OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No.: 20096662
	CDTFA Case ID: 279-875
4JR ENTERPRISES, INC.	

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Aksel Bagheri, Attorney

For Respondent: Jason Parker, Chief of Headquarters Ops.

M. GEARY, Administrative Law Judge: On May 20, 2024, following a hearing of three consolidated appeals filed by related corporations, the Office of Tax Appeals (OTA) issued an Opinion (the Opinion) sustaining the California Department of Tax and Fee Administration's (respondent's)[1] action, which reduced the taxable measure from $49,7778,190 to $43,119,665, and otherwise denied 4JR Enterprises, Inc.'s (appellant's) petition for redetermination of an April 5, 2018 Notice of Determination for tax of $2,279,006,[2] plus applicable interest, and a fraud penalty of $569,752 for the period January 1, 2010, through March 31, 2016 (liability period). Appellant submitted a timely petition for rehearing dated June 17, 2024. OTA concludes that appellant has not established grounds for a new hearing.

OTA may grant a rehearing where any of the following grounds is established and materially affects the substantial rights of the filing party: (1) an irregularity in the appeal proceedings, which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) accident or surprise, which occurred during the appeal proceedings and prior to the issuance of the Opinion, and which ordinary caution could not have prevented; (3) newly

[1] Sales and use taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to respondent. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to BOE.

[2] OTA will round dollar amounts in this Opinion, which may cause some totals to be slightly different than amounts stated in the evidence.

discovered, material evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law that occurred during the OTA appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6).)

As stated above, OTA heard the appeals of three related corporations at a consolidated hearing. A. Rabadi owned the three corporations (the Rabadi entities) that operated multiple service stations with minimarts. The corporations were appellant, High Five Enterprises, and JR Fueling.

For appellant, respondent initially determined a deficiency for the liability period measured by $49,778,190, which consisted of the following items: (1) unreported taxable gasoline sales totaling $37,695,284; (2) unreported taxable sales of diesel fuel totaling $261,558; (3) unreported taxable sales of minimart merchandise totaling $11,245,474; (4) unreported taxable sales of propane totaling $434,800; and (5) unreported taxable cigarette rebates totaling $141,074. Respondent calculated an error ratio of 46.34 percent.[3] A later reaudit of minimart sales reduced that measure from $11,245,474 to $4,586,949, which reduced the total measure of unreported taxable sales to $43,119,665 and the error ratio to 40.12 percent. The only measures at issue on appeal to OTA were unreported gasoline and diesel sales. Appellant also contested the fraud determination.

For purposes of its petition for rehearing, appellant concedes the liability for tax and interest. However, appellant argues that it is entitled to a new hearing on the fraud penalty issue because there is insufficient evidence to justify the Opinion's conclusions regarding that penalty and because at least some of those conclusions are contrary to law.[4]

Insufficient evidence

To find that there is insufficient evidence to justify the Opinion, OTA must find, after weighing the evidence in the record, including reasonable inferences based on that evidence, that OTA clearly should have reached a different opinion. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P.)

[3] The error ratio is calculated by dividing unreported taxable sales by reported taxable sales.

[4] The petition does not state the factual or legal bases for the argument that the Opinion is contrary to law, but this ground will nevertheless be addressed below.

As stated in the Opinion, evidence submitted for OTA's consideration established the following additional facts:

- J. Humphrey is a bookkeeper and tax preparer who has been maintaining the books and handling all of the tax filings for the Rabadi entities and several other businesses owned by A. Rabadi for many years and continued to do so at least to the date of the hearing in this appeal. Appellant provided sales summaries, purchase invoices, bank statements, and cancelled checks to J. Humphrey, who used the information to prepare appellant's sales and use tax returns.
- Appellant used a point-of-sale (POS) system at its service stations and minimarts. Cashiers ran a sales report at the end of each shift. That report showed total sales, credit sales, and cash sales. It would also have shown taxable and nontaxable sales.
- By letter dated April 28, 2016, respondent informed appellant that JR Fueling was going to be audited. On June 7, 2016, respondent informed appellant regarding the books that would be required for the audit, and R. Rabadi, A. Rabadi's sister and the manager of the Rabadi entities, agreed to make the requested books and records available by July 8, 2016.
- On June 22, 2016, J. Humphrey informed respondent that he would not be assisting with the audit because he did not have time.
- R. Rabadi did not provide appellant's books and records on July 8, 2016. On July 20, 2016, R. Rabadi informed respondent that J. Humphrey had not had the time to gather the necessary records. On July 25, 2016, R. Rabadi made an appointment to provide the requested records to respondent on August 2, 2016.
- On August 2, 2016, R. Rabadi informed respondent that most of appellant's records had been mistakenly shredded in February 2016, and other records, including monthly sales reports provided to J. Humphrey for preparation of appellant's sales and use tax returns, had been discarded by R. Rabadi in the normal course of business.

- One of appellant's suppliers, ConocoPhillips Company Payment Systems (Conoco), was also a credit payment processor.[5] Evidence shows that in March of 2017, Conoco twice offset amounts it owed to appellant for credit sales against larger amounts appellant owed to Conoco for fuel. Conoco offset credit card receipts of $3,596 (shown in a March 16, 2017 invoice) against a fuel charge of $23,904 (shown in a March 13, 2017 invoice), leaving a net of $20,308 due to the vendor. Later that month, Conoco offset credit card receipts of $4,293 (shown on a March 24, 2017 invoice) against fuel and related charges totaling $22,553 (shown on February 23, 2017 and March 21, 2017 invoices), leaving a net due of $18,260. A March 2017 bank statement shows these two net withdrawals, as well as three other transfers out to Conoco totaling $59,682, for total transfers out to Conoco that month of $98,241. Appellant also provided electronic funds transfer forms showing transfers from Conoco into appellant's account for credit card receipts from March 17, 2017, through March 22, 2017, each showing a deposit of between $2,735 and $4,116. The bank statement shows 18 such transfers into appellant's account, totaling $92,163. There is no independent evidence of offsets taken during the liability period.
- Appellant stated at the hearing that it provided as its Exhibit 5 all pages of Form 1099-K data that the IRS purportedly sent directly to appellant.[6] An examination of the exhibit revealed that it is incomplete (i.e., it does not include all pages provided by the IRS) and appears to have been altered.
- A. Rabadi testified that he relied on employees, including his sister, and his outside bookkeeper to see to the routine management, record keeping, and tax reporting. No witness explained how appellant reported taxes due or what caused appellant to fail to report taxable sales of $43,119,665.

[5] Appellant argued that another fuel supplier was – and at least implied that all fuel suppliers were – also a merchant services provider who offset appellant's credit sales revenue against amounts appellant owed the supplier for fuel, but there was no credible evidence to support that assertion.

[6] Form 1099-K is an Internal Revenue Service form titled "Payment Card and Third Party Network Transactions." Form 1099-K shows the monthly and annual amount paid to the merchant in a calendar year by customers using some type of payment card or third-party network, if the amount paid to the merchant exceeds $20,000 in that calendar year.

Appellant has consistently taken the position that respondent should have based the audit on a bank deposit analysis. It argued at the hearing – and argues still – that there is insufficient evidence to justify the Opinion, in part because the Opinion erroneously concludes that substantial gross receipts from sales were not deposited into appellant's bank account(s) and what appellant did deposit was less than its taxable sales. Appellant argues that the evidence shows, on the contrary, its reported sales were consistent with its deposited revenue. The crux of appellant's argument is that respondent (and OTA) miscalculated gross receipts from sales that should have been deposited into appellant's bank account(s) because both failed to consider amounts that fuel vendors owed to appellant for credit sales but offset against amounts appellant owed to these vendors for fuel. It is these alleged offsets upon which appellant bases its petition for rehearing. Appellant contends that the understatement of reported taxable sales could have been due to its accountant's failure to notice the offsets – just as respondent and OTA failed to notice them – which caused the credit card deposits to be less than actual credit sales revenue.[7] Appellant urges OTA to find that because the evidence establishes this plausible, non-fraudulent reason for the understatements, respondent did not carry its burden of proving fraud or intent to evade by clear and convincing evidence. Instead, appellant argues, OTA all but ignored the argument.

The Opinion considered appellant's contentions regarding offsets to be part of appellant's argument that respondent should have used a bank deposit analysis (i.e., one which should have taken the alleged offsets into consideration). The Opinion explains that respondent is authorized to determine a liability on the basis of any information in its possession (Rev. & Tax. Code, § 6481; *Appeal of Amaya*, 2021-OTA-328P) and later rejects appellant's argument that a bank deposit analysis would produce a more accurate result. The Opinion rejects that argument because there was no bank deposit analysis in the hearing record.

The hearing record also does not contain persuasive evidence of offsets taken during the liability period. The lowest amount of unreported quarterly gasoline sales during the liability

[7] According to appellant, at least two of its fuel vendors, Conoco and Northwest Dealerco Holdings LLC, were also merchant services providers. Appellant asserts that these entities offset amounts owed to appellant from its credit sales against much larger amounts that appellant owed the entities for fuel. Appellant argues that due to what was, at worst, a negligent failure of appellant's accountant to recognize the offsets, taxable sales were understated by the amount of the offsets and that appellant's bank deposits accurately reflect revenue actually received by appellant (i.e., revenue less offsets).

period was over $625,000. The average amount of unreported quarterly fuel (gasoline and diesel) sales during the liability period was over $1.5 million.[8] The evidence showed two offsets in March of 2017, at least a year after the end of the liability period, totaling less than $10,000. The evidence also showed that there were 18 credit sales payments that Conoco made to appellant during that month, which is evidence that those payments were not offset. While R. Rabadi testified that the bookkeeper – apparently referring to J. Humphrey – handled these matters, and that it was her understanding that Conoco offset amounts Conoco owed to appellant against amounts appellant owed to Conoco, her testimony was vague; and given R. Rabadi's role in the alleged destruction of appellant's business records, her inconsistent statements regarding those records, her relationship to appellant's owner, and the lack of independent evidence of offsets during the liability period, OTA gave her unsupported testimony little weight.

OTA rejected appellant's argument that this evidence should have caused OTA to conclude that this "plausible explanation for the underreporting" negated respondent's effort to prove fraud by clear and convincing evidence. Before issuing the Opinion, OTA weighed all the evidence to determine whether respondent met its burden of proof. This is what the law requires. (*Appeals of Jafari and Corona Motors, Inc.*, 2023-OTA-401P.) Now, after weighing the evidence in the record, including reasonable inferences based on that evidence, OTA must find whether appellant has established that OTA clearly should have reached a different result. (*Appeals of Swat-Fame, Inc., et al., supra*.) OTA finds that appellant has not carried that burden. The evidence upon which appellant relied was not persuasive. There was no credible evidence of meaningful offsets occurring during the liability period. In the absence of such corroborating evidence, appellant's argument that there may have been offsets does not outweigh, much less negate, the clear and convincing evidence upon which OTA sustained respondent's finding of fraud.

Contrary to law

Much like Code of Civil Procedure (CCP) section 657, upon which it was based, the original version of California Code of Regulations, title 18, (Regulation) section 30604 provided that a rehearing could be granted on the ground that there was "insufficient evidence to justify the written opinion or the opinion is contrary to law; . . . ." (See former Cal. Code Regs., tit. 18,

[8] For A. Rabadi's three corporations combined, the average amount of unreported quarterly fuel sales during the liability period was over $1,379,000.

§ 30604(d), effective January 18, 2018.) Some Opinions issued by OTA cite *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906, for the proposition that an Opinion is contrary to law if it is "unsupported by any substantial evidence."[9] (*Appeal of Graham and Smith*, 2018-OTA-154P.) The current Regulation section 30604 separates the "insufficient evidence" and "contrary to law" grounds and provides that the "contrary to law" standard of review shall involve a review of the Opinion for consistency with the law. (Cal. Code Regs., tit. 18, § 30604(b).)

While appellant states that it seeks a rehearing "on the grounds that the Opinion is contrary to law and that there is insufficient evidence to justify the Opinion," its argument appears to be focused entirely on the sufficiency of the evidence, addressed above. To the extent appellant contends the Opinion is inconsistent with the law for some other reason, OTA has reviewed the Opinion and finds that its fraud analysis and conclusions, the only ones at issue here, are consistent with the law.

Consequently, the petition for rehearing is denied.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

Date Issued: 12/13/2024

[9] Regulation section 30604 is essentially based upon the provisions of CCP section 657. (See *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654 [BOE utilizes CCP 657 in determining grounds for rehearing]; *Appeal of Do*, 2018-OTA-002P [OTA adopts BOE's grounds for rehearing].) Therefore, the language of CCP section 657 and case law pertaining to the operation of the statute are persuasive authority in interpreting the provisions contained in this regulation.