BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:)
)
STAR OF INDIA LLC,) OTA No. 18083620,
) 21088499
Appellant.)
_______________________________)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Tuesday, May 20, 2025

Reported by:

EMMETT BARNARD
CSR No. 14529

Job No:
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TRANSCRIPT OF PROCEEDINGS, taken at 400 R Street, Suite 470, Sacramento, California, commencing at 9:30 A.M. and concluding at 12:02 P.M. on Tuesday, May 20, 2025, reported by Emmett Barnard, CSR No. 14529, a Certified Shorthand Reporter in and for the State of California.

APPEARANCES:

Panel Lead:	ADMINISTRATIVE LAW JUDGE NATASHA RALSTON
Panel Members:	ADMINISTRATIVE LAW JUDGE KEITH LONG
	HEARING OFFICER KIM WILSON
For the Department:	STATE OF CALIFORNIA FRANCHISE TAX BOARD
	NALAN SAMARAWICKREMA, HEARING REPRESENTATIVE
	JASON PARKER, HEARING REPRESENTATIVE
	STEVE SMITH, TAX COUNSEL
For the Appellant:	KAI MICKEY

I N D E X

E X H I B I T S

(Department's Exhibits A through X were received at page 7)

(Appellant's Exhibits 1 through 4 were received at page 7)

PRESENTATION

CLOSING STATEMENT

Tuesday, May 20, 2025

9:30 A.M.

ADMINISTRATIVE LAW JUDGE RALSTON: So we are now on the record in the appeal of Star of India LLC. These matters are being heard before the Office of the Tax Appeals. The OTA case numbers are 18083610 and 21088499. Today's date is Tuesday, May 20th, 2025, and the time is approximately 9:35 A.M. Today's hearing is being heard by a panel of three administrative law judges and hearing officers.

I am Judge Ralston, and I will be the lead judge. Judge Long and Hearing Officer Wilson are the other members of the this tax appeal panel. All three of us will meet after the hearing and produce a written decision as equal participants. Although I'm the lead judge and I will conduct the hearing, any judge or hearing officer on this panel may ask questions or otherwise participate to ensure that we have all the information that we need to decide this appeal.

As I mentioned this hearing is being live streamed to the public. We have our stenographer present, Mr. Barnard, who is reporting this hearing verbatim to ensure that we have an accurate record. We ask that everyone speaks one at a time and does not speak over each other. Even if you think you know what we're going to ask, please let us finish the question. Also, speak clearly and loudly. When needed, Mr. Barnard will stop the hearing process and ask for clarification, and after the hearing Mr. Barnard will produce the official hearing transcript, which will be available on the Office of Tax Appeals' website.

I'm going to ask the parties to please introduce themselves for the record starting with Mr. Mickey. Please state your name and who you represent.

MR. MICKEY: Yes. I'm Kai Mickey. I'm president of Sales Tax Specialists, and I'm here representing Star of India LLC.

ADMINISTRATIVE LAW JUDGE RALSTON: Thank you. And for the CDTFA.

MR. SAMARAWICKREMA: Nalan Samarawickrema, representative of the Department.

MR. PARKER: Jason Parker, Chief of Headquarters Operation Bureau, CDTFA.

MR. SMITH: Steven Smith, attorney. CDTFA.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you.

So we have held the prehearing conference on this matter on April 8th, 2025. The Respondent, CDTFA, have submitted Exhibits A through X, and Appellant indicated at the prehearing conference that they had no objection to Respondent's Exhibits A through X.

Mr. Mickey, is that still the case?

MR. MICKEY: Yes.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you. So Respondent's Exhibits A through X shall be admitted -- are admitted without objection.

(Exhibits A through X were admitted into evidence.)

ADMINISTRATIVE LAW JUDGE RALSTON: And the Appellant has previously submitted Exhibits 1 through 4, and Respondent had no objection to Appellant's Exhibits 1 through 4; is that still correct?

MR. SAMARAWICKREMA: Yes, Judge.

ADMINISTRATIVE LAW JUDGE RALSTON: Thank you. So Appellant's Exhibits 1 through 4 are admitted without objection.

(Exhibits 1 through 4 were admitted into evidence.)

ADMINISTRATIVE LAW JUDGE RALSTON: Neither party intends to call any witnesses. As far as the time estimates Mr. Mickey has requested 90 to 120 minutes to use for your opening presentation. The panel members may have questions for you after that, and CDTFA, Mr. Samarawickrema, will go after that. We'll have 45 minutes for your presentation, and then lastly we'll go back to the Appellant, and you will have 10 minutes for rebuttal.

Does that sound like what we discussed at the prehearing conference for everyone?

MR. MICKEY: It does. I don't think I'll take as long as I thought it would, but that is what we discussed. Yes.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Great. Thank you.

MR. SAMARAWICKREMA: If you had any question, 60 minutes.

ADMINISTRATIVE LAW JUDGE RALSTON: I'm sorry. What?

MR. SAMARAWICKREMA: 60 minutes.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. 60 minutes?

MR. SAMARAWICKREMA: Yes.

ADMINISTRATIVE LAW JUDGE: Okay. So depending on how things go and how long things actually take, we may take a break in between that time. I will let you guys know, and the panel members, as I said, may have questions as we go along. So does anyone have any questions before we move on to our opening presentations?

MR. MICKEY: No.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Hearing none, Mr. Mickey, please begin when you're ready.

PRESENTATION

MR. MICKEY: Well, thank you very much. I'm not sure what is the best way to go about doing this so I did it -- I picked a way to do it. We have two audits here. There are some individual specific issues with each audit, and then there are overlapping issues with both audits.

So what I've decided to present first is we'll be looking at the second audit period, and during my presentation, rather than referring to your case numbers if it will be okay, we could just refer to audit number one as the old audit and audit number two as the newest audit just to make it easy to present because we're going to have to go back and forth to the exhibits to my worksheets. So it might be more helpful to do that it that way.

So I'm going to be focusing on initially on a couple of things with number two, which is the second audit period. We are going to start by going through my exhibits. A little background notes here. Between the two audits there were different people doing the returns. It's pointed out in the audit that in the first audit there was an individual that was running the business. That person is no longer available. They did not participate in the second audit, or at least they were not involved in the second audit.

And I got involved late, and so this is a very old case -- as you all are aware -- and unfortunately between the time that the audit was done and when I came on board, most of the records have become unavailable. So some of the -- and we'll discuss that a little bit when we start talking about penalties later, but I'm limiting most of my discussion to what's in the audit, but I wanted to point out that was that the reason -- and I'm going to have a little issue with that in a bit, but I just wanted to be transparent and clear that that's what's going on here.

So in the first presentation I'd like to look at my Exhibit 1, and the Exhibit 1 has to do with scheduled -- that markup issue in the second audit, and I think my exhibits were clear, but I did want to walk through and kind of explain what I did. I don't know if it's appropriate, but I guess I will start by asking does the staff agree with what I've done here? To make it really easy. Is that about appropriate thing to ask?

ADMINISTRATIVE LAW JUDGE RALSTON: We'll just have you give your presentation.

MR. MICKEY: Okay. So starting with schedule 12B is where this starts, and our 12 -- our 2 12D. In the exhibits, your OTA exhibit file that you presented, that you put everything together on, the original working papers can be found on page 382 and 383 of that document. What I provided you is a revised schedule showing adjustments to the markup area of the audit.

The current reaudit is showing $410,995 in markup sales for the second audit period. Once this adjustment is made you'll see that we come down to an understated taxable sales amount based on the markup of 1.5762.

(The court reporter asked for clarification.)

MR. MICKEY: The original numbers were 410,995, and the adjustment that we're asking for brings the audited understated sales adjusted down to 125,762. And the way this comes about is if you look at my Exhibit 1, page 4 of 8, you'll see down at the bottom there's some yellow boxes and green boxes. This is just a replication of what was the original audit look like on that schedule R 12D, and what the original auditor did -- and there's a lot of back and forth in all this, and

I'm trying to clear a lot of that out in this discussion. A lot of it doesn't really have meaning when we look at what we're doing here.

Ultimately, in the reaudit -- the first reaudit -- it was accepted that the 2013 income tax return figures would be used as the purchases for the 2013 period in this schedule, and you see down there at the bottom. It's row 42, and right now my numbers shows 135,017 and reaudit that number is 204,947, and if you look at the next page, page 5 of 8, you see this is a schedule that the Department auditors did not have, didn't even ask for. Or if they did ask for, they didn't get it. I don't know what happened. I wasn't involved in that, but they did not have that, and so they were using the 204,947 as the purchases subject to the markup calculations.

They then separated that out in into alcohol and food, but what I discovered, as you can see here, is when you look at the secondary page of the cost of goods sold for the 2013 --

(The court reporter asked for clarification.)

MR. MICKEY: Cost of goods sold. I'll talk closer to this. The second page, page 2, cost of goods sold, you will see that the 204,947 -- which I've highlighted -- it actually consists of two amounts. One amount is purchases less cost of items withdrawn for personal use, 135,071, and then there's cost of labor of 69,876.

Those two numbers make up the 204,947, and we should all agree that the labor is not subject to the markup, and so all I've done here is replaced the correct amount of 135,071 into the previous amount of 204,947, and you'll see that again on page 4 down at the bottom in the yellow box. And then secondarily in the reaudit they used an estimate of -- excuse me -- estimate of 2014 purchases based on 2013.

Well, we got the 2014 income tax figures, and so we are asking that we substitute the calculated 2014 amounts for the actual amounts on the 2014 income tax return, schedule C cost of goods sold, and the original audit -- or the reaudit showed 252,176 as the cost of goods sold, and you can see from page 7 on my Exhibit 1 that the total cost of goods sold for that year was actually 193,066.

Now, what I did also was I'm going show you that when you look at the 2013 period, you'll see on page 6 of 8 I've highlighted the line 26 where it would be wages, and there are no wages shown, and that's in 2013. That should be accepted that the wages are the 37 -- line 37 in the cost of goods sold is 69,876.

So the taxpayer's CPA had combined purchases of inventory with wages to come up with goods sold, and in 2013 they separately stated those two amounts in the cost of goods sold. That's how we get to 135,017 that replaces the original reaudit figure on schedule 12D.

Keeping in line with that same analysis, we look at 2014, page 8 of my exhibit. I, again, have highlighted the wages line, and you'll see there's no wages, and so what I did in 2014 is looked at and considered the 190,366 total cost of goods sold as being inclusive of purchases and the labor.

And I used the percentage that was developed from the segregated amounts in 2013 to segregate the 2014 amount, and that's how we came up with the 125,642 of purposes. That is 66 percent of the 190,366, and in 2013 the purchases was 66 percent of the total. That's how we came up with those numbers.

And if you look at the totals, just look at reasonableness for 2013 and 2014. In 2013 the total cost of goods sold both labor and purchases was 204,947 with two separately stated amounts, and in 2014 the total combined figure was 193,066. Those are materially close, which should be -- should make it able to accept that they're the same kind of number in different years. So when you separate the one number into two in 2014, you get very reasonable numbers that are close to 2013.

So now all we've done is gone back to the first page -- or it's actually page 4 and substituted down there at the bottom the 135,071 for 2013 and the 125,642 for 2014, and let it flow through because what they get with those numbers, they then needed to break those into alcohol and food.

And so the exhibit, if you go to page 3 of 8, and you see a green boxes. Well, the green boxes are allowing you to reference where those numbers are coming from, and this simply taking the formulas that are in the existing reaudit working papers and letting them do their job, and we come up with a new revised percentage of error simply by replacing the incorrect cost of goods sold and estimated cost of goods sold with the new verified amounts from the income tax return.

And so by doing so and reducing the percentage of error down to 23.92, 69.3, which you see on page 3 of 8 of the exhibit, you factor that in back on our 2 12A, all I did there was change the percentage of error, and we get the understated taxable sales of 125,762 instead of the 410,995.

So our adjustment by correcting the cost of goods sold for the same figures that were being used and accepted in the audit -- we've just corrected them --

results in the measure of understated taxable sales based on the markup being reduced by $285,233. So hopefully the schedules are clear to what I did.

Again, just to be clear, they have essentially the same audit working papers with the numbers changed for the cost of goods sold, and it all flow through. The only change we made. So that's our presentation for this first item in the audit.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you. Yeah. You can keep going.

MR. MICKEY: Okay. Next, if you look at my Exhibit 2 -- so this is one's going to be a little bit more confusing to show -- and you'd all be sitting around the table, and I could show you all but -- so this is an area where the difference between recorded and reported -- I'm asking for this adjustment because inside this number there are basically two types of transaction.

One of these transactions is more coupons, and one of them, the other, is other basic clerical differences, and at the end of this journey here this category of difference between recorded and reported should only be $37,590. $37,590 because there is a $167,565 in coupons that the auditor treats as being recorded in this figure, and when I say auditor treats them as being recorded, here's the explanation for that.

Throughout this audit and even the first audit these coupons, which we'll talk about in a bit, have a monetary value to them, and the auditors took the approach in this case that the monetary value of the recorded amount of coupons based on volume, time to sell, was a recorded sales amount, and that is wrong.

And I think when you dig into the working papers I did, the Department will see the same thing is they recorded the number of coupons, but it's very clear that within the sales they did not record any sale amount related to these coupons. Just the volume of coupons.

And so when the auditor looked at this -- and you will need to look at schedule R2 12F, which I think I gave you -- actually, couple ways you can look at this. So if you will look page 5 of 5 of my Exhibit 2, okay, this is schedule 12H-2b, and this is recorded breakfast coupon food sales per sales journals. That is a slightly misrepresentative title. It would be more properly stated as recorded breakfast coupon food volume of redeemed coupons for the sales journal.

(The court reporter asked for clarification.)

MR. MICKEY: Yeah. It's recorded breakfast coupons redeemed in volume is really what they should be. There were no food sales recorded for these coupons in the sales journal. So column C, it's referencing sales journal. Number of breakfast coupons redeemed. It gives it an 8.99 value. We will talk about that in a little bit, but that's moot to this discussion.

You can follow down. 18,639 coupons. They calculated a price of $167,565 based an the 8.99 selling price, and then when you follow the schedule through to the next schedule, schedule 12H-2, you see that now they have reported food sales per sales journal and schedule. So now these auditors are bringing forth different elements of a what they call sales and adding them together to get recorded food sales to then use that total recorded food sales to compare it to the food sales that they reported.

And so here's where the problem comes in. On page 4 of 5 of my exhibit you see I've highlighted column F. Okay. This 167,565. It is included in now the 492,058, which is total recorded food sales. Okay. The problem is these are not recorded food sales. They may be coupons. Okay. They're the coupons that were redeemed. So that's the other issue, but they were not recorded sales.

So you must exclude this 167,565 from column H. This should not be in this calculation, which you would then reduce the 492,058 in column H by the 167,565, okay, but it's a little bit more convoluted than that because now you go to 12H-2, and you see that I've also highlighted column F, and this is another way of looking at it. This is actually -- that's the same page. I'm sorry. You go to 12H. When the -- all right.

So now they're bringing everything today on this column to come up with their total recorded taxable measure, which you'll see in column G. All right. So column C plus D is going to equal column E, and you see that column E is called total recorded taxable alcohol and food sales, 750,219.

They then add some gratuity to it, and they get total recorded taxable measure of 769,025. I hope you're here with me. Then they compare that to total taxable sales 555,769, and this is how they come up with the --

(The court reporter asked for clarification.)

MR. MICKEY: I'm sorry. I thought I was going slow. I am trying to go slow because this is very complicated. All right. Let me back up. Column C, total recorded alcohol sales. That comes from another schedule, which we're not at right now. Column D, total recorded food sales, XX. This is the number that came from the schedule that I had you look at here just before this that includes the auditor's calculation of the sales price value of the redeemed coupons.

So the 492,058 in column D on 12H includes the 167,565 in calculated coupon sales. When combining column C and D on schedule 12H, you get the 750,219 in total recorded taxable alcohol and food sales. Remember, the 750,219 includes the calculated sales for the food coupons.

They then add some mandatory gratuity, so 10,705 to the 750,219. So column E plus column F then equals column G. So the total recorded taxable measure now, as calculated by the auditor, becomes 760,925. Again, remember that number now includes the calculation for those food coupons.

So now they take that number in column G and compare it against the reported taxable measure from the sales tax returns in column H, and the difference becomes the 205,155 in column I. So that means that that difference of 205,155 includes the 167,565 from those coupons. Those coupons were not recorded. The value of the coupons are not recorded, and there's comments throughout the audit that confirm that.

So all we're asking here is that this category on 12H -- and you'll see my yellow box here -- we're removing the estimated coupon values from the 205,155, and we come up with a revised recorded versus reported of 37,590. Now what we have -- yeah.

So that's -- I mean, it's all math, and it's -- hopefully, when you look at the exhibit after hearing me mumble through trying to explain going back and forth, it will make sense, but it's a simple thing that the auditor calculated and audited recorded taxable measure, compared it against reported taxable measure, and got a difference. And when calculating the audited recorded taxable measure, they included an amount that is not a recorded sales amount. That's basically what happened simplified. So the 167,565 should not be part of recorded versus reported differences on the schedule.

I guess if you have questions, you'll ask me questions on this after we're done with all of them. What if I don't remember what I said? I'm just kidding. All right. That's our presentation on this one.

ADMINISTRATIVE LAW JUDGE RALSTON: Yeah. We're taking notes, and yeah. We'll ask questions if we need to.

MR. MICKEY: Okay. Okay. So now we're going to move on to Exhibit 3. This one hinges on the adjustment we just talked about. It's a flowthrough. If you look at the differences in Exhibit 2, if you look at page 4 of 5 my of my Exhibit 2, you'll see that in the forth quarter of '12 there's zero. Okay. So they did not have the information to calculate the differences in schedules 12H for the fourth quarter 12th. So they calculated for first quarter '13 forward.

They then needed to calculate an average to plug into the fourth quarter of 2012. So essentially what they did is they took the quarterly average difference for the period for first quarter '13 to third quarter '15, and applied that difference into the fourth quarter of 2012 on schedule 12G.

So if you go to my Exhibit 3, from first quarter '13 to third quarter '15 -- I am in row 11 now. You see I've highlighted the 324,493, okay, and then if you scroll over -- the best way I can describe this -- you see the difference if column J of 37,591. That's the new difference that I gave you in the other exhibit.

So the original difference was 205,155. They got an average based on that in the original reaudit. We've now corrected that number down to being 37,590, rounded 591, which means that the quarterly average is 3,417. 3,417. So we look at schedule 12G. It did show $18,651 as the plugged calculated estimated difference for that period. It should now be 3,417 after making the adjustment we just talked about in the other schedules.

So really 12H and 12G are addressing the same issue. 12H was done for the period where they had all the records. 12G was the straggling early period where they did not have the records for, so they did an average based on 12H. So since we corrected 12H, we now need to correct 12G's average as well, and that's the 3,417 instead of 18,651. That's it for that one. Okay.

Okay. So now we're going to look at -- start looking at a couple of things having to do initially with really the percentage of error. Now we're going to go back to the first audit. There's no difference -- we've already addressed the differences between recorded and reported in the second line.

There's now -- in the first audit there's schedule 12B and 12C differences. What happened here was the auditor -- and this is the unfortunate part having to do with the length of time this has gone on, and there were a number of remodeling efforts at the location, change in personnel, and so unfortunately what has happened is I don't have access to the records that the auditor used to come up with the differences in the 12B and 12C of the first audit.

Audit schedules 12C in the first audit were differences based directly on calculations that the auditor performed based on sales records that the auditor had in their possession. 12B is, again, a projection based on the results of 12C. So they kind of go together, and the issue that we have here is multifold.

On schedule -- there are comments in the audit that the auditor showed up, and that there were 12 boxes of records for the auditor to look at the accountant's office, the original accountant's office. I don't have those 12 boxes of records. We have searched upside down and backwards, everywhere we could.

So unfortunately I don't have those, but the auditor had them, and those 12 boxes of records -- there's also other comments that talk about -- had the sales journals in it, had daily receipts, what they call the dailies, and then the monthlies.

So the auditor in the 12C schedule used monthly summaries for second and third quarter of -- second and third quarter of '18 and accepted the monthly sales summaries, and then used the dailies to add up the dailies for two quarters, and you'll see those in schedules 12E and F, I think, on the audit, and the auditor claims that the amounts that they compiled from the dailies exceeded the amounts that were on the monthlies, and so for the remaining period from 1/1 of

2009 until the third -- March of 2011 the auditor disregarded the monthly summaries and did a projection based on the results of second quarter 2008 through the second quarter of 2009.

Herein lines our issue. We believe that the auditor should have done more work at the time before just projecting this, and had the auditor done that, the projected clerical differences would have been less. And on schedule 12C of the audit -- of the reaudit, the auditor makes a comment that says scheduling dailies was taking an excessive amount of time, and there were multiple days missing so our percentage of error was computed using the above quarters.

So I fully understand that the auditors have the right to, you know, basically do whatever they want -- disregard records and so on -- but at the same time there should be some accountability held towards the audit staff to recognize that when there are issues that they're finding, that they should be able and willing to do enough work to reasonably support what they are doing, and not just throw their hands up and say this is taking too much time.

This is a significant amount of purported understatement that could have been calculated based on actual figures, and they weren't. They did have the monthly summaries for the entire period, and they're still in existence, and so we are asking that because the auditor chose not to do sufficient sampling, a sufficient review, a sufficient analysis in light of the a circumstances with the records that they were provided, that we should not have to live with these results. We should be able to use the amounts that the auditor should use at the beginning that still exist, and those are what's in the audit.

The auditor does not have -- secondarily, the auditor does not have more than, I think, a few days' worth of these dailies that the auditor used. There's some in the exhibits, but for the most part they don't exist either, and so we're just asking that we base the reconciliation on the monthly summaries that are available instead of these daily summaries, and at least they'll be based on recorded amounts that we know. I trust that makes sense.

Okay. Next area that we're going to talk about is the unreported breakfast coupons, and this is an interesting area. Throughout -- these unreported breakfast coupons represent coupons that were redeemed or purportedly redeemed by hotel guests in the restaurant, and the hotel guests had received these coupons from the hotel upon renting a room, getting accommodations.

Throughout the whole audit period, both first and second audit period, it's real clear that these breakfast coupon dollar amounts were not included as sales in the sales journal, and the auditors in the first audit based their revenue estimate of these coupons based on a single amount that they found on one of the worksheets that shows $7.95. And I might add it's the same worksheet that is of a series of we asked to use in the reconciliation. So this was acceptable for this, and so we don't really take issue with the calculation of the dollar amount in the second -- in the first audit.

This is kind of -- hedging whether I should just address the first audit and the second audit, but they kind of go together. The second audit has the same thing, unreported breakfast coupons, and this is right now they're 658,428 --

(The court reporter asked for clarification.)

MR. MICKEY: On schedule R2 12F of the second audit, there is an unrecorded breakfast coupons and banquet sales based on an average from prior audit, and the total's now sitting at 658,428. When analyzing the worksheets, you will see that in that number there's actually $475,605 worth of calculated coupon values.

Okay. That number. So between the first audit, which has $582,215 in these coupons at a calculated dollar amount based on the auditor's calculations, and then there's 475,605 in the second audit. So right around a million dollars worth of these coupons between the first and the second audit period.

In the second audit period the auditors took a position -- two positions. Number one, they could not -- would not rely upon the recorded amount of coupons that were redeemed. There is a schedule in the audit. It is schedule 12F 2 is the schedule that shows the number of reported breakfast coupons for the second audit period, and it's in column E and F, and so the taxpayer had recorded these coupons of 18,639 in volume for the period.

The auditors really arbitrarily decided that that was not sufficient numbers of these coupons, and so they proceeded to then use an estimated quarterly amount of coupons based on the first audit. So they totally disregarded the 18,639, and they took an average from the 61,031 that were redeemed in the first audit. So basically equated the number of coupons that were redeemed in the second audit period to the number of coupons that were redeemed in the first audit period.

Now, in another memo, the issue we have that now is that in a memo dated March 4th, 2021, David Hofer, district principal auditor for Sacramento, responded to the petition section and said, records were determined to be inadequate per review of both the prior and current audits. It was determined that the accounting procedures, types of sales, and quantity of sales were substantially the same. There's not a large gap between the audit periods.

So they are just looking at this. Now, remember they would not accept the journals, the sales summaries. They're accepting the -- they're not accepting the number of coupons, and they're also raising the value of the coupons by a dollar. So they're all over the place as far as what they're doing with these coupons, and what we believe should happen is they should accept the number of coupons that were recorded.

There was also a coupon discussion where the coupons were at 3.49. Instead of using 7.95, they should use the 3.49 coupon value -- that's also exhibits in the working papers -- and reduce that 475,605 in the second audit period considerably based on what was recorded.

Now, secondarily on the coupons. This is something that was really missed all the way along the road, and remember as I explained earlier they do not treat these as sales. They're not recorded. They're not rung up. The idea was that the restaurant would be reimbursed by the hotel for the number of coupons. Now, if that happened, then I guess the sales between the hotel or the restaurant and the hotel, according to Regulation 1603 would be taxable sales.

However, after investigating this and asking the right questions, it was determined that money never changed hands between the hotel and the restaurant for these coupons. So, really, everything we're talking about -- the selling price, the value, the number, the quantity is kind of moot because there were no sales because there were no transfers of money.

Now, you can argue there was a sale, and if you argue that there was a sale, it was never paid, then there's a bad debt deduction. So either way you look at it, the unreported breakfast coupons are -- should not be set up as taxable sales in the audit.

And to support this we go Exhibit 4, and these are the three affidavits that I've obtained from three individuals that were knowledgeable about what was going on in time, and they're self-explanatory. They say essentially the same thing, but these three individuals -- the officer manager Alan Bocast; Vinod

Sharma, the owner of the hotel or part owner of the hotel; and Albert Bashir, who's general manager of the hotel -- all confirming, verifying, validating, and certifying that the hotel did not end up paying the restaurant for these coupons.

So we either need to remove the coupons from the audit as there being no sales because there was no exchange so there's just nothing there, or we need to add in a bad debt allowance for these items. Either way, there should be no tax due on the breakfast coupons. So that will address the specific issues that we have in the audit.

There are a few other items in the audit, but due to materiality I'm not addressing them today, and so now I want to move on to talking about the penalties. There are three penalties. We have negligent penalty on the first audit, we have a negligence penalty on the second audit, and a fail -- finality penalty on the second audit.

For the finality penalty, which we touched on at the prehearing conference, due to the age and the time lapsed I believe that we'd like to ask that the OTA, that you consider the information that has already been provided in -- it's in O -- Exhibit Q in the CDTFA's exhibit.

Okay. We would just ask that you consider that. The information is already there. There's nothing more that I can add. The only thing I would add is if we need to file -- what I think would be appropriate would be a declaration of timely mailing, that if you determine that's necessary, that we be allowed to meet that specific requirement based on the information that's in that exhibit, but I have nothing more to present on that penalty today.

On the negligence penalty with the first audit I would like to address the fact that it was the taxpayer's first audit. A sizable chunk of that is due to misunderstanding -- that audit is due to misunderstandings of the law and an amount that we don't believe is taxable anyway.

The taxpayer did have books and records at that time. They presented a large volume of records to the auditor. I know that it talks later about, you know, this wasn't provided, this wasn't provided, but they had 12 boxes at least of records. There was significant items that were presented later that were ignored by audit staff in various different intervals.

Those are things that don't really apply to any of the issues that we have with the numbers now, but they had records. They made a diligent effort to report correctly, and it is generally the CDTFA's policy to have some leniency on taxpayers when it's their first audit. So we would ask that that be considered and taken in its totality, and the penalty in the first audit be removed.

Now, at the second audit when we look at the adjustments that are in the second audit, the bulk of the liability is going to be the these coupons. We've already addressed the markup and brought it down to a negligible amount. The difference between recorded and reported should be brought down to a very minor, negligible amount.

The additional taxable sales based on average, that should be a small amount, and the unrecorded amounts of 658,428, that is substantially these coupons, which are still an issue and really not subject to taxes in the first place. So based on that, even though this was a repeated audit, they had similar errors as pointed out in the audit working papers. The errors are still reasonable and not due to negligence.

They had records in that audit. The records were accepted in that audit, and no issue with the -- minor exception of the markup, which ended up being, again, almost eliminated, and so we do don't believe the negligence should apply in that audit either, and we ask that it be removed based on that. That will conclude my presentation right now.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you for your presentation. I did have a question for you. When you were talking about the recorded versus reported value of the coupons, and you had mentioned -- I think you said that the value of the coupons was not recorded, and that there was evidence in the record to support that. Can you explain a little bit more about that and maybe point out some of what that evidence is?

MR. MICKEY: Well, there are comments that clarify that the way the coupons were handled -- and you can see it on the first audit. If you look at the sales summaries -- let me see where they're at here. So if you go to Exhibit C in the first audit, you'll see that there are monthly summaries, and on monthly summaries there is a column called breakfast coupon.

Those are the numbers of coupons that were redeemed, but there's also comments and auditor's verification talking with the taxpayer that the value of the coupons -- I mean, I wish it was -- value of the coupons is not record in the sales. Just the volume of coupons are recorded in the sales.

So then what they were supposed to be doing is they're going to take these coupons, multiply it by the amount of the value, and the hotel was going reimburse the restaurant, and nobody realized it was not taxable. That's why the restaurant calculated the number, and the auditor explains they put them in there and took them as a deduction, and that's the best that we have.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you. Now I'm going check in with my co-panelist.

Judge Long, did you have any questions?

ADMINISTRATIVE LAW JUDGE LONG: Yes. Just a few questions. First, regarding the reduction of unreported taxable sales $125,762, the wage ratio question, do you have any documentary evidence for the wage ratio in 2014 other than the projected calculation from the 2013 federal return?

MR. MICKEY: No.

ADMINISTRATIVE LAW JUDGE LONG: No. There's no documentation of wages paid in the hearing binders, right?

MR. MICKEY: Not that I'm aware of.

ADMINISTRATIVE LAW JUDGE LONG: Okay. And then I wanted to go to also the difference between the recorded and reported that the redeemed coupons. I'm not quite sure how to word this so bear with me.

If I'm the hotel guest, and I give the restaurant my coupon, that is what you mean by reduction, right?

MR. MICKEY: Yes.

THE COURT: And so I, the hotel guest, receive the food?

MR. MICKEY: Yes.

ADMINISTRATIVE LAW JUDGE LONG: And can you explain to me how that is not a sale?

MR. MICKEY: Oh. I'm not saying it wasn't a sale. I'm saying there was no money transferred between -- the way the law says -- 1603 says that that type of transaction is basically a -- the hotel is the consumer so the sale from the restaurant to the hotel would be a taxable sale, but I don't disagree with that.

What we're saying is that if there was a sale that took place, the restaurant was never reimbursed for it. So the hotel never paid that. So if there is no money exchanged, you still have a sale perhaps, but no consideration is ever changed. So at worst you have a bad debt deduction.

ADMINISTRATIVE LAW JUDGE LONG: Okay. And then with respect to the affidavits and just in regard to how much weight we should apply to that, is there an relationship Mr. Sharma, the owner of India Star, and Mr. Sharma, the owner of the hotel?

MR. MICKEY: Vinod Sharma is a member or part of the hotel, and part of the restaurant.

ADMINISTRATIVE LAW JUDGE LONG: Okay.

MR. MICKEY: The LLC.

ADMINISTRATIVE LAW JUDGE LONG: And then --

MR. MICKEY: The other two are completely independent, and I want to add that during the first audit period -- this is very important. You bring up a good point.

During the first audit period, Vinod Sharma was active in the restaurant, but he did not -- was not active -- I mean, he was active in the hotel. I'm sorry. I misspoke -- active in the hotel, but another gentleman, Harnek something, was running and in charge of the restaurant, and so Vinod Sharma was not active in the restaurant during the first audit period.

ADMINISTRATIVE LAW JUDGE LONG: Okay. And then I just want to make sure that I'm clear. Regarding the later -- the newer audit with respect to the breakfast coupons, obviously, you argued that this measure of tax should be reduced on the older audit for the breakfast coupons. Is your position that the second audit's unreported breakfast coupons should be reduced to zero or to how much?

MR. MICKEY: Well, I believe they should be reduced -- there's two arguments. They should be reduced to zero because there was no money exchanged for any of this, but the second audit period -- there's two reasons why the breakfast coupons should be reduced.

It should be reduced because the volume of redeemed coupons should be reduced down to what was recorded, and the selling -- the value, if you will, of the coupons should either should be the 3.49, which was used during that period as evidenced by a sample of the coupons that were provided and not the $9 that was used by the auditor; or secondarily, there's no basis for using $9 in that audit period if they're going to base it on the first audit period, which was 7.95. So yes. They should either be reduced for those two reasons or eliminated entirely for the other reason.

ADMINISTRATIVE LAW JUDGE LONG: Okay. And then I just have one last question regarding -- obviously bad debt deductions kind of have their own set of rules. Were bad debts deducted on Appellant's federal income tax return?

MR. MICKEY: I don't know that.

ADMINISTRATIVE LAW JUDGE LONG: Okay. No further questions. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Hearing Officer Wilson.

HEARING OFFICER WILSON: Yes. I have a

question. In going Exhibit 1 on 12D, how did you determine the split between alcohol and food on that?

MR. MICKEY: Okay. So that is the -- that's the auditor's calculation. So on 12D if you look at Exhibit 1 page 4 of 8, the -- let me find this. Okay. So at the bottom. You see the yellow boxes and the green boxes? So the green boxes and the -- so the 42,223 as an example for alcohol from 2013 and the 92,848, those are formulas inside there from the auditor's schedule.

They did a segregation test and determined all of that. So all we did was plug the different number -- that's why we have the black box around the yellow. The only number we changed ourself were the two yellow ones. The green, that changed because of the formulas in there.

HEARING OFFICER WILSON: Okay. And then for the markups that -- the new markups calculated, do you find those to be reasonable?

MR. MICKEY: Well, actually, I find the food to be high now, but --

HEARING OFFICER WILSON: And the alcohol?

MR. MICKEY: They look reasonable. I think they're still reasonable. I think that they are -- yeah. I think they're reasonable.

HEARING OFFICER WILSON: Okay. So the next schedule --

MR. MICKEY: I take that back. I don't think the food is high, actually, for the type of food. I think that's reasonable. It's in the range.

HEARING OFFICER WILSON: So the next schedule, 12B.

MR. MICKEY: 12B. Which one?

HEARING OFFICER WILSON: Your schedule 12B.

MR. MICKEY: Oh, yes. Okay.

HEARING OFFICER WILSON: So is the reason the that only alcohol is because --

MR. MICKEY: That's what the auditors did. They accepted the food markups as they were before, and they only marked up the alcohol.

HEARING OFFICER WILSON: So with the adjustments that you provided did you recalculate what the food -- if there was an error on the food since it's different?

MR. MICKEY: Actually, the percentage of markup for both of them for the food increased based on what we did because there were fewer purchases. So the reflected markup went up on the food, and we just used the same markup that the auditor used on the alcohol, the 3.692. We didn't change that.

HEARING OFFICER WILSON: I might have some questions later. That's it for now.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you.

Mr. Barnard, before we move on to the next presentation, CDTFA is going to have about an hour to do their hour presentation. Did you need break?

THE COURT REPORTER: Yes, please.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Great. Then we'll take a break for about ten minutes, and -- well, we'll take a ten-minute break. Just remember if you're staying in the room, that the microphones are on, and it's still recording.

(The proceedings went off the record.)

ADMINISTRATIVE LAW JUDGE RALSTON: We are back on the record in Star of India.

Mr. Samarawickrema, you have 60 minutes, and please begin when you're ready.

PRESENTATION

MR. SAMARAWICKREMA: Thank you, Judge. Appellant is a California limited liability company that operated a restaurant with a bar located inside --

(The court reporter asked for clarification.)

MR. SAMARAWICKREMA: Appellant is a California limited liability company that operates the restaurant with a bar located inside of a hotel in Chico, California. The hotel was operated by a separate corporation. However, Mr. Vinod Kumar Sharma was an officer at both the Appellant and the hotel.

The hotel had 172 guest rooms, and several rooms for meetings and special events. Appellant also offered room service to hotel guests and onsite special events and banquet services. Hotel provided their guests with breakfast coupons and discount coupons that can be redeemed at Appellant's restaurant and bar.

Two audit periods are subject of this appeal. For easier difference the Department is going to refer to the audit April 1st, 2008, to March 31st, 2011, as the first audit, and refer to the audit October 1st, 2012, to September 30th, 2015, as the second audit.

During the first audit period, Appellant recorded total sale of around $1.4 million and claimed exempt food sales of around of $1.1 million resulting in reported taxable sale of around $305,000, and this is shown on Exhibit A, pages 16 and 17.

During the second audit period Appellant reported total sale of around $695,000 and claimed exempt food sale of around $25,000, and sales tax reimbursement included a total sale of around $16,000, resulting in reported taxable sale of around $654,000, and this is shown on Exhibit J, pages 28 and 29.

During our presentation we will explain why the Department rejected Appellant's reported total and taxable sales for both audit periods; why the Department used an indirect audit approach; how the Department determined Appellant's unreported taxable sales; why the Department recommended an egregious penalty; and why the Department recommended a finality penalty for the second period of for this Appellant.

During both audits Appellant failed to provide complete sale records. Appellant did not provide complete documents of original entry, such as cash register receipts or guest receipts, credit cards sales receipts, banquet sales contracts, banquet sales invoices, complete sales journals, sales summaries to support their reported sales for both audit periods.

In addition, Appellant failed to provide complete purchase information or purchase journals for both audit periods. For the first period Appellant informed the Department that their manager was responsible for preparing the sales and use tax returns no longer worked for them, and therefore Appellant could not explain how they reported their sales on their sales and use tax returns.

Appellant was also unable to explain what source they relied upon to find sales and use tax return for the first audit period. For the second audit Appellant informed they use guest checks to record sales. The guest checks and credit cards sales transactions were recorded onto the sales spreadsheet, then the sales from the sales spreadsheets were recorded onto a monthly sales journal, and these sales journals are on Exhibit N.

These sales journals include sales for the restaurant, bar, and banquets and also included the number of breakfast coupons redeemed. In addition, these sales journals segregated sales by method of payment such as cash, credit cards, or room charge, and these are shown on Exhibit N and Exhibit O.

Appellant indicated that these sales journals were used to prepare their sales and use tax return for the second audit period. However, Appellant failed to provide source documents to verify the completeness of sales reflected on these sales journals. Therefore, the Department did not accept Appellant's reported taxable sales for both audit periods due to lack of reliable records.

The Department also determined that Appellant did not provide complete records that could be verified that are reported taxable sales for audit periods. The

Department completed five verification methods to evaluate the accuracy of Appellant's reported taxable sales. First, the Department analyzed Appellant's reported sales for both audit periods, and these are shown on Exhibit X, pages 2 through 5.

The Department ordered average daily reported taxable sales of $399 ranging from as low as $111 to as high as $1072. Based on the business capacity, location of the business, customer base, and the number of days open for business, the Department views this as a very low daily taxable sales for this business. For comparison, Appellant's average taxable daily sales based on our auditor taxable sales for both audits were $1,900.

Second, the Department analyzed Appellant's profit and loss statement for periods April 2008 through June 2009 and January 2013 through December 2014, and compared the sales reflected on profit and loss statement of around $1.6 million with Appellant's reported total sales for the same period. The Department calculated an overall difference of around $563,000, and the information required to calculate these differences are shown on Exhibit A, page 16; Exhibit B, page 45; Exhibit J page 28; and Exhibit M.

Third, the Department reviewed

Appellant-provided federal income tax returns schedules for years 2012 and 2013, and compared the sales reflected on federal income tax return of around $629,000 with Appellant's reported total sales tax for the same period. The Department calculated an overall difference of $198,000, and this calculation is on Exhibit X, page 13.

The Department also analyzed cost of goods sold amounts and other expense items reflected on Appellant-provided federal income tax return schedules for years 2012 and 2013. The Department noted explained variances on cost of goods sold, wage expenses, rent expenses, insurance expenses, and utilities.

For example, Appellant's cost of goods sold was around $63,000 for year 2012, around $205,000 in 2013. Rent expenses were around 4,400 for year 2012 and around $67,000 in 2013, and utilities were $15,000 for year 2012 and around $46,000 in 2013.

Appellant did not provide any source documents or other reliable information to verify the information reflected on Appellant's federal income tax returns schedules. Based on these analyses the Department determined that Appellant's federal income tax returns schedules were unreliable and unacceptable.

Fourth, for the second audit the Department compared reported total sale of around $431,000 with a cost of goods sold of around $260,000 reflected on Appellant's federal income tax returns schedules and calculated and overall reported book mark of around 61 percent, and this calculation is on Exhibit X, page 13. Based on the items sold, many prices, customer base, services provided, and the location of the business, the Department expected to see a higher book markup than the reported book markup for this business for this period.

Fifth, the Department attested Appellant did sales worksheets for fourth quarter 2008, first quarter 2009, and second quarter 2009, and noted total sale of around $353,000, but Appellant only reported $86,000, and these calculations are on Exhibit B, page 17, and pages 33 through 42. Appellant did not report more than 75 percent of their recorded sales on daily sales worksheets for this period.

The Department also noted that Appellant failed to record some of their daily sales amount in their daily sales worksheets. Appellant was unable to explain reasons for low average daily reported taxable sales, sales differences in profit and loss statements, federal income tax returns, daily sales worksheets, and lower reported markups.

Therefore, the Department conducted further investigation by analyzing Appellant's daily sales worksheets for fourth quarter 2008, first quarter 2009, and second quarter 2009, and monthly sales summaries for second quarter 2008 to second quarter 2009 for the first audit period. The Department used the information from the first audit period, available sales journals for first quarter 2013 through third quarter 2015, available guest checks for September 2015, and available purchase invoices for third quarter 2015 for the second audit period.

For the first audit the Department noted that guests of the hotel received coupons for breakfast in Appellant's restaurant. For each coupon redeemed at the restaurant the hotel paid Appellant $7.95, excluding sales tax reimbursement, and this is shown on Exhibit C, page 40.

Using the 30 monthly summaries, the Department noted that Appellant had accepted around 61,000 breakfast coupons, a monthly average of around 2,000 coupons. The Department used the recorded breakfast coupons for 30 months, average monthly coupons, and the price per coupon to determine auditor taxable breakfast sales of around $582,000 for the first audit period, and these calculations are shown on Exhibit B, pages 23 and

24.

In addition to unreported taxable breakfast sales the Department used Appellant's sales summaries for second quarter 2008 and third quarter 2008, and daily sales sheets for fourth quarter 2008 through second quarter 2009, and determined that Appellant collected sales tax reimbursement of around $48,000 comprised of around $5,900 from banquets for second quarter 2008 and third quarter 2008, and around $19,000 from the restaurant and around $23,000 from the bar for second quarter 2008 through third quarter 2009, and these calculations are shown on Exhibit B, page 28.

For each monthly periods the Department divided the recorded sales tax reimbursement collected by applicable sales tax rates to determine audited taxable sale of around $653,000 for second quarter 2008 through second quarter 2009, which exceeded Appellant's reported taxable sales for that period by around $497,000, and this calculation is shown on Exhibit B, pages 27 and 28.

The Department also noted that Appellant's daily sales sheets and monthly sales summaries showed that Appellant recorded sales tax reimbursement of around $19,000 from the restaurant for second quarter 2008 through second quarter 2009, and this is shown on Exhibit B, page 29.

Using the applicable sales tax rates the Department calculated that Appellant had collected sales tax reimbursement on taxable restaurant sales of around $257,000 for this period. However, the Department noted that Appellant had recorded total restaurant sale of around $292,000, excluding sales tax reimbursement for the same period, and determined a difference of around $35,000 as additional unreported taxable restaurant sales, and this is shown an Exhibit B, page 29.

The Department found that Appellant recorded sales tax reimbursement of around $5,900 from banquet sales in their monthly sales summaries for second quarter 2008 and third quarter 2008. It found no recorded banquet sales for periods after third quarter 2008. The Department determined that Appellant had made banquet sales through the audit period.

Based on Appellant's recorded sales tax reimbursement for banquet sales for second quarter 2008 and third quarter 2008, the Department determined average taxable banquet sale of around $41,000 per quarter, and used this quarterly average to determine unrecorded taxable banquet sale of around $122,000 for three quarters from fourth quarter 2008 to second quarter 2009, and this is shown on Exhibit B, pages 31 and 32.

The Department found Appellant did not record total daily sale amounts for seven days for restaurant and 11 days for bar for fourth quarter 2008, and total daily sales amount for six days for restaurant and three days for second quarter 2009. Using average recorded daily restaurant and bar sales amounts, the Department determined the sales for these unrecorded sales amount of around $20,000 for fourth quarter 2008 and second quarter 2009, and these calculations are shown on Exhibit B, pages 35 through 41.

Based on these findings the Department determined sales summaries for the first audit period, except second quarter 2008 and third quarter 2008 to be incomplete and unreliable because the amounts recorded in the daily sales sheets exceed the amounts recorded in monthly sales summaries.

As explained earlier the Department used the monthly sales summaries and the daily sales sheets to determine audited taxable sales, excluding audited taxable breakfast sales for second quarter 2008 to second quarter 2009, and these calculations are shown on Exhibit B, pages 26 and 27.

The audited taxable sales, excluding audited taxable breakfast sales, were compared with the corresponding reported taxable sales to determine the error rate of around 35 percent for second quarter 2008 through second quarter 2009. Appellant did not provide any sales records for third quarter 2009 to first quarter 2011. Therefore, the Department used this error rate and reported taxable sales to determine unreported taxable sale of around $652,000 for third quarter 2009 to first quarter 2011, and this calculation is shown on Exhibit B, page 25.

In total the Department determined unreported taxable sale of around $1.9 million for the first audit period, and this calculation is shown on Exhibit B, page 14. The Department then compared the total underreported taxable sales with a reported taxable sale of around $306,000 to calculate the error rate of around 624 percent for the first audit period. Appellant also did not provide complete sales record for the second audit period.

Therefore, the Department conducted further investigation by analyzing Appellant's available records and the first audit information for the second audit period. The Department analyzed the available guest checks for September 2015 and sales amounts recorded in Appellant's sales journals for first quarter 2013 through third quarter 2015. The Department noted that the Appellant's redeemed coupons are recorded in their sales journals, but sales amounts were not.

Therefore, based on the available guest checks and sales journals the Department calculated sales made with coupons redeemed for first quarter 2013 through third quarter 2015, computing restaurant alcohol sale of around $16,000, bar alcohol sale of around $248,000, banquet alcohol sale of around $900, and coupon alcohol sale of around $13,000, resulting in total sale of alcohol beverage of around $278,000, and these calculations are on Exhibit J, pages 74 and 75.

The Department adjusted the alcohol beverage sales for sales tax reimbursement, determining alcohol beverage sales of around $258,000. Similarly, the Department determined the food sales from each source, resulting in total for sale of around $492,000, and these calculations are on Exhibit J, pages 82 and 83.

Appellant added an 18 percent mandatory gratuity charge to banquet sales and room services. Based on recorded mandatory gratuities from room services and total restaurant and bar tips reflected on Appellant's guest checks for September 2015, the Department determined the mandatory gratuity charge for room service of around 14 percent, and this calculation is on Exhibit J, page 93.

The Department used the recorded food and alcohol banquet sales and 18 percent mandatory gratuity rate to determine mandatory gratuities for food and alcohol banquet sales and other banquet fees, and this calculation is shown on Exhibit J, pages 90 and 91. The Department then determined the mandatory gratuities of around $11,000 for first quarter 2013 through third quarter 2015.

The Department then combined taxable sale of around $258,000 for alcohol beverages, $492,000 for food, $11,000 in mandatory gratuities and fees, and determined recorded taxable sale of around $761,000 for first quarter 2013 through third quarter 2015. The Department then compared the recorded taxable sale of around $761,000 with reported taxable sale of around $556,000, and calculated unreported taxable sale of around $205,000 and an error rate of around 37 percent for first quarter 2013 through third quarter 2015, and these calculations are shown on Exhibit J, page 73.

Appellant did not provide sales journals for fourth quarter 2012. In order to give a benefit to Appellant the Department determined unreported taxable sale of around $19,000 for this period based on average unreported taxable sale approach instead of 14 error rate approach for fourth quarter 2012, and this is shown an Exhibit J, page 72.

Had the Department determined the unreported taxable sales using reported taxable sales and the error rate of around 37 percent for fourth quarter 2012, then the unreported taxable sales would increase by around $18,000 from around $19,000 for $37,000. As mentioned earlier the Department noted Appellant recorded their number of redeemed coupons in their sales journals but not the sales amounts.

Therefore, the Department used Appellant's sales journals for first quarter 2013 through third quarter 2015 and scheduled around 19,000 breakfast coupons redeemed during the 33-month period, and this is shown on Exhibit J, page 86. When compared to the around 16,000 breakfast coupons redeemed during the 30-month period in the first audit period, the Department determined that the number of breakfast coupons redeemed during the second audit period were low, and this comparison was shown on Exhibit J, pages 68 and 69.

Appellant redeemed 68 breakfast coupons per day during the first audit period, and Appellant recorded only 19 breakfast coupons redeemed per day during the second audit period. The Department compared these average daily breakfast coupons with the number of guest rooms in the hotel of 172 and determined average daily breakfast coupon number of 19 for the second audit is not reasonable. Therefore, the two breakfast coupon averages were compared, and a monthly amount of about 1,500 and a quarterly difference of around 4,000 were calculated, and this has shown on Exhibit J, page 69.

The Department determined the difference as unrecorded breakfast coupons. Appellant contends that the value of the breakfast coupon is only $3.49 and has provided sample coupons to support their contentions. This is shown an Exhibit S, page 68.

However, at the time of the audit fieldwork for second audit, Appellant's manager indicated that the value of the coupons were $8.99, and also based on Appellant's own sales tax worksheets for second quarter 2008. It was determined Appellant was being reimbursed and $7.95 by the hotel, and that Appellant was taking a deduction for the reimbursed breakfast amounts. Therefore, the quarterly unreported breakfast coupons were multiplied by $8.99 value received from the hotel to determine unrecorded breakfast sale of $476,000 for the second audit period, and these calculations are shown Exhibit J, page 64.

Similarly, the Department used the taxable banquet alcohol sale of around $900, banquet food sale of around $8,300, and service charge of around $1,900 recorded in the sale journal for first quarter 2013 through third quarter 2015 and divided them by 11 quarters to calculate the average quarterly taxable banquet sales, totaling $80 for alcohol, $750 for food, around $200 for taxable service charge, and these calculations are on Exhibit J, pages 67, 75, 76, 82, 83, 84 and 91.

In the first audit Appellant provided the sales journals for second quarter 2008 and third quarter 2008 with some detailed information on the banquet sales, which were divided by two quarters to calculate average quarterly taxable sale of around $2,000 for alcohol, around $12,000 for food, and around $29,000 for service charges, rentals, and other fees.

The quarterly averages for second quarter 2008 and third quarter 2008 were compared to the quarterly averages for first quarter 2013 through third quarter 2015, and the differences of around $1,700 for alcohol, $11,000 for food, and around $29,000 for service charges, rentals, and other fees were calculated.

The service charge was substantially higher in the first audit period, and therefore in order to give a benefit to Appellant the Department calculated an average quarterly service charge of around $2,600 using a percentage of around 20 percent derived from recorded monthly averages of banquet food sales, alcohol sales, and service charges.

The quarterly differences of banquet sales alcohol, food, and service charges were multiplied by 12 quarters to determine unrecorded banquet sale of around $183,000 for the second audit period, and these calculations are shown on Exhibit J, page 65. In total the Department determined around $658,000 in additional unrecorded breakfast coupon sales and banquet sales for the second audit period, and these calculations are on Exhibit J, page 65.

To verify the reasonableness of the recorded and unrecorded food and alcohol sales, the Department analyzed Appellant's product mix, available purchasing information, and pricing policies. To understand Appellant's product mix the Department conducted a purchase segregation using available merchandise purchases invoices for second quarter 2015, and this purchase segregation is shown on Exhibit J, pages 61 through 63. Based on this purchase segregation the alcohol purchases total around $7,000 and food purchases total around $30,000. Combined, the purchases for the third quarter 2015 total around $37,000.

The Department also scheduled alcohol and food purchases in the first audit from the profit and loss statement for second quarter 2008 through fourth quarter 2009, and this is shown on Exhibit J, page 16. The Department estimated that five percent of recorded food purchases from the first audit were supplies so an adjustment of five percent was made to the recorded purchases for second quarter 2008 through fourth quarter 2009. Based on the recorded alcohol purchases and adjusted food purchases for second quarter 2008 to fourth quarter 2009, the Department calculated average quarterly purchases for alcohol of around $20,000 and food of around $43,000.

The Department noted that the alcohol and food purchases for third quarter 2015 was substantially lower than for second quarter 2018 through fourth quarter 2009. Based on this information the Department determined that the merchandise purchase invoices for third quarter 2015 were incomplete, and it appears that Appellant failed to provide their complete purchase invoices for this period.

Therefore, the Department used Appellant's first audit purchase information to determine purchases of around $252,000 for year 2014. Even though the Department did not accept the amount listed on Appellant's federal income tax return schedules, it used the cost of goods sold amount on Appellant's 2013 federal income tax return, which totaled around $205,000.

The Department also calculated the alcohol purchase percentage of around 31 percent and food purchase percentage of around 69 percent, and these percentages are shown on Exhibit J, page 60. The Department used this information with a recorded and unrecorded food and alcohol sales for years 2013 and 2014 to calculate an alcohol markup of around 48 percent and a food markup of around 153 percent for these four years combined, and this is shown an Exhibit J, page 58.

To verify the reasonableness of alcohol markup, the Department performed short shelf test using Appellant's available alcohol purchase invoices with the respective over pour and breakage allowances and available selling prices, and calculated a weighted average alcohol markup of around 269 percent, and this calculation is shown on Exhibit J, page 56.

At the time of the audit fieldwork for second audit the Department attempted to get additional information to conduct the full shelf test. However, Appellant did not provide the information that is required to complete a full shelf test. This obstructed the Department's ability to gather additional complete facts to understand Appellant's pricing policies. It also prevented the Department from determining Appellant's actual alcohol markup.

Therefore, the Department used the best available information to determine Appellant's alcohol markup for the second audit period. Based on this shelf test results the Department determined that it is required to markup Appellant's alcohol purchases to determine accurate alcohol sales for the second audit period.

Even though the Department determined that Appellant's federal income tax return schedules were unreliable, it used the cost of goods sold reflected on Appellant's 2013 federal income tax returns. Also, in order to give a benefit the Appellant, the Department assumed Appellant had the same cost of goods sold amounts for year 2014 instead of estimating purchases using the purchase information from the first audit, and this is shown on Exhibit J, page 55.

Then the Department used the alcohol purchases available for sales and weighted alcohol markup factor of around 370 percent to determine audited alcohol sale of around $464,000 for years 2013 and 2014. The Department then compared the audited alcohol sales with recorded and unrecorded alcohol sales to determine additional alcohol sales based on cost plus markup audit method of around $255,000 for the same period.

The additional alcohol sales based on cost plus markup method was compared with recorded alcohol sales and unrecorded alcohol sales at banquets to calculate respective error rates for years 2013 and 2014, and these calculations are shown on Exhibit J, page 55.

The Department used recorded alcohol sales and unrecorded alcohol sales at banquet with respect to error rates to determine additional alcohol sale of around $411,000 for the second audit period, and these calculations are shown on Exhibit J, page 53. In total, the Department determined unreported taxable sale of around $1.3 million for the second audit period, and this calculation is shown on Exhibit J, page 52.

The Department then compared the total unreported taxable sales with a reported taxable sale of around $654,000 to calculate the error rate of around 198 percent for the second audit period. The audit calculation of unreported taxable sales for both audit periods are based on the best available information was reasonable.

When the Department is not satisfied with accuracy or the sales and use tax return file, it may rely upon any facts contained in the return or upon any information that comes into the Department's possession to determine if any tax liability exists, a taxpayer shall maintain and make available for examination on request by the Department all records necessary to determine the correct tax liability under the sales and use tax laws and all records necessary for the proper completion of the sales and use tax returns.

When a taxpayer challenges a notice of determination, the Department has the burden to explain the basis for that deficiency. When the Department's explanation appears reasonable, the burden of proof shifts to the taxpayer to explain why the Department asserted deficiencies not valued.

Since Appellant failed to provide necessary records for both audit periods, the Department used the best available information to determine the unreported taxable sales for both audit periods. The audit calculation of unreported taxable sales based on the best available information was reasonable.

Appellant did not agree with the audit finding for both audit periods. Prior to prehearing conference statement dated April 4th, 2025, Appellant contended that the value of the breakfast is only $3.49 rather than the value using the second audit of $8.99 per person. This is shown on Exhibit R, page 2.

However, Appellant changed their previous argument and now claim that the hotel did not reimburse them for the breakfast coupons provided to hotel guests for the period April 2008 to September 2015. Now Appellant is arguing that Appellant provided free breakfast for guests of the hotel, and this is contrary to Appellant's previous representative email communication, and this is shown an Exhibit R, page 2.

Appellant also contended that the sales calculated in the second audit period are incorrect because the Department used the results of the first audit period. Moreover, Appellant disputed estimated alcohol purchases for years 2013 and 2014. As support, Appellant provided a declaration from office manager and the general manager of the hotel and Appellant's member, and they're stating that the hotel did not reimburse Appellant for the breakfast coupons provided to hotel's guests for the period April 2008 to September 2015.

Appellant also provided part of their federal income tax returns for years 2013 and 2014 to argue that the cost of goods sold amount reflected on Appellant's federal income tax return include wages. Using this information Appellant calculated alcohol sales adjustment of around $285,000 for the second audit period, and these calculations are shown on Appellant's Exhibit 1.

Appellant also requested several other adjustments, including $168,000 for breakfast coupon sales, and these other adjustments are on Appellant's Exhibit 2 and 3. The Department analyzed the information and ultimately rejected it.

The Department ordered that Appellant made inconsistent arguments regarding the arrangement that they had with the hotel regarding breakfast coupons, but Appellant failed to provide any agreements that they had with the hotel, and any of the area of viable information other than three new declarations.

Appellant also failed to provide their complete alcohol and food purchase invoices to support the purchase amount reflected on Appellant's Exhibit 2. As stated previously the Department used Appellant's cost of goods sold reflected on their 2013 federal income tax return to give a benefit to Appellant.

Had the Department estimated the purchases based on the purchases reflected on Appellant's first audit period to determine alcohol sales for the second audit period, then the unrecorded alcohol sales would increase by around $167,000 from around $411,000 to $578,000, and the information Appellant required to calculate these amounts are on Exhibit J, pages 54 and 55.

Therefore, the Department finds that the estimated amount, as is in these two audits, are not only reasonable but also benefit the Appellant. The Department imposed a negligence penalty for both audit periods based upon its determination that Appellant's books and records were incomplete and inadequate for sales and use tax returns and because Appellant failed to accurately report their taxable sales for both audit periods.

The Department generally does not impose an negligence penalty with the taxpayer has not been previously audited. Nevertheless, even in connection with the first audit, the imposition of the negligence penalty is warranted if there's evidence established that any bookkeeping and reporting errors cannot be attributable to the taxpayer's good faith, and a reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the sales and use tax floor or regulations.

Relevant factors such as general state of the books and records and the Appellant's business experience must be considered, and when the evidence clearly shows that the understatement is due to negligence, then the penalty applies even when the Appellant has not been previously audited.

Specifically, the Department noted that the Appellant failed to provide complete records for both audit periods, and Appellant failed to provide complete books and records to support their reported taxable sales. Appellant's failure to provide complete books and records for the both audit periods are evidence of negligence.

In addition, the audit examination disclosed unreported taxable sale of around $3.2 million, which, when compared with the reported taxable sale of around $960,000 for both audit periods, resulted in a combined error rate of around 333 percent. This high combined error rate is additional evidence of negligence.

Finally, the Department imposed a finality penalty because the determination for the second period became final on February 20th, 2016, and Appellant did not file a timely petition for redetermination and did not make a full payments towards the determination by this date. However, the Department recommended waiving the finality penalty for the second audit period if Appellant pays the full liability within 30 days of the date of notice of the redetermination for the second audit period.

In conclusion, when Appellant did not provide complete books and records, the Department was unable to verify the accuracy of reported taxable sales using a direct audit method. Therefore, an alternate audit method were used to determine unreported taxable sales for both audit periods.

Accordingly, the Department determined there are reported taxable sales for both audit periods based upon the best available information. The evidence shows that the audits produced reasonable results. Appellant has not provided any reasonable documentation or evidence to support an adjustment to the audit finding.

Therefore, for all of these reasons the Department requests appeal be denied. This concludes our presentation. We are available to answer any questions the panel may have. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you. I did have a question. I know you addressed it, but I didn't catch everything you said. So if you could just answer again where the Appellant has stated that some of the federal information tax returns incorrectly contain wage information in the -- I believe in the cost of goods sold.

So what was CDTFA's response to that?

MR. SAMARAWICKREMA: I didn't understand your question.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. So the Appellant stated that -- I think it was the 2014 federal tax return contained labor amounts or wages in the cost of goods sold, and I thought you addressed it during your presentation, but I missed part of what you said.

MR. SAMARAWICKREMA: Yeah. Exhibit X. The last page of the exhibit. Exhibit X, page 13.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay.

MR. SAMARAWICKREMA: We compared the line 17, the cost of goods sold according to the federal income tax return, but instead of 62,000, compared 2013. And also --

MR. PARKER: Judge Ralston, one thing we did note in the 2014, they had cost of goods sold of 190,000 without any adjustment for the wages. The Appellant's representative made an adjustment for that so there's no evidence of that. On the 2013 the information on cost of goods sold does show a line item four, wages. However, the taxpayer hasn't provided the purchase invoices to verify that the information on the income tax returns is correct.

The information for the cost of wages may be other items that they may have separated out -- food purchases versus alcohol purchases. Obviously, we can't verify the information because we don't have the purchases available. So we were going with the best available information we had, and as Mr. Samarawickrema mentioned in the presentation, the cost of goods sold in the earlier audit period were significantly higher, and if we used similar amounts in this -- in the second audit period, the alcohol sales would have gone up tremendously. Does that sort of answer the question?

ADMINISTRATIVE LAW JUDGE RALSTON: Yes. Thank you. So I think that is all my questions. Judge Long, did you have any questions?

ADMINISTRATIVE LAW JUDGE LONG: No questions. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. And Hearing Officer Wilson, did you have any questions?

HEARING OFFICER WILSON: I do not. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Thank you. Okay.

So Mr. Mickey, you have about ten minutes for rebuttal. So please begin when you're ready.

CLOSING STATEMENT

MR. MICKEY: Okay. Regarding the income tax return figures, the -- I know that the Department is going to argue exactly what they argue, but we're looking at what the best available information is. They used that repeatedly. Best available information. The CDTFA auditors routinely look at income tax returns and whether they have backup documents or not. If it serves their purpose, they use the information on income tax returns. Countless audits are based on income tax returns.

Auditors generally take the cost of goods sold or the purchases sometimes, don't even -- and ignore the cost of goods sold off the income tax returns almost routinely. Now, I get that there were records that were maybe not provided. I don't know whether they were in those 12 boxes of records that the auditor initially had -- well, this is the second audit so I don't know what happened on this audit, but this information, to say that the cost of labor might be something else like food purchases, that's not very reasonable in our opinion.

And when you look at the tax returns, you can see -- even if you look at the Exhibit X, page 13, you see that for 2012 there is a wage amount, okay, and there's a wage amount of 96,000 on there, and the purchases are lower, 62,000. And then in 2013 it goes up to 204,000. So by the preponderance of the evidence it's real clear that the 204,947 that's on the income tax return is the most accurate number that they had.

You might also note that in the file there are copies of the P&Ls that the auditors just ignored based on their argument that the records weren't shown to verify them. Those purchases are less than what's on here.

So this is even a higher number, and to say now that if they would have used an estimate based on the prior audit, it would have been higher, I mean, they could use any estimate and make it higher if they wanted to. We're looking for what the right number is here, the best number, and so to say you can't use or you shouldn't use the 2013 figures because they could have used another kind of estimate and come up with a higher number, that's not reasonable, either. They should look and be consistent with what they do, and so we will hold that the 2013 simple change in the cost of goods sold figure is valid.

Now, in their presentation there's a lot of other information that leads up to how they did the whole audit, and I can't disagree with most of what he said. It's just a play-by-play action of what happened with the audit. We're not even addressing those issues.

I'm simply saying that the best information available for the 2013 markup analysis is the tax return that they previously accepted. Whether they did a benefit or not, they recognized it, they accepted it. I'm just now directing that number. That's all we're asking for.

And when it comes to 2014, again, yes, you're absolutely right. I don't have a breakdown for it, but when you -- auditors do this all the time, too. They look at the reasonableness, and they look at the all these other facts. They have comment after comment based on their -- you know, looking at the business location and the nature of the business, they make the decisions.

We're just simply saying that if you look at the 2013-2014 total figures, and you acknowledge that on those tax returns, which I've shown you, there is not a line item for wages. That is very, very reasonable -- in my view meets the preponderance of the evidence -- that the 2014 in total is a lump sum figure that also includes the wages, and that's why we did what we did. That's how we calculated the 34 percent being for wages, and the 66 percent for cost of goods sold -- the true cost of goods sold.

I don't know what else to say. I think that this is the best information. I think it's typically information that is used by auditors. It would have been used if they would have had this information, this breakdown, they probably would have used it. I can't speak for them, but the fact is we have it now, and it should be used. It's a simple change in the audit calculations.

Second thing, on the difference between recorded and reported. In the second audit period where I've explained and shown you that there's 167,565 in coupons there. I'm simply asking you to recognize that that 167,565 is not a difference between recorded and reported. That, if anything, it should have been part of the column K, and it should be added to the 475,605.

I'm just identifying that. Within that 205,155 there is the 167,565 in coupons that are not in there, and by their admission they acknowledge that the -- you asked the question earlier, too. They answered it there -- is that these coupons were recorded in the sales journal at volume, but the sales amounts were not. So you can't include the 167,565 in that difference. It needs to be moved and combined with the other coupons of 475,605.

Then when you make that adjustment, that followthrough adjustment from the 18,651 on schedule 12G, which is my Exhibit 3 I think it was, that's just a natural mathematical follow through based on the procedure, and that's why that changes. And so there shouldn't be any question with that, and that -- I don't have anything more, any other questions.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. Thank you. I'm just going the check in with my panel one more time to see if they have any questions.

Judge Long.

ADMINISTRATIVE LAW JUDGE LONG: No questions. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. And Hearing Officer Wilson.

HEARING OFFICER WILSON: No questions. Thank you.

ADMINISTRATIVE LAW JUDGE RALSTON: Okay. So it looks like we are ready to conclude the hearing. Today's hearing in the Star of India LLC is now adjourned, and the record is closed. The panel will meet and decide your case later on, and we will send you a written opinion of our decision within 100 days. Thank you, everybody, for attending.

(The proceedings concluded at 12:02 P.M.)

C E R T I F I C A T E   O F   R E P O R T E R

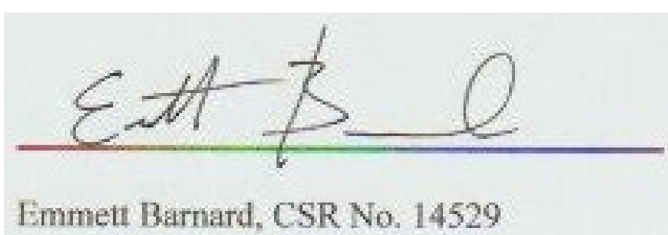
I, EMMETT BARNARD, do hereby certify:

That I am a disinterested person herein; that the foregoing Office of Tax Appeals hearing was reported in shorthand by me, Emmett Barnard, a Certified Shorthand Reporter of the State of California.

That the said proceedings were taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said hearing nor in any way interested in the outcome of said hearing.

IT WITNESS WHEREOF, I have hereunto set my hand this 12th day of June, 2025.



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