OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 221011591
	CDTFA Case IDs: 002-847-954; 003-850-317
F. LANDEROS,	
dba Landeros Furniture	

OPINION

Representing the Parties:

For Appellant: Carlos Gomez, Attorney

For Respondent: Courtney Daniels, Attorney
Cary Huxsoll, Attorney
Jeanine Candelaria, Hearing Representative

For Office of Tax Appeals: Corin Saxton, Attorney

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, F. Landeros dba Landeros Furniture (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's petition for redetermination of a Notice of Determination (NOD) dated April 30, 2021.[1] The NOD is for tax of $572,636, plus applicable interest, and a fraud penalty of $143,090 for the period January 1, 2009, through December 31, 2013 (liability period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Suzanne B. Brown, and Sheriene Anne Ridenour held an electronic oral hearing for this matter on June 20, 2024. At the conclusion of the hearing, the record closed, and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (See Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" refers to BOE.

[2] Whether CDTFA timely issued the NOD depends on whether appellant acted fraudulently throughout the liability period. If he did, there is no limit to the time in which CDTFA must issue an NOD. (See R&TC, § 6487(a).) Whether appellant committed fraud throughout the liability period is an issue OTA will examine in this Opinion.

ISSUES

1. Whether OTA has jurisdiction to consider and/or remedy alleged federal and state constitutional violations in the context of business tax appeals; if so, whether such alleged violations occurred and estop CDTFA's civil audit and subsequent determination.
2. Whether appellant's payment of restitution satisfies the remaining civil liability.
3. Whether the doctrine of laches applies and bars CDTFA's determination.
4. Whether adjustments to the measure for unreported taxable sales of $6,442,662 are warranted.
5. Whether CDTFA properly imposed the 25 percent fraud penalty.

FACTUAL FINDINGS

1. Appellant, a sole proprietor doing business as Landeros Furniture, owns a Southern California chain of furniture stores. Specifically, appellant owns a "Superstore" location in Beaumont and three "Group Stores" locations in San Bernardino and Redlands. During the liability period, appellant did not manage or operate the Superstore but operated the Group Stores.
2. On February 19, 2013, CDTFA began an audit of appellant's business.[3]
3. Upon audit, appellant provided the following books and records: federal income tax returns for 2010 and 2011; incomplete bank statements for the first quarter of 2010 (1Q10) through 4Q12; profit and loss statements for 2010, 2011, and 2012; incomplete sales and purchase invoices for the Superstore for the liability period; and purchase invoices for the Group Stores for the liability period.
4. Using appellant's records, CDTFA calculated appellant's markup rates, which decreased significantly each year from 2010 through 2012. CDTFA also found that appellant's bank deposits exceeded reported total sales by $2,825,832 for the same period.
5. Lacking any explanation from appellant for this $2,825,832 discrepancy, CDTFA suspected appellant of tax evasion and began a fraud investigation on July 1, 2013.

[3] The record is unclear as to the period CDTFA originally chose for audit. Although a BOE-414Z (*Assignment Contact History*) form identifies an audit period of July 1, 2009, through June 30, 2012, a probable cause statement dated April 4, 2014, states that the audit period covered the period January 1, 2010, through December 31, 2012.

6. Pursuant to this fraud investigation, CDTFA obtained a search warrant for the following locations: appellant's home; appellant's bookkeeper's business; appellant's bank; the Superstore; and the Group Stores.
7. On April 8, 2014, with the assistance of the California Highway Patrol, CDTFA executed the search warrant and obtained the following items: computers; computer servers; sales tax reports for the liability period; sales invoices for the liability period; handwritten sales invoices for the liability period; and notebooks with handwritten daily sales information for the liability period.[4]
8. At the time of the April 8, 2014 search, two CDTFA investigators interviewed appellant.
9. Using sales tax reports obtained from the search, CDTFA identified unreported taxable sales of $55,377 made by the Superstore for the period January 1, 2011, through December 31, 2013.[5]
10. Using handwritten sales invoices obtained from the search, CDTFA also identified unreported taxable sales of $1,293,803 made by the Group Stores for the same period.[6]
11. CDTFA's fraud investigation identified a total tax liability of $108,301 for the period January 1, 2011, through December 31, 2013.
12. On September 25, 2017, the San Bernardino County District Attorney's Office filed a misdemeanor complaint against appellant, alleging two counts of willfully making false and fraudulent tax returns on or about August 1, 2011, and October 31, 2011, in violation of R&TC section 7152(a).[7]
13. On May 22, 2018, appellant pled guilty to these two misdemeanor charges.

[4] CDTFA stored these items at an evidence warehouse and returned them to appellant on December 21, 2018.

[5] The record is unclear as to why CDTFA's examination of the seized evidence covered the period January 1, 2011, through December 31, 2013, rather than the period identified in the probable cause statement, January 1, 2010, through December 31, 2012.

[6] As already noted, during the search, CDTFA also obtained notebooks with handwritten daily sales information. However, during the fraud investigation, CDTFA used the handwritten sales invoices rather than the notebooks to calculate unreported taxable sales, reasoning that the handwritten sales invoices were preferrable to the notebooks because the notebooks included payments received from layaway plans.

[7] R&TC sections 7152(a) and 7153 state that any person required to make, render, sign, or verify any report who makes any false or fraudulent return, with intent to defeat or evade the determination of an amount due required by law to be made is guilty of a misdemeanor punishable by a fine of not less than $1,000 and not more than $5,000, or imprisonment not exceeding one year in the county jail, or both.

14. As part of a plea bargain agreement, appellant paid $92,916 in restitution to CDTFA for the period April 1, 2011, through December 31, 2013.
15. Upon concluding its fraud investigation, CDTFA resumed its audit of appellant.
16. CDTFA expanded the audit period to January 1, 2009, through December 31, 2013 (i.e., the liability period at issue) based on its determination that fraud occurred during this period.
17. Using sales tax reports generated from appellant's point of sale (POS) software, CDTFA identified unreported taxable sales of $480,386 by the Superstore for the liability period.[8]
18. Because the Group Stores did not use POS software,[9] CDTFA used appellant's handwritten sales notebooks (obtained from the search) to calculate unreported taxable sales of $5,962,275 for the liability period. These notebooks listed total daily sales by the following payment types: cash; credit/debit cards; cash on delivery; checks; and payments made pursuant to public assistance programs.[10] CDTFA verified the accuracy of the notebooks by tracing total sales for several days for each location to the invoices.
19. From its search, CDTFA also obtained handwritten sales invoices for the Group Stores; however, CDTFA did not use the handwritten sales invoices to calculate unreported taxable sales because the invoices were incomplete.[11]
20. CDTFA also identified a deficiency measure for unreported taxable delivery and set up fees of $353,666 for the Superstore, which are not in dispute.
21. On April 30, 2021, CDTFA issued to appellant the NOD for the liabilities disclosed by the audit.
22. Appellant filed a timely petition for redetermination.

[8] This $480,386 deficiency amount is significantly higher than the $55,377 amount CDTFA identified during its fraud investigation because the liability period is two years longer than the fraud investigation period.

[9] Appellant's bookkeeper reported taxable sales for the Group Stores using appellant's handwritten documents, which listed monthly sales for the Group Stores.

[10] The notebooks also listed sales made to "Rent-A-Center"; however, CDTFA did not include the Rent-A-Center sales in its calculation of unreported taxable sales.

[11] Invoices were missing for periods ranging from one day to nearly a year.

23. During its internal appeals process, CDTFA conceded to relieve interest accrued for the following three periods: (1) April 22, 2018, through February 19, 2019; (2) April 25, 2019, through July 30, 2020; and (3) October 29, 2020, through April 29, 2021. Otherwise, CDTFA denied appellant's petition for redetermination via a June 27, 2022 decision.

24. This timely appeal to OTA followed.

25. During the appeal, appellant included a copy of an invoice from one of the Group Stores in San Bernardino dated July 28, 2012 (invoice #24096) with a debit card receipt attached. The invoice listed a mattress, box spring, and warranty for $189 plus tax reimbursement of $15.12 for a total charge of $204.12. The bottom of the invoice states that there are no refunds or exchanges, that layaways are final, and there is "no money back." The debit card receipt indicated that the customer paid $204.12 to appellant.

DISCUSSION

Issue 1: Whether OTA has jurisdiction to consider and/or remedy alleged federal and state constitutional violations in the context of business tax appeals; if so, whether such alleged violations occurred and estop CDTFA's civil audit and subsequent determination.

On appeal, appellant argues that CDTFA violated two of his constitutional rights, which in turn requires setting aside the determination at issue. First, appellant argues that CDTFA violated his Fifth Amendment right against self-incrimination when CDTFA "interrogated" him on April 9, 2014, without advising him of his rights pursuant to *Miranda v. Arizona* (1966) 384 U.S. 436, 478-479. Appellant asserts that any statements obtained by CDTFA from such an unlawful interrogation should be excluded, and CDTFA's determination, to the extent based on such statements, should be reversed.

Second, appellant argues that the Double Jeopardy Clauses of the U.S. and California Constitutions bar CDTFA's determination. Specifically, appellant asserts that the NOD liabilities (i.e., tax, interest, and the fraud penalty) are "so extreme and so divorced from the Government's damages and expenses" that they functionally constitute punishment. And because the San Bernardino County District Attorney's Office prosecuted appellant and he pled guilty to two misdemeanor charges of willfully making false and fraudulent tax returns, appellant

argues that the subsequently issued NOD is equivalent to a successive criminal prosecution violative of his constitutional right against double jeopardy.

In response, CDTFA argues that OTA lacks jurisdiction to consider such constitutional contentions. Specifically, CDTFA asserts that OTA lacks the authority to determine whether appellant is entitled to a remedy for CDTFA's actual or alleged violation of any substantive or procedural right unless the violation affects the adequacy of the NOD or the amount at issue in the appeal per Regulation section 30104(e) (formerly subsection (d)).[12]

As a general rule, determining constitutional issues is beyond an administrative agency's jurisdiction. (*Petruska v. Gannon University* (3rd. Cir. 2006) 462 F.3d 294, 308.) Under the California Constitution, administrative agencies, including OTA, have no power to refuse to enforce a statute on the basis of it being unconstitutional unless an appellate court has determined that such statute is unconstitutional. (Cal. Const., art. III, § 3.5; see also Cal. Code Regs., tit. 18, § 30104(a).) OTA is the successor to, and is vested with, the duties, powers, and responsibilities of the State Board of Equalization (BOE) that are necessary or appropriate to conduct appeals hearings with respect to franchise and income taxes (FIT), as well as business taxes (including state and local sales and use taxes). (Gov. Code, § 15672(a).)

In the context of FIT appeals, BOE, OTA's predecessor, had a long-established policy of abstaining from deciding constitutional issues in appeals involving proposed assessments of additional tax. (See *Appeal of Aimor Corp.* (83-SBE-221) 1983 WL 15592 (*Aimor*).) "This policy is based upon the absence of any specific statutory authority which would allow the Franchise Tax Board [FTB] to obtain judicial review of a decision in such cases and upon [BOE's] belief that judicial review should be available for questions of constitutional importance." (*Ibid*.) OTA has approvingly cited *Aimor* and BOE's abstention policy in various FIT-focused opinions, including the precedential Opinion in *Appeal of Acosta and Castro*, 2022-OTA-235P.

As with FTB, the rationale underlying the abstention policy applies to CDTFA. CDTFA is similarly situated because it lacks specific statutory authority to obtain judicial review of OTA's decisions in appeals involving CDTFA's business tax determinations. Additionally,

[12] Regulation section 30104(e) concerns the limits of OTA's jurisdiction in the context of remedying a tax agency's actual or alleged violation of a taxpayer's substantive or procedural right to due process under the law (e.g., whether there was adequate notice, a fair and unbiased decisionmaker, a reasonable opportunity to be heard, etc.). It does not relate to OTA's supposed jurisdiction to consider alleged violations of an accused's constitutional rights in the criminal law context. Accordingly, OTA will not address this aspect of CDTFA's argument further.

OTA is an independent appeals body and not a court of general jurisdiction, let alone a tax court. (See R&TC, § 15672(b).) For these reasons, OTA clarifies that its adoption of BOE's policy of abstaining from deciding constitutional issues in FIT appeals extends to business tax appeals as well. Therefore, to the extent appellant claims that CDTFA violated its constitutional rights (i.e., the Fifth Amendment rights against self-incrimination and double jeopardy), OTA abstains from determining such constitutional issues. The proper forum for appellant's constitutional claims is a court of competent (i.e., general) jurisdiction such as a state superior court.

Issue 2: Whether appellant's payment of restitution satisfies the remaining civil liability.

On appeal, appellant argues that he satisfied all liabilities at issue here upon pleading guilty to two misdemeanor charges of willfully making false and fraudulent tax returns and paying $92,916 in restitution. In support of this argument, appellant cites to *Creel v. C.I.R.* (11th Cir. 2005) 419 F.3d 1135 (*Creel*).[13]

An order of restitution under California Penal Code section 1202.4(f) is separate and distinct from CDTFA's right to pursue a civil remedy. (*Vigilant Ins. Co. v. Chiu* (2009) 175 Cal.App.4th 438, 444; *Appeal of Delgado*, 2018-OTA-200P [addressing taxes imposed pursuant to the Cigarette and Tobacco Products Tax Law].) A restitution order is not a civil judgment and does not resolve civil liability. (*Vigilant Ins. Co. v. Chiu*, *supra*, at pp. 444-445; *Appeal of Delgado*, *supra*.) A victim (here, CDTFA) 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).) OTA's precedential Opinion in *Appeal of Delgado*, *supra*, holds that a taxpayer's criminal restitution payment to CDTFA is separate and distinct from the taxpayer's civil liabilities for tax and penalties. Further, R&TC section 7157(a)(2) provides that criminal restitution orders are treated as final and may be collected by CDTFA.[14] R&TC section 7157(a)(2) does not limit CDTFA's ability to pursue additional unpaid taxes. To the

[13] In *Creel*, a taxpayer pled guilty to willfully failing to file income tax returns, and, as a part of his plea agreement, he was ordered to pay restitution of $83,830 "plus any applicable penalties and interest." The United States Court of Appeals for the Eleventh Circuit found that the taxpayer's restitution payment extinguished additional taxes, interest, and penalties.

[14] 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]."

contrary, the Sales and Use Tax Law explicitly authorizes CDTFA to issue "[o]ne or more deficiency determinations" for the same reporting period. (R&TC, § 6481.)

In summary, the premise of *Appeal of Delgado* applies equally to sales and use tax determinations, and the court-ordered criminal restitution payments do not preclude CDTFA from issuing one or more NODs to appellant for his unreported sales and use taxes. Appellant has also not cited to any authority holding that the satisfaction of a restitution order precludes the enforcement of the statutes at issue, nor is OTA aware of any. Consequently, the R&TC is controlling, and appellant's reliance on federal case law is misplaced.[15] OTA concludes that appellant's payment of restitution does not satisfy his remaining civil liability.

Issue 3: Whether the doctrine of laches applies and bars CDTFA's determination.

On appeal, appellant argues that the doctrine of laches applies to bar CDTFA's determination because CDTFA delayed completing its audit until after the criminal charges stemming from the initial audit were resolved. Appellant contends that CDTFA's delay was prejudicial due to his detrimental reliance on the status quo, resulting in the loss of records that would have proven nontaxable sales, thereby inflating the determination.

In response, CDTFA argues that OTA, as an administrative agency, lacks the authority to apply the doctrine of laches.

Laches is typically available as a defense in administrative proceedings run by the state. (*Malaga County Water District v. State Water Resources Control Bd.* (2020) 58 Cal.App.5th 447, 466.) However, laches is not available where it would nullify an important policy adopted for the benefit of the public. (*Mercury Ins. Co. v. Lara* (2019) 35 Cal.App.5th 82, 112; *Clary v. City of Crescent City* (2017) 11 Cal.App.5th 274, 286; *Golden Gate Water Ski Club v. County of Contra Costa* (2008) 165 Cal.App.4th 249, 263.)

Here, a portion of all sales and use taxes imposed by California are designated exclusively to assist local governments in maintaining a sufficient level of public safety services,

[15] In *Creel*, the court recognized that, as a general matter, under applicable federal law, the federal government can recover criminal penalties from an individual in a criminal prosecution and can recover additional civil penalties in a civil proceeding. (*Creel, supra*, 419 F.3d at 1140.) However, the court found it significant that the taxpayer's plea agreement included "interest and penalties which may be imposed by the Internal Revenue Service," and, based on this language, the court found that the restitution obligation was drafted such that "Creel's civil tax liabilities were inextricably intertwined with his criminal tax liabilities." (*Id.* at pp. 1140, 1142.) However, appellant's plea agreement is distinguishable from that of *Creel* because appellant's plea agreement did not include any language suggesting that appellant's restitution subsumed his civil liability. Thus, even if *Creel* was controlling authority, it would not change OTA's analysis.

which are "critically important to the security and wellbeing of the State's citizens and to the growth and revitalization of the State's economic base." (Cal. Const., art. XIII, § 35(a), (b).) The purpose of any tax proceeding between CDTFA and a taxpayer is determining the taxpayer's correct amount of tax liability. (R&TC, § 7081.) Because applying laches would undermine an important public policy for imposing sales and use taxes (i.e., funding local government's public safety services), the doctrine of laches is unavailable to bar CDTFA's determination of appellant's tax liability.[16] Thus, in the context of sales and use tax appeals, OTA cannot apply the doctrine of laches against CDTFA.

Issue 4: Whether adjustments to the measure for unreported taxable sales of $6,442,662 are warranted.

California imposes upon all retailers a sales tax measured by the 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, it is presumed 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 tax returns or the amount of tax required to be paid to the state by any person, CDTFA may compute and determine the amount required to be paid on the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.) If any person fails to make a return, CDTFA will estimate the gross receipts of the person based upon any information within its possession or that may come into its possession. (R&TC, § 6511.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Las Playas #10*, 2021-OTA-204P.) If CDTFA's determination is not reasonable and rational, then the determination should be rejected. (See *Appeal of Praxair, Inc.*, 2019-OTA-301P.) If CDTFA's determination is reasonable and rational, then the determination is presumed correct. (See *In re Renovizor's, Inc.*

[16] The United States Court of Appeals for the Ninth Circuit has similarly held that laches is not a defense to the United States' enforcement of tax claims. (See *Dial v. Commissioner* (9th Cir. 1992) 968 F.2d 898, 904.)

(9th Cir. 2000) 282 F.3d 1233, 1237, fn. 1; see also *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 445 (*Paine*).) The burden of overcoming this presumption is on the taxpayer. (*Paine*, *supra*, 137 Cal.App.3d at 445.)

Generally, appellant bears the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 30219(a).) The standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Las Playas #10, Inc.*, *supra*.) To satisfy their burden of proof, a taxpayer must prove both that the tax assessment is incorrect and what the proper amount of tax should be. (*Appeal of AMG Care Collective*, *supra*.)

Here, CDTFA established the amount of appellant's unreported taxable sales on an actual basis using appellant's own records (i.e., the POS sales tax reports for the Superstore and the handwritten sales notebooks for the Group Stores). Accordingly, OTA finds that appellant's determination was reasonable and rational, and the burden of proof shifts to appellant to show that the determination is incorrect.

On appeal, appellant argues that the amount of unreported taxable sales is overstated for both the Superstore and the Group Stores. With respect to the Superstore, appellant avers that, according to his accountant, "sales figures recorded by the [a]ccount [a]nalysis reports from [the POS software] do not match the numbers extracted by the CDTFA, which employed higher numbers." In other words, appellant asserts that audited taxable sales for the Superstore are overstated and belied by his records. Regarding the Group Stores' unreported taxable sales, appellant argues that adjustments are warranted for nontaxable optional warranties, as evidenced by invoice #24096.

Appellant also asserts that adjustments are warranted for returns and refunds. In support of this assertion, appellant contends that the Superstore had a policy of allowing returns and refunds and argues that this policy indicates that the Group Stores also accepted returns and refunds.

Additionally, appellant argues that CDTFA's audit method is flawed because the handwritten sales invoices are more reliable than the handwritten notebooks. In support of this argument, appellant notes that the fraud investigation used the handwritten sales invoices to

calculate a significantly lower deficiency measure;[17] appellant posits that this occurred because the invoices were preferrable to the notebooks because the notebooks included payments received from layaway plans. Appellant further notes that the notebooks simply list total sales by payment type and do not distinguish between taxable and nontaxable sales, arguing that an examination of the handwritten sales invoices would allow nontaxable sales to be identified. Appellant concludes that the preponderance of the evidence establishes that, under a reliable calculation method, any tax liability must be reduced by more than half.

With respect to appellant's assertion that audited taxable sales for the Superstore are overstated, appellant has not provided any documentary evidence supporting this assertion. Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Las Playas #10, Inc.*, *supra*.) Consequently, OTA is not persuaded by appellant's unsupported assertion.

Regarding appellant's argument that adjustments are warranted to the Group Stores' unreported taxable sales for nontaxable warranties, the invoice appellant relies on in support of this argument (invoice #24096) does not separately state a warranty charge; instead, the invoice lists a single $189 charge for the sale of a mattress, box spring, and warranty. Thus, it appears that the warranty was mandatory and included in the sale price, which means the warranty is taxable. (See Cal. Code Regs., tit. 18, § 1655(c)(2).) The invoice also lists a $15.12 charge for sales tax reimbursement based on the sale price. Attached to the invoice is a debit card receipt for $204.12, which equals the total amount of the sale price plus sales tax reimbursement. The fact that appellant charged and collected sales tax reimbursement on the sale price is consistent with OTA's finding that the warranty was mandatory and thus taxable. Therefore, OTA concludes that appellant has failed to show that adjustments are warranted for alleged nontaxable warranties.

As for appellant's argument that adjustments to the Group Stores' unreported taxable sales are warranted for returns and refunds, OTA notes that the Group Stores' invoices (e.g., invoice #24096) state that there are no refunds or exchanges, that layaways are final, and there is "no money back." Therefore, OTA finds that the Group Stores did not accept returns or issue refunds. Even if the Group Stores made an occasional exception and accepted a return,

[17] Appellant notes that the fraud investigation identified unreported taxable sales of $1,293,803 for the Group Stores for the period 2011 through 2013, which is significantly lower than the unreported taxable sales of $3,558,169 for the same period based on the notebooks.

appellant has not provided any evidence substantiating such a return and refund. Accordingly, OTA concludes that no adjustments are warranted on the bases of alleged returns and refunds.

As for appellant's argument that the Superstore's policy of allowing returns is indicative of a similar policy for the Group Stores, the evidence reflects that appellant did not manage or operate the Superstore location (a third party operated it), and, based on the Group Stores' invoices (e.g., invoice #24096), it appears that the Superstore's policy on returns and refunds differed from that of the Group Stores.

Turning to appellant's argument that the handwritten sales invoices are more reliable than the notebooks, OTA finds this argument lacks merit because these invoices were incomplete, missing invoices for periods ranging from one day to nearly a year.[18] Furthermore, CDTFA verified the accuracy of the notebooks by tracing total sales for several days for each location to the invoices.

Regarding appellant's reliance on the fraud investigation's finding that the notebooks included payments for incomplete layaway agreements, OTA finds this conclusion is contradicted by the Group Stores invoices (e.g., invoice #24096), which state that layaways are final.

As for appellant's argument that the difference between the fraud investigation's deficiency measure and the audit deficiency measure indicates that the civil audit deficiency measure is overstated, OTA finds this contention lacks merit. The alleged discrepancy exists because the fraud investigation relied on incomplete source documentation and made allowances that were not warranted.[19]

Concerning appellant's argument that the handwritten sales invoices are more reliable than the notebooks because the notebooks do not distinguish between taxable and nontaxable sales, the record does not indicate that any of the Group Stores' invoices identified nontaxable sales, and appellant has provided neither argument nor evidence of nontaxable sales listed in these invoices. Based on the foregoing, OTA finds that the notebooks constituted the best available evidence for calculating the Group Stores' taxable sales, and OTA concludes that

[18] See footnote 11, *ante*, page 4.

[19] Specifically, the fraud investigation made an allowance for payments made pursuant to layaway agreements that were never completed, despite the absence of any evidence of incomplete layaway agreements. Furthermore, although the fraud investigation noted that Group Stores' delivery charges were taxable, the fraud investigation did not include delivery charges in the calculation of taxable sales.

appellant has not identified a basis for reducing the deficiency measure for unreported taxable sales.[20] Accordingly, adjustments to the measure of unreported taxable sales of $6,442,662 are not warranted.

Issue 5: Whether CDTFA properly imposed the 25 percent fraud penalty.

R&TC section 6485 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 shall be imposed on the entire deficiency "if any part" of that deficiency determination is due to fraud. (*ISIF Madfish, Inc.*, 2019-OTA-292P.)

CDTFA must establish fraud by clear and convincing evidence. (Cal. Code Regs., tit. 18, § 1703(c)(3)(C).) Fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owing. (*Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30; *Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307.) Fraud can be proven by circumstantial evidence. (*ISIF Madfish, Inc.*, *supra*.) Circumstantial evidence of fraud or intent to evade taxation includes but is not limited to the following: substantial discrepancies between recorded amounts and reported amounts that cannot be explained; sales tax or sales tax reimbursement is properly charged, evidencing knowledge of the requirement of the law, but not reported; inadequate records; failure to cooperate with tax authorities; failure to file tax returns; and lack of credibility in the taxpayer's testimony. (*Tenzer v. Superscope, Inc.*, *supra.*; *Rau's Estate v. Commissioner* (9th Cir. 962) 301 F.2d 51, 54-55; *Powell v. Granquist* (9th Cir. 1958) 252 F.2d 56, 60.) Federal courts also have concluded that the "[m]ere omission of reportable income is not of itself sufficient to warrant a finding of fraud [but] repeated understatements in successive years when coupled with other circumstances showing an intent to conceal or misstate taxable income present a basis" for inferring fraud. (*Rau's Estate v. Commissioner*, *supra* 301 F.2d at pp. 54-55 [quoting *Furnish v. Commissioner* (9th Cir. 1958) 262 F.2d 727, 728.])

As relevant here, except in cases of fraud, for taxpayers filing returns on other than an annual basis, CDTFA must mail an NOD within three years after the last day of the calendar

[20] Regarding appellant's argument that the preponderance of evidence establishes that, under a reliable calculation method, any tax liability must be reduced by more than half, OTA notes that appellant has not identified a method that would warrant such a reduction. Therefore, OTA will not consider this assertion further.

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).)

On appeal, appellant argues that CDTFA has failed to prove fraud by clear and convincing evidence, and, in the absence of a showing of fraud, CDTFA issued the NOD after the statute of limitations set forth in R&TC section 6487 expired. Appellant argues that CDTFA believes an NOD is timely whenever fraud is included in the NOD because, under Regulation section 1703, the fraud penalty applies if any part of the deficiency is due to fraud. Appellant argues that CDTFA's position is based on a misinterpretation of Regulation section 1703. Appellant asserts that, under CDTFA's reasoning, a taxpayer's $1 fraud today can vitiate the statute of limitations for a decades-old deficiency, which would lead to absurd results.

Appellant's position appears to presume that "deficiency determination" for purposes of R&TC section 6485 and Regulation section 1703(c)(3)(C) refers to each distinct type of liability identified in the audit (e.g., an individual audit item), and appellant argues that evidence of fraud in one distinct "deficiency determination" cannot be transposed across separate determinations that span different businesses, services, and time periods. Thus, while not entirely clear,[21] appellant's argument appears to be that the fraud penalty can only apply to deficiencies stemming from fraud and that the NOD is untimely with regard to any nonfraudulent liability.

Under this reasoning, appellant identifies three types of "deficiency determinations" for which CDTFA has allegedly failed to prove fraud by clear and convincing evidence: (1) the liability for the Superstore's unreported taxable delivery and set up fees; (2) the liability for the Superstore's unreported taxable sales; and (3) the liability for the Group Stores' unreported taxable sales.

Regarding the liability for the Superstore's unreported taxable delivery and set-up fees, appellant asserts that he did not report these fees due to misunderstanding the Sales and Use Tax Law, noting that the Superstore did not collect sales tax reimbursement on these fees. As for the Superstore's unreported taxable sales, appellant contends that he was not involved in the Superstore's management, and that a third party oversaw sales tax reporting for the Superstore.

[21] The entirety of appellant's argument is not readily comprehensible. Citing to Regulation section 1703(c)(3)(C), appellant argues that "the use of the singular 'determination,' rather than plural, manifests an intent to limit the application of a 'part' only to the particular determination to which it pertains."

Regarding the Group Stores' unreported taxable sales, appellant argues that, at most, the record establishes negligent non-reporting.[22] Appellant asserts that although he ran a small business for a number of years, this was his first audit, and he hardly possessed specialized knowledge or sophistication in tax matters, as evident from the handwritten records used by the Group Stores. Furthermore, appellant argues that the error rate CDTFA identified is overstated, and appellant alleges that he voluntarily submitted records to CDTFA in the audit, without falsification or deletion, and appellant argues that this offsets circumstantial evidence of fraud such as the error rate.

Appellant's assertion that the statute of limitations is not impacted by the fraud penalty provisions of R&TC section 6485 is correct. The applicable statute of limitations is set forth in R&TC section 6487, which "clearly contemplates tolling of the three-year statute of limitations only for the reporting periods for which fraud or evasion has been shown." (*Appeal of Senehi*, 2023-OTA-446P.) Therefore, if the NOD includes untimely quarterly reporting periods in which no fraud occurred, the NOD is unenforceable as to those quarterly reporting periods. In other words, although the fraud penalty applies to the entire amount of tax included in the NOD, it only applies to tax liabilities that are properly included in the NOD, and it does not apply to tax liabilities that are barred by the applicable statute of limitations.

With respect to appellant's argument that the fraud penalty can only apply to deficiencies stemming from fraud (i.e., audit item deficiency measures resulting from fraud), OTA finds that appellant bases this argument on a misinterpretation of the term "deficiency determination." Although "deficiency determination" is not defined in the Sales and Use Tax Law, R&TC section 6481 authorizes CDTFA to make "one or more deficiency determinations . . . of the amount due for one or more than one period" when CDTFA is not satisfied with a return. Given that the amount due by a taxpayer could include multiple *types* of liabilities, CDTFA's authority to identify the amount due in a single deficiency determination indicates that "deficiency determination" refers to the aggregate liability established for a given period. Consequently, appellant's interpretation of the term "deficiency determination" conflicts with the plain language of R&TC section 6481.

[22] Appellant also argues that CDTFA improperly considered evidence that it could not consider. However, OTA declines to summarize or address these arguments given that it can decide the issue of fraud without describing or analyzing the evidence to which appellant objects.

To summarize, the fraud penalty applies to the entire tax liability identified in the NOD, even if only some of the liability resulted from fraud. However, if no fraud occurred in a portion of the liability period that is outside the statute of limitations, then the NOD is untimely and unenforceable as to that portion of the liability period. Because the entirety of the NOD at issue here is time-barred in the absence of fraud, it is CDTFA's burden to show by clear and convincing evidence that fraud occurred during at least some portion of every quarterly reporting period in the liability period.[23]

Here, OTA finds that the record contains clear and convincing evidence that the entirety of the unreported taxable sales amount of $5,962,275 for appellant's Group Stores resulted from fraud. Appellant collected sales tax reimbursement on these sales, which shows appellant's awareness that these sales were taxable. Furthermore, the size of the deficiency measure is egregious, and the record shows that appellant consistently underreported taxable sales for the Group Stores by substantial amounts throughout the liability period. Even if OTA was to accept appellant's argument that the deficiency measure is overstated by half (which OTA does not), this would still mean that the Group Stores locations failed to report taxable sales of nearly three million dollars over a five-year period, and appellant has not explained how he could have unintentionally made such a large understatement. In addition, appellant hid records for the Group Stores (i.e., the handwritten notebooks and sales invoices) from CDTFA during the audit, which indicates that appellant attempted to deceive CDTFA during the audit; this, in turn, indicates that the tax deficiencies appellant hoped to conceal resulted from deliberate underreporting.

In summary, based on all the facts and circumstances described, OTA concludes that CDTFA has clearly and convincingly established fraud throughout the liability period. Therefore, CDTFA properly imposed the 25 percent fraud penalty, and the NOD is timely for the entire liability period.

[23] Thus, the fraud analysis is much simpler in cases where the NOD is timely even in the absence of fraud because, in such cases, CDTFA need only prove fraud for one portion of the liability period.

HOLDINGS

1. OTA abstains from deciding constitutional issues in business tax appeals cases.
2. Appellant's payment of restitution does not satisfy his remaining civil liability.
3. OTA cannot apply the doctrine of laches in sales and use tax cases.
4. Adjustments to the measure of unreported taxable sales of $6,442,662 are not warranted.
5. CDTFA properly imposed the 25 percent fraud penalty.

DISPOSITION

CDTFA's decision to relieve appellant of interest for certain periods (April 22, 2018, through February 19, 2019; April 25, 2019, through July 30, 2020; and October 29, 2020, through April 29, 2021) but to otherwise deny appellant's petition for redetermination is sustained.

DocuSigned by:
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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

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

Date Issued: 9/25/2024