OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 19095231
BERI RESTAURANTS GROUP, INC.	CDTFA Case IDs: 277-899, 048-012
dba Subway #11219 and 17162[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

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Beri Restaurants Group, Inc. dba Subway #11219 and 17162 (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[2] denying appellant's petition for redetermination of a Notice of Determination (NOD) dated April 6, 2018 (Case ID 277-899), and a related claim for refund of criminal restitution payments applied towards the NOD pursuant to R&TC section 7157 (Case ID 048-012).

The NOD covers the period January 1, 1998, through December 31, 2010 (liability period). The NOD is for $758,768.46 in tax, plus applicable interest. In addition, the NOD includes two penalties imposed for different portions of the liability period covered: a fraud penalty of $142,601.23 for the period January 1, 1998, through December 31, 2006; and a penalty of $75,345.66 pursuant to R&TC section 6597 (the 40 percent penalty) for the remainder

[1] Appellant operated 11 different Subway locations in Southern California under different dbas; however, it closed out all except for two dbas on or prior to June 30, 2004. At the close of the liability period, appellant operated the following Subway locations: Subway #11219 and 17162.

[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.

of the liability period. A third penalty, an amnesty double fraud penalty of $91,225.41, was imposed for the amnesty-eligible periods: 1998 through 2002. CDTFA concedes that absent fraud, the NOD is untimely as to all reporting periods.

The California Attorney General's office charged and criminally prosecuted appellant, appellant's president and sole shareholder A. Beri, and some related entities, for tax evasion in connection with their operation of Subway franchise locations in Southern California during the period January 1, 2007, through December 31, 2010.[3] A. Beri, on behalf of himself, on behalf of appellant, and on behalf of a related entity, pled guilty to felony tax evasion for the period January 1, 2010, through December 31, 2010. As part of a plea agreement covering 66 charges, the Superior Court of California, County of Orange (Court) ordered A. Beri to pay criminal restitution of $3,021,059 to CDTFA for the entire period subject to the charges. (See R&TC, § 7157.) CDTFA applied payments totaling $43,431.96 from A. Beri's criminal restitution payments towards appellant's unpaid tax liability.

On December 12, 2017, appellant filed the underlying claim for refund requesting refund of A. Beri's criminal restitution payments. Thereafter, CDTFA issued the NOD at issue in this appeal on April 6, 2018. After satisfying the criminal restitution order, A. Beri also requested that his individual felony tax evasion charge be dismissed pursuant to the terms of the plea agreement. The Court granted the request on January 3, 2020. On appeal, appellant contends that CDTFA failed to establish fraud and, as such, the NOD is untimely.

This matter was scheduled to be heard before the Office of Tax Appeals (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 pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).[4]

ISSUES

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

[3] The statute of limitations to initiate a criminal proceeding had lapsed for earlier periods. (See R&TC, § 7154.)

[4] 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 fill the vacancy on the Panel.

2. Whether CDTFA timely issued the NOD.[5]
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 an NOD for the reporting periods covered by the plea agreement.
5. Whether relief of the amnesty double fraud penalty is warranted.

FACTUAL FINDINGS

1. Appellant, a California corporation, was an authorized franchisee of Doctors Associates, Inc. dba Subway (franchisor).
2. As relevant to this appeal, appellant operated five Subway franchise locations in Southern California during the liability period.[6] Appellant held a California seller's permit, No. 097-204565, which was effective January 1, 1998, through December 31, 2015.
3. Appellant had one corporate officer, A. Beri, who was its president and sole shareholder during the liability period. Appellant's president was also the president and, in conjunction with spouse R. Beri, the majority or sole shareholder (or owner) of Denny's franchise locations, Del Taco franchise locations, and over twenty additional Subway franchise locations owned and operated in Southern California by related entities under the control of appellant's president, A. Beri.
4. Appellant's Point of Sale system generated two types of reports: Control Sheets (daily sales reports), which detailed daily sales information, and Weekly Inventory & Sales Receipts (weekly sales reports).
5. Appellant's franchise agreement required it to send the daily and weekly sales reports to the franchisor. The franchisor used these sales reports to calculate the applicable royalty fees that appellant owed to the franchisor.

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[5] Absent a finding that the NOD is timely, issues 3 and 4 are moot.

[6] The audit included unreported taxable sales from the following Subway franchise locations: 1058, 11219, 10108, 15106, and 17162. During calendar year 2003, appellant closed Subway stores 1058, 10108, and 15106. Appellant operated the remaining two Subway locations though the close of the liability period.

6. During the liability period, A. Beri signed and filed appellant's sales and use tax returns (SUTRs) as its president.[7] The SUTRs were not signed by a paid preparer. A. Beri also signed appellant's application for seller's permit as its president.

7. In December 2008, CDTFA began an audit of Subway franchise locations owned by a separate entity, Ajay Beri Corporation, Inc. (ABC), of which appellant was also the president.

8. For the audit of ABC, A. Beri provided daily sales reports for the third quarter of 2007 (3Q07), which disclosed a taxable sales percentage of 23.8 percent. ABC did not provide source documentation, such as cash register Z-tapes. CDTFA informed A. Beri that CDTFA was going to perform a one-day observation test at three of ABC's Subway franchise locations to verify the taxable percentage. During the observation test, CDTFA observed that the same customers made purchases at all three Subway locations, and CDTFA found it unusual that the observed taxable percentage, and sales data, were inconsistent with the recorded data in the daily and weekly sales reports.

9. On June 23, 2011, CDTFA, in conjunction with law enforcement, executed a search warrant at various locations associated with appellant, ABC, A. Beri, appellant's franchisor, and other related entities and individuals.[8]

10. Upon examination of computer hard drives, which had been seized by CDTFA in conjunction with law enforcement pursuant to the criminal investigation, CDTFA's forensic investigator determined that appellant (and the other entities owned and operated by A. Beri) maintained two sets of sales tax records. Appellant used the first set of books and records for reporting sales to its franchisor, and the second set for reporting sales to CDTFA. The first set of records, which appellant, ABC, and the related entities submitted to their franchisor, included recorded sales amounts and sales tax reimbursement collected that were substantially higher than the recorded sales amounts

[7] CDTFA submitted a copy of the SUTRs as sub-exhibit 14, to its Exhibit A.

[8] The following locations were searched: all the Subway franchise locations owned by appellant and ABC; 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 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.

and sales tax reimbursement collected reflected in the second set of records. Appellant reported sales to CDTFA based on the substantially lower amounts reflected in the second set of records.

11. Upon further examination, CDTFA determined that the first set of books and records correctly recorded daily sales data, including "sales tax" amounts. In the second set, the daily data concerning "sales tax" amounts had been modified and replaced with a formula, which multiplied the original "sales tax" amount by a fractional percentage,[9] and which ultimately replaced the original "sales tax" values with the adjusted formula amounts, which were substantially less.

12. CDTFA concluded that it was unable to use the results of the observation test in its audit of appellant, ABC, or any of the related entities operating Subway franchise locations in Southern California. The reason is because, 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's president had intentionally interfered with CDTFA's observation test in order to influence the audit results to understate taxable sales. CDTFA's forensic examination of the cell phone revealed text messages from A. Beri instructing Subway franchise employees to disguise themselves as Subway customers and to make purchases of nontaxable items during the time that CDTFA was conducting an observation test at the three Subway franchise locations to determine the taxable percentage. For example, appellant's president sent the following text to multiple Subway franchise employees on February 22, 2010, prior to the observation tests:

> "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."

13. CDTFA also discovered text messages showing that A. Beri monitored the number of nontaxable sales made during the observation tests, apparently with the intention of

[9] 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.

deflating the taxable sales ratio so it would more closely align with the reduced taxable ratios contained in the falsified set of records that appellant used to report sales to CDTFA.[10]

14. CDTFA obtained appellant's daily and weekly sales reports for the liability period from the franchisor pursuant to the search warrant.

15. CDTFA's forensic examination of seized computer hard drives disclosed detailed financial statements that compiled sales data for appellant's franchise locations. The amounts listed on the income and expense analysis closely reconciled with the data appellant reported to its franchisor, except for, as relevant here, an important difference: the sales tax reimbursement collected substantially exceeds the sales tax appellant reported to CDTFA. 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. These were the files that included a formula to reduce the "sales tax" amount by a fractional percentage (discussed above).

16. CDTFA also seized copies of SUTRs and accompanying sales tax worksheets for appellant and some related entities operating franchise locations. CDTFA discovered substantial discrepancies between amounts reported to CDTFA and amounts reported to appellant's franchisor. CDTFA noted that some seized sales tax worksheets 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;[11] 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."

17. 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

[10] 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."

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

period January 1, 2007, through December 31, 2010.[12]

18. On November 1, 2016, A. Beri, as appellant's president, executed a plea agreement with the Attorney General's office. A. Beri, appellant's president, agreed to plead guilty to felony tax evasion (Count 65), for the following:

> Defendants A[.] Beri and Beri Restaurant Group, Incorporated [(appellant)], being persons required to make, render, sign or verify any report, to with: a sales tax return for seller's permit number Y EA 097-204565, unlawfully filed 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.

19. 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 lists the felony tax evasion charge against defendants A. Beri and appellant, to which appellant's president pled guilty.

20. Also on November 1, 2016, A. Beri as an individual, and R. Beri on behalf of the related entity operating Subway franchise locations, ABC, executed the plea agreement. A. Beri and ABC both agreed to plead guilty to additional tax evasion charges (Count 63) for filing false SUTRs 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.[13]

21. 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 $760,281. The total amount of restitution identified by CDTFA for five related entities, including appellant, was

[12] 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.)

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

$3,021,059 in unpaid tax, excluding interest and penalties.[14]

22. 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 (i.e., calendar years 2007 to 2010).

23. 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.

24. 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 payment of the criminal restitution. The plea agreement did not contain any language addressing dismissal of appellant's felony tax evasion charge.

25. 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.

26. Effective October 30, 2017, CDTFA applied $43,431.96 out of $3,021,059 of the criminal restitution payments towards appellant's account.[15]

27. On December 12, 2017, appellant timely filed a claim for refund of the criminal restitution payments applied to its account.

28. On April 6, 2018, which was after the criminal restitution payments were paid to the State of California, CDTFA issued the NOD to appellant.

29. The liability disclosed in the NOD was calculated based on an audit of the sales reports

[14] 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. (See CDTFA Fraud Memo, Exhibit 7.)

[15] 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.

that CDTFA seized from the franchisor. In addition, for periods in which the weekly sales reports included information on sales tax, CDTFA upgraded the 25 percent fraud penalty to a 40 percent penalty.

30. On August 1, 2019, CDTFA issued a decision denying appellant's petition and related refund claim. This timely appeal followed.

31. After timely paying the required criminal restitution, A. Beri requested dismissal of his felony tax evasion charge, which request was granted pursuant to the terms of the plea agreement.[16]

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 and, 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, in pertinent part, 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), (g).)

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, CDTFA concedes that, absent fraud, the NOD would be untimely and, as such, the amount of tax, interest, and penalties determined pursuant to the NOD 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 the criminal defendants and the Attorney General's

[16] 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.

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 NOD 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 $43,431.96 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 NOD. Appellant contends that the criminal restitution was ultimately applied to a time-barred deficiency. 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 NOD is 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 petition (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.

Issue 2: Whether CDTFA timely issued the NOD.

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, absent a finding of fraud during each of the respective quarterly reporting periods covered by the NOD, the NOD is untimely.[17] Fraud or intent to evade must be established by clear and convincing evidence. (*Appeal of ISIF Madfish Inc.*, 2019-OTA-292P.)

[17] 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. (See *Appeal of Senehi*, 2023-OTA-446P.)

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. 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.

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 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 and appellant's president, A. Beri, pled guilty to felony "tax evasion" for "unlawfully fil[ing] false or fraudulent sales tax returns [for appellant] 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 during any 12-month period. As relevant to the NOD, which asserts $758,768.46 in tax (an average of $63,230.71 per calendar year), 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). There is nothing in the law which would prevent a person criminally charged with felony tax evasion from being held civilly liable for the 25 percent fraud penalty.

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, including the precedent set forth in *Appeal of Erilane, supra*, applies to an administrative tax appeal before OTA.[18]

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).[19]) 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].) In other words, in this case appellant's president has

[18] 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.*

[19] Regulation section 30214(f), allows the Panel to consider the California Evidence Code in determining the weight to afford evidence.

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. (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 the precedent set forth in *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 reporting period(s) 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).) Here, the guilty plea to felony tax evasion included an admission that both A. Beri and appellant filed "false or fraudulent sales tax returns." OTA does not find it material 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.[20] The guilty plea is still evidence that OTA may consider. Under the precedent cited above, it is sufficient to establish tax evasion that appellant (whether

[20] As noted in Factual Finding # 34, *supra*, the terms of the plea agreement specify the California 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 ABC's felony tax evasion charge (count 63) or of A. Beri's misdemeanor tax evasion charge (count 63), and there is no evidence to suggest that these counts were dismissed.

by or through its president) pled guilty to felony tax evasion. Furthermore, A. Beri's plea of guilty to tax evasion is additional, and relevant, direct evidence of appellant's tax evasion, just as ABC's guilty plea to felony tax evasion during the period at issue is additional indirect evidence to support a finding of fraud. Furthermore, appellant neither presented nor identified any viable evidence in the record before OTA to contradict A. Beri's guilty plea. Appellant, through its president, pled guilty to felony tax evasion and this Opinion may consider the effect of appellant's admission to felony tax evasion.

Pursuant to Regulation section 30214(f)(1), all relevant evidence is admissible; accordingly, 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 as president of appellant and ABC, whether viewed individually or taken together, are admissible for OTA to consider as direct and indirect evidence of fraud.[21]

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 appellant's president, A. Beri, sent Subway franchise employees during observation tests that would have directly impacted appellant's audit results, 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 the NOD. Here, for calendar year 2010, appellant reported taxable sales of $390,979, and the daily and weekly sales reports established sales tax reimbursement collected on sales of $716,752. Based on all the above, there is ample direct and indirect 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 (by and through its president, A. Beri) 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

[21] 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).)

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 NOD as to the reporting periods covered by January 1, 2010, through December 31, 2010.

The period January 1, 1998, through December 31, 2009

At the start of the audit of a related entity controlled by appellant's president, which was operating Subway franchise locations in Southern California, appellant's president furnished a falsified set of records for the third quarter of 2007 to hide the true gross receipts generated by his Subway franchise locations from CDTFA. When CDTFA attempted to verify the accuracy of these records, appellant's president directed Subway franchise employees to disguise themselves as customers and purchase nontaxable food items at three Subway franchise locations operated by ABC during CDTFA's observation tests, for the purpose of artificially deflating the taxable sales ratio of the Subway franchise locations (which would have directly benefitted appellant because CDTFA could have applied the observation test results to all of the related Subway franchise locations). Based on records seized by CDTFA, in conjunction with law enforcement, pursuant to a search warrant, CDTFA discovered that the fraudulent reporting activities had extended back in time to at least 1998. 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 SUTRs. During this period, appellant reported $4,341,581 in taxable sales to CDTFA, even though its legitimate records (as reported to its franchisor) reflected sales tax due (and collected) on taxable sales of $13,134,277 during the same period. In other words, appellant reported only 33 percent of its sales tax liabilities to CDTFA.

There is direct and compelling evidence of fraud and a demonstrated pattern of fraudulent activities by appellant, its president, and related entities under the control of appellant's president

and which operated Subway franchise locations in the same geographic region. This pattern of fraudulent reporting of Subway franchise location sales in Southern California was continuous, persistent, and substantial for all reporting periods and consistently extended throughout the period at issue, as demonstrated by appellant's own admission, under penalty of perjury, that these same types of activities identified in earlier periods had constituted felony tax evasion during 2010. 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 NOD. As such, CDTFA timely issued the NOD as to the reporting periods covered by January 1, 1998, through December 31, 2009.

Relevance of the second set of books and records

Appellant asks that the second (falsified) 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. In reliance on this position, appellant argues that the available evidence cannot be used to find that appellant maintained a second set of books and records. OTA finds these arguments unpersuasive. Subject to limited exceptions which are not pertinent here, in an appeal to OTA there is no authority for excluding records seized pursuant to a valid search warrant.[22] 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.

Based on all the above, OTA finds that CDTFA timely issued the NOD as to all reporting periods.

[22] 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.

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

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*.)

Here, CDTFA calculated the liability using appellant's own records, which appellant furnished to its franchisor to report its sales (including sales tax amounts). OTA finds that appellant's own records are a reasonable and rational basis to compute appellant's taxable sales. 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.

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,[23] and in violation of CDTFA's Operations Memorandum No. 1162 dated November 17, 2010 (Ops Memo 1162).[24] 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 a taxpayer's premises by an auditor, is simply not relevant in the context of a search warrant executed by law enforcement.[25]

In summary, appellant 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.

Issue 4: Whether appellant's court-ordered criminal restitution payments precluded CDTFA from issuing an NOD 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

[23] 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.

[24] 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.

[25] 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.)

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, as opposed to the Sales and Use 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 CDTFA.[26] Second, R&TC section 7157(a)(2) imposes no limitation upon CDTFA's ability to pursue unpaid taxes. On 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 did not, and do not, preclude CDTFA from issuing one or more NODs to appellant for its unreported sales and use taxes.

Issue 5: Whether relief of the amnesty double fraud penalty is warranted.

Under the provisions of R&TC section 6592(a), a taxpayer may be relieved of the amnesty penalties if the taxpayer's failure to participate in the amnesty program was due to reasonable cause or circumstances beyond its control, and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect.

Appellant requests relief of the amnesty double fraud penalty on the basis that appellant was not aware of the amnesty program.

The record in this appeal does not support appellant's contention. In its decision, CDTFA stated that it mailed to all permit holders, including appellant, numerous letters which explained the Tax Amnesty Program and the due dates for participation. Appellant has provided

[26] 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]."

no explanation or evidence indicating that it did not receive these letters. Furthermore, given that appellant's related entities, including ABC, also held seller's permits during the amnesty-eligible period, appellant would have also received notice of the amnesty program from CDTFA's mailing to these related entities. Based on the foregoing, OTA concludes that relief of the amnesty double fraud penalty is not warranted.

HOLDINGS

1. OTA lacks jurisdiction to refund appellant's criminal restitution payments, regardless of whether the NOD was timely.
2. CDTFA timely issued the NOD.
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 an NOD for the period covered by the plea agreement.
5. Appellant has not established that relief of the amnesty double fraud penalty is warranted.

DISPOSITION

CDTFA's denial of the petition for redetermination and related claim for refund is sustained.

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Andrew J. Kwee
Administrative Law Judge

We concur:

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

M. GEARY, Administrative Law Judge, concurring: While I agree with the majority's Holdings and Disposition, I cannot agree with part of its analysis.

There is abundant evidence of appellant's fraud or intent to evade the payment of tax. Beri Restaurants Group, Inc.'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 as admissions against a party's interests; 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." (*Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd.* (1962) 58 C.2d 601, 605.) The majority appears to agree with the California Supreme Court when it states that a plea of guilty to felony tax evasion does not conclusively establish fraud in a California appeal under the Sales and Use Tax Law. Yet, in reliance on opinions issued by the State Board of Equalization – with which I also disagree, for the same reason – the majority ultimately gives these pleas conclusive effect when it creates a rebuttable presumption of fraud based only on a taxpayer's guilty plea. In my view, allowing a guilty plea alone to satisfy the California Department of Tax and Fee Administration's burden of establishing tax evasion by clear and convincing evidence steps past the line drawn by our Supreme Court, a step that was unnecessary in this case.

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

Date Issued: 11/14/2023