OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 19095244
	CDTFA Case IDs 277-083, 275-085
BERI FOODS GROUP, INC., dba Subway 12780	

OPINION

Representing the Parties:

For Appellant: David Dunlap Jones, Attorney

For Respondent: Sunny Paley, Attorney

For Office of Tax Appeals: Corin Saxton, Attorney

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561 and 6901, Beri Foods Group, Inc. dba Subway 12780 (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of the Notice of Determination (NOD) dated September 8, 2017. The NOD is for $182,950.48 in tax, a 25 percent fraud penalty of $15,264.80,[2] a 40 percent penalty of $48,756.56 (the 40 percent penalty),[3] and applicable interest, for the period November 30, 2003, through December 31, 2010 (liability period).

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

[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 NOD states that the fraud penalty was imposed for the period November 30, 2003, through December 31, 2010. However, CDTFA states in its decision that the fraud penalty was imposed for the periods November 30, 2003, through December 31, 2006, and October 1, 2010, through December 31, 2010.

[3] The 40 percent penalty was imposed for the period January 1, 2007, through September 30, 2010.

ISSUES

1. Whether CDTFA has provided clear and convincing evidence of fraud.
2. Whether the payment of restitution satisfies any remaining civil liability.
3. Whether adjustments are warranted to the tax liability as determined by CDTFA.
4. Whether CDTFA properly imposed the 40 percent penalty and whether appellant is entitled to relief of the penalty.
5. Whether appellant is entitled to relief of interest.

FACTUAL FINDINGS

1. Appellant, a California corporation, operated a Subway sandwich restaurant in San Pedro during the liability period. Ajay Beri Corporation (ABC) transferred this restaurant to appellant on November 30, 2003. ABC owned 23 sublocations while holding a seller's permit, 16 of which were transferred to related limited liability companies (LLCs) on December 31, 2009.[4] ABC's president, A. Beri, is the president or a member of each related entity,[5] and ABC's bookkeeper, A. Avina, prepared the sales and use tax returns for these related entities.
2. Appellant's Point of Sale (POS) system[6] generated two types of weekly reports: Control Sheets, which detailed daily sales information, and Weekly Inventory & Sales Receipts (WISRs), which compiled daily inventory and sales information. Both reports generally listed sales tax reimbursement. Pursuant to appellant's franchise agreement with its franchisor, Doctors Associates, Inc. (DAI), appellant was required to transmit Control Sheets and WISRs from its POS systems to DAI on a weekly basis.
3. On January 19, 2011, in response to CDTFA's determination that appellant's related entity, ABC, consistently underreported taxable sales, CDTFA began a fraud

[4] ABC transferred sublocations 6 through 9 to appellant on December 31, 2009. ABC also transferred sublocations 10 through 13 to Beri Enterprises, LLC on December 31, 2009; sublocations 15 through 18 to Beri Ventures, LLC on December 31, 2009; and sublocations 14, 19, 20, and 22 to Reliance Restaurants, LLC on December 31, 2009. ABC closed sublocations 4 and 23 in January 2011.

[5] A. Beri is appellant's sole corporate officer.

[6] 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 "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.

investigation of appellant and appellant's related entities. On June 23, 2011, CDTFA and the California Highway Patrol executed two search warrants on the following locations: Subway restaurants owned by appellant and its related entities; franchisor DAI; the office of appellant's accountant; the residence of appellant's bookkeeper, A. Avina; a storage unit containing business records;[7] and the residences and offices of A. Beri. As a result of these search warrants, CDTFA obtained computers, a cell phone belonging to A. Beri, and over 400 boxes of records. In addition, DAI provided appellant's WISRs for the liability period.

4. CDTFA's forensic examination of the seized computers disclosed detailed financial statements, including an income and expense analysis for 2007 through 2009 that compiled sales data for most locations for appellant. The amounts listed on the income and expense analysis are substantially similar to the data provided by DAI,[8] and the sales tax reimbursement listed on the income and expense analysis exceeds the sales tax appellant reported on the sales and use tax returns (SUTRs). Furthermore, CDTFA found WISRs attached to appellant's November 2010 sales tax prepayment return, and the data in these WISRs, matches that of the WISRs provided by 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.[9] And although the draft sales tax worksheet indicates a taxable sales ratio of 58 percent,[10] 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*]."

5. CDTFA also found several electronic files of ABC's Control Sheets, in which the sales tax computation was overridden to show a lesser amount, while increasing the nontaxable

[7] 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.

[8] The income and expense analysis lists sales tax totaling $144,185.07 for 2007 through 2009, and the WISRs show sales tax totaling $143,752 for this period.

[9] According to CDTFA's Detailed Narrative Description, "[t]he WISRs attached to the November and December 2010 sales tax returns show the same sales tax amounts as WISRs from DAI but the sales taxes were reduced on the final work sheet used to file the returns as instructed by [A. Beri]."

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

sales figure and keeping the gross receipts amount intact;[11] 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. CDTFA found that the WISRs provided by DAI consistently showed higher sales tax reimbursement amounts than those listed in ABC's Control Sheets.

6. 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 the observation test CDTFA performed in its audit of ABC (for the period January 1, 2006, through December 31, 2009),[12] 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.[13]

7. Appellant argues that the errors were due to mistaken use of worksheets with a minimum threshold percentage. According to the CDTFA's Memorandum of Interview of R. Casey, an employee of A. Beri, stated that the minimum threshold percentage for taxable sales was twice the soda sales, or approximately 18 percent, and that R. Casey believed there was a requirement to report a percentage of taxable sales that were greater than or equal to the minimum threshold percentage.

8. The California Attorney General's office filed a 66-count criminal complaint against A. Beri, appellant, several Beri entities, and others.[14] 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, who owned and worked at related entities, testified during the

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[11] 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.

[12] For example, A. Beri 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*.)

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

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

preliminary hearing that he approached A. Beri on more than one occasion to discuss underreporting, but A. Beri dismissed his concerns.[15]

9. On November 1, 2016, A. Beri, as an individual, and ABC executed a plea agreement with the California Attorney General's office. A. Beri and ABC both agreed to plead guilty to tax evasion (Count 63) for filing false SUTRs for the period January 1, 2010, through December 31, 2010, with the intent to defeat or evade the tax due. This charge was punishable as a felony or misdemeanor.[16]

10. As part of the same plea agreement, A. Beri also pled guilty to felony tax evasion as charged in Count 65, unlawfully filing false or fraudulent SUTRs 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.

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

12. During and for the purposes of the criminal proceedings, CDTFA established that the criminal defendants, including appellant, owed a total of $3,021,059 in tax for the period January 1, 2003, through December 31, 2010.[17] 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 agreement 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 criminal restitution in full.

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[15] 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."

[16] A. Beri pled guilty to a misdemeanor, and ABC pled guilty to a felony.

[17] The $3,021,059 in restitution consists of: (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) Beri Foods Group, Inc., dba Subway, $153,693; and (5) Delco Enterprises, Inc., dba Del Taco $35,337.

13. A. Beri timely paid the $3,021,059 in restitution, and the felony count against him was dismissed.

14. CDTFA issued appellant the aforementioned NOD. The NOD is based on an audit report dated February 13, 2017, which found a deficiency measure of $2,136,707 for unreported taxable sales. This deficiency measure is based on the WISRs obtained from DAI, which show sales tax reimbursement collected during the liability period of $273,006. Because some of the WISRs lack sales tax reimbursement data,[18] CDTFA used a ratio of sales tax reimbursement to total sales (based on the prior week and following week) to estimate the sales tax reimbursement of $6,081 for weeks missing sales tax data.[19] CDTFA compared reported/audited sales tax reimbursement of $279,087 to reported sales tax of $96,136 to establish unremitted sales tax reimbursement of $182,951, which CDTFA used to calculate a deficiency measure of $2,136,707 for the liability period.[20]

15. Appellant petitioned the NOD and filed a claim for refund for payments made towards the NOD and requested relief of interest.[21]

16. On June 7, 2019, appellant submitted to CDTFA a request for relief of penalties including a collection cost recovery fee (CCRF). However, CDTFA did not impose a CCRF on appellant.[22]

17. CDTFA issued a decision denying appellant's petition and claim for refund. CDTFA also determined that appellant did not show that interest should be relieved.

18. This timely appeal followed.

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[18] Sales tax reimbursement data is missing on some of the WISRs in first quarter of 2006 (1Q06), 2Q06, and 4Q06, as indicated on Schedule 12C-1.

[19] For example, CDTFA estimated sales tax reimbursement of $683.23 for the week ending October 31, 2006 by dividing total sales tax reimbursement of $1,510.80 (collected in weeks ending October 24, 2006 and November 7, 2006) by total sales of $21,199.83 (made in weeks ending October 24, 2006, and November 7, 2006) to calculate a ratio of sales tax reimbursement to total sales of 7.13 percent ($1,510.80 ÷ $21,199.83), which CDTFA applied to total sales of $9,582.44 for the week ending October 31, 2006.

[20] Appellant reported taxable sales of $1,103,085 for the liability period.

[21] Effective October 30, 2017, restitution payments totaling $182,950.48 were applied to this NOD, leaving only the penalties and interest unpaid.

[22] The request for relief did not include a request for relief of interest; however, appellant previously requested relief of interest.

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. (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, the Office of Tax Appeals (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, 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 error ratio, 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 appellant knowingly and consistently understated its taxable sales for the liability period, and that the understatement was significant, as demonstrated by an error rate of 193.70 percent (unreported taxable sales of $2,136,707 ÷ reported taxable sales of $1,103,085) for the liability period. CDTFA contends that A. Beri had access to the POS system data so he knew the correct amounts of gross receipts and tax reimbursement collected, but chose to report a fraction of the reimbursement collected. CDTFA also contends that A. Beri's and ABC's guilty pleas demonstrate fraud.

CDTFA asserts that A. Beri controlled appellant's business operations and maintained accounts of its assets and revenues,[23] and that he filed SUTRs for all entities he owned and operated, including appellant, and remitted payments of sales tax to CDTFA. CDTFA contends that A. Beri understood the sales tax reporting requirements[24] 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 states that A. Beri operated numerous Subway and Denny's locations with similar or greater underreporting. CDTFA asserts that falsified sales and tax information for the other franchise entities was seized, including a double set of computer files showing the same sales information as the franchisor-provided sales reports, but that one set with file names including the word "modified" showed reduced sales tax amounts.

Appellant argues that its underreporting was unintentional and that it did not commit fraud. Appellant asserts that A. Avina prepared the SUTRs using weekly Control Sheets that were faxed to appellant's headquarters from each individual store. Appellant asserts that A. Avina 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. According to the Memorandum of Interview of R. Casey, the minimum

[23] 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.

[24] CDTFA states 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.

threshold percentage for taxable sales was twice the soda sales, or approximately 18 percent, and R. Casey believed it was a requirement to report a percentage of taxable sales that were greater than or equal to the minimum threshold percentage. Appellant claims that A. Avina used the second Tabulation Sheet in error when filing the return. Appellant also argues that it did not maintain a double set of books and records, and appellant argues that evidence obtained through the search warranted executed on locations owned by other entities should not be considered in this appeal.

Appellant argues that OTA should not consider the WSIRs because these documents lack adequate evidentiary foundation, including authentication, and were obtained by CDTFA through an illegal search and seizure and in violation of R&TC section 19504.7 and CDTFA's Operations Memo No. 1162.[25] Appellant also contends that the WISRs are unreliable evidence of taxable sales, as suggested by an email from the DAI, which states, in part, that "the data must be interpreted with caution. . . . the columns headed 'POS Sales' and 'Sales Tax' are less accurate, as some weeks may not be represented fully with a data upload from the stores."[26]

OTA finds appellant's arguments to be unpersuasive. A. Beri had access to the correct tax information via the POS system. Nevertheless, appellant consistently and significantly underreported, as demonstrated by an error rate of 193.70 percent for the liability period. Given the size and consistency of the underreporting, it is unlikely that the "minimum threshold" would be confused with appellant's sales tax obligations.[27]

Appellant's own records indicate appellant was aware of underreporting. According to CDTFA's Detailed Narrative Description, "[t]he WISRs attached to the November and December 2010 sales tax returns show the same sales tax amounts as WISRs from DAI but the sales taxes were reduced on the final work sheet used to file the returns as instructed by [A. Beri]." The record includes a November 2010 sales tax prepayment return with WISRs

[25] Appellant cites to what purports to be page 10 from Operations Memo. No. 1162 dated November 17, 2010, which states, in part, "The auditor may not remove records from the taxpayer's or representative's premises without permission from the taxpayer or designee."

[26] CDTFA determined deficiencies for other Beri entities on the basis of reports made to the Subway franchisor.

[27] Appellant contends that the franchisor informed the franchisees that they should double soda sales tax to arrive at the minimum sales tax threshold, so the franchisees can determine whether they were properly charging sales tax. However, a development agent for Subway restaurants in Los Angeles and Orange County testified in appellant's criminal matter that DAI did not implement a taxable threshold until 2011, in response to appellant's tax issues.

attached, and the data in these WISRs matches that of the WISRs provided by DAI. Nonetheless, the final sales tax worksheet for this prepayment return (which identified the sales tax ultimately reported of $2,109) lists less sales tax than that identified in the WISRs and less sales tax than that identified in a draft sales tax worksheet of $2,665.66. And although the draft sales tax worksheet indicates a taxable sales ratio of 58 percent,[28] 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*]." 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.

Furthermore, A. Beri admitted in his plea that he filed fraudulent 2010 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 error rate was the result of intentional underreporting.[29]

Appellant asserts that the charges of tax evasion filed against appellant were dropped, which indicates that appellant 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.) Appellant had an opportunity to provide evidence for OTA to consider when deciding the weight to give to the plea and provided no such evidence.

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

[29] A. Beri is a member or the president of appellant's related entities; the returns for these entities were prepared by appellant's bookkeeper; and appellant acknowledges that these entities employed the same reporting practices as appellant. Given appellant's connections with these related entities, evidence of intentional underreporting by appellant's related entities constitutes evidence of intentional underreporting by appellant, and vice versa. Therefore, OTA rejects appellant's argument that evidence concerning appellant's related entities should not be considered in this appeal.

Appellant argues that records obtained from appellant's franchisor through a search warrant have no foundation and are inadmissible. However, 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. (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)).[30] OTA finds the data obtained from the franchisor to be relevant evidence that may be considered.

OTA also finds that appellant's contentions that the seized records were obtained in violation of R&TC section 19504.7 and CDTFA's Operations Memo. No. 1162 are unfounded. R&TC section 19504.7 does not apply to CDTFA; it applies to the Franchise Tax Board. Also, it is clear, even from the single page provided by appellant, that Operations Memo. 1162, which states that an auditor may not remove records from the taxpayer's or representative's premises without permission from the taxpayer or designee, does not apply to those authorized by search warrants to search for, seize, and examine evidence of a possible crime.

As to appellant's arguments regarding the email from DAI, OTA does not read the email to indicate that the sales tax records – they are identified as weekly inventory and sales reports in the appeals involving Subway restaurants – were unreliable for the purpose for which CDTFA used them. The email states, in part, that "POS Sales and Sales Tax are less accurate as some weeks may not be represented fully with a data upload from the stores." This appears to indicate that the records might understate, not overstate, sales tax reimbursement collected by the franchisee.

When considered together, OTA finds that the foregoing evidence constitutes clear and convincing proof of fraud for the entirety of the liability period. Thus, the NOD was timely issued, and the fraud penalty was properly imposed.

[30] 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).)

Issue 2: Whether the payment of restitution satisfies any remaining civil liability.

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 conduct. (Pen. Code, § 1202.4(f).) An order of restitution under California Penal Code section 1202.4(f) does not bar a subsequent civil action based on the same facts. (*Vigilant Ins. Co. v. Chiu* (2009) 175 Cal.App.4th 438, 444 (*Vigilant*); *Appeal of Delgado*, 2018-OTA-200P (*Delgado*).)

Appellant argues that CDTFA is precluded from asserting civil tax deficiencies in excess of the court-ordered restitution of $3,021,059 paid by A. Beri. Appellant contends that R&TC section 7157(a)(2) precludes the imposition of additional tax, interest, and penalties because the amount imposed by a court as an order for restitution is treated as final.[31] Appellant also argues 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 this matter on the basis that it involved the Cigarette and Tobacco Products Tax Law.

Appellant argues that *Delgado* improperly relied on *Vigilant* because it did not involve a government entity and concerned nonmonetary damages. Furthermore, appellant argues that *Vigilant* and *Delgado* are distinguishable from this matter because appellant does 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 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.

[31] 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]." The subdivision's reference to the finality of a restitution order 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.

The payment of restitution to CDTFA has been credited against appellant's civil tax liability, but it does not eliminate or absolve the remaining penalties and interest. Accordingly, appellant remains liable for the remaining unpaid civil liability.

Issue 3: Whether adjustments are warranted to the tax liability 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 not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, CDTFA relied on sales tax reimbursement data provided by appellant to its franchisor, an independent third party. Therefore, CDTFA used appellant's own record of sales tax reimbursement collected from customers. OTA finds CDTFA's use of sales tax reimbursement listed in the WISR's obtained from DAI, was reasonable and rational. Accordingly, the burden of proof shifts to appellant to establish that a result different from CDTFA's determination is warranted.

Appellant argues that the WISRs, upon which the deficiency measure is based, are inadmissible because they were unlawfully obtained.[32] However, CDTFA obtained the WISRs via a search warrant executed on appellant's franchisor. CDTFA may compute and determine

[32] Appellant also argues that it was never audited; however, appellant was in fact audited.

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 within CDTFA's possession or that may come into its possession. (R&TC, § 6481.) Consequently, the purported absence of chain of authentication does not preclude use of WSR data.[33]

Concerning appellant's argument that the WISRs are unreliable, sales tax reimbursement was recorded in appellant's POS system contemporaneously with the sale and transmitted by the POS system to appellant's franchisor via WISRs and Control Sheets. Therefore, the sales tax reimbursement identified in the WISRs are highly probative of appellant's sales tax obligations, and appellant has not articulated a legitimate reason to question the accuracy of the WISRs' sales tax reimbursement data.

Appellant also argues that the deficiency measure is inaccurate because CDTFA estimated sales tax reimbursement for weeks which the WISRs lacked sales tax data,[34] and that CDTFA disadvantaged appellant by selectively disregarding documentation obtained from appellant's business through the search warrants. OTA finds it was reasonable for CDTFA to estimate taxable sales for periods where the WISRs lacked sales tax data, using sales tax data from surrounding weeks, and appellant has not identified the documentation it believes CDTFA should have used to calculate taxable sales.

OTA notes that on Schedule 12C-1, Franchisor-provided WISRs, Note 1 states that the total sales for the week of November 26, 2003, through December 2, 2004, includes sales made from November 26, 2003, through November 29, 2003, when the business was owned by ABC (seller's permit # SY EA 100-118243), and that the location's start date under the seller's permit of appellant was November 30, 2005. Note 1 states that because the WISRs did not provide a breakdown for the daily sales, the daily sales for November 26, 2003, through November 29, 2003, are not known and cannot be segregated from the December 2, 2003 weekly total. Based on the above, it appears that underreported taxable sales for the week of November 26, 2003, through December 2, 2004, includes sales made by a different taxpayer.

[33] 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).)

[34] Appellant also argues that it was not audited and that CDTFA does not identify the weeks in which sales tax data is missing from the WISRs. However, OTA gives this argument no further consideration because appellant was audited and, in Schedule 12C-1, CDTFA identifies the weeks lacking sales tax data.

Accordingly, OTA finds that the measure of underreported taxable sales should be reduced by $2,421.[35] However, this overpayment will serve as a credit against penalties and interest that remain due. (R&TC, §§ 7157(c), 6483.)

Issue 4: Whether CDTFA properly imposed the 40 percent penalty and whether appellant is entitled to relief of the penalty.

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) appellant knowingly collected sales tax reimbursement from its customer(s); (2) appellant failed to timely remit the sales tax for which it 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

[35] To remove sales made by ABC, OTA made the following calculations to estimate the sales by ABC. Divide sales tax of $349 for the week ending December 2, 2003, as indicated by Schedule 12C-1, by 7 to calculate average daily sales tax of $50. Multiply that amount by 4 to estimate sales tax of $200 for November 26, 2003, through November 29, 2003. Remove the $200 from 4Q03 tax collected amount of $1,794, as indicated on Schedule 12C-1, to establish an estimate of $1,594 in sales tax collected for that period. Then, subtract tax reported of $1,051 for 4Q03, as indicated on Schedule 12A, from $1,594 to establish underreported tax of $543. This calculation results in underreported taxable sales of $6,582 for 4Q03 ($542 ÷ .0825, according to the formula in Schedule 12A), which is $2,421 less than 4Q03 underreported taxable sales of $9,003 calculated in the audit.

establish a procedure for requesting relief.[36] OTA interprets R&TC section 6597 to require the taxpayer or its designee to request relief and prove a factual basis for the request.

The evidence shows that, in every quarter within the period to which CDTFA applied the penalty, appellant knowingly collected sales tax reimbursement and failed to timely remit the sales tax for which it 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 appellant's arguments that it unknowingly underreported.

Appellant argues that CDTFA cannot impose the penalty because the determination is 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 determination is not barred by the statute of limitations. Therefore, OTA finds that CDTFA correctly imposed the 40 percent penalty. In addition, appellant does not argue, and the record does not show that the penalty should be relieved.

Issue 5: Whether appellant is 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 in certain circumstances, including where the failure to pay the tax was due to a disaster, where the failure to pay the tax was due in whole or in part to an unreasonable error or delay by an employee of CDTFA acting in their official capacity, and where the failure to pay the tax was due to erroneous advice received from CDTFA. (R&TC, §§ 20, 6593, 6593.5(a)(1), 6596.) 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(b), 6593.5(c), 6596(c)(2).) CDTFA determined that appellant did not show that interest could be relieved.

Appellant makes the same arguments in support of its request for interest relief that it makes in support of its request for relief of the penalties. Appellant has not alleged or offered any evidence to prove an unreasonable error or delay by an employee of CDTFA acting in their

[36] 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 by 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.

official capacity or that any other basis exists to relieve interest. Therefore, OTA finds that appellant is not entitled to relief of interest.

HOLDINGS

1. CDTFA has provided clear and convincing evidence of fraud.
2. Restitution payments do not satisfy any remaining civil liability.
3. Adjustments are warranted to the tax liability as determined by CDTFA.
4. CDTFA properly imposed the 40 percent penalty and appellant is not entitled to relief of the penalty.
5. Appellant is not entitled to relief of interest.

DISPOSITION

Underreported taxable sales is reduced by $2,421,[37] and the 25 percent penalty and interest should be reduced accordingly.[38] Otherwise, CDTFA's denial of the petition for redetermination and claim for refund is sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

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

DocuSigned by:
Susana Seyller For
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Sheriene Anne Ridenour
Administrative Law Judge

Date Issued: 5/16/2024

[37] As previously discussed, this overpayment will serve as a credit against penalties and interest that remain due.

[38] The 40 percent penalty is not affected because it was not imposed on underreported tax before 1Q07.