal of the felony tax evasion charge, which request was granted pursuant to the terms of the plea agreement.[25]

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[24] The remaining payments were applied towards the unpaid liabilities of related entities under the same ownership as appellant and are not at issue in this appeal.

[25] The evidentiary record does not contain documentation regarding the dismissal of A. Beri's felony charge; however, CDTFA's decision acknowledges that it was dismissed, and therefore this is listed here as an undisputed fact.

DISCUSSION

Issue 1: Whether OTA has jurisdiction to refund criminal restitution payments.

CDTFA contends that OTA lacks jurisdiction to order a refund of criminal restitution payments, therefore "the restitution payments made by [appellant] as part of the criminal plea agreement and applied against the amounts [owed] to CDTFA are not refundable, regardless of the timeliness of the corresponding claims for refund."

R&TC section 6901 provides authority for CDTFA to refund any amount of tax, interest, or penalty which was not required to be paid. (R&TC, § 6901(a)(1).) R&TC section 7157 provides that "Notwithstanding Chapter 7 (commencing with Section 6901), a refund or credit shall not be allowed for any amounts paid or payments applied" pursuant to a restitution order or any other amounts imposed by a court of competent jurisdiction for criminal offenses upon a person or any other entity and paid to CDTFA. (R&TC, § 7157(a)(1), (c).)

R&TC section 6487 generally provides a three-year statute of limitations for CDTFA to issue a deficiency determination, absent fraud. OTA has jurisdiction to resolve an appeal of a CDTFA decision on a claim for refund. (Gov Code, § 15672; Cal. Code Regs., tit. 18, § 30103(b).) In this case, it is undisputed that, absent fraud, the first and third NODs, and the increase to the second NOD, would be untimely and, as such, the amounts of tax, interest, and penalties determined pursuant to those NODs would constitute an amount that is not required to be paid within the meaning of R&TC section 6901(a)(1).)

Pursuant to a plea agreement between appellant, appellant's president, and the Attorney General's office, the Court ordered that criminal restitution be paid to the prosecutor's office and remitted to CDTFA. This order was given prior to CDTFA issuing the NODs at issue. Appellant's president received deferred sentencing on his felony tax evasion plea contingent upon payment in full of the restitution within 18 months from the date of his guilty plea, which otherwise would have imposed a jail term of 270 days. A. Beri ultimately received dismissal of that charge after the required payments were made. It is undisputed that CDTFA applied $2,165,503.09 of the criminal restitution payments towards appellant's tax liabilities. It is further undisputed that appellant requests a refund for these payments pursuant to R&TC section 6901 on the basis that CDTFA was barred by statute from issuing the first and third NOD, and the increase to the second NOD. Appellant contends that the criminal restitution was ultimately applied to time-barred deficiencies. Based on the above facts, OTA is prohibited by

R&TC section 7157 from granting a refund for any payment made on behalf of appellant which was satisfied, in full or part, out of the $3,021,059 criminal restitution proceeds. This is true even if OTA ultimately finds that the NODs are untimely, or the amounts are not otherwise required to be paid.

Based on the finding that OTA is barred by statute from issuing a refund for the payments at issue in this appeal, the remaining issues (issues 2, 3 and 4) shall only address appellant's petitions of the NODs (i.e., appellant's liability for additional amounts *in excess of* the amounts already paid pursuant to the criminal restitution payments). OTA will not further address any of appellant's refund claims.[26]

Issue 2: Whether CDTFA timely issued the NODs.

As relevant here, R&TC section 6487(a) provides that except in the case of fraud or intent to evade, every NOD shall be mailed within three years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined or within three years after the return is filed, whichever period expires the later. It is undisputed that the second NOD is the only NOD that was timely issued within the generally applicable three-year statute of limitations period or waiver period. In other words, absent a finding of fraud during each of the respective quarterly reporting periods covered by the remaining determinations, the remaining NODs are untimely.[27]

R&TC section 6485 further provides that if any part of the deficiency for which a deficiency determination is made is due to fraud or an intent to evade the Sales and Use Tax Law or authorized rules and regulations, a penalty of 25 percent of the amount of the determination shall be added thereto. Fraud or intent to evade must be established by clear and convincing evidence. (*Appeal of ISIF Madfish Inc.*, 2019-OTA-292P.) The express language of R&TC section 6485 makes it clear that a fraud penalty applies to the entire deficiency determination "if any part" of the NOD is due to fraud.

[26] In reaching this conclusion OTA need not, and does not, make any finding on the timeliness of appellant's refund claims. OTA also need not address the issue of jurisdiction and whether there was a valid refund claim filed for payments made towards the increase to the second NOD.

[27] Appellant reported on a quarterly basis. Thus, the plain language of this statute indicates that the three-year statute of limitations applies to each reporting period covered by a determination. R&TC section 6487(b) contains a similar limitations period for annual filers.

The R&TC does not define fraud, but there are federal precedents that provide guidance. For example, fraud may be proved by direct or circumstantial evidence. (*Appeal of ISIF Madfish Inc., supra*.) Circumstantial evidence of fraud may include the understatement of income, inadequate records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealment of assets, failure to cooperate with tax authorities, and lack of credibility in the taxpayer's testimony. (*Ibid*.) While the mere omission of reportable income is not of itself sufficient to warrant finding of fraud, repeated understatements in successive years, coupled with other circumstances showing intent to conceal or misstate taxable income, present a basis for a fraud finding. (*Ibid*.)

The Third NOD

The third NOD covers the period January 1, 2010, through December 31, 2010. As part of a plea agreement in the case of *People v. Ajay Beri, et. al*., Court Case No. 16CF1378, appellant pled guilty to felony "tax evasion" for "unlawfully fil[ing] false or fraudulent sales tax returns for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the reporting, assessment, or payment of a tax or an amount due required by law to be made . . . in violation of [R&TC] sections 7152, subdivision (a) and 7153.5, a felony." R&TC section 7153.5 provides, in pertinent part, that any person who violates the Sales and Use Tax Law with the intent to defeat or evade the reporting, assessment, or payment of a tax or an amount due required by law to be made is guilty of a felony when the underreporting exceeds $25,000.00 during any 12-month period. As relevant to the third NOD, which asserts $88,941.12 in tax during a 12-month period, both the fraud penalty imposed by R&TC section 6485 and criminal fraud in R&TC section 7153.5 apply in the context of tax evasion (i.e., intent to evade the tax).

Numerous federal courts have held that a conviction for federal income tax evasion, either upon a plea of guilty, or upon a jury verdict of guilt, conclusively establishes fraud in a subsequent civil tax fraud proceeding. (*Fontneau v. United States* (1st Cir. 1981) 654 F.2d 8, 10 [guilty plea]; *Moore v. United States* (4th Cir. 1965) 360 F.2d 353, 355-356 [conviction following trial]; *Amos v. Commissioner* (4th Cir. 1965) 360 F.2d 358; *Tomlinson v. Lefkowitz* (5 Cir. 1964) 334 F.2d 262, 264-265 [conviction following trial]; *Gray v. Commissioner* (6th Cir. 1983) 708 F.2d 243, 246 [guilty plea]; *Plunkett v. Commissioner* (7th Cir. 1972) 465 F.2d 299,

305-307 [guilty plea]; *Considine v. United States* (9th Cir. 1982) 683 F.2d 1285, 1287; *Armstrong v. United States* (Ct.Cl. 1965) 354 F.2d 274, 291 [conviction following trial].)

As correctly stated by the State Board of Equalization (board), "the California Courts have not determined, in a tax case, whether a plea of guilty in a prior criminal action will work a collateral estoppel in a subsequent civil proceeding." (*Appeal of Erilane* (74-SBE-050) 1974 WL 2866, summarizing *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd.* (1962) 58 C.2d 601.) Nevertheless, the California Supreme Court concluded that a guilty plea in a non-tax criminal proceeding is admissible as a party admission in a civil proceeding. (See *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., supra*, 58 C.2d at p. 607 [plea of guilty in a non-tax criminal matter does not create collateral estoppel in a non-tax civil action].) OTA believes this same logic applies to a tax appeal.[28]

OTA's Rules for Tax Appeals provide that the Panel may use the California rules of evidence when evaluating the weight to give evidence presented in a proceeding before OTA. (Cal. Code Regs., tit. 18, § 30214(f).) Consistent with all the above, OTA believes that, while a plea of guilty to felony tax evasion does not conclusively establish fraud in a California appeal under the Sales and Use Tax Law (i.e., collateral estoppel does not apply to such an appeal), an admission, under penalty of perjury, to tax evasion is highly persuasive and direct evidence of fraud in a tax proceeding before OTA. (See, e.g., *Appeal of Erilane, supra,* [guilty plea for failing to file a return in a Franchise and Income Tax Appeal under the board's Rules for Tax Appeals is not collateral estoppel].[29]) In other words, in this case appellant has admitted under penalty of perjury that appellant intended to evade the payment of tax for 2010. This is highly persuasive and direct evidence of fraud.

Given this conclusion that a guilty plea to tax evasion is highly persuasive, direct, evidence of tax evasion, the next question is the weight that OTA will give to an admission to tax evasion under OTA's Rules for Tax Appeals. The board, in a precedential decision, addressed this question in a Franchise and Income Tax Appeal under the board's Rules for Tax Appeals.

[28] This Opinion uses the term "OTA" to refer to the position of the majority of this Panel; however, there is a concurring Opinion which expresses a different position from the majority in that it declines to follow the board's precedential decision in *Appeal of Erilane, supra.*

[29] This case is not directly on point because the board's Rules for Tax Appeals do not contain a provision comparable to California Code of Regulations, title 18, section 30214(f), which allows the Panel to consider the California Evidence Code in determining the weight to afford evidence. In addition, the nature of the penalty (failure to file) is different.

(See, e.g., *Appeal of Chow* (86-SBE-130) 1986 WL 22796, [citing *Appeal of Erilane*, *supra*, for the proposition that "a prior guilty plea operates as an admission against interest which, by itself, can justify a fraud penalty if not adequately explained away by the taxpayer."]) In other words, the board, applying *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., supra,* concluded that a guilty plea is sufficient, by itself, to sustain fraud. (*Ibid*.) OTA will also apply this standard under its own Rules for Tax Appeals. As such, applying *Appeal of Chow*, *supra,* OTA finds that appellant's admission to tax evasion is, absent evidence to the contrary, sufficient in and of itself for CDTFA to meet its burden of establishing tax evasion by clear and convincing evidence, and to sustain imposition of a fraud penalty for the period covered by the guilty plea.

Appellant questions the admissibility and reliability of its admission to tax evasion considering the dismissal of the felony tax evasion charge against its president, A. Beri. Appellant further contends that there are reasons for entering into a plea agreement other than guilt, such as financial considerations, risk of imprisonment, and the emotional toll of a criminal proceeding. First, OTA's Rules for Tax Appeals provide that all relevant evidence is admissible, so OTA may consider this evidence. (Cal. Code Regs., tit. 18, § 30214(f).) However, here, appellant seeks to refocus the analysis on a red herring because appellant separately pled guilty to tax evasion. Thus, as a preliminary matter, for purposes of an administrative appeal before OTA, OTA does not find it material or relevant that the plea agreement contemplated the dismissal of *A. Beri's* felony tax evasion charge contingent upon A. Beri's payment of criminal restitution to CDTFA, or that *A. Beri's* felony charge was later dismissed consistent with that agreement.[30] It is sufficient to establish tax evasion by appellant that *appellant* pled guilty to tax evasion. Thus, *A. Beri's* plea of guilty to tax evasion, both as a felony and as a misdemeanor,[31] is additional, relevant, and direct evidence of appellant's tax evasion. Furthermore, there is no evidence in the record to contradict A. Beri's guilty plea. However, here, appellant itself pled guilty to felony tax evasion and so this Opinion focuses first on the effect of appellant's admission to felony tax evasion.

[30] As noted in Factual Finding # 34, *supra*, the terms of the plea agreement specify the state Attorney General's office would move for dismissal of A. Beri's felony tax evasion charge (count 65). The plea agreement contains no language regarding dismissal of appellant's felony tax evasion charge (count 63) or of A. Beri's misdemeanor tax evasion charge (count 63), and appellant does not contend that its own felony tax evasion charge was dismissed.

[31] For both the felony and the misdemeanor count, A. Beri pled guilty to violating R&TC section 7153.5, the same section that appellant pled guilty to violating.

Here, appellant pled guilty to felony tax evasion, and appellant's felony tax evasion charge (count 65) was never dismissed. Similarly, A. Beri's other felony tax evasion charge (count 63; the one he pled guilty to as a misdemeanor) was also not dismissed. Furthermore, pursuant to California Code of Regulations, title 18, section 30214(f)(1), all relevant evidence is admissible; so appellant's guilty plea to felony tax evasion, and its president's guilty plea to tax evasion both as a felony and as a misdemeanor, whether viewed individually or taken together, are admissible as direct and compelling evidence of fraud.[32]

Furthermore, additional direct evidence of fraud, which is consistent with the guilty plea, includes appellant's maintenance of a falsified set of sales tax records, appellant's active interference with CDTFA's audit process to reduce the taxable sales ratio as demonstrated by text messages that A. Beri sent to appellant's employees, the custom formulas which appellant added to artificially deflate sales tax, and (as discussed below) the demonstrated pattern of fraudulent activities which consistently extended throughout the reporting periods covered by all three NODs. Here, for calendar year 2010, appellant reported taxable sales of $1,134,888, and the daily and weekly sales reports established sales tax reimbursement collected on sales of $2,015,755. Based on all the above, there is ample direct evidence of fraud, and appellant failed to establish any evidence to the contrary.

In summary, OTA finds that appellant's guilty plea to felony tax evasion is direct and compelling evidence of fraud. In addition, appellant's admission to tax evasion for the period at issue (calendar year 2010) is supported by other direct and contemporaneous evidence of fraud, and appellant failed to provide evidence to the contrary, such as evidence that would cause us to question the validity of appellant's guilty plea to felony tax evasion. (See *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., supra*, 58 C.2d at p. 607.) Under these facts, there is ample evidence to sustain the fraud finding. As such, CDTFA timely issued the third NOD.

[32] Appellant pled guilty to felony tax evasion, and A. Beri pled guilty to it (an offense punishable as a felony) both as a misdemeanor (count 63) and as a felony (count 65). A plea of "no contest" to a misdemeanor may not be used against a defendant in a civil proceeding based upon the act on which the criminal prosecution is based. (Pen. Code, § 1016(3).) However, a plea of no contest to an offense punishable as a felony, regardless of whether it is ultimately punished as such, is admissible as a party admission in a civil action based upon the act on which the criminal prosecution is based. (*Rusheen v. Drews* (2002) 99 Cal.App.4th 279, 288.) These evidentiary limitations are not applicable in an administrative proceeding before OTA because all evidence is admissible. Nevertheless, OTA may consider the rules of evidence in determining the weight to give evidence presented in a proceeding before OTA. (Cal. Code Regs., tit. 18, § 30214(f).)

The Second NOD

The second NOD covers the period January 1, 2006, through December 31, 2009. At the start of the audit, appellant furnished a falsified set of records for the third quarter of 2007 to hide its true gross receipts from CDTFA. When CDTFA attempted to verify the accuracy of these records, appellant directed its employees to disguise themselves as customers and purchase nontaxable food items during CDTFA's observation test for the purpose of artificially deflating appellant's taxable sales ratio for the period covered by the second NOD. Nevertheless, appellant also maintained records of its true sales and reported the correct sales figures to its franchisor, including sales tax reimbursement collected from customers. For sales reported to CDTFA, appellant modified its sales reports to insert a formula which suppressed the true and correct "sales tax" amounts by applying a fractional percentage. Appellant also maintained sales tax worksheets with handwritten notes for this period demonstrating that appellant's president was personally involved in falsifying the reported taxable sales on appellant's sales and use tax returns. During this period, appellant reported $703,341 in sales tax to CDTFA, even though its legitimate records (as reported to its franchisor) established sales tax due (and collected) of $1,762,101. In other words, appellant reported only 40 percent of its sales tax liabilities to CDTFA. Under these facts, OTA finds that CDTFA established by clear and convincing evidence a consistent pattern of activity demonstrating fraud or an intent to evade the payment of sales tax for the entirety of the period covered by the second NOD.

The First NOD

The first NOD covers the period January 1, 2003, through December 31, 2005. Based on records seized by CDTFA, in conjunction with law enforcement, pursuant to a search warrant, CDTFA discovered that the fraudulent reporting activities covered by the second and third NOD, had extended back in time to earlier reporting periods. CDTFA obtained appellant's daily and weekly sales reports for the period January 1, 2003, through December 31, 2010, from the franchisor pursuant to the search warrant and calculated the liability based on that information. Appellant reported sales tax of $128,505 for this period, and the daily and weekly sales reports established a liability of $314,460.15 in tax. As with the second NOD, appellant only reported 40 percent of its sales tax liabilities to the CDTFA. Based on the direct and compelling evidence of fraud and the demonstrated pattern of fraudulent activities which consistently extended

throughout the reporting periods covered by all three NODs, as supported by appellant's own admission, under penalty of perjury, that these same types of activities constituted felony tax evasion during 2010, CDTFA established fraud by clear and convincing evidence for all periods at issue in this appeal.

In rebuttal, appellant argues that it did not maintain a second set of books and records. Appellant separately asks that the second set of books and records that CDTFA seized through the search warrants in the criminal matter be excluded from the evidentiary record in the instant appeal because it was obtained without appellant's permission. OTA finds these arguments unpersuasive. Subject to limited exceptions which are not pertinent here, there is no authority for excluding records seized pursuant to a valid search warrant in an appeal before OTA.[33] As pertinent to this appeal, all relevant evidence is admissible. (Cal. Code Regs., tit. 18, § 30214(f).) Furthermore, CDTFA may base its determination on any information in its possession. (R&TC, § 6481.) Appellant's falsified sales tax records are admissible on the basis they are relevant to establishing fraud, regardless of whether they were seized without appellant's consent, or that the underlying criminal matter was ultimately dismissed pursuant to a plea agreement. As such, OTA has no basis to exclude the set of falsified records from the evidentiary record. These records are evidence of fraud.

In summary, CDTFA established fraud or an intent to evade the payment of tax by clear and convincing evidence. Therefore, CDTFA timely issued all the NODs at issue in this appeal.

Issue 3: Whether appellant established that adjustments are warranted to the determined measure of tax.

Appellant makes two arguments concerning the deficiency measures: Appellant argues that its transfer(s) of the 16 Subway franchise locations to four different entities qualify as an exempt occasional sale. Appellant also contends that the liability for unreported taxable sales based on appellant's sales reports furnished to CDTFA by the franchisor is overstated. Appellant contends that the evidence seized pursuant to the search warrant is unreliable and inadmissible as evidence because it was obtained without appellant's permission.

[33] OTA will not admit evidence it finds to be privileged or any evidence when its probative value will be substantially outweighed by the probability that its admission will necessitate undue consumption of time. (Cal. Code Regs., tit. 18, § 30214(f).) Neither of these grounds is present here.

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

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid upon the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Amaya*, 2021-OTA-328P.) If CDTFA carries its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Appeal of Amaya, supra*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

The Occasional Sale Exemption

When a person sells a business that is required to hold a seller's permit, tax generally applies to the gross receipts from the retail sale of tangible personal property held or used by that business in the course of its activities requiring the holding of the seller's permit. (Cal. Code Regs., tit. 18, § 1595(b)(1).) In such circumstances, the gross receipts from the sale of the business include all consideration received by the transferor, including cash, notes, and any other property as well as any indebtedness assumed by the transferee. (Cal. Code Regs., tit. 18, § 1595(b)(1).) As an exception, occasional sales are exempt from tax. (R&TC, § 6367.) To qualify for the exemption, two tests must be met: (1) all or substantially all the property held or used by the person must be transferred and (2) after the transfer the real or ultimate ownership of the property is substantially similar to that which existed before the transfer. (R&TC, § 6006.5(b); Cal. Code Regs., tit. 18, § 1595(b)(2).)

With respect to the first test, substantially all the property means 80 percent or more of all the tangible personal property held or used by the person in the course of activities requiring the holding of a seller's permit. (Cal. Code Regs., tit. 18, § 1595(b)(2).)

With respect to the second test, stockholders holding an ownership interest in the corporation or other entity are regarded as having the real or ultimate ownership of the property. (Cal. Code Regs., tit. 18, § 1595(b)(2).) A simultaneous transfer of all or substantially all the assets to more than one entity may qualify under the second test. (Cal. Code Regs., tit. 18, § 1595(b)(2).) However, if there are multiple non-simultaneous transfers, then each transfer must be examined independently. (See Cal. Code Regs., tit. 18, § 1595(b)(2).) As with the first test, the real or ultimate ownership is substantially similar if 80 percent or more of that ownership of the tangible personal property is unchanged after the transfer. (Cal. Code Regs., tit. 18, § 1595(b)(2).)

Here, the parties dispute whether the exemption applies. Appellant bears the burden of establishing that all elements to the exemption are met, in order to establish that tax does not apply to its gross receipts from the transfer of the business. (R&TC, § 6091; *Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 766, 769.) Therefore, for purposes of providing a complete legal analysis, OTA addresses each element required to claim the disallowed exemption.[34] With respect to the requirement for substantially similar ownership before and after the transfer, it is undisputed that A. Beri and R. Beri were the sole shareholders of appellant, and the sole owners of all the LLCs receiving the asset transfers. Nevertheless, there is no evidence in the record to show what respective percentage of ownership A. Beri and R. Beri held in any entity. Thus, for example, there is no evidence to show whether R. Beri held 90 percent or 10 percent ownership in any entity. As such, appellant failed to establish that the ownership of any of the receiving LLCs (i.e., Beri Enterprises, LLC, Beri Development, LLC, Beri Ventures, LLC, or Reliance Restaurant, LLC) was substantially similar to appellant's

[34] The concurrence asks that the majority decline to address one of the elements required to claim the exemption on the basis that CDTFA's Investigation's and Special Operations Bureau (ISOB) did not question whether one of the required elements had been met during the internal appeal before CDTFA. Nevertheless, OTA is required to apply the law, and the law requires that the taxpayer establish all elements required to claim an exemption; thus, this Opinion addresses all elements required to claim the disallowed and disputed exemption.

ownership. For that matter, the record also does not show A. Beri's or R. Beri's ownership interest in appellant.[35]

Even if appellant satisfied the first test, the second requirement is that appellant must transfer all or substantially all the assets of its business. Here, appellant did not provide evidence from which to value the tangible personal property. Appellant also failed to provide documents regarding the transfer of the assets. However, CDTFA provided appraised values for the 16 restaurants transferred, which is the best available evidence.[36] In absence of any contemporaneous written evidence documenting the transfers, aside from CDTFA's appraised values,[37] there is no basis to conclude what occurred qualified as one "simultaneous" transfer of 16 Subway franchise locations; as opposed, for example, four separate transfers each transferring four Subway franchisees; or for that matter 16 separate transfers each involving 1 Subway franchise. Furthermore, even if appellant could show it made one simultaneous transfer of 16 Subway franchise locations, appellant only transferred 74.7 percent of its assets on December 31, 2009, which is below the 80 percent threshold required to claim the exemption.

Ultimately, appellant failed to provide documentation to show there was a simultaneous transfer of 16 Subway franchise locations involving at least 80 percent of appellant's tangible personal property used in the business. The fact that all the transfers occurred on December 31, 2009, does not make what occurred a "simultaneous" transaction. One transfer could have occurred at 8 a.m., and another occurred as an afterthought at 9 p.m. via a separate written agreement. Without evidence, OTA cannot conclude otherwise. This is why appellant

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[35] Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in this state is community property. (Fam. Code, § 760.) Nevertheless, OTA cannot conclude that because A. and R. Beri are married that the Subway franchise locations are community property, and if so, guess their percentage ownerships. There is no evidence to show whether the property was acquired before or during marriage, or whether there is a prenuptial agreement covering the restaurants, or any other exception. In absence of any documentation on the transfers, OTA makes no finding on whether, if appellant established that this were community property, the analysis would be different. Nevertheless, OTA will address the next element.

[36] It is unclear if the appraised values included items other than tangible personal property, such as goodwill. Nevertheless, in absence of any other evidence of value, the appraisals are the best available evidence. Even if goodwill were included, it would not be unreasonable to assume that the percentages of tangible personal property to goodwill would be similar for all the businesses because they are all Subway restaurants and thus that the appraised values for all restaurants would be impacted equally and, hence, not materially change the analysis of this element (whether 80 percent of the tangible personal property was transferred).

[37] Although the appraised values are listed in a CDTFA exhibit, CDTFA obtained this financial document (and hence, the appraised values) from appellant.

would need to provide the document of transfer showing that all 16 assets were transferred simultaneously pursuant to the same written contract or agreement. In the absence of such documentation, the highest appraised location transferred was Subway 36047, appraised at $720,000. Under these facts, appellant is only able to show that the largest single transfer it made on December 31, 2009, was of 6 percent ($720,000 of $11,997,000) of its assets, which fails to meet the 80 percent threshold.

In summary, appellant must carry the burden to establish entitlement to the exemption. Appellant failed to provide evidence sufficient to establish that appellant made a transfer greater than 6 percent of its assets, or that the ownership was substantially similar after the transfers.

The accuracy of the daily and weekly sales reports

With respect to appellant's dispute of CDTFA's use of the sales reports seized from the franchisor, appellant asserts that CDTFA improperly obtained the daily and weekly sales reports in violation of R&TC section 19504.7,[38] and in violation of CDTFA's Operations Memorandum No. 1162 dated November 17, 2010 (Ops Memo 1162).[39] Additionally, appellant contends that CDTFA failed to produce a declaration from the franchisor's custodian of records, and appellant argues that these records are therefore untrustworthy.

As already stated, above, all relevant evidence is admissible in this appeal. (R&TC, § 6481; Cal. Code Regs., tit. 18, § 30214(f).) As such, appellant's arguments regarding laws governing the Franchise Tax Board and the CDTFA Operations Memorandum are unpersuasive. OTA will afford the proper weight to this evidence and give due consideration to appellant's legal arguments. (Cal. Code Regs., tit. 18, § 30214(f)(4).) R&TC section 19504.7, by its terms, does not apply to law enforcement or to CDTFA. As such, there is no basis for OTA to conclude that law enforcement officials were prohibited from seizing records from appellant's franchisor without first providing advance notice to appellant. For the same reason, OTA finds that the CDTFA internal policy memorandum cited by appellant, addressing removal of documents from

[38] R&TC section 19504.7(a) provides that an officer or employee of the Franchise Tax Board may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice in advance to the taxpayer that contacts with persons other than the taxpayer may be made.

[39] This document states, in pertinent part, that an auditor may not remove records from the taxpayer's or representative's premises without permission from the taxpayer or designee.

a taxpayer's premises by an auditor, is simply not relevant in the context of a search warrant executed by law enforcement.[40]

OTA further finds that it was reasonable and rational for CDTFA to rely upon documentation seized by law enforcement pursuant to a duly authorized search warrant, in determining appellant's unreported tax liability. As such, the burden is on appellant to establish error with the determination. Appellant has failed to provide any documentation to establish error with the seized documents or with CDTFA's calculation. As such, OTA has no basis to order an adjustment to the liability calculated by CDTFA based upon documents lawfully seized by CDTFA, in conjunction with law enforcement, pursuant to a search warrant.[41]

Issue 4: Whether appellant's court-ordered criminal restitution payments preclude CDTFA from issuing NODs for the reporting periods covered by the plea agreement.

Appellant argues that CDTFA is precluded from asserting civil tax deficiencies in excess of the court-ordered criminal restitution of $3,021,059 for the underreporting at issue in this appeal. Appellant contends that R&TC section 7157(a)(2) precludes the imposition of additional tax, interest, and penalties because the amount imposed by a court as an order for restitution is treated as final. This argument is without merit.

As a preliminary matter, the plea agreement providing for the restitution payment specifically covered appellant's criminal tax evasion for the 2010 calendar year. Furthermore, OTA has concluded, and the law is clear, that an order of restitution is separate and distinct from CDTFA's right to pursue a civil remedy. (*Appeal of Delgado*, 2018-OTA-200P.) Although appellant contends that *Appeal of Delgado, supra*, is not on point because it deals with taxes imposed pursuant to the Cigarette and Tobacco Products Tax Law, there is nothing in the Sales and Use Tax Law which would warrant a different outcome. First, R&TC section 7157(a)(2) merely provides that criminal restitution orders are treated as final and may be collected by

[40] CDTFA's policy manuals provide internal guidance to CDTFA and, while they may provide helpful guidance, they do not constitute legal authority and are not binding on OTA. (*Appeal of Micelle Laboratories, Inc*, 2020-OTA-290P.)

[41] Based on the finding that no adjustments are warranted, OTA need not address the issue of whether OTA has jurisdiction over the notice dated November 27, 2017. As such, OTA makes no finding on whether the November 27, 2017 notice document is a notice of determination or a notice of increase.

CDTFA.[42] Second, R&TC section 7157(a)(2) imposes no limitation upon CDTFA's ability to pursue unpaid taxes. To the contrary, the Sales and Use Tax Law explicitly authorizes CDTFA to issue "[o]ne or more deficiency determinations" for the same reporting period. (R&TC, § 6481.) In summary, the premise of *Appeal of Delgado* applies equally to sales and use tax determinations, and the court-ordered criminal restitution payments do not preclude CDTFA from issuing one or more NODs to appellant for its unreported sales and use taxes.

HOLDINGS

1. OTA lacks jurisdiction to refund appellant's criminal restitution payments, regardless of whether the NODs are timely.
2. CDTFA timely issued the NODs.
3. Appellant failed to establish that any adjustments are warranted to the determined measure of tax.
4. Appellant's court-ordered criminal restitution payments do not bar CDTFA from issuing NODs for the period covered by the plea agreement.

DISPOSITION

CDTFA's denial of the petitions for redetermination and claims for refund is sustained.

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Andrew J. Kwee
Administrative Law Judge

I concur:

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Josh Lambert
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Josh Lambert
Administrative Law Judge

[42] R&TC section 7157(a)(2) states, "Amounts imposed by a court of competent jurisdiction as an order of restitution for criminal offenses shall be treated as final and due and payable to the State of California on the date that amount is established on the records of [CDTFA]."

M. GEARY, Administrative Law Judge, CONCURRING:

While I agree with the majority's Holdings and Disposition, I cannot agree with parts of its analysis.

First, there is abundant evidence of appellant's fraud or intent to evade the payment of tax. Ajay Beri Corporation's (appellant's) guilty plea to a felony tax evasion charge, and A. Beri's guilty plea to misdemeanor and felony tax evasion charges are particularly persuasive in this regard. The California Supreme Court has held that such pleas are admissible in these proceedings as admissions against appellant's interests (*Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd.* (1962) 58 C.2d 601, 605); but the Court also states that "It would not serve the policy underlying [the doctrine of] collateral estoppel, however, to make such a plea conclusive." Yet, in reliance on opinions issued by the State Board of Equalization – with which I also disagree, for the same reason – the majority gives these pleas conclusive effect when it finds that "a guilty plea is sufficient, by itself, to sustain fraud." Although, other language in the majority opinion states that the guilty pleas are, absent evidence to the contrary, sufficient to establish tax evasion by clear and convincing evidence, it seems to me that the majority has needlessly gone well past the line drawn by our Supreme Court.

The second instance where the majority eagerly goes into areas where it need not venture is in its discussion of California Code of Regulations, title 18, (Regulation) section 1595 and its application to appellant's transfer of multiple fast-food restaurants to related companies owned by the same persons. The California Department of Tax and Fee Administration (CDTFA) sought to assess sales tax in connection with the included transfers of tangible personal property. Appellant argued that these were not taxable events pursuant to Regulation section 1595(b)(2). According to the evidence, CDTFA agreed that the ownership of the transferred property remained essentially the same after the questioned transfers (unchanged ownership), but it argued that appellant had not transferred the required 80 percent of its tangible personal property used in its business. While the majority concludes that the latter position was correct, it reaches this conclusion only after first deciding the unchanged ownership issue that was not in dispute. The majority later goes on to establish other requirements for application of Regulation section 1595(b)(2) that had not been argued by either party. The Office of Tax Appeals' (OTA's) primary goal should always be to reach the correct legal result. To do that, it may, on occasion, be necessary to address factual or legal issues not raised by the parties after giving the

parties an opportunity to be heard. There may even be a rare occasion when OTA must question or even refuse to accept a concession. Here, neither was required to reach the correct legal result.

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Michael F. Geary
Administrative Law Judge

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