

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No.: 21067999
F & B ASSOCIATES, INC.,)	CDTFA Case ID: 126-044
dba Best Beverage Catering)	
)	
)	

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:	Kevan McLaughlin, Attorney
For Respondent:	Jarrett Noble, Attorney

N. RALSTON, Administrative Law Judge: On September 23, 2024, the Office of Tax Appeals (OTA) issued an Opinion sustaining a decision issued by California Department of Tax and Fee Administration (respondent).¹ Respondent's decision denied a petition for redetermination filed by F & B Associates, Inc. (appellant) of a Notice of Determination (NOD) dated May 19, 2016. The NOD is for \$4,850,919.79 in tax, plus applicable interest, and a fraud penalty of \$1,212,730.50 for the period October 1, 2008, through September 30, 2013 (liability period).

On October 23, 2024, appellant timely petitioned for a rehearing with OTA on the basis that OTA's Opinion is contrary to law and is unsupported by sufficient evidence. OTA concludes that the grounds set forth in this petition do not constitute a basis for granting a new hearing.

OTA will grant a rehearing where one of the following grounds for a rehearing exists and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the appeal proceedings which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise, occurring during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered evidence, material to the appeal, which the party could not

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

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 in the OTA appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Riedel*, 2024-OTA-004P.)

As provided in *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654, it is appropriate for OTA to look to Code of Civil Procedure section 657 and applicable caselaw as relevant guidance in determining whether a ground has been met to grant a new hearing.

Contrary to Law

To find that the Opinion is contrary to law, OTA must determine whether the Opinion is “unsupported by any substantial evidence.” (*Appeal of Graham and Smith*, 2018-OTA-154P, citing *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906 (Sanchez-Corea).) This requires a review of the Opinion to indulge “in all legitimate and reasonable inferences” to uphold the Opinion. (*Sanchez-Corea, supra*, 38 Cal.3d at p. 907.) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Appeal of Swat-Fame, Inc.*, 2020-OTA-045P.) In its review, OTA considers the evidence in the light most favorable to the prevailing party (here, respondent). (*Ibid.*)

Appellant contends that OTA’s Opinion is contrary to law because it fails to adequately address and apply the law and is impermissibly based on inferences and presumptions. The central focus of appellant’s petition for rehearing is the interpretation and application of R&TC section 6485. In support, appellant cites to various federal authorities discussing the application of federal law to federal income tax fraud penalties.

In response, respondent asserts that the Opinion is consistent with California law and that the Opinion correctly points out that there were substantial differences between amounts appellant reported on its federal income tax returns (FITRs) and sales and use tax returns (SUTRs) as well as substantial differences of approximately \$24,600,000 between appellant’s general ledger and its SUTRs. Respondent further asserts that appellant’s accrual account disclosed unremitted sales tax reimbursement of \$1,155,068, and that appellant underreported its taxable sales for every quarter of the liability period in amounts ranging from \$500,000 to \$5,000,000. Respondent also contends that the Opinion correctly notes that appellant had considerable business experience, that it had been through a prior audit with the same issues as in the present appeal, that appellant was unable to provide records demonstrating which

sales were subject to tax, and that appellant had failed to establish that any adjustments to the disputed measure of tax are warranted.

Presently, there are numerous precedential Opinions that bind OTA's interpretation of R&TC section 6485, including *Appeal of ISIF Madfish, Inc.*, 2019-OTA-292P (*ISIF Madfish*), *Appeal of Farrell*, 2023-OTA-095P, and *Appeals of Jafari and Corona Motors, Inc.*, 2023-OTA-401P. For authorities, each of those three precedential Opinions cite to the statute, the corresponding regulation (i.e., Cal. Code Regs., tit. 18, § 1703(c)(3)(C)), and relevant case law. From the macro perspective, the three precedential Opinions share commonality in the authority cited as well as the analytical framework. (E.g., *Powell v. Granquist* (9th Cir.1958) 252 F.2d 56, 60; *Rau's Estate v. Commissioner* (9th Cir. 1962) 301 F.2d 51, 54-55; *Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30 *Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307; *State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1240-1241).

Here, the underlying Opinion interpreted R&TC section 6485 consistent with precedential authority. The Opinion used the same analytical framework and relied on substantially similar legal authorities, which is demonstrable because the Opinion: principally cited to *ISIF Madfish* [citing *Bradford v. Commissioner, supra*, 796 F.2d at p. 307] to establish that for R&TC section 6485 appeals, fraud may be proved by circumstantial evidence; and relevant circumstantial evidence, or badges of fraud, including understatement of income, inadequate records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealing assets, and failure to cooperate with tax authorities. (*Ibid.*) Further, the Opinion utilized *ISIF Madfish* [citing *Rau's Estate v. Commissioner, supra*, 301 F.2d at pp. 54-55], for the proposition that an understatement alone may not be sufficient to warrant a finding of fraud, but repeated understatements in successive years, combined with other circumstances showing intent to conceal or misstate taxable income, provides a sufficient basis for a finding of fraud. Thus, the Opinion applied the correct law for R&TC section 6485.

OTA reviewed and weighed the arguments and evidence provided by both parties in drafting its Opinion. The evidence showed that appellant's reporting had been found significantly deficient in the prior audit under similar circumstances to those OTA examined in the present appeal (e.g., recorded but not reported taxable sales, unsupported claimed nontaxable sales, and failing to remit collected sales tax reimbursement). Appellant continued to report far fewer taxable sales than it recorded, and it continued to remit far less sales tax than it accrued. While appellant's records showed that appellant properly charged and collected sales tax reimbursement, appellant failed to report approximately a third of its taxable sales.

Appellant had considerable business experience, including the aforementioned prior audit, yet appellant has not satisfactorily explained the deficiency, which is substantial both in amount and in the rate of understatement. Thus, OTA's Opinion is based on substantial evidence and is not contrary to law.

With regard to appellant's argument that OTA's decision impermissibly shifts the burden of proof to appellant, it argues that fraud is odious and is never presumed but must be established by proof. (*Marchica v. State Bd. of Equalization* (1951) 107 Cal.App.2d 501, 509.) Appellant asserts that there are reasons, other than fraud, that may account for the substantial discrepancies between recorded and reported taxable sales. Appellant asserts that OTA failed to review and analyze respondent's position that appellant's records were inadequate, but rather shifts the burden to appellant to show that the records were adequate.

OTA reviewed the evidence provided by both parties and determined that respondent met its burden in showing that there was clear and convincing evidence of fraud. As previously stated, direct evidence of a taxpayer's fraudulent intent or intent to evade the payment of taxes due is not required. (*Rau's Estate v. Commissioner, supra*, 301 F.2d at pp. 54-55.) The required intent can be proved through circumstantial evidence. (*Bradford v. Commissioner, supra*, 796 F.2d at p. 307.) An understatement alone may not be sufficient to warrant a finding of fraud, but repeated understatements in successive years, combined 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., supra* [citing *Rau's Estate, supra*].)

Respondent provided evidence that there were substantial differences between amounts appellant reported on its FITRs and SUTRs as well as substantial differences of approximately \$24,600,000 between appellant's general ledger and its SUTRs. Respondent was also able to show that appellant's accrual account disclosed unremitted sales tax reimbursement of \$1,155,068, that appellant underreported its taxable sales for every quarter of the liability period in amounts ranging from \$500,000 to \$5,000,000, and that similar mistakes were made in the prior audit. OTA reviewed the evidence provided by respondent and determined that the audited results were correct based on the available evidence. Appellant stated at the hearing respondent had seized documents from appellant that would support an adjustment to the audited liability. OTA held the record open to allow appellant time to obtain copies of these seized records and provide them to OTA. Due to the associated cost appellant declined to do so.

OTA reviewed respondent's audit and the applicable evidence and determined that respondent had met its burden of proof by clear and convincing evidence. While OTA gave

appellant the opportunity to refute respondent's evidence, this does not constitute impermissibly shifting the burden of proof to appellant. OTA merely gave appellant the opportunity to disprove respondent's documentation.

As for appellant's arguments that there are reasons, other than fraud, that may account for the substantial discrepancies between recorded and reported taxable sales, appellant has failed to demonstrate that the discrepancy in this case can be explained by something other than fraud. OTA is required to base its Opinion on the record before it. (Cal. Code Regs., tit. 18, § 30214(f).) While appellant has alleged that there are other possible explanations for the understatements, the record does not support any explanation other than fraud. OTA reviewed the record before it and determined, as explained above, that respondent proved that appellant was fraudulent by clear and convincing evidence. Appellant has been unable to refute this finding.

Appellant also asserts that reliance on a professional has been held as defense to fraud penalties.² As noted above, there is often no direct evidence of a specific intent to evade tax. Instead, OTA must rely on all the factors, taken together to determine whether respondent has clearly and convincingly established that all or a significant portion of the understatement was due to fraud. (*ISIF Madfish, supra*). Appellant's reliance on a professional is simply one factor of many that OTA must review to determine whether respondent proved by clear and convincing evidence that the fraud penalty is warranted. Here the aforementioned factors, when taken together, indicate that respondent has clearly and convincingly established that all or a significant portion of the understatement was due to fraud.

Thus, OTA's Opinion is based on substantial evidence and is not contrary to law.

Insufficient Evidence to Justify the Opinion

To find an insufficiency of evidence to justify the opinion, OTA must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, OTA clearly should have reached a different opinion. (Code Civ. Proc., § 657; *Appeals of Swat-Fame, et al.*, 2020-OTA-045P.)

Appellant argues that there is insufficient evidence to justify the Opinion because appellant provided testimony at the hearing to describe how appellant attempted to report

² *Neonatology Assocs., P.A. v. Commissioner* (2000) 115 T.C. 43, 99, aff'd, (3d Cir. 2002) 299 F.3d 221; see also *Estate of Temple v. Commissioner* (1976) 67 T.C. 143, 162 ("While a taxpayer's reliance upon his accountant to prepare accurate returns may indicate an absence of fraudulent intent, . . . this is true in the first instance only if the accountant has been supplied with all the information necessary to prepare the returns.")

taxable and non-taxable sales and to explain why certain documents were not available on appeal. As noted above, OTA determined that respondent had provided clear and convincing evidence to show that the fraud penalty was properly imposed. OTA reviewed the evidence provided by both parties, including appellant's witness testimony, in concluding that the fraud penalty was warranted. Appellant's dissatisfaction with the outcome of the appeal is not a basis for rehearing. (*Appeal of Shanahan*, 2024-OTA-040P.) After weighing the evidence, which lacks documentation supporting the witness testimony, OTA finds that appellant has not shown the Opinion clearly should have reached a different decision. As a result, appellant has failed to establish that there is insufficient evidence to justify the Opinion. Thus, OTA cannot grant a rehearing based on this ground.

Signed by:



25F8FE08FF56478...

Natasha Ralston
Administrative Law Judge

We concur:

Signed by:



CB1E7DA37831416

Josh Lambert
Administrative Law Judge

DocuSigned by:



48745BB806914B4...

Josh Aldrich
Administrative Law Judge

Date Issued: 3/19/2025