OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of: **BERI DEVELOPMENT, LLC, dba Subway,** **BERI VENTURES, LLC, dba Subway,** **BERI ENTERPRISES, LLC, dba Subway,** **AND** **RELIANCE RESTAURANTS, LLC,** **dba Subway**	OTA Case Nos. 19075086, 19075088, 19075089, and 19075104 CDTFA Case IDs: 120-061, 149-009, 112-035, 116-046, and 116-048

OPINION

Representing the Parties:

For Appellants: David Dunlap Jones, Attorney

For Respondent: Sunny Paley, Attorney

For Office of Tax Appeals: Corin Saxton, Attorney

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Beri Development, LLC (BD); Beri Ventures, LLC (BV); Beri Enterprises, LLC (BE); and Reliance Restaurants, LLC (RR), each dba Subway (collectively, appellants) appeal a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellants' respective petitions for redetermination of Notices of Determination (NODs) for the period January 1, 2010, through December 31, 2010 (liability period), as well as denying a claim for refund that RR filed for payments made towards its NOD.

The NOD issued to BD is dated September 6, 2017, and is for $35,962.73 in tax, plus applicable interest, a 25 percent fraud penalty (fraud penalty) of $237.45,[2] and a 40 percent penalty of $14,005.22 for failing to remit sales tax reimbursement collected from customers

[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

[2] The fraud penalty for BD was imposed for the period October 1, 2010, through December 31, 2010.

(40 percent penalty)[3] for the liability period. The NOD is based on a Field Billing Order (FBO)[4] which found unreported taxable sales of $368,848.[5] The deficiency measure of $368,848 is based on a comparison of reported taxable sales of $813,490 to recorded taxable sales of $1,182,338 ($1,182,338 - $813,490), which CDTFA calculated by capitalizing the sales tax reimbursement listed on the Weekly Inventory & Sales Receipts (WISRs) obtained from appellants' Subway franchisor, Doctors Associates, Inc. (franchisor DAI).

The NOD issued to BV is dated September 14, 2017, and is for $49,925.30 in tax, plus applicable interest, and a 40 percent penalty of $19,970.11 for the liability period. The NOD is based on an FBO which found unreported taxable sales of $512,055. The deficiency measure of $512,055 is based on a comparison of reported taxable sales of $735,077 to recorded taxable sales of $1,247,132 ($1,247,132 - $735,077), which CDTFA calculated by capitalizing the sales tax reimbursement listed on the WISRs obtained from franchisor DAI.

The NOD issued to BE is dated September 5, 2017, and is for $54,154.46 in tax, plus applicable interest, and a 40 percent penalty of $21,661.77 for the liability period. The NOD is based on an FBO which found unreported taxable sales of $555,429. The deficiency measure of $555,429 is based on a comparison of reported taxable sales of $909,867 to recorded taxable sales of $1,465,296 ($1,465,296 - $909,867), which CDTFA calculated by capitalizing the sales tax reimbursement listed on the WISRs obtained from franchisor DAI.

The NOD issued to RR is dated August 31, 2017, and is for $51,550.52 in tax, plus applicable interest, and a 40 percent penalty of $20,620.21 for the liability period. The NOD is based on an FBO which found unreported taxable sales of $528,723. The deficiency measure of $528,723 is based on a comparison of reported taxable sales of $755,089 to recorded taxable sales of $1,283,812 ($1,283,812 - $755,089), which CDTFA calculated by capitalizing the sales tax reimbursement listed on the WISRs obtained from franchisor DAI.

Appellants waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record.

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[3] The 40 percent penalty for BD was imposed for the period January 1, 2010, through September 30, 2010.

[4] An FBO is used "to recommend an additional tax liability or refund from procedures other than those used in regular audits. It is not an audit report and does not change the audit status of the account." (CDTFA Audit Manual § 0201.09 (February 2015).)

[5] The FBOs for appellants do not appear to be in the administrative record; however, the parties do not dispute the amount of unreported taxable sales each FBO found, upon which the applicable NOD is based.

ISSUES[6]

1. Whether CDTFA has provided clear and convincing evidence of fraud.[7]
2. Whether adjustments are warranted to the tax deficiencies, as determined by CDTFA.[8]
3. Whether courtordered criminal restitution payments preclude CDTFA from issuing determinations.[9]
4. Whether CDTFA properly imposed the 40 percent penalties and if so, whether appellants are entitled to relief of the penalties.
5. Whether appellants are entitled to relief of interest.

FACTUAL FINDINGS

1. Appellants are each a California limited liability company (LLC). BD, BV, and BE each operating various Subway sandwich restaurants in Los Angeles County during the liability period. These restaurants were transferred to appellants from Ajay Beri Corporation (ABC) on December 31, 2009, when ABC transferred most of its locations

[6] Prior to this matter being submitted on the written record, OTA held a prehearing conference (PHC) with the parties. The parties did not identify Issues 4 and 5 during the PHC, or the subsequent Minutes and Orders. However, CDTFA addressed the issues in its decision., and appellant has not expressly waived those issues. Therefore, OTA will address them in this Opinion out of an abundance of caution.

[7] A fraud penalty was imposed on BD. Although BD claims on appeal that a fraud penalty was not imposed, OTA notes that the NOD includes a fraud penalty of $237.45 for the period October 1, 2010, through December 31, 2010. Although unclear, it appears to OTA that BD is arguing that the NOD is untimely for the period prior to January 1, 2010, through September 30, 2010, because a fraud penalty was not applied for this period. However, a finding that any part of a deficiency determination was due to fraud is sufficient to suspend the statute of limitations to issue a deficiency determination as to the entire reporting period in which any part of the deficiency was due to fraud. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.)

CDTFA did not impose a fraud penalty on BV, BE, or RR; however, a finding that any part of a deficiency determination was due to fraud is sufficient to suspend the statute of limitations to issue a deficiency determination as to the entire reporting period in which any part of the deficiency was due to fraud. (*Appeal of ISIF Madfish, Inc.*, *supra*.) Therefore, the statute of limitations is tolled whenever there is a finding of fraud, regardless of whether a fraud penalty has been imposed.

Additionally, while appellants have not raised specific arguments with respect to the 40 percent penalty imposed on each entity, the standard for imposing the 40 percent penalty is the preponderance of the evidence (*Appeal of ISIF Madfish, Inc.*, *supra*), and a showing of fraud would exceed this standard.

[8] Although the tax liabilities are satisfied and a claim for refund is barred, OTA addresses appellants' dispute regarding the amount of the deficiency since any reductions to the tax deficiency would warrant corresponding reductions to the outstanding interest and penalty amounts.

[9] A court is required to order a person convicted of a crime to make restitution to the victim(s) for economic loss suffered as a result of the defendant's conduct. (Pen. Code, § 1202.4(f).)

to appellants and to related LLCs.[10] ABC's president, A. Beri, is the president or a member of each related entity, and ABC's bookkeeper, A. Avina, prepared the sales and use tax returns for each entity, including appellants.

2. Appellants' each had a Point of Sale (POS) system,[11] Subshop 2000, which generated two types of weekly reports: control sheets, which detailed daily sales information; and WISRs, which compiled daily inventory and sales information. Both reports generally listed sales tax reimbursement. Pursuant to each appellants' franchise agreement with franchisor DAI, appellants were required to transmit control sheets and WISRs from their respective POS systems to franchisor DAI on a weekly basis.
3. On January 19, 2011, in response to CDTFA's determination that appellants' related entity, ABC, consistently underreported taxable sales, CDTFA began a fraud investigation of appellants and appellants' related entities. On June 23, 2011, CDTFA and the California Highway Patrol executed two search warrants on the following locations: Subway restaurants owned by appellants and related entities; franchisor DAI; the office of appellants' accountant; the residence of A. Avina; a storage unit containing business records;[12] and the residences and offices of appellants' two members, A. Beri and R. Beri. As a result of these search warrants, CDTFA obtained computers, a cell phone belonging to A. Beri, and over 400 boxes of records.
4. Franchisor DAI provided appellants' WISRs for the liability period.
5. CDTFA's forensic examination of the seized computers disclosed detailed financial statements, including an income and expense analysis by location. While the amounts listed on the income and expense analysis are substantially similar to the data provided by

[10] ABC owned numerous sublocations while holding a seller's permit, and transferred locations on November 30, 2003, and on December 31, 2009, to Beri Foods Group, Inc. (BFG) and to appellants, respectively. BD sold two of its locations following the liability period.

Appellants' seller's permits were each opened effective January 1, 2010. Appellants' seller's permits each list A. Beri and R. Beri as appellants' two members. A. Beri is also BFG's president.

[11] A POS system typically includes one or more terminals, which are the modern equivalent of cash registers. Depending on the equipment and software, POS systems can generate reports (sometimes referred to as "Z-tapes") which summarize sales activity for the period of time selected by the operator. These reports can include breakdowns of sales by type and amount, including product or service, credit or cash, and taxable or nontaxable.

[12] While executing the first search warrant, A. Avina informed CDTFA of the storage unit, and a supplemental search warrant was obtained to search the storage unit and A. Avina's residence.

franchisor DAI, the sales tax reimbursement listed on the income and expense analysis exceeds the sales tax reported to CDTFA.[13]

6. CDTFA also found a second set of records containing several electronic files of ABC's "control sheets," which were not generated by Subshop 2000 and in which the sales tax computation was overridden to show a lesser amount, while increasing the nontaxable sales figure and keeping the gross receipts amount intact.[14] CDTFA determined that the cells containing sales tax amounts were based on a formula that multiplied the value in the adjusted drink sales cell by 16.01 to 37.98 percent. Upon comparison, CDTFA found that the WISRs provided by franchisor DAI consistently showed higher sales tax reimbursement amounts than those listed in ABC's control sheets.

7. Sales tax returns and accompanying sales tax worksheets for some of appellants' related entities were included in the records that CDTFA seized. ABC's second quarter of 2010 (2Q10) sales tax return and worksheet showed sales tax amounts substantially lower than the sales tax listed on the WISRs and control sheets that franchisor DAI provided, even though all other data on the seized worksheets matched that of franchisor DAI's WISRs and control sheets. Additionally, although the 4Q10 sales tax returns for BV and RR include control sheets and draft sales tax returns listing the correct sales tax amount, both entities' final 4Q10 sales tax worksheets contain a reduced sales tax amount and a handwritten notation at the bottom of the document stating, "Ok per 11 am meeting on 01-27-11."

8. Furthermore, CDTFA found WISRs attached to related-entity Beri Foods Group, Inc.'s (BFG's) November 2010 sales tax prepayment return, and the data in these WISRs matches that of the WISRs provided by franchisor DAI. Nonetheless, the final sales tax worksheet for this prepayment return (which identified the sales tax ultimately reported) lists less sales tax than that identified in the WISRs and less sales tax than that identified

[13] CDTFA compared the sales tax reimbursement listed on the income and expense analysis to the amounts listed on franchisor DAI's WISRs and found that, while the amounts do not correspond exactly, the yearly sales tax listed for each location on the income and expense analysis was usually within $100 to $200 of the amounts listed in the WISRs, with the amounts listed in the income and expense analysis sometimes exceeding the amounts listed in the WISRs. For example, while the income and expense analysis for BFG lists sales tax totaling $144,185.07, the WISRs indicate sales tax totaling $143,752.

[14] The exact dates of these electronic control sheets are not clear from the record, but it appears these electronic control sheets were created for periods in 2007 and/or 2008.

in a draft sales tax worksheet. And although the draft sales tax worksheet indicates a taxable sales ratio of 58 percent,[15] a handwritten notation on the draft sales tax worksheet states, "For [A. Beri] to Review" and "Per [A. Beri] ~ 46% Taxable ~ 54% Non taxable [*sic*]."

9. CDTFA's forensic examination of A. Beri's cell phone revealed text messages from A. Beri to employees, such as A. Avina, instructing them to make purchases, as customers, of nontaxable items during an observation test CDTFA performed in its audit of ABC (for the period January 1, 2006, through December 31, 2009),[16] as well as text messages showing that A. Beri monitored the ratio of nontaxable sales made during the observation test, with the intention of inflating it.[17]

10. The Office of the Attorney General, a part of California's Department of Justice, filed a 66count criminal complaint against A. Beri, ABC, several of appellants' related entities, and others.[18] On November 30, 2015, a preliminary hearing concluded in the matter of *The People of the State of California vs. A. Beri, et al.*, Orange County Superior Court Case No. 16CF1378. According to the court transcript, R. Luthra, a member of at least four of appellants' related entities, testified during the preliminary hearing that he approached A. Beri on more than one occasion to discuss underreporting, but A. Beri dismissed his concerns.[19]

11. On November 1, 2016, A. Beri, as an individual, and R. Beri, on behalf of ABC, executed a Plea Addendum with the California Department of Justice. A. Beri and ABC both agreed to plead guilty to tax evasion (Count 63) for filing false sales and use tax returns

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

[16] For example, A Berri sent the following text to multiple employees, including A. Avina, on February 22, 2010: "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. Please call me or text me if you got any questions." (*Sic*.)

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

[18] As relevant here, the criminal complaint charged the defendants with tax evasion in violation of R&TC section 7153.5.

[19] The court stated during the hearing that "Mr. Luthra testified that when he realized there was under reporting or there was something fishy going on with the books regarding the company he was involved with, he did approach A. Beri. A. Beri provided some sort of a response like, 'trust me, everyone does it this way,' and that was on more than one occasion."

for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the tax due. For Count 63, A. Beri agreed to plead guilty in violation of R&TC section 7153, a misdemeanor, and ABC agreed to plead guilty in violation of R&TC section 7153.5, a felony. A. Beri also pled guilty to felony tax evasion (Count 65), which charged A. Beri and a related entity with unlawfully filing false or fraudulent sales and use tax returns for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the tax due, in the amount of $25,000 or more. In addition, A. Beri agreed to pay restitution of $3,021,059.

12. A. Beri signed the Plea Addendum and related forms under penalty of perjury, declaring his understanding that the signed and filed forms constituted conclusive evidence of the guilty plea.

13. During and for the purposes of the criminal proceedings, CDTFA established that the criminal defendants owed a total of $3,021,059 in tax for the period January 1, 1998, through December 31, 2010.[20] The court ordered A. Beri to serve 270 days confinement on home monitoring on the misdemeanor count and to pay restitution to CDTFA on all counts in the amount of $3,021,059 "even if any of these counts have been dismissed as part of a plea agreement." The Plea Addendum included provisions for delayed sentencing on the felony tax evasion guilty plea and dismissal of the felony tax evasion count upon payment of the restitution in full within 18 months of the plea. The court froze A. Beri's assets pending payment of the restitution in full.

14. A. Beri timely paid the $3,021,059 in restitution; therefore, Count 65 (felony tax evasion) against him was dismissed.

15. Based on the evidence obtained through its search warrants, CDTFA determined that appellants committed fraud, and CDTFA issued appellants the aforementioned NODs at issue here.[21]

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[20] The $3,021,059 in restitution was calculated as follows: (1) ABC, $1,842,078; (2) B&L Diners, Inc. dba Denny's, $229,670; (3) Beri Restaurants Group, Inc. dba Subway, $760,281; (4) BFG dba Subway, $153,693; and (5) Delco Enterprises, Inc. dba Del Taco $35,337.

[21] Effective October 30, 2017, CDTFA applied to BD's, BV's, BE's, and RR's liability a payment of $35,962.73, $49,925.30, $54,154.56, and $6,550.52, respectively, made pursuant to a criminal restitution plea agreement, which paid off the tax liabilities in full. RR filed a claim for refund for its payment; however, R&TC section 7157(c) bars refunds or credits for amounts paid or payments applied pursuant to a restitution order.

16. Appellants submitted requests for relief of penalties including a collection cost recovery fee (CCRF) to CDTFA. However, CDTFA did not impose a CCRF on appellants.[22]
17. CDTFA issued decisions denying appellants' petitions and requests for relief of penalties, as well as RR's claim for refund. CDTFA also determined that appellants did not show that interest should be relieved.
18. This timely appeal followed.

DISCUSSION

Issue 1: Whether CDTFA has provided clear and convincing evidence of fraud.

CDTFA imposed a 25 percent fraud penalty pursuant to R&TC section 6485. Under R&TC section 6485, if any part of the deficiency for which a deficiency determination is made is due to fraud or an intent to evade the law or authorized rules and regulations, a penalty of 25 percent of the amount of the determination shall be added thereto. The NOD will be barred by the three-year statute of limitations unless clear and convincing evidence establishes fraud in at least some portion of every reporting period that would otherwise be barred.[23] (R&TC, § 6487(a); *Appeal of Senehi*, 2023-OTA-446P.)

Fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owed. (*Bradford v. Commissioner* (9th Cir. 1986) (*Bradford*) 796 F.2d 303, 307.) Fraud must be established by clear and convincing evidence. (Cal. Code Regs., tit. 18, § 1703(c)(3)(C); *State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1241.) However, this does not mean that CDTFA must prove every contested fact by clear and convincing evidence. (*Appeals of Jafari and Corona Motors, Inc.*, 2023-OTA-401P.) Rather, OTA looks to the totality of the evidence to determine whether CDTFA has met its burden. (*Ibid*.)

Although fraud may not be presumed, it is rare to find direct evidence that fraud has occurred, and thus it is often necessary to make the determination based on circumstantial evidence. (*Bradford, supra*, 796 F.2d at p. 307; *Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18,

[22] The requests for relief of penalties do not include a request for relief of interest; however, appellants previously requested relief of interest.

[23] Except in cases of fraud, for taxpayers filing returns on other than an annual basis, an NOD must 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 later. (R&TC, § 6487(a).)

30.) Where there is a substantial deficiency that cannot be explained satisfactorily as being due to an honest mistake or to negligence and where the only reasonable explanation is a willful attempt to evade the payment of tax, the penalty for fraud or intent to evade the tax should apply. (*Bradford*, *supra*, 796 F.2d at p. 307.)

Circumstantial evidence of intent to evade taxation includes, but is not limited to: substantial discrepancies between recorded amounts and reported amounts which cannot be explained (the likelihood that a deficiency is due to intent to evade increases in direct proportion to the percentage of error, which is the understatement divided by the reported amount); tax or tax reimbursement properly charged, evidencing knowledge of the requirements of the law, but not reported; inadequate records; failure to cooperate with tax authorities; and consistent, substantial understatements of income. (*Bradford*, *supra*, 796 F.2d at p. 307; *Powell v. Granquist* (9th Cir. 1958) 252 F.2d 56, 60.)

CDTFA argues that appellants knowingly and consistently understated their taxable sales, and that the understatements were significant, as demonstrated by the following percentages of error: (1) 45.34 percent for BD;[24] 69.66 percent for BV;[25] 61.05 percent for BE;[26] and 70.02 percent for RR.[27] CDTFA also asserts that appellants each maintained two separate sets of records, with one set containing tax amounts that match those provided by franchisor DAI, and one with lower tax amounts that were reported to CDTFA.

CDTFA contends that as appellants' only members, A. Beri and R. Beri knew the correct

[24] CDTFA asserts that while it found recorded taxable sales of $1,182,338 in the sales reports from franchisor DAI's POS system for the liability period, BD reported taxable sales of only $813,490 for that period, resulting in unreported taxable sales of $368,848, an underpayment of $35,964 in tax, and a 45.34 percentage of error ($368,848 ÷ $813,490).

[25] CDTFA asserts that while it found recorded taxable sales of $1,247,132 in the sales reports from franchisor DAI's POS system for the liability period, BV reported taxable sales of only $735,077 for that period, resulting in unreported taxable sales of $512,055, an underpayment of $49,925 in tax, and a 69.66 percentage of error ($512,055 ÷ $735,077).

[26] CDTFA asserts that while it found recorded taxable sales of $1,465,296 in the sales reports from franchisor DAI's POS system for the liability period, BE reported taxable sales of only $909,867 for that period, resulting in unreported taxable sales of $555,429, an underpayment of $54,156 in tax, and a 61.05 percentage of error ($555,429 ÷ $909,867).

[27] CDTFA asserts that while it found recorded taxable sales of $1,283,812 in the sales reports from franchisor DAI's POS system for the liability period, RR reported taxable sales of only $755,089 for that period, resulting in unreported taxable sales of $528,723, an underpayment of $51,549 in tax, and a 70.02 percentage of error ($528,723 ÷ $775,089).

amounts of gross receipts and tax reimbursement collected but chose to report a fraction of the reimbursement collected. CDTFA asserts that A. Beri and R. Beri controlled appellants' business operations and maintained accounts of its assets and revenues,[28] and that A. Beri filed SUTRs for all entities he owned and operated, including for appellants, and remitted payments of sales tax to CDTFA. CDTFA contends that A. Beri understood the sales tax reporting requirements[29] and notes that it provides all relevant laws and regulations to each permitholder at the time the permit is issued, and that it also issues quarterly Tax Bulletins and special industry mailings. CDTFA contends that A. Beri and R. Beri operated other franchisee locations with similar or greater underreporting, and that A. Beri's and ABC's guilty pleas demonstrate fraud.

Appellants argue that each of their underreporting was unintentional and not fraudulent. Appellants contend that CDTFA has not proven fraud and, therefore, the NODs are untimely. Appellants assert that their bookkeeper, A. Avina, prepared the sales and use tax returns using weekly control sheets that each store faxed to appellants' headquarters. Appellants argue that their bookkeeper consolidated each control sheet into a tabulation sheet and that a second tabulation sheet was designed to verify that the stores were charging at least the minimum sales tax threshold percentage. Appellants contend that their bookkeeper used the second tabulation sheet in error when filing the sales tax return and, therefore, appellants accidentally reported the "minimum threshold" of sales tax instead of taxable sales. In support, appellants provide a declaration, dated November 14, 2012, from A. Avina stating that he mistakenly used the secondary set of data. Appellants argue that they did not maintain a double set of books and records, and that evidence obtained through the search warrant executed on locations owned by other entities should not be considered in this appeal.

[28] CDTFA asserts that this is evidenced by documents obtained from the search warrant, including charts listing business locations, percentage of ownership in each business entity, a detailed personal financial statement listing business locations, real properties, loans, and an income and expense analysis by location.

[29] CDTFA contends that taxable food sales and nontaxable food sales were segregated on the SUTRs and sales tax reimbursement was charged, including applicable district taxes on retail sales, evidencing A. Beri's knowledge of the requirements of the Sales and Use Tax Law concerning sales tax reimbursement.

A. Beri had access to appellants' correct tax information via the POS systems.[30] Nevertheless, appellants consistently and significantly underreported their taxable sales during the liability period. Specifically, BD's, BV's, BE's, and RR's underreporting resulted in percentages of error of 45.34 percent, 69.66 percent, 61.05 percent, and 70.02 percent, respectively, for the liability period, each of which is significant.[31] Given the size and consistency of appellants' underreporting, OTA finds that the underreporting is unlikely the result of confusing the "minimum threshold" with appellants' sales tax obligations, as opposed to being the result of intentional underreporting.

Furthermore, documents seized from BV and RR indicate an awareness of underreporting. Specifically, the 4Q10 sales tax returns for BV and RR include control sheets and draft sales tax returns listing the correct sales tax amount; however, both entities' final 4Q10 sales tax worksheets contain a reduced sales tax amount and a handwritten notation at the bottom of the document stating, "Ok per 11 am meeting on 01-27-11." OTA finds that this documentation demonstrates an awareness of the amount of sales tax owed, and that lesser amounts were deliberately reported. Given appellants' connections with each other and with their related entities, evidence of intentional underreporting by one related entity constitutes evidence of intentional underreporting by the other related entities, and vice versa.

CDTFA also found WISRs attached to related entity BFG's November 2010 sales tax prepayment return, and the data in these WISRs matches that of the WISRs provided by franchisor DAI. Nonetheless, the final sales tax worksheet for this prepayment return (which identified the sales tax ultimately reported) lists less sales tax than that identified in the WISRs and less sales tax than that identified in a draft sales tax worksheet. And although the draft sales tax worksheet indicates a taxable sales ratio of 58 percent,[32] a handwritten notation on the draft

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[30] In addition, the sales amounts in appellants' worksheets correspond to the correct sales amounts in the WISRs.

As noted above, A. Beri orchestrated a scheme to inflate nontaxable sales in CDTFA's observation test. A. Beri is a member or the president of appellants' related entities; the returns for these entities were prepared by appellants' bookkeeper; and appellants acknowledge that these entities employed the same reporting practices as appellants. Given appellants' connections with these related entities, OTA finds that evidence of intentional underreporting by appellants' related entities constitutes evidence of intentional underreporting by appellants, and vice versa.

[31] Though, in and of itself, these percentages of error are not indicative of fraud.

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

sales tax worksheet states, "For [A. Beri] to Review" and "Per [A. Beri] ~ 46% Taxable ~ 54% Non taxable." This documentation indicates that, although a draft return identified the proper amount of sales tax, a lesser amount was reported pursuant to the instructions of A. Beri, which is indicative of intentional underreporting. Additionally, the income and expense analysis by location, including BFG, lists taxable sales and sales tax reimbursement amounts that significantly exceed the reported taxable sales and reported sales tax reimbursement amounts, which further demonstrates an awareness of underreported taxable sales.[33]

In addition, A. Beri admitted in his plea that he filed fraudulent SUTRs for other entities, with deficiencies determined based on the same kind of evidence presented in this appeal. The record shows that A. Beri was engaged in a pattern of conduct with the intent to evade tax. The court transcript indicates that R. Luthra approached A. Beri on more than one occasion to discuss underreporting, but A. Beri dismissed his concerns. Finally, the evidence shows that A. Beri intentionally interfered with CDTFA's investigation by creating fraudulent data that he hoped CDTFA would consider in its observation test. Therefore, when considered along with A. Beri's fraudulent conduct in the audit of ABC, it stands to reason that the modified records were completed with intent to underreport, and that percentage of error was the result of this intent.

Appellants note that they were not a part of the criminal complaint,[34] which appellants argue indicates that they did not commit fraud. However, A. Beri's plea constitutes an admission against interest, which is clearly relevant to the issues presented in this appeal. (See *Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd.* (1962) 58 C.2d 601, 605.) Appellants had an opportunity to provide evidence for OTA to consider when deciding the weight to give to that plea and provided no such evidence.

Appellants also argue that records obtained from franchisor DAI through a search warrant have no foundation and are inadmissible. However, rules relating to evidence and witnesses

[33] As for appellants' argument that evidence obtained through the search warrant executed on locations owned by other entities should not be considered in this appeal, OTA notes that A. Beri, who is a member or the president of appellants' related entities, orchestrated a scheme to inflate nontaxable sales in CDTFA's observation test; the returns for these entities were prepared by appellants' bookkeeper; and appellants acknowledge that these entities employed the same reporting practices as appellants. Given appellants' connections with these related entities, OTA finds that evidence of intentional underreporting by appellants' related entities constitutes evidence of intentional underreporting by appellants, and vice versa.

[34] Appellants were not included in the felony criminal complaint filed against A. Beri, ABC, and some of appellants' related entities.

contained in the California Evidence Code and California Code of Civil Procedure do not apply to proceedings before OTA. (Cal. Code Regs., tit. 18, § 30214(f).) Generally, all relevant evidence is admissible (Cal. Code Regs., tit. 18, § 30214(f)(1)), though the panel may use the rules of evidence to determine the weight to be given to evidence (Cal. Code Regs., tit. 18, § 30214(f)(4)).[35] OTA finds the data obtained from franchisor DAI to be relevant evidence that may be considered.

OTA finds that the foregoing, when considered in totality, constitutes clear and convincing evidence that appellants each intended to evade the payment of tax that they collected and knew was due. As such, OTA finds that there is clear and convincing proof of fraud for the entirety of the liability period. Thus, each NOD was timely issued, and the applicable fraud penalty was properly imposed.

Issue 2: Whether adjustments are warranted to the tax deficiencies, as determined by CDTFA.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state 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).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) Unsupported assertions are

[35] In addition, OTA does not have the jurisdiction to decide whether a taxpayer is entitled to a remedy for CDTFA's actual or alleged violation of any substantive or procedural right to due process under the law, unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal. (Cal. Code Regs., tit. 18, § 30104(e).)

not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, CDTFA relied on sales tax data provided by appellants to franchisor DAI, an independent third party. Therefore, CDTFA used appellants' own records of sales tax reimbursement collected from customers.[36] OTA finds that CDTFA's use of the sales data listed on the WISRs obtained from franchisor DAI was reasonable and rational. Accordingly, the burden of proof shifts to appellants to establish that a result different from CDTFA's determinations is warranted.

Appellants argue that the WISRs, upon which the deficiency measures are based, are unreliable and, therefore, the deficiency measures are overstated. Appellants also argue that CDTFA disadvantaged appellants by selectively disregarding documentation obtained from appellants' businesses through the search warrants.

Regarding the unreliability of the WISRs, appellants contend various reasons as to why the WISRs are unreliable, such as: (1) it is unclear how these records were obtained from franchisor DAI; (2) CDTFA has not provided a copy of these records; (3) there is no declaration from a custodian of record authenticating the WISRs; (4) appellants were not required to report the sales tax reimbursement to franchisor DAI; and (5) appellants did not track sales tax reimbursement using WISRs through their POS systems.

CDTFA obtained the WISRs via a search warrant executed on franchisor DAI, and CDTFA included the corresponding WISRs as an exhibit in its briefing for each of appellants' appeal.[37] CDTFA may compute and determine the tax required to be paid upon the basis of the facts contained in the taxpayer's sales and use tax returns or upon the basis of any information

[36] Appellants argue that CDTFA did not audit their businesses. It appears to OTA that appellants are arguing that CDTFA did not examine appellants' own documentation and, thus, did not "audit" appellants. However, OTA notes that CDTFA compared appellants' reported amounts to those appellants provided franchisor DAI via control sheets and WISRs (i.e., data from appellants' own records). Therefore, OTA finds appellants' argument lacks merit.

[37] Appellants argue that WISRs were improperly obtained in violation of R&TC section 19504.7 and CDTFA's Operations Memorandum No. 1162 dated November 17, 2010 (Ops Memo 1162). However, R&TC section 19504.7 pertains only to the Franchise Tax Board, not CDTFA; therefore, the statute is not relevant to this appeal. As for Ops Memo 1162, appellants appear to argue that CDTFA violated the guidance set forth in this memo by using records obtained in the audit of franchisor DAI. While Ops Memo 1162 requires taxpayer authorization for CDTFA's removal of records from the taxpayer's location and prohibits CDTFA from accessing these records at another taxpayer's location, this memo does not prohibit use of documentation obtained through the audit of a taxpayer's franchisor. On the contrary, Ops Memo 1162 explicitly authorizes such activity, noting that "Government Code section 15618 authorizes an auditor to examine records of the taxpayer and of persons doing business with the taxpayer."

within CDTFA's possession or that may come into its possession. (R&TC, § 6481.) Consequently, the purported lack of adequate evidentiary foundation, including authentication, does not preclude use of WISR data.[38] Moreover, given that the WISRs were obtained by a search warrant executed on franchisor DAI, the authenticity of these documents is not in doubt, and the purported absence of adequate evidentiary foundation is of no consequence.

Furthermore, each of appellants' respective POS systems contemporaneously recorded sales tax reimbursement with the sale and the POS systems transmitted the information to franchisor DAI via WISRs and control sheets. Although appellants argue that the WISR sales tax reimbursement data is unreliable because DAI did not require appellants to report such data, whether appellants were obligated to transmit the data does not diminish its probative value. Similarly, although appellants argue that they did not use the WISRs to track sales tax reimbursement, appellants' alleged use of a different method also does not diminish the probative value of the WISR sales tax reimbursement data.

Appellants also argue that CDTFA disadvantaged appellants by selectively disregarding documentation obtained from appellants' businesses through search warrants. However, appellants have not identified the documentation they believe CDTFA should have used to calculate taxable sales, or how such documentation would warrant adjustments to the deficiencies.

In summary, OTA finds that CDTFA's use of sales tax reimbursement listed in the WISRs obtained from franchisor DAI, was reasonable and rational. Appellants have not articulated a different method for verifying taxable sales, and appellants' criticisms of CDTFA's audit methodology are unfounded. Based on the foregoing, OTA concludes that appellants have not met their burden of proof to establish that adjustments are warranted to the deficiency measures.

Issue 3: Whether court-ordered criminal restitution payments preclude CDTFA from issuing determinations.

When a person is convicted of a crime, the court is required to order the defendant to make restitution to the victim(s) for economic loss suffered as a result of the defendant's

[38] And as noted above, rules relating to evidence and witnesses contained in the California Evidence Code and California Code of Civil Procedure do not apply to proceedings before OTA, and generally, all relevant evidence is admissible. (Cal. Code Regs., tit. 18, § 30214(f) & (f)(1).)

conduct. (Pen. Code, § 1202.4(f).) A restitution order is not a civil judgement and does not resolve civil liability. (*Vigilant Ins. Co. v. Chiu* (2009) 175 Cal.App.4th 438, 444-445 (*Vigilant*); *Appeal of Delgado*, 2018-OTA-200P (*Delgado*).) As such, an order of restitution under California Penal Code section 1202.4(f) is separate and distinct from the victim's (here, CDTFA's) right to pursue a civil remedy. (*Vigilant*, *supra*, 175 Cal.App.4th at p. 444; *Delgado*, *supra*.) A victim can recover through both restitution and civil judgment, subject to the condition that the restitution amount shall be credited against the civil liability. (Pen. Code, § 1202.4(j).)

Appellants argue that CDTFA is precluded from asserting civil tax deficiencies in excess of the court-ordered restitution of $3,021,059 paid by A. Beri. Appellants contend that R&TC section 7157(a)(2)[39] 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. However, the reference to the finality of a restitution order in R&TC section 7157(a)(2) confirms that the restitution amount is immediately collectible and does not preclude CDTFA from issuing determinations for tax and penalties in excess of a restitution payment.

Appellants also argue that *Delgado* is distinguishable because it involves the Cigarette and Tobacco Products Tax Law. *Delgado* sets forth that a taxpayer's criminal restitution payment to CDTFA is separate and distinct from the taxpayer's civil liabilities for tax and penalties. *Delgado* does not limit this principle to cigarette and tobacco products tax, and the premise applies equally to sales and use tax determinations. Therefore, *Delgado* is not distinguishable from the present case on the basis that it involved the Cigarette and Tobacco Products Tax Law.

Additionally, appellants argue that *Delgado* improperly relied on *Vigilant* because it did not involve a government entity and concerned nonmonetary damages. Appellants also argue that *Vigilant* and *Delgado* are distinguishable because appellants do not "rely" on California Penal Code section 1202.4.

OTA finds these distinctions inconsequential. The restitution payments at issue here, as in *Vigilant*, were made pursuant to California Penal Code section 1202.4, and the principle set forth in *Vigilant* is not limited to the characteristics of the civil action at issue in that case. The

[39] 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]."

plain language of California Penal Code section 1202.4(j) – which states that restitution shall be credited to any other judgments – indicates that restitution payments made pursuant to California Penal Code section 1202.4 do not absolve civil liability. *Vigilant* and *Delgado* are not distinguishable simply because appellants' legal argument is based on R&TC section 7157(a)(2). Furthermore, as discussed above, OTA finds appellants' reliance on R&TC section 7157(a)(2) unavailing.

Appellants also argue that A. Beri entered into the Plea Addendum under the belief that the restitution payments would satisfy all liabilities with CDTFA. However, A. Beri's reasons for entering into the Plea Addendum have no bearing on whether the restitution payments preclude CDTFA from issuing determinations.

Based on the foregoing, OTA finds the restitution payments to CDTFA are separate and distinct from appellants' civil liabilities for tax and penalties. The payment of restitution to CDTFA has been credited against appellants' civil tax liabilities, but it does not eliminate or absolve the remaining penalties and interest. Accordingly, appellants remain liable for the remaining unpaid civil liabilities.

Issue 4: Whether CDTFA properly imposed the 40 percent penalties and if so, whether appellants are entitled to relief of the penalties.

Any person who knowingly collects sales tax reimbursement and fails to timely remit it to the state is liable for a penalty of 40 percent of the amount not timely remitted if the failure to remit exceeds certain thresholds. (R&TC, § 6597(a)(1).) The penalty does not apply if the person's liability for unremitted sale tax reimbursement averages $1,000 or less per month or does not exceed 5 percent of the total amount of the tax liability for which the sales tax reimbursement was collected for the period in which the tax was due, whichever is greater. (R&TC, § 6597(a)(2)(A).) In order for OTA to sustain CDTFA's imposition of the 40 percent penalty, CDTFA must establish that: (1) appellants knowingly collected sales tax reimbursement from their customer(s); (2) appellants failed to timely remit the sales tax for which they collected the reimbursement; and (3) the amount of sales tax collected but not remitted exceeds the applicable threshold. (R&TC, § 6597(a)(1)-(2).) The applicable standard of proof is by a preponderance of the evidence. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.)

The law provides for relief of the 40 percent penalty if the taxpayer establishes that its actions were due to a reasonable cause or circumstances beyond the taxpayer's control and

occurred notwithstanding the taxpayer's exercise of ordinary care and the absence of their willful neglect. (R&TC, § 6597(a)(2)(B).) R&TC section 6597 provides six examples of reasonable cause, none of which is relevant to the facts under consideration. R&TC section 6597 does not establish a procedure for requesting relief.[40] However, OTA interprets R&TC section 6597 to require the taxpayer or its designee to request relief and prove a factual basis for the request. (See *Appeal of Senehi*, *supra*.)

The evidence shows that, in every quarter within the period to which CDTFA applied the penalty, appellants knowingly collected sales tax reimbursement and failed to timely remit the sales tax for which they collected the reimbursement. In addition, the amount of sales tax collected but not remitted exceeds the minimum thresholds set forth in R&TC section 6597(a)(2). In Issue 1, OTA rejected all of appellants' arguments that they unknowingly underreported. Therefore, OTA finds that CDTFA correctly imposed the 40 percent penalties. The next question is whether relief of the penalties is warranted.

Appellants argue that CDTFA cannot impose the penalties because the determinations are barred by the statute of limitations and CDTFA has not proven fraud. However, OTA determined in Issue 1 that CDTFA has shown fraud, and thus the determinations are not barred by the statute of limitations. Therefore, OTA finds that CDTFA correctly imposed the 40 percent penalty. In addition, appellants do not argue, and the record does not show, that the penalties should be relieved. As such, OTA finds that appellants are not entitled to relief of the 40 percent penalties.

Issue 5: Whether appellants are entitled to relief of interest.

There is no statutory right to interest relief. The law allows CDTFA, in its discretion, to grant relief of all or any part of the interest imposed on a person under the Sales and Use Tax Law where the failure to pay the tax is due in whole or in part to an unreasonable error or delay by an employee of CDTFA acting in their official capacity. (R&TC, §§ 20, 6593.5(a)(1).) Such an error or delay shall be deemed to have occurred only if no significant aspect of the error or

[40] R&TC section 6592 establishes a procedure for requesting relief of some penalties when an untimely return of payment is due to reasonable cause and circumstances beyond the person's control and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. Taxpayers requesting relief under R&TC section 6592 are required to file a statement under penalty of perjury setting forth the facts upon which the person bases the claim for relief. (R&TC, § 6592(b).) The 40 percent penalty is not one of the penalties covered by R&TC section 6592.

delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c).)

Appellants' requests for relief do not include a request for relief of interest. However, even if they did, appellants make the same arguments in support of interest relief that they make in support of relief of the penalties. Appellants have not alleged or offered any evidence to prove an unreasonable error or delay by an employee of CDTFA acting in their official capacity. Therefore, OTA finds that appellants are not entitled to relief of interest.

HOLDINGS

1. CDTFA has provided clear and convincing evidence of fraud.
2. Adjustments are not warranted to the tax deficiencies.
3. Court-ordered criminal restitution payments do not preclude CDTFA from issuing determinations.
4. CDTFA properly imposed the 40 percent penalties and appellants are not entitled to relief of the penalties.
5. Appellants are not entitled to relief of interest.

DISPOSITION

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

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

We concur:

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

Signed by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

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