OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 20106826
	CDTFA Case ID: 035-083
PARTNERSHIP OF A. BERI AND V. BERI,	
dba Subway	

OPINION

Representing the Parties:

For Appellant: Kenneth M. Barish, Attorney

For Respondent: Sunny Paley, Attorney
Stephen Smith, Attorney
Kim Wilson, Hearing Representative

For Office of Tax Appeals: Corin Saxton, Attorney

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 and California Code of Regulations, title 18, (Regulation) section 5220, the Partnership of A. Beri and V. Beri,[1] dba Subway (appellant) appeals an August 13, 2019 Decision and a September 14, 2020 Supplemental Decision (collectively, Decisions) issued by the California Department of Tax and Fee Administration (respondent)[2] denying appellant's petition for redetermination of a May 26, 2016 Notice of Determination (NOD).[3] The NOD is

[1] The former V. Beri, who testified at the hearing, is now V. Kapila.

[2] Sales 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.

[3] The NOD was based on an April 29, 2016 Field Billing Order which identifies a deficiency consisting of the difference between recorded tax reimbursement collected from customers and tax reported on sales and use tax returns.

for $67,660[4] in tax, plus accrued interest, and a 25 percent fraud penalty of $16,915 for the period January 1, 2003, through December 31, 2003 (liability period).[5]

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Richard Tay, and Josh Lambert held a consolidated oral hearing for this and two related matters in Cerritos, California, on November 8, 2023.[6] At the conclusion of the hearing, the parties submitted the matter, and OTA closed the record. However, on January 12, 2024, OTA reopened the record to request additional information. Both parties filed additional briefs, and on March 21, 2024, OTA again closed the record.

ISSUES

1. If OTA concludes that the NOD was timely issued, are adjustments to the liability warranted?[7]
2. Has respondent proved appellant's fraud by clear and convincing evidence?

FACTUAL FINDINGS

1. Appellant, a husband-and-wife partnership, operated multiple Subway restaurants in California. A. Beri and V. Beri also owned two other entities (the related entities) whose appeals were consolidated with appellant's appeal for hearing: Taste America Foods Group, Inc. (Taste America) and Ava Beri Restaurants Group, Inc. (ABRG), both California corporations that operated multiple Subway restaurants in California.
2. During the period of time at issue in these related appeals, another A. Beri (hereinafter referred to as "the other A. Beri") owned and controlled various entities (hereinafter

[4] This Opinion rounds amounts to the nearest dollar. This may cause immaterial differences in some totals referred to in this Opinion, but rounding is not intended to alter the rights or obligations of the parties.

[5] The NOD, which was issued well after expiration of the normally applicable three-year statute of limitation, will be found untimely except for reporting periods for which clear and convincing evidence shows that appellant filed sales and use tax returns that were fraudulent or intended to evade the Sales and Use Tax Law or authorized rules and regulations. All subsequent references to fraud should be read as references to fraud or intent to evade the Sales and Use Tax Law or authorized rules and regulations.

[6] The related matters are the appeals of Taste America Foods Group, Inc. and appellant's successor, Ava Beri Restaurants Group, Inc.

[7] The prehearing conference minutes and orders identify Issue 2 as follows: "Are adjustments to the measure of unreported taxable sales warranted?" While "measure" is a meaningful term when unreported taxable sales are at issue, it is an unnecessary and sometimes artificial complication when excess tax reimbursement (see R&TC, § 1700(b)(1), (2)) is at issue, as it is in this appeal.

referred to as "the other Beri entities") that operated multiple franchise restaurants in California, including Subway restaurants, Denny's restaurants, and Del Taco restaurants.

3. According to the Field Billing Order (FBO) upon which the NOD was based, appellant operated multiple Subway restaurants at various times during the liability period. The seller's permits for all locations were closed effective December 31, 2003.

4. Appellant's Subway franchisor, Doctors Associates, Inc. (DAI) required its franchisees to use a particular point of sale (POS) system[8] to operate the restaurants and to generate and automatically transmit to DAI two types of weekly reports: "Control Sheets" (hereinafter referred to as "DAI Control Sheets") and "Weekly Inventory & Sales Reports" (WISRs). Both contained daily and weekly totals for sales tax reimbursement collected from customers.[9]

5. The evidence also includes copies of or references to the following documents:

    - Another report entitled "Control Sheet" (hereinafter referred to as "Deposit Control Sheet"), which is much simpler than the DAI Control Sheets referred to above, and which appears to be more focused on tracking revenue by broad category (e.g., sandwich sales, drink sales, etc.) and documenting total revenue collected and cash deposited into appellant's bank account;[10]
    - "Control logs" (also referred to as "Store Control Logs), which may have been another name used by some to describe Deposit Control Sheets, or may have been a different document, a sample of which has not been provided and about which little is revealed by the evidence; and
    - "Control log verification reports," a sample of which has not been provided and about which little is revealed by the evidence.[11]

6. After the audit of ABRG revealed what respondent concluded was evidence of possible

[8] A point-of-sale system typically includes one or more terminals, which are the modern equivalent of a cash register. Depending on the equipment and software, POS systems can generate reports that 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.

[9] The reports also tracked other data that is not directly relevant to this appeal.

[10] There are copies of these documents in evidence.

[11] Declarations submitted by appellant contain references to "control logs" and "control log verification reports."

fraud, respondent initiated a fraud investigation of appellant, the related entities, and the other Beri entities. On June 23, 2011, respondent, with the assistance of law enforcement personnel, executed search warrants on several locations, including numerous restaurants owned by appellant and the related entities, A. Beri and V. Beri's residence, the bank where A. Beri and V. Beri conducted business, the residence and business locations of the other A. Beri, and DAI's office. During the search, respondent seized potential evidence, including several computers, hard drives, USB flash drives, sales register tapes, WISRs, various control sheets, and purchase documents. In addition, respondent seized DAI Control Sheets and WISRs that appellant had transmitted to DAI for most of the weeks within the liability period.

7. At least some of the WISRs obtained from DAI were the subject of an October 11, 2010 email from P. Bollettieri, then Tax Manager for DAI (the Bollettieri email).[12] The Bollettieri email states, in part,

> The data must be interpreted with caution. The columns entitled 'Sales 20nn' are the most accurate. However, 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.

8. Respondent's evidence includes what respondent refers to as "sample" Deposit Control Sheets for several locations owned by appellant and the related entities. There are two different Deposit Control Sheets for each of many weeks during the liability period. These Deposit Control Sheets show different amounts for sales made and sales tax reimbursement collected from customers for the same week. For example, one of the Deposit Control Sheets for ABRG's location number 7870[13] for the week ending October 9, 2007, shows gross sales of $12,229, net sales of $11,382, sales tax of $847, and cash deposited of $6,702 (apparently $2,250 less than the required deposit), while the other Deposit Control sheet for the same location and period shows gross sales of $9,987, net sales of $9,735, sales tax of $252, and a cash deposit of $6,702 (only $8 less than the

[12] According to the evidence, in April 2010, DAI first provided WISRs for all California franchisees for the period 2007 through 2009 in connection with an audit of DAI.

[13] At the hearing, both parties relied on evidence that pertains to one or both of the other related entities. In its post-hearing submission, respondent offered, and OTA admitted over appellant's objection, similar evidence pertaining to appellant.

required deposit).[14] The DAI Control sheet for the same location and period shows gross sales of $12,309, net sales of $11,358, and sales tax of $891.

9. Respondent's evidence includes a memorandum of interview (MOI) dated April 1, 2014, in which respondent memorialized an interview with A. Montoya. According to the Montoya MOI, the witness stated:

- She worked as the controller for A. Beri from approximately 2009 to 2011.[15]
- She was familiar with both DAI Control Sheets and Deposit Control Sheets.
- A. Beri instructed the witness to alter numbers on Excel spreadsheets. She was not certain, but she believed that A. Beri instructed her to lower sales amounts so the column that contained the amount by which the actual deposit differed from total revenue (sales + sales tax reimbursement) was in the range of $5 or less.
- She ended her employment with appellant on bad terms due to the fact that she did not feel comfortable doing what she was instructed to do.

10. Appellant's evidence includes a declaration by K. Joshi (Declarant 1), who, according to the declaration, held a degree in accounting and provided accounting services to clients, including ABRG.[16] The declaration states that,

- Beginning in June 2009, Declarant 1 provided bookkeeping and accounting services to ABRG, including reconciling bank accounts, preparing and filing sales and use tax returns, filing payroll returns, maintaining monthly accounting, and preparing monthly profits and loss statements.
- Declarant 1 used "monthly Store Control Logs," Excel worksheets prepared by store managers to show the "details of gross sales, sales, tax, net sales, and the type of sales such as credit card or cash," to prepare sales and use tax returns and to reconcile revenue with bank deposits.

[14] It appears that "net sales" shown on Deposit Control Sheets was calculated by subtracting sales tax reimbursement from total sales. It is not clear how "net sales" were calculated on the DAI Control Sheets.

[15] The MOI does not indicate what specific entity or entities employed her.

[16] The declaration of Declarant 1 indicates that Declarant 1 provided independent accounting services to appellant. According to the evidence, Declarant 1 used an email address that identified Declarant 1 as the controller of "beri group."

- Declarant 1 and A. Beri met monthly, primarily to review financial statements, and Declarant 1 would file the sales and use tax returns following A. Beri's review and approval.

11. Appellant's evidence also includes a June 8, 2016 declaration by E. Martinez (Declarant 2), who, according to the declaration, oversaw the office administration of ABRG and its related entities since November of 2009. Declarant 2 states that she reconciled "control sheets from the individual stores" with the "control logs" and prepared the "control log verification reports."[17]

12. Respondent ultimately concluded that the WISRs, in which appellant reported sales tax reimbursement collected from customers, constituted the best evidence upon which to base its determination.[18] There were some weeks for which DAI did not provide data for some locations, and DAI did not provide any data for one restaurant for the one month (December) that appellant owned it. Respondent did not attempt to estimate or project amounts for the periods for which data was not available.

13. For the liability period, appellant reported total sales of $1,119,578 and claimed deductions totaling $865,191, including $844,207 for nontaxable food sales.[19] Appellant reported taxable sales of $254,387 and $20,993 tax due.

14. The WISRs showed that appellant collected sales tax reimbursement during the liability period totaling $88,653. On that basis, respondent concluded that appellant collected $67,660 in sales tax reimbursement from its customers that it did not report or remit to the state ($88.653 - $20,993). The percentage of error (unreported sales tax reimbursement ÷ reported sales tax reimbursement) was just over 322 percent.

15. On the basis of its investigation, respondent concluded that appellant was guilty of fraud. Respondent issued the April 29, 2016 FBO for $67,660 in tax, applicable interest, and penalties totaling $16,915. On the basis of that FBO, respondent issued the May 26, 2016 NOD.

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[17] As previously stated, none of the admitted documents are entitled "control logs" or "control log verification reports."

[18] While appellant opened its first restaurant in 2001, DAI provided WISRs (and DAI Control Sheets) for periods beginning in 2003.

[19] Claimed nontaxable food sales were approximately 75.40 percent of reported total sales.

16. On June 9, 2016, appellant filed a timely petition for redetermination. The parties participated in an appeals conference as part of respondent's internal appeals process. On August 13, 2019, and September 14, 2020, respondent issued its Decisions denying the petition.

17. This timely appeal followed.

PRELIMINARY MATTERS

As part of the post-hearing briefing, the following questions were directed, first, to respondent:

1. Does respondent contend that the October 20, 2010 NOD issued to ABRG was timely, without a finding of fraud, as to all periods covered by the NOD?
2. If OTA concludes that the July 1, 2016 NOD issued to ABRG is barred by the statute of limitations, how will that finding affect the October 20, 2010 NOD issued to ABRG?

In addition, OTA asked respondent to provide:

- copies of all statute waivers executed by or on behalf of ABRG;
- Deposit Control Sheets pertaining to Subway restaurant # 7870 for relevant time periods other than those for which respondent had already provided them and Deposit Control Sheets pertaining to any other restaurant locations owned by any appellant during the relevant times;
- a copy of the earliest report that includes findings for the audit of ABRG for the period July 1, 2005, through December 31, 2009;
- a copy of all Forms 414-Z that cover periods prior to May 3, 2013, for the audit of ABRG; and
- a copy of the notification that D. Cathy refers to in the October 19, 2015 memorandum that was in evidence.

Respondent timely submitted its additional brief and evidence.

Appellant was allowed to reply to respondent's submission and did so. Appellant objected to respondent's submission on the grounds that the proposed new evidence had not been previously provided to appellant and it is not responsive to OTA's request for additional briefing and evidence. In the latter regard, appellant argues that respondent's proposed new Exhibit EE is not the "similar evidence" that OTA requested, but rather, is "parts of the failed criminal

investigation files" and indecipherable, requiring further analysis and explanation, and that respondent's brief contains unsolicited editorializations and extraneous information.

OTA considered appellant's objections. The objections were overruled, and respondent's proposed Exhibits DD through HH were admitted. All the proposed new exhibits are relevant, and appellant has had a reasonable opportunity to consider and respond to the submissions.

DISCUSSION

Issue 1: If OTA concludes that the NOD was timely issued, are adjustments to the liability warranted?[20]

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent may determine a taxpayer's liability 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted.[21] (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Appellant asserts that it did not use the WISRs to prepare its sales and use tax returns

[20] Although it may seem counterintuitive to address this apparently contingent issue before what could be the dispositive fraud issue, there are reasons why OTA addresses this issue first, not the least of those reasons being the importance of the tax liability to the fraud issue.

[21] While this shifting of the burden may seem contrary to the requirement that respondent prove fraud by clear and convincing evidence, it is not. As will be discussed below under Issue 2, respondent has the burden of proving fraud by clear and convincing evidence, but the usual presumptions regarding respondent's determination of an amount of tax due still apply. (*Appeals of Jafari and Corona Motors, Inc.*, 2023-OTA-401P.)

(SUTRs), and it points to the Bollettieri email to support an argument that the WISRs are inaccurate and unreliable and do not constitute sufficient evidence of sales tax reimbursement collected. Appellant also points to one of respondent's comments contained in an October 18, 2010 report of the revised audit of ABRG, which states that the restaurants do not fall under the 80/80 rule because of the significant cold-food-to-go business.[22] On that basis appellant argues that respondent acknowledged that the Subway restaurants do substantial nontaxable food sales and that, while sales of cold food to go are typically not subject to tax (Cal. Code Regs., tit. 18, § 1603(c)(1)(B)), respondent nevertheless erroneously concludes that essentially all of appellant's sales were subject to tax.[23] Appellant also questioned how respondent could conclude that all of appellant's sales were taxable when, according to the evidence, respondent was at about the same time negotiating with representatives of Subway franchisees in southern California and suggesting to those representatives that an appropriate ratio of taxable to total sales would be 40 percent for 2007 and 2008, 45 percent for 2009, and 55 percent for 2010.[24]

Appellant argues that respondent should have done a bank deposit analysis to confirm that appellant's store managers deposited all sales revenue.[25] Appellant argued that if respondent's accusations had any merit, such an analysis would show that millions of dollars – apparently referring to the unremitted sales tax – was missing. Appellant at least implies that

[22] According to respondent's publication *Tax Guide for Restaurant Owners*, the "80/80 rule" applies when more than 80 percent of sales are sales of food, and more than 80 percent of the food sold is taxable. If the 80/80 rule applies and the taxpayer does not separately track sales of cold food products (excluding carbonated beverages) sold to-go, the taxpayer is responsible for tax on 100 percent of its sales. (See Cal. Code Regs., tit. 18, § 1603(c)(3).) The Decision in appellant's appeal indicates that it was undisputed that the 80/80 rule applied to appellant's sales. Appellant later argued otherwise, but respondent found in its Supplemental Decision that the 80/80 rule applied.

[23] Apparently referring to data from an audit of ABRG, appellant asserts that respondent's findings indicate appellant collected tax on more than 100 percent of appellant's sales for the period 3Q05 through 3Q07, while respondent's computation indicates the taxable sales accounted for between 95 percent and 97 percent of total sales during that period.

[24] Appellant's evidence included a July 14, 2011 letter from respondent to a representative of certain Subway franchisees wherein respondent states that these ratios should substantially account for the majority of taxable sales at a typical Subway restaurant.

[25] Generally, when respondent performs a bank deposit analysis, it presumes all deposits constitute revenue from sales unless evidence establishes otherwise. To be useful for estimating taxable sales, all revenue must have been deposited into the account(s) reviewed, and there must be a reasonable basis for identifying deposit sources (e.g., non-sales revenue, taxable sales revenue, nontaxable sales revenue, tips, sales tax reimbursement, etc.).

OTA should at least view respondent's failure to do a bank deposit analysis with suspicion, or that it could even assume that the result of such an analysis would show no missing funds.

Additionally, appellant states that, following an information exchange with respondent regarding respondent's audit, the IRS examined ABRG's federal income tax returns for 2008 and 2009, and this examination resulted in comparatively small tax liabilities of $12,244 for 2008 and a $13,163 refund for 2009. On the basis of those findings, appellant argues, at least implicitly, that respondent distorted the percentages of taxable sales.

Finally, in one of its briefs, appellant described language in the Decision, which suggested that appellant might be arguing that someone other than A. Beri, such as an employee, might have committed fraud. Appellant responded to that perceived suggestion in one of its briefs, stating "We are unsure why there is mention of fraud by employees. Our position is that there was no fraud, not that someone other than Mr. Beri committed fraud." Yet, appellant argued at the hearing that appellant's store managers could have been embezzling from appellant, and in support of this argument, appellant offered into evidence various emails and other documents that appear to refer to theft insurance claims submitted by appellant to its insurance company.[26] Appellant does not explain how a theft by a store manager should impact the liability at issue in this appeal, and OTA finds that this argument lacks both relevance and any meaningful support in the record. It will not be discussed further.

OTA first examines the evidence to determine whether respondent has carried its initial burden of showing that its determination was reasonable and rational. According to the evidence, the WISRs, upon which respondent based its determination, contained information that was automatically transmitted electronically by appellant's POS systems, which were used by all of appellant's locations, directly to the franchisor pursuant to the franchise agreement. While the record for this appeal does not definitively state why the franchisor wanted, or how it used, the information, the logical inference is that the franchisor believed it needed accurate inventory and sales data and that it relied on its POS system to ensure that it received accurate data. This is precisely the kind of information that is typically most reliable because it is likely to contain accurate and complete data and is obtained from an independent source.

[26] The documents appear to refer to three separate claims for covered embezzlement losses in 2010, two insurance payments to appellant totaling over $57,600, and a $4,063 insurance payment to Taste America. Appellant also did not explain why it was submitting claims more than six years after it ceased owning and operating Subway restaurants.

Appellant disagrees. It interprets the Bollettieri email to state that the WISR sales tax data could be inaccurate and is unreliable. On the basis of the Bollettieri email, appellant opines that DAI had a software problem that it was reluctant to disclose. However, the email states that the sales tax data can be less accurate because "some weeks may not be represented fully with a data upload from the stores." OTA finds that a more reasonable interpretation of that language is that the author was indicating that any inaccuracy could lead to an *understatement* of sales tax reimbursement collected from customers.[27] Appellant's conclusion regarding a possible software problem is speculative, at best. Based on the evidence, OTA finds that respondent's reliance on the WISRs to establish sales tax reimbursement collected from customers was reasonable and rational.

The methodology for calculating the liability was basically simple math. Respondent divided the sales tax reimbursement collected from customers by the applicable tax rate to calculate sales that were taxable or sales for which appellant collected excess sales tax reimbursement (excess tax). Respondent deducted reported amounts to calculate the amounts at issue. OTA finds that the methodology employed to calculate the liability was rationally designed to calculate a reasonable estimate of taxes due and that the determined amounts constitute reasonable estimates of the amounts due.[28] On the basis of the evidence, OTA finds that respondent has met its initial burden of showing that its determination was reasonable and rational. The burden therefore shifts to appellant to show error and a more accurate result. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Appellant did not provide testimony or other evidence to show that appellant's POS system inaccurately recorded sales tax reimbursement collected from customers or that the WISRs did not accurately show the amount of sales tax reimbursement collected from customers. Instead, appellant argues that it did not use the WISRs to prepare its SUTRs; it used Store Control Logs, as stated by Declarant 1.

Appellant's evidence does not prove a more accurate tax liability. Declarant 1 states that SUTRs were prepared from monthly "control logs," but there are no "control logs" – and no monthly reports – in evidence. Amounts of sales tax reimbursement collected as shown in the

[27] As already stated, there were weeks for which DAI did not provide WISRs.

[28] When determined amounts are based on a comparison of amounts recorded by appellant's POS systems with amounts reported on appellant's SUTRs, as they were here, OTA would expect a high degree of accuracy.

WISRs agree with the similarly described amounts shown in the DAI Control Sheets, so it is unlikely that the declarants' references to control logs were actually references to Control Sheets, at least not those that were produced by appellant's POS system. Given Declarant 1's description of the control logs, and the fact that Declarant 1 used them to compare revenue with bank deposits, it is likely that Declarant 1's references to control logs, at least, were actually references to Deposit Control Sheets; and while Declarant 2 mentions "control logs" and "control sheets," there are no control logs in evidence, and there is insufficient evidence in the record to show how Declarant 2 reconciled "Control Sheets" and control logs. Neither declaration reveals that the declarant was familiar with the WISRs upon which the determination is based. Furthermore, appellant has not shown upon what document or data even one of appellant's SUTRs at issue was based. No source documents were provided, and appellant did not explain why there were two Deposit Control Sheets showing different amounts of sales and sales tax reimbursement collected for the same periods. It is difficult to determine the relevance of, much less whether any meaningful weight should be given to, these declarations, and OTA cannot find in these declarations or any other evidence a credible explanation for how appellant calculated the sales reported in its SUTRs. OTA concludes that these declarations do not show error in respondent's analysis, and they do not establish a more accurate result.

Appellant's argument regarding the 80/80 rule and its criticism of respondent's conclusion that over 95 percent of sales in some periods were "taxable" indicates that appellant misunderstands the bases for respondent's determination. Respondent did not conclude that over 95 percent of appellant's sales in some periods were taxable sales. Respondent simply accepted appellant's own reports to its franchisor regarding sales tax reimbursement collected from customers and on the basis of that evidence concluded that appellant collected sales tax reimbursement on over 95 percent of its sales in some periods. The 80/80 rule is immaterial to the analysis.

The evidence that indicates respondent was negotiating acceptable nontaxable sales ratios with a representative of some Subway restaurant owners, while of some anecdotal interest, also has no direct bearing on the issues in this appeal. There is no evidence that those negotiations resulted in a binding agreement that required respondent to accept a particular nontaxable sales ratio. More importantly, though, an agreement about the ratio of taxable (or nontaxable) sales to

total sales is immaterial to the determination of a liability based on sales tax reimbursement collected from customers.

Appellant's argument about respondent's failure to do a bank deposit analysis is also unpersuasive. R&TC section 6481 states that respondent can base its determination on any information which is in its possession, or which may come into its possession. Respondent need only demonstrate on appeal that its determination is reasonable and rational. It did that here. Respondent is not required to do more unless appellant carries its burden. If appellant believed its bank records would support its position, it should have done the analysis and submitted proof to OTA. It did not do that.

Lastly, regarding appellant's argument that the results of the IRS examination of ABRG's federal income tax returns for 2008 and 2009 are evidence of error in respondent's analysis, OTA notes the following comparison based on the evidence. First, this evidence does not pertain to appellant. Consequently, its relevance to this appeal is marginal. Second, ABRG reported to respondent that it had gross sales in 2008 and 2009 of $5,074,602 and $5,564,774, respectively. ABRG reported to the IRS that it had gross receipts in 2008 and 2009 of $4,946,920 and $5,664,034, respectively.[29] The IRS exam resulted in *increases* to ABRG's gross receipts: a $1,002,175 increase for 2008 and a $933,840 increase for 2009. Thus, the IRS concluded that ABRG's gross receipts for 2008 and 2009 were $874,493 more and $933,100 more, respectively, than what ABRG reported to respondent. Although these amounts are $7,310 less and $117,529 less than respondent's determined amounts for 2008 and 2009, respectively, OTA does not know upon what evidence the IRS based the increases. Therefore, even if this evidence pertained to appellant, OTA would not be able to give it much weight.

On the basis of the foregoing, OTA finds that appellant has failed to establish that a result different from respondent's determination is warranted. Appellant has not shown that respondent erred in its analysis, and it has not established a more accurate liability. Consequently, OTA concludes that adjustments to the liability are not warranted.

[29] Thus, for 2008, appellant reported $127,682 less to the IRS and for 2009, appellant reported $99,260 more to the IRS.

Issue 2: Has respondent proved appellant's fraud by clear and convincing evidence?

Proof of fraud is required in this case both to warrant respondent's imposition of the fraud penalty and to support respondent's argument that the three-year statute of limitations does not apply to bar the asserted liability for all periods.

Respondent imposes a penalty of 25 percent of the unpaid tax if it is determined that any part of the deficiency for which a deficiency determination is made is due to fraud. (R&TC, § 6485; Cal. Code Regs., tit. 18, § 1703(c)(3)(C); see also *State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1240-1241 .) R&TC section 6487(a) provides that except in the case of fraud or intent to evade, every NOD shall be mailed within three years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined or within three years after the return is filed, whichever period expires later.

The plain language of R&TC section 6487(a) indicates that the three-year statute of limitations applies to each reporting period covered by a determination. As previously stated, the NOD that is the subject of this appeal was not filed within the three-year statute of limitations. Thus, in order for the NOD to be deemed timely, the evidence must prove that appellant intended to defraud the state or evade the payment of tax for at least some portion of each reporting period for which respondent determined a liability.[30] (*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. (*Appeal of Delgado*, 2018-OTA-200P.) Fraud must be established by clear and convincing evidence. (Cal. Code Regs., tit. 18, § 1703(c)(3)(C); *Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.) However, this does not mean that respondent must prove every contested fact by clear and convincing evidence. (*Appeals of Jafari and Corona Motors, Inc.*, 2023-OTA-401P.) Rather, OTA looks to the totality of the evidence to determine whether respondent has met its burden of proof. (*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. (*Appeal of Delgado, supra*.) An understatement alone may not be sufficient to warrant finding of fraud, but repeated understatements in successive reporting periods, combined

[30] Respondent has not argued otherwise.

with other circumstances showing intent to conceal or misstate taxable income, provides a sufficient basis for a finding of fraud. (*Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P.) Other "badges" of fraud include inadequate records, implausible or inconsistent explanations of behavior, concealment of assets, failure to cooperate with tax authorities, and a taxpayer's lack of credibility. (*Ibid*.)

Respondent concluded in its evasion penalty recommendation that:

- Appellant's owners, who jointly or separately owned and operated 19 Subway restaurants under various ownership structures (i.e., corporations, partnerships, etc.), have substantial experience as food retailers.
- Respondent's custom and practice was to provide to all applicants for seller's permits: various publications, including Publication 73, which explains the legal requirements applicable to, and the responsibilities of, seller's permit holders; and continuing education through quarterly Tax Bulletins and other industry mailings.
- Appellant's WISRs and SUTRs showed that appellant understood its obligations regarding sales tax reimbursement collected from customers.
- Appellant substantially and consistently underreported sales tax reimbursement collected from customers and failed to remit sales tax and excess tax to the state.
- Appellant's own records show that it failed to report $67,660 in sales tax reimbursement collected from customers during the liability period, which represents a percentage of error of approximately 322 percent, which could not have been the result of an honest mistake or mere negligence.[31]
- ABRG continued the consistent and substantial underreporting after it took over the stores until shortly after respondent discovered substantially similar underreporting practices by ABRG, at which time the accuracy of the tax reporting by all three related entities (including appellant) improved substantially.
- Appellant was aware of the massive overcollection of sales tax reimbursement.
- A consistent pattern of underreporting over several years and involving multiple ownership entities owned by appellant's owners evidence a willingness to file fraudulent SUTRs.

[31] The $67,660 in unremitted sales tax reimbursement collected from customers is the equivalent of tax on sales of $820,121.

- Appellant's owners were the beneficiaries of the fraud.

At the hearing and in its post-hearing submission, respondent argued that the following additional evidence would support a finding of fraud:

- Documents seized pursuant to search warrants show that appellant's owners created and maintained "control sheets" for appellant (and the other entities owned by A. Beri and V. Beri) that contain sales and tax amounts that are significantly less than the amounts shown on the documents provided by the franchisor.
- The Montoya MOI, which, according to respondent, indicates that A. Beri trained at least one employee to create falsified reports.[32]

Appellant generally asserts that respondent has not proved fraud by clear and convincing evidence. More specifically, appellant argues that the deficiency is overstated, there is no direct evidence of fraud, and the circumstantial evidence upon which respondent relies is insufficient as a whole to meet respondent's burden of proof by clear and convincing evidence.

Regarding the documents that respondent characterizes as appellant's second set of records to support underreported amounts, appellant argues that the documents timely disclosed prior to the hearing are entitled to little, if any, weight because the record does not show the source of the documents, their relevance to entities and periods other than ABRG and the three months that they purport to represent, or that they were used for any nefarious purpose. Appellant also argues that the control logs do not show a pattern of underreporting because they show that sales tax was overreported on some days.[33]

Appellant states that respondent interviewed multiple witnesses but relies on information from only one, A. Montoya, because the others provide no support for respondent's fraud allegation. Appellant argues that even the Montoya MOI is nothing more than a biased interpretation of what the interviewee said, prepared by respondent, and that it contains, at best, only vague suggestions of wrongdoing. Appellant asserts that it, on the other hand, has provided

[32] Respondent also argues that transcripts of text messages between A. Beri and Ajay Beri are evidence of their collusive effort, with others, to interfere with and corrupt the results of observation tests conducted by respondent to determine the liability of entities owned, at least in part, by the other A. Beri. Appellant argues the transcripts are irrelevant. Because those transcripts are not in evidence, OTA will not address them further.

[33] This Opinion has already addressed appellant's objections to the admission of the documents included in respondent's post-hearing submission.

sworn declarations from two witnesses, one of whom appellant describes as an independent, third party, and both of whom essentially exonerate appellant's owners by stating facts under oath.

Finally, appellant at least implies that decisions by both the California Department of Justice and the Los Angeles County District Attorney's office to not pursue criminal charges against appellant or its owners constitute evidence that there was no fraud.

OTA must determine whether there is clear and convincing evidence of fraud *by appellant*. A finding of fraud here does not require OTA to find that any particular owner, agent, or employee is responsible for the fraud. To the extent that appellant knowingly filed false returns, appellant is responsible for the fraud.

The scope and magnitude of appellant's underreporting is persuasive evidence of fraud. There was underreporting in every quarter of the liability period. Appellant reported just 21.5 percent of the sales tax reimbursement it collected from its customers during 1Q03. For the remainder of the liability period, that percentage was 25.7 percent (for 2Q03), 21.4 percent (for 3Q03), and 26.1 percent (for 4Q03). As a result of the underreporting, appellant kept over $67,000 that should have been paid to the state.

It is notable that no competent witness appeared for appellant to offer any credible explanation for how appellant could have failed to remit over $67,000 in taxes collected from customers over a period of one year, or how appellant could have failed to notice substantial differences between sales tax reimbursement collected from customers according to the reports sent to the franchisor and sales tax reimbursement remitted to respondent. These facts alone present a strong circumstantial case for fraud in connection with every SUTR at issue. But there is more evidence of fraud.

The evidence shows that both of the other related entities created and maintained what appear to be altered Deposit Control Sheets for some weeks and that these show different recorded amounts for sales, collected sales tax reimbursement, and the amount by which the deposit was over or short, meaning more or less than, the total revenue (i.e., sales plus sales tax reimbursement). Appellant focused on what it claimed was a lack of authentication of this evidence, arguing that its source had not been established, and on its materiality, arguing that it was for a different entity, ABRG, and not a sufficiently large sample to be given much weight. Appellant failed to address its substance.

The twelve sets of Deposit Control Sheets discovered on electronic media seized pursuant to search warrants are persuasive evidence that ABRG altered its business records to misrepresent the amount of sales tax reimbursement collected from customers. Not only do these Deposit Control Sheets appear to be what respondent asserts they are, the alterations made to the documents are generally consistent with the Montoya MOI in that, for example, a total of $31,623.65 in deposit shorts shown on one set 12 Deposit Control Sheets – ones that were consistent with amounts shown on the corresponding WISR – became only $174.70 in deposit shorts on the altered set of 12 Deposit Control Sheets, a difference of $31,448.95. While it is true that the two sets of Deposit Control Sheets timely disclosed by respondent prior to the hearing and admitted into evidence at the hearing pertain to an ABRG Subway, much of appellant's evidence admitted in this matter, including both declarations, also pertains to ABRG.[34] Also, although the Deposit Control Sheets do not cover this liability period and represent less than all the periods at issue in the related appeals, they are persuasive evidence of an effort by appellant's owners and their related entities to file fraudulent SUTRs based on altered business records. Notwithstanding the absence of Deposit Control Sheets from 2003, the evidence shows a consistent pattern of substantial underreporting across all the liability periods in the related appeals. On the basis of this evidence, OTA finds that appellant knowingly based its SUTRs upon Deposit Control Sheets that had been altered by or on the instruction of A. Beri.

Lastly, there is no evidence in the record regarding the reasons for any prosecutor's decision not to prosecute appellant or its owners for a crime related to appellant's underreporting. Even if such evidence was in the record, it would be, at most, evidence of an opinion regarding the likelihood of a successful criminal prosecution. Such an opinion would be entitled to little, if any, weight in this civil proceeding.

On the basis of the evidence, OTA concludes that there is clear and convincing evidence that appellant intended to evade the payment of tax that it collected and knew was due for every quarter in the liability period. Thus, the NOD was timely issued, and the fraud penalty was properly imposed.

[34] In its post-hearing submission, respondent provided many samples of Deposit Control Sheets for all the restaurants operated by ARBG, including the four that had been previously operated by appellant, most of the restaurants operated by Taste America, and two additional restaurants for which respondent apparently did not obtain data from the franchisor.

HOLDINGS

1. No adjustments to the liability are warranted.
2. Respondent has proved appellant's fraud by clear and convincing evidence.

DISPOSITION

Respondent's actions denying appellant's petition for redetermination are sustained.

DocuSigned by:
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Michael F. Geary
Administrative Law Judge

We concur:

DocuSigned by:
CB1F7DA37831416...
Josh Lambert
Administrative Law Judge

DocuSigned by:
43F5DCA21D8D46B...
For
Richard Tay
Administrative Law Judge

Date Issued: 6/27/2024