

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
J. GOMEZ and A. ROMERO-LARA,) OTA NO. 230914398
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 APPELLANTS.)
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, October 9, 2024

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings,
taken at 12900 Park Plaza Drive, Suite 300,
Cerritos, California, 90703, commencing at
9:32 a.m. and concluding at 10:33 a.m. on
Wednesday, October 9, 2024, reported by
Ernaly M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: ALJ LAUREN KATAGIHARA

Panel Members: ALJ JOSHUA LAMBERT
H.O. ERICA PARKER

For the Appellant: RAUL CARREGA

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

NALAN SAMARAWICKREMA
CHRISTOPHER BROOKS
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-5 were received into evidence at page 7.)

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

O P E N I N G S T A T E M E N T

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Cerritos, California; Wednesday, October 9, 2024

9:32 a.m.

JUDGE KATAGIHARA: Okay. Let's go on the record.

We're opening the record in Appeal of Joanna Gomez and Adrian Romero-Lara before the Office of Tax Appeals. This is OTA Case No. 230914398. Today is Wednesday, October 9th, 2024. The time is 9:32 a.m.

We're holding this hearing in person in Cerritos, California. I'd like to begin by asking the parties to please identify themselves by stating their name and title for the record.

Let's begin with Appellants.

MR. CARREGA: Raul Carrega.

JUDGE KATAGIHARA: And who is here for Respondent?

MR. SAMARAWICKREMA: Nalan Samarawickrema, Hearing Representative for the CDTFA.

MR. PARKER: Jason Parker, Chief of Headquarters Operations Bureau with CDTFA.

MR. BROOKS: Christopher Brooks, attorney for the CDTFA.

JUDGE KATAGIHARA: Okay. I am Administrative Law Judge Lauren Katagihara, the lead Panel Member for this case. And with me today is Judge Josh Lambert and Hearing

1 Officer Erica Parker. We are the panel hearing and
2 deciding this case.

3 As we confirmed at the prehearing conference, we
4 are considering two issues today: One, is whether further
5 adjustments to the measure of Appellant's unreported
6 taxable sales are warranted; and two, whether the
7 negligence penalty was properly imposed.

8 We also confirmed at the prehearing conference
9 that CDTFA concedes to a \$227,421 reduction to the measure
10 of Appellants' unreported taxable sales because CDTFA is
11 now accepting Appellants' fourth quarter 2020 reported
12 sales. However, Appellants continue to dispute the
13 liability associated for this quarter or the lack thereof
14 because they dispute the, quote, "entire audit report,"
15 unquote.

16 No witnesses were identified to testify at
17 today's hearing. So there will be no testimony provided.

18 Let's discuss exhibits. Pursuant to the Minutes
19 and Orders, after the prehearing conference, Appellants'
20 Exhibits 1 through 4 and Respondent's Exhibits A through F
21 were admitted into evidence. The parties had until
22 September 23rd to propose additional exhibits. Respondent
23 did not propose any additional exhibits, but Appellants
24 proposed documents labeled Exhibits E, F, and G.
25 Appellants were instructed to use numbers for their

1 exhibits, so we will call those exhibits, Exhibits E
2 through G. I'm sorry. We'll call Exhibits E through G,
3 Exhibits 5 through 7 instead.

4 With respect to Exhibit 6, Appellants identified
5 a physical cash register with the intention of showing the
6 Panel Members the display on the cash register. OTA
7 provided Appellants with two options on how to submit
8 their intended evidence, but Appellants did not opt for
9 either. So Exhibit 6 will not be admitted into evidence.

10 With respect to Exhibit 7, Appellants proposed to
11 admit OTA September 18th, 2024, prehearing conference
12 Minutes and Orders as evidence. However, this document is
13 not considered evidence and is already part of the
14 administrative record. So Exhibit 7 will also be excluded
15 from evidence.

16 Respondent, you did not file any objection to
17 Appellants' Exhibit 5, so that exhibit will be admitted.
18 In short, Appellants' Exhibits 1 through 5 and
19 Respondent's Exhibits A through F are admitted into
20 evidence.

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

23 (Department's Exhibits A-F were received in
24 evidence by the Administrative Law Judge.)

25 JUDGE KATAGIHARA: Okay. And with that,

1 Mr. Carrega, you may now proceed with your presentation.
2 You have 10 minutes.

3 Is your mic on?

4 MR. CARREGA: Oh, okay. Here it goes. I'm
5 sorry. Thank you.

6

7

PRESENTATION

8 MR. CARREGA: I'd like to start with my client's
9 business, talk a little bit about their business. Their
10 business is a tire business, and what they do is they sell
11 tires. They also -- the main thing is they fix flats,
12 install tires, clean tires, involves -- valves. There are
13 many businesses in this area that also do the same thing.
14 So it's very competitive. He just can't buy a tire and
15 say, oh, we're gonna, you know, charge 10 percent or
16 15 percent. The market sort of dictates what you can
17 charge. It isn't where, okay, it -- it -- the market
18 basically tells, hey, you can't charge this amount because
19 a guy down the street charges, you know, maybe 2 percent
20 based on his gross up. Or other guy on the left side of
21 you charges 5 percent.

22 So the model -- the pricing model is basically
23 repairs, fixing flat tires, cleaning up the tires, and
24 doing more of the nonsales process because there just
25 isn't money in that process. When you look at the tire

1 that everyone drives or uses, it's your standard tire.
2 Where the money may be in the higher end would be, say, a
3 big truck tire, which they really don't sell too much.
4 That -- that may be where the higher margins are.

5 With that said, I'd like to say that the best --
6 to look at the gross profit because that's what this case
7 is about, is we need to look at the books. The books --
8 the books are what's going to tell you exactly how much
9 money we're making. And so I'd like to just point out a
10 few exhibits and talk a little bit about them and maybe
11 the relationship. With Exhibit A, this is a profit margin
12 by industry, and it's just -- I pulled it up from the
13 internet. And I want --

14 JUDGE KATAGIHARA: Mr. Carrega, sorry to
15 interrupt you. By Exhibit A, do you mean Exhibit 1 or are
16 you discussing Respondent's Exhibit A?

17 MR. CARREGA: I'm talking with my exhibit that I
18 submitted as Exhibit A. So I -- if we renumbered them, I
19 guess it would be 1.

20 JUDGE KATAGIHARA: Thank you.

21 MR. CARREGA: That exhibit talks about all the
22 different industries. You have different industries, auto
23 tires, auto parts, and so many different industries. It's
24 20 pages, or who knows how long. I know there's -- the
25 State has offered another, you know, exhibit where they

1 or -- where they get the average and they, you know, some
2 national average they use, and they say this is the
3 national average.

4 My point here is that we can come up with any
5 gross profit depending where you look, internet, or how
6 that report is done. If you take a national average, it's
7 going to be much different than, say, you take an average
8 of the Los Angeles area. Or if you take a, you know,
9 small business, depending on what your parameters are,
10 you're going to get different results. This exhibit shows
11 that auto parts, the margin is 1.7 percent. And I'd just
12 like to point that out. It's less than 10 percent they're
13 claiming that we should be reporting.

14 Exhibit B or Exhibit 2, I gather, we talk about
15 there's a -- the IRS has a program. This is just more of
16 a memo where the IRS, if it's the first time -- you know,
17 first time audit, the IRS will abate the penalty. You
18 know, this is first time because, you know, what standards
19 are we following? And so the IRS has this program where
20 this is your first audit, you won't -- there's no
21 penalty -- well, negligence penalty. And I want to say
22 that the negligence penalty is very weak here considering
23 when it's made up of estimates of -- of a report that's
24 estimates. It's not from the books.

25 So one thing -- because I'll go back and talk

1 about this penalty later, but I just wanted to show that
2 the government, IRS has a penalty thing where no -- no
3 penalty is applied. And I want to say I think by applying
4 this penalty here is -- is not only wrong, but it's also a
5 little arrogant when you consider that my report, which is
6 come up with who knows an average -- a national average,
7 and it's right. It's not an estimate. They keep
8 suggesting that, oh, we're going to submit a negligent
9 penalty based on this report that we feel is bogus and
10 false.

11 I want to -- and then the last thing I want to
12 talk about, some of the standards that perhaps maybe these
13 are suggestions that when you're auditing. Perfect
14 example, what they did is they used the two-week. They
15 just went and used two weeks, and then they made a sample
16 out of two weeks, and this is it. This is -- we're going
17 to base on our tax on these two weeks. Now, they probably
18 have the authority to do that. However, they're not
19 really following standards.

20 And I just want to mention this book. It's just
21 a practical guide to audit sampling. Let's take an
22 example of their sample. They sample two weeks, and let's
23 just say there's 50 weeks in a year. Okay. So if we
24 double that, so that's 100. Let's just say 100 weeks, and
25 then we double their sample to 4. So the percentage of

1 them being in error is 96 percent. And they didn't
2 address anything about their sample or what type of sample
3 it was, whether it was rather random, whether it was -- no
4 one knows. I think my -- their response was it's
5 propriety. It's our sample propriety from whatever
6 information they have.

7 So I just want to mention that -- that small
8 business want to know. Okay. If you're gonna come up
9 with an estimate, you're not going to use our books, then
10 follow some guidance. Follow some standards that, you
11 know, everyone follows outside the state. So those are
12 the three I want to suggest.

13 Now, I want to talk about my three exhibits. I
14 guess they would be called Number 3, 4, and 7 -- I
15 believe, if we're not going -- I originally called
16 Exhibit C, Exhibit D, and Exhibit G. But if we're
17 renumbering them, I suspect it would be 3, 4, and 7. I'd
18 like to -- if we could see those three exhibits
19 side-by-side. The first exhibit is the Engagement Letter.
20 And I -- if it's 3 or C. It should be the Engagement
21 Letter. And if we look at the Engagement Letter, we see
22 that the audit, they're saying -- and we view this as a
23 contract, my client, that you have to -- that the audit
24 period is going to be from January 1st, 2018, to the
25 period, September 30, 2020.

1 That's what this Engagement Letter says, and we
2 gave the auditors that information, whatever they needed.
3 And they decided it wasn't sufficient, the evidence, we
4 have to do something else. That's fine. So when we look
5 at the engagement, that's fine. However, if you look at
6 Exhibit D, or if you want to call it Item 4, their audit
7 period is April 1st, 2018, to December 31st, 2020. A
8 different audit period. And also, Cindy, you know, the
9 conference auditor ignored the Engagement Letter, along
10 with other false assertions that were made.

11 Here, you have an audit report that's taking a
12 whole account that doesn't comply with the Engagement
13 Letter. It's an audit period that is a big surprise to us
14 when they -- when they issued the report. We call this
15 fraud. And I know that's a harsh word but, nevertheless,
16 it's wrong.

17 Now, when we go to the final exhibit with 7 -- I
18 don't know if that one is allowed. But here you have --

19 JUDGE KATAGIHARA: Mr. Carrega, will you identify
20 what you believe to be Exhibit 7.

21 MR. CARREGA: Exhibit G.

22 JUDGE KATAGIHARA: Is it Exhibit G that --

23 MR. CARREGA: It's the prehearing, but I don't
24 know if -- you say that's not allowed?

25 JUDGE KATAGIHARA: That's not --

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MR. CARREGA: Okay.

JUDGE KATAGIHARA: That's part of the administrative record.

MR. CARREGA: Well, forget about that.

JUDGE KATAGIHARA: Okay. Thank you.

MR. CARREGA: But what was in there, is they -- basically, I'm going to call it a cover up because they agree that the report was -- whatever you want to call it -- was -- was wrong. The report is wrong. Whether it -- whatever you want to call it. Wrong. It's not the true tax liability, nevertheless. And they're agreeing to adjusting it.

In conclusion, I want to -- quoting -- what's happening is they're quoting facts that are not facts, creating samples that are not samples, and fabricating independence when no there's no independence. When we look at these exhibits -- and you could ignore the prehearing Exhibits C and D. Side-by-side this audit team has crossed the line. Their Engagement Letter, their audit report, they've crossed the line. The evidence shows the audit team has audited a different period. The report is wrong. We call it fraud, and the evidence shows it. And the two strong exhibits we have are 3 and 4.

Thank you.

JUDGE KATAGIHARA: Do my Co-Panelists have any

1 questions for Appellant?

2 Okay. Respondent, you can proceed with your
3 presentation. You have 30 minutes.

4 MR. SAMARAWICKREMA: Thank you, Judge.

5

6

PRESENTATION

7 MR. SAMARAWICKREMA: Appellant operated a retail
8 tire shop in Bell Gardens, California. The Department
9 audited Appellants' business for the period of
10 April 1st, 2018, through December 31st, 2020. During the
11 audit period, Appellants reported around \$2.1 million as
12 total sales and claimed two types of deductions resulting
13 in reported taxable sales of around \$838,000. And this is
14 exhibit shown on Exhibit A, page 21.

15 During our presentation, we will explain why the
16 Department rejected Appellants' reported taxable sales;
17 why the Department used an indirect audit approach; and
18 how the Department determined Appellants' unreported
19 taxable sales for the audit period; and why the Department
20 recommended a 10 percent negligence penalty.

21 During the audit, Appellants failed to provide
22 complete sales records. Appellants did not provide
23 complete documents of original entry, such as sales
24 receipts, credit card sales receipts, sales journals, or
25 sales summaries to support their reported total taxable

1 and nontaxable sales for the audit period. In addition,
2 Appellants failed to provide any purchase invoices or
3 purchase journals for the audit period.

4 Appellants were unable to explain how they
5 reported their total taxable and nontaxable sales on their
6 sales and use tax returns. Appellants were also unable to
7 explain what sources they relied upon to complete their
8 sales and use tax returns. The Department did not accept
9 Appellants' reported taxable sales due to lack of reliable
10 reports. The Department also determined that Appellants
11 did not provide complete books and records that could be
12 used to verify their reported taxable sales for the audit
13 period.

14 The Department completed five verification
15 methods to verify the reasonableness of Appellants'
16 reported total and taxable sales. First, the Department
17 reviewed Appellants' federal income tax return for years
18 2018 and 2019 and compared the sales reflected on federal
19 income tax returns with reported total sales and only
20 noted immaterial differences. And this information is on
21 Exhibit B, page 54. The Department also compared the
22 reported total sales, including labor charges with the
23 cost of goods sold reflected on Appellants' federal income
24 tax returns and noted reported total book markup of around
25 38 percent. And this calculation is on Exhibit B,

1 page 53.

2 Second, Appellants provided Department with bank
3 statements for year 2019. The Department reconciled net
4 bank deposits with reported total sales and only noted
5 immaterial differences. And these reconciliations are on
6 Exhibit B, page 52.

7 Third, Appellants did not provide their credit
8 card sales information for the audit period. Therefore,
9 the Department obtained Appellants credit card sales
10 information for the audit from the Department's internal
11 sources. And this information is shown on Exhibit B,
12 pages 60 through 62. The Department compared the credit
13 card sales with reported total sales and calculated an
14 overall credit card sales ratio of around 49 percent for
15 the audit period. And these calculations are on
16 Exhibit B, page 59. The Department viewed this as a
17 reasonable credit card sales ratio for this business.
18 Accordingly, the Department conceded this reported total
19 book markup and reported credit card sales ratio as
20 reasonable for Appellants' type of business. Therefore,
21 the Department accepted Appellants' reported total sales
22 for the audit period.

23 Fourth, the Department analyzed reported taxable
24 sales for the period April 2018 to September 2020, and
25 noted that Appellants on average only reported around

1 36 percent of total sales as Appellants' taxable sales.
2 And these calculations are on Exhibit B, page 57. On the
3 other hand, the Department noted that fourth quarter 2020
4 reflects an 85 percent reported taxable sales.
5 Appellants' taxable sales percentage increased from the
6 average reported taxable sales percentage of around
7 36 percent during the first 11 quarters of the audit
8 period to 85 percent on the last quarter. These
9 calculations are shown on Exhibit B, page 57.

10 The Department found this significant because
11 Appellants filed their fourth quarter 2020 sales and use
12 tax return after Appellants receive the first notice of
13 the audit from the Department. And this information is on
14 Exhibit A, pages 10 and 15, and Exhibit B, pages 72
15 through 74. Based on the analysis of available sales
16 invoice for the October 1st, 2020, through
17 October 15th, 2020, the audited taxable sales percentage
18 was around 86 percent. And these calculations are on
19 Exhibit B, pages 48 through 51. The Department considered
20 this audited taxable sales percentage as reasonable for
21 Appellants' type of business.

22 Fifth, the Department compared reported taxable
23 sales of around \$452,000, with the cost of goods sold of
24 around \$966,000 reflected on Appellants' federal income
25 tax returns and calculated an overall negative reported

1 taxable book markup of around 53 percent. And these
2 calculations are on Exhibit B, page 53. Appellant was
3 unable to explain the reason for the low average taxable
4 sales percentages, negative reported taxable book markups.
5 Therefore, the Department conducted further investigation
6 by analyzing Appellants' federal income tax returns and
7 available sales invoices.

8 Appellants failed to provide current sales and
9 purchase invoices for the Department to conduct a shelf
10 test to understand their pricing policies. Appellants
11 also failed to provide any of their purchase records for
12 the audit period. Therefore, the Department used a cost
13 of goods sold of around \$966,000 reflected on Appellants'
14 2018 and 2019 federal income tax return and a 10 percent
15 markup to determine Appellants' taxable sales of around
16 \$1 million for the same period. And these calculations
17 are on Exhibit B, page 46.

18 Audited taxable sales were compared with reported
19 taxable sales for the same period to determine unreported
20 taxable sales of around \$611,000 and corresponding error
21 rate of around 144 percent for year 2018 and 129 percent
22 for year 2019. And these calculations are on Exhibit B,
23 page 46. Then the Department applied the respective error
24 rates to the reported taxable sales for the audit period,
25 except fourth quarter 2020, to determine the unreported

1 taxable sales of around \$872,000 for the period April 2018
2 through September 2020. And these calculations are on
3 Exhibit B, page 55.

4 Appellants' representative provided its Exhibit 1
5 to show that the average gross profit margin for auto
6 parts business was around 22 percent, and average net
7 profit margin was around 2 percent. For Appellants'
8 information, the gross profit margin is calculated using
9 gross profit and sales. On the other hand, markup is
10 calculated using gross profit and purchases of cost of
11 goods sold. In other words, this average gross profit
12 margin of 22 percent is equivalent to markup of around
13 28 percent. But in this audit, the Department used only
14 10 percent markup to determine the unreported taxable
15 sales for the audit period, except fourth quarter '20.

16 Therefore your Panel can see that the markup that
17 the Department used in this audit is significantly lower
18 than the Appellants' provided industrial markup of
19 28 percent. Had the Department used Appellants' provided
20 industry markup of 28 percent to determine Appellants'
21 unreported taxable sales, the amount increase by around
22 \$245,000 from \$872,000 to \$1.1 million. Therefore, the
23 Department finds that the markup that was used in this
24 audit is not only fair and reasonable but also benefits
25 the Appellants.

1 The Department also scheduled the available sales
2 invoices for the period October 1st, 2020, through
3 October 15, 2020, to segregate the sales amount into
4 taxable sales, nontaxable labor, and sales tax
5 reimbursement collected. And this information is on
6 Exhibit B, pages 48 through 51. The Department then
7 compared the taxable sales with the total sales and
8 calculated an audited sales percentage of around
9 86 percent. And this calculation is now on Exhibit B,
10 page 51. The Department applied the audited taxable sales
11 percentage of 86 percent to reported total sales to
12 determine the audited taxable sales of around \$1.7 million
13 for the audit period. And this calculation is on
14 Exhibit B, page 47.

15 Audited taxable sales were compared with reported
16 taxable sales of around \$838,000 to determine unreported
17 taxable sales of around \$902,000 for the audit period.
18 And these calculations are on Exhibit B, page 47. The
19 Department noted substantial discrepancies between audited
20 and reported taxable sales using both audit methods. To
21 give a benefit to Appellants, the Department accessed the
22 unreported taxable sales of around \$872,000 based on the
23 cost plus markup method, rather than the unreported
24 taxable sales of around \$902,000 based on the taxable
25 sales ratio method. And these calculations are on

1 Exhibit B, pages 47 and 55.

2 The Department then compared the unreported
3 taxable sales based on the cost-plus markup method with a
4 reported taxable sale of around \$838,000 to calculate the
5 error rate of around 104 percent for the audit period.
6 The audit calculation of unreported taxable sales, based
7 on the cost-plus markup method, was reasonable and was in
8 Appellants' favor since it was the lower of the
9 differences determined. Ultimately, the Department used
10 an audit method which gives the lowest deficiency measure
11 which benefits the Appellants. When the Department is not
12 satisfied with accuracy or the sales and use tax return
13 filed, it may rely upon any facts contained in the return
14 or upon any information that comes into the Department's
15 possession to determine if any tax liability exists.

16 The taxpayer shall maintain and make available
17 for examination on request by the Department all records
18 necessary to determine the correct tax liability under the
19 sales and use tax laws and all reports necessary for the
20 proper completion of the sales and use tax returns. When
21 a taxpayer challenges an audit of determination, the
22 Department has the burden to explain the basis for that
23 deficiency. When the Department's explanation appears
24 reasonable, the burden of proof shifts to the taxpayer to
25 explain why the Department asserted deficiencies are not

1 valid.

2 The audit calculation of unreported taxable
3 sales, based on the best available information, was fair
4 and reasonable. Appellants disputed the audit liability
5 claiming that the 10 percent markup used to determine the
6 audited taxable sale is too high. Appellants did not
7 provide reliable evidence to demonstrate that their
8 taxable markup is lower than 10 percent. As stated
9 earlier, Appellants provided Exhibit 1, Profit Margin By
10 Industry. The application of this 10 percent markup is
11 not only fair and reasonable but also benefits Appellants.
12 For all these reasons, the Department has no basis upon
13 which to recommend an adjustment to the estimated markup
14 of 10 percent.

15 Finally, the Department imposed a negligence
16 penalty for these Appellants based upon its determination
17 that Appellants' books and records were incomplete and
18 inadequate for sales and use tax purposes, and because
19 Appellants failed to accurately report their taxable
20 sales. In analyzing the issue of negligence, one of the
21 factors that must be considered is whether the taxpayer
22 has been previously audited. A negligence penalty is not
23 generally imposed when the taxpayer has not been
24 previously audited.

25 Nevertheless, even in connection with the first

1 audit, the imposition of a negligence penalty is warranted
2 if there's evidence establishing that any bookkeeping and
3 reporting errors cannot be attributable to the taxpayer's
4 good faith and reasonable belief that its bookkeeping and
5 reporting practices were in substantial compliance with
6 the requirement of the sale and use tax law or
7 regulations.

8 Relevant factors, such as general state of the
9 books and records and Appellant's business experience must
10 be considered. And when the evidence clearly shows that
11 the understatement is due to negligence, the penalty
12 applies even when Appellant has not been previously
13 audited. Specifically, the Department noted that
14 Appellants provided limited records for the audit period,
15 and Appellants failed to provide documents of original
16 entry to support their reported sale tax liability. As a
17 result, the Department had to calculate Appellants'
18 taxable sales based on the cost-plus markup method.

19 In addition, the audit examination disclosed
20 unreported taxable sales of around \$872,000, which when
21 compared with reported taxable sale of around \$838,000 for
22 the audit period resulted in an error rate of around
23 104 percent. This high error rate is additional evidence
24 of negligence. Appellants provided a short paragraph from
25 a textbook regarding what are sampling and non-sampling

1 errors. However, Appellants have not identified any
2 errors in the Department's calculation, nor provided any
3 supporting documents to support any changes to the audit
4 finding. In preparation for the hearing, the Department
5 reviewed the audit and did not find any errors.
6 Therefore, Appellants' citation on this textbook has no
7 procedural value in this appeal.

8 Appellants have made baseless accusations of
9 fraud and impropriety against the Department's employees
10 working on this case during the audit and appeal process.
11 These claims are not accurate and are made without any
12 foundation. These claims do not establish that the
13 Department's ultimate determination was unreasonable or
14 lack any rational basis. In conclusion, when Appellants
15 did not provide complete source documentation, the
16 Department was unable to verify the accuracy of reported
17 taxable sales using a direct audit method. Therefore, an
18 alternative audit method was used to determine unreported
19 taxable sales.

20 Accordingly, the Department determined the
21 unreported taxable sales based upon the best available
22 information. The evidence shows that the audit produced
23 fair and reasonable results. Appellants have not provided
24 any reasonable documentation or evidence to support an
25 adjustment to the audit finding. For all of these reasons

1 the Department requests the appeal be denied.

2 This concludes our presentation. We are
3 available to answer any questions the Panel may have.

4 Thank you.

5 JUDGE KATAGIHARA: I do have a few questions for
6 CDTFA. There's been a lot of discussion about the lack of
7 complete documents, like purchase invoices and sales
8 invoices. Does CDTFA have any specifics about the
9 incompleteness of those documents? For example, did you
10 receive some invoices that, you know, were not
11 consequential? Or did you receive some invoices and they
12 were just large chunks of time missing from them?

13 MR. SAMARAWICKREMA: The Department -- like in
14 the Engagement Letter, the Department listed all the
15 documents that were required to complete the audit. But
16 during the audit, Appellants only provided federal income
17 tax returns for two years, bank statement for 2019, that
18 is one year. And the Appellants only provided sales
19 invoices from October for 15 days in 2020. That's all the
20 Department received.

21 JUDGE KATAGIHARA: And the invoices for the
22 15 days are the two-week sample size that was used, was
23 that created -- was that test period used because those
24 were the invoices that Appellant provided, or did you
25 specifically ask for that time period?

1 MR. SAMARAWICKREMA: Those are the only invoices
2 that were available for the Department and we -- the
3 Department used those 15-day information and did -- we
4 didn't -- well, you know, we didn't -- based on the
5 information, that's all we had, and we don't know whether
6 it's complete because those are the only information.
7 That's the reason we use a markup -- 10 percent markup and
8 use the taxable sales percentage as a secondary approach.
9 And also if you -- we also compared the two-weeks sales
10 information to fourth quarter 2020, and those taxable
11 sales percentage were in line.

12 JUDGE KATAGIHARA: Okay. And it's noted in the
13 audit work papers that there were 86 invoices provided for
14 that two-week period. Did CDTF determine that that was a
15 complete set of invoices, or did you have any reason to
16 believe it was not?

17 MR. SAMARAWICKREMA: Based on the information we
18 have, we don't know.

19 JUDGE KATAGIHARA: Okay.

20 MR. SAMARAWICKREMA: Yeah. But we have one
21 quarter of information, the fourth quarter '20. And based
22 on that information, we can see that the taxpayer reported
23 86 percent taxable sales, and the previous -- the first 11
24 quarters they were 36 percent. And, you know, it appears
25 that taxpayer improved their reporting, and they reported

1 the correct amount of taxable sales, and it's just because
2 after we sent the first Engagement Letter. We sent the
3 first Engagement letter in December 8, 2020, and the
4 taxpayer requested for us to transfer the audit from
5 Cerritos office to the Glendale office. And that's why
6 there was another Engagement Letter dated in April.

7 JUDGE KATAGIHARA: Okay. Let's talk about the
8 fourth quarter '20 accepted reporting. Looks like
9 schedule 12a, which is Exhibit B, page 24.

10 MR. SAMARAWICKREMA: Right.

11 JUDGE KATAGIHARA: Okay. Are you there?

12 MR. SAMARAWICKREMA: Yeah. I'm here.

13 JUDGE KATAGIHARA: It says that both third
14 quarter '20 and fourth quarter '20 had an increase in
15 reported taxable sales.

16 MR. SAMARAWICKREMA: Right.

17 JUDGE KATAGIHARA: So how come CDTFA is only
18 accepting the fourth quarter '20 reported sales?

19 MR. SAMARAWICKREMA: Yeah. So the -- we use a
20 credit card ratio, and the taxpayer increase the -- yeah.
21 Give me one minute. I'll tell you exactly which -- if you
22 may refer to page 57, Exhibit B.

23 JUDGE KATAGIHARA: I'm sorry. Did you say 57?

24 MR. SAMARAWICKREMA: 57, Exhibit B. I mean, the
25 Bates Number 57.

1 JUDGE KATAGIHARA: Is that the statement one
2 calculation?

3 MR. SAMARAWICKREMA: Right. Yeah. So the -- the
4 taxpayer's taxable sales percentage is 37 percent, and the
5 fourth quarter is 85 percent. So it appears, you know,
6 based on the information, taxpayer did not report the
7 correct amount of taxable sales for third quarter 2020.

8 JUDGE KATAGIHARA: Okay. So the comment in 12a
9 is incorrect? Is that you're saying? Because the comment
10 in 12a states that the reporting increased for fourth
11 quarter '20 and third quarter '20.

12 MR. SAMARAWICKREMA: What he meant to say is the
13 taxable sales were increased in 2020 fourth quarter.
14 Yeah. Because we review it, so the only reason we didn't
15 make adjustments for the third quarter because the
16 reported taxable sales were 37 percent and -- yeah.

17 MR. PARKER: Judge Katagihara, can I add one
18 thing real quick? If you look at Exhibit B Bates stamp
19 43, the --

20 JUDGE KATAGIHARA: Hold on. Give me a second to
21 get there, please.

22 MR. PARKER: Okay. Sure.

23 JUDGE KATAGIHARA: Okay. That's page 22 of
24 Exhibit B?

25 MR. PARKER: Let me see.

1 JUDGE KATAGIHARA: Your Bates stamp 43, but it's
2 page 22 of Exhibit B.

3 MR. PARKER: Yeah. So that's the -- the
4 transcript of the reported returns. And you can see from
5 second quarter '20 the reported gross sales of \$194,000.
6 In third quarter of '20, they increase that to \$314,000.
7 So there was a significant increase in reported sales for
8 the business in third quarter '20 and also in fourth
9 quarter '20.

10 JUDGE KATAGIHARA: Okay. So if there was an
11 increase in reported sales for third quarter '20 and
12 fourth quarter '20, then the comment is correct in 12a?

13 MR. PARKER: I believe --

14 JUDGE KATAGIHARA: Or are you saying that even
15 with this increase reporting that it's still a 37 percent
16 reporting?

17 MR. PARKER: For third quarter '20, they still
18 only reported 37 percent of their gross sales as taxable,
19 and that's why the additional taxable sales should remain
20 in the audit. Fourth quarter '20, they reported
21 85 percent, and we found that to be reasonable based on
22 the information in the audit.

23 JUDGE KATAGIHARA: Okay. Thank you for that
24 clarification. Back to 12a, I also want to discuss the
25 percentages of error on a yearly basis. So for 2020, you

1 applied the 2019 percentage of error. And, again, back to
2 that comment, it says it's because there was an increased
3 reporting by the Appellants for third quarter '20 and
4 fourth quarter '20. I'd like CDTFA to address why that
5 justifies using the 2019 percentage of error rate.

6 MR. SAMARAWICKREMA: Yeah. So if you go to the
7 12a-1, that is page 46 -- Bates stamp 46. The -- if we
8 use -- generally we use the average. That is 134 percent
9 based on the average. But in order to give a benefit, we
10 use 126. That's -- that is the 2,009 percentage of error.

11 JUDGE KATAGIHARA: So what was the error rate for
12 2020, not including fourth quarter '20?

13 MR. SAMARAWICKREMA: Oh, 128.

14 JUDGE KATAGIHARA: I'm sorry. Can you repeat
15 that?

16 MR. SAMARAWICKREMA: 128.76.

17 JUDGE KATAGIHARA: That looks like the percentage
18 error for 2019.

19 MR. SAMARAWICKREMA: Yeah. So that's the
20 percentage of error we used for the third quarter 2020.

21 JUDGE KATAGIHARA: But you're saying 2019 POE was
22 higher than the 2020, and that's why you use 2019 as a
23 benefit to the Appellants?

24 MR. SAMARAWICKREMA: No. What I meant was that
25 the -- in the page 46, Column F, has an average percentage

1 of error of 134.96 based on the 2018 and 2019.

2 JUDGE KATAGIHARA: Did you not have the cogs for
3 2020?

4 MR. SAMARAWICKREMA: That is right. We did not
5 have 2020 but just federal income tax returns.

6 JUDGE KATAGIHARA: Okay.

7 MR. SAMARAWICKREMA: Yeah.

8 MR. PARKER: Also, Judge Katagihara, if I can add
9 one more thing. For third quarter 2020, if you use the
10 reported gross sales of \$314,352 and use a percentage of
11 85 percent being taxable, the estimate ends up around
12 \$256,000 of taxable sales that should have been reported
13 in third quarter 2020. And based on the percentage of
14 error applied, it was \$262,690. So it's very much in the
15 same reasonableness ballpark.

16 JUDGE KATAGIHARA: Okay. Thank you. I think
17 those are it for my questions.

18 Ms. Parker, do you have any questions for CDTFA?

19 Mr. Lambert?

20 JUDGE LAMBERT: Hi. Yes. This is Judge Lambert.
21 I just had a question. It was being discussed that
22 there's a significant reported taxable sales change in
23 maybe 3Q '20 to 4Q '20. And there are statements made by
24 CDTFA that coincided when the auditor reached out and
25 maybe it's related. And I was wondering, I was looking at

1 CDTFA's records, and it looks like the audit Engagement
2 Letter might have been in December 2020. So I'm not sure
3 exactly when the auditor reached out. But also, if the
4 change started in 3Q '20, does that make it less?
5 Possibly, does that lessen the chance that it was
6 connected to when the auditor reached out to Appellants,
7 if the change started before CDTFA reached out?

8 MR. SAMARAWICKREMA: The first Engagement Letter
9 issued by the Cerritos office in December 8th, 2020, then
10 the Appellants' representative request to transfer the
11 audit, and that request is on page 72 of Exhibit B. That
12 is on December 21st, 2020.

13 JUDGE LAMBERT: Okay. Thanks. So I'm wondering
14 it was stated that perhaps Appellants -- or it was implied
15 that Appellants changed the reporting after receiving the
16 audit letter, but it seems like the reporting maybe
17 changed -- started before then.

18 MR. SAMARAWICKREMA: No, Judge. Because the
19 December 8th, 2020, we contacted the taxpayer, and then
20 the fourth quarter 2020 is due on January 31st, 2021. So,
21 you know, the Appellants reported the fourth quarter 2020
22 after they received and after the rep contacted the
23 Cerritos office to transfer the audit. The request for a
24 transfer was made on December 21st, 2020. That is before
25 January 31st, 2021.

1 JUDGE LAMBERT: Okay. And --

2 MR. PARKER: Judge Lambert, can I just add
3 something to that? Sorry.

4 JUDGE LAMBERT: Sure.

5 MR. PARKER: Just to reiterate what we said
6 before, third quarter 2020, they significantly increased
7 their gross sales. However, their taxable percentage was
8 still at 37 percent; where fourth quarter 2020, they
9 reported 85 percent taxable.

10 JUDGE LAMBERT: Okay. So there was a change
11 there from 3Q to 4Q. And, yeah, I was wondering more
12 about the 3Q reporting also, when they reported that.
13 That would seem like that -- was that return due before
14 the audit letter?

15 MR. PARKER: Judge Lambert, I checked in our
16 system just now to see when they filed the third quarter
17 2020 return, and it was filed October 27th of 2020. Which
18 is before the -- when -- before the auditor contacted the
19 taxpayer for audit.

20 JUDGE LAMBERT: Okay. Thanks. I was just trying
21 to clarify the facts around that statement.

22 And I had one more question for Mr. Carrega.

23 I was wondering what the -- if you're aware of
24 why there was such a significant change in the reported
25 taxable sales, you know, as we've discussed, starting in

1 fourth quarter 2020, and what the reason for that was?

2 MR. CARREGA: Well, what -- my client does
3 single-entry accounting, not accrual accounting. So you
4 may have -- you know, you buy some tires, a whole bunch of
5 tires, and maybe they'll get -- the sale will take place,
6 you know, the next period. It's -- so when you do single
7 entry accounting, not doing the accrual system, numbers
8 can fluctuate and perhaps that's why. Or I have to look
9 deeper into it, but that's one of my suggestions. Also
10 when you have inventory, that also plays a part with the
11 fluctuation.

12 JUDGE LAMBERT: Okay. It was not related to
13 being contacted by CDTFA auditors, the change? Or you
14 don't know?

15 MR. CARREGA: Contacted -- all I have is what the
16 Engagement Letter says.

17 JUDGE LAMBERT: Okay. Okay. Thanks. That's all
18 the questions I have.

19 JUDGE KATAGIHARA: Do you have any final
20 questions?

21 HEARING OFFICER PARKER: No.

22 JUDGE KATAGIHARA: Mr. Carrega, you may proceed
23 with closing remarks.

24

25

CLOSING STATEMENT

1 MR. CARREGA: Okay. I'd like to start off when
2 you mentioned about the negligence penalty. The
3 negligence penalty was calculated on a number that they
4 now agree that is not correct. So all the arguments
5 behind the negligence penalty based on this tax is, I
6 feel, is not valid because they changed the report. It's
7 no longer the sales that they claimed that they calculated
8 the negligence. They based their negligent penalty based
9 on a number that they later changed. And that includes
10 what the Appeals Bureau. They also said, yeah, the
11 negligence penalty because of these -- because of this
12 number. Well, that number no longer -- they agree that
13 that no longer exists.

14 I'd like to also add -- one of the comments that
15 we did not provide documents. I want to say that that
16 comment is false. We provided the documents that they
17 requested. And I'd like to say that the sales invoice is
18 about the size of this paper. And if I recall, they
19 wanted me to make copies of all these invoices, and I was
20 like, no. You need to come and look at the records. We
21 can't make -- spend hours making copies. It's, you know,
22 we have real simple copy machine. It's not a high-power
23 copy machine. So I do recall talking with an auditor
24 regarding the document, and they did not want to come to
25 the premises. So I think they decided, oh, well, we don't

1 have to look at so much. And then I think we did
2 something like that. So we did provide everything they
3 wanted.

4 Let me see what other comments I had listed here.
5 96 percent error rate, that's what we're dealing with.
6 There were so many schedules here, and so many that -- oh,
7 we did this for the taxpayer. Oh we did not use this
8 report. We used this one. We're so gracious. We used
9 this one, or we used that one. The bottom line is
10 96 percent error rate wasn't even addressed. And the
11 reports they used, you can come up with anything you want.
12 You know, all you do is take two weeks. Especially as I
13 mentioned, when you're dealing with an accounting system,
14 that single entry that has inventory, things can
15 fluctuate.

16 And then also throwing in a credit card, you
17 know, sales are very nil with credit card -- you know,
18 using a credit card and then using that percentage. It's
19 not just does -- it does not give a realistic of a tax
20 liability. I just want to reiterate the Engagement Letter
21 is a contract, and that's how we view it. When the
22 contract doesn't follow their audit -- what they're
23 auditing, you know, the report is false.

24 The client has Bill of Rights. It says that the
25 Engagement Letter should be an important thing here as to

1 what -- what this audit is going to be, and they never
2 followed it.

3 That's it.

4 JUDGE KATAGIHARA: Thank you, Mr. Carrega.

5 CDTFA, do you have any statements that you want
6 to make regarding your refusal to come to the premises to
7 look at Appellants' invoices?

8 THE STENOGRAPHER: Judge, your mic may not be on.

9 JUDGE KATAGIHARA: I'm sorry. My microphone was
10 off. Do you need me to restate that?

11 CDTFA, do you have any statements that you want
12 to make regarding your refusal to come to the premises to
13 look at Appellants' invoices?

14 MR. SAMARAWICKREMA: Based on the audit report,
15 we reviewed the audit report and also the audit notes, and
16 we didn't see something to that effect. But if the
17 taxpayer provided information, we review. And we listed
18 all the documents in the verification comments, you know,
19 what other documents that we received during the audit.
20 And in the audit it only listed two federal income tax
21 returns, bank statements for 2019, and sales invoices for
22 October 1st, 2020, through October 15th, 2020.

23 JUDGE KATAGIHARA: Okay. Thank you.

24 MR. PARKER: Judge Katagihara, I'd just like to
25 add on Exhibit A, page 17, these are the audit notes. I

1 do note a comment by the auditor that on May 25th, 2021,
2 that they spoke to the POA and scheduled an appointment on
3 Wednesday, June 2nd, at his office to conduct the field
4 audit. So it doesn't sound like we were unwilling to go
5 to the field in this case.

6 Thank you.

7 JUDGE KATAGIHARA: Mr. Carrega, would you look to
8 say anything in rebuttal?

9 MR. CARREGA: I want to say this might have been
10 during the time of COVID. I'm not sure, but it was -- I
11 think the Department was very -- couldn't make it a
12 certain period or something like that. And then when I
13 was able, they weren't able. I don't recall exactly, but
14 I do recall that might have had some factor into it.

15 JUDGE KATAGIHARA: Okay. Thank you.

16 Hearing Officer Parker, do you have any final
17 questions for the parties?

18 HEARING OFFICER PARKER: I do not.

19 JUDGE KATAGIHARA: Judge Lambert?

20 JUDGE LAMBERT: No questions.

21 JUDGE KATAGIHARA: Okay. Thank you.

22 Then this concludes the hearing. I want to thank
23 the parties for their presentations. This appeal will be
24 decided on the evidence presented. The record is now
25 closed, and the case will be submitted today.

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So we will send both parties our written decision no later than 100 days from today.

We will take a brief recess before the next hearing, which is scheduled to begin in approximately 10 minutes.

Thank you.

(Proceedings adjourned at 10:33 a.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 23rd day of October, 2024.

ERNALYN M. ALONZO
HEARING REPORTER