

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

D. HAMBARDZUMYAN,
dba The Fav Smoke Shop) OTA Case No. 230813957
) CDTFA Case ID: 2-342-761
)
)
)**OPINION**

Representing the Parties:

For Appellant:

Grigor Demirchyan, Representative
D. Hambardzumyan

For Respondent:

Jennifer Barry, Attorney
Cary Huxoll, Attorney
Jason Parker, Chief of Headquarters Ops.

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, D. Hambardzumyan dba The Fav Smoke Shop (appellant) appeals a decision, as amended by a supplemental decision and second supplemental decision, issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on November 2, 2020. The NOD is for tax of \$187,328, plus applicable interest, and a negligence penalty of \$18,732.75 for the period February 4, 2018, through March 31, 2019¹ (liability period).²

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Natasha Ralson held an electronic oral hearing for this matter on March 19, 2025. At the conclusion of the oral hearing, the record was closed, and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, section 30209(b).

¹ The audit measure established by CDTFA only relates to the period from February 4, 2018, through January 3, 2019. The parties do not dispute that appellant owned the business during that timeframe.

² The NOD also includes payments/credits of \$24.81.

ISSUES

1. Are any adjustments to the measure of unreported taxable sales warranted?
2. Did CDTFA properly impose the negligence penalty?

FACTUAL FINDINGS

1. Petitioner, a sole proprietor dba The Fav Smoke Shop, operated a retail cannabis dispensary in North Hollywood, California (the business). CDTFA issued a seller's permit to appellant effective February 4, 2018.³
2. This was appellant's first audit.
3. For the liability period, appellant reported total sales of \$187,649, all of which were taxable.
4. CDTFA's Statewide Compliance Outreach Program (SCOP) conducted observation tests of the business on Tuesday, March 19, 2019, from 1:35 pm. to 2:35 p.m. and on Thursday, March 21, 2019, from 1:35 p.m. to 2:35 p.m. On Monday, March 25, 2019, CDTFA observed the business was closed. CDTFA observed a total of 39 people entering the business during the two one-hour observations, or an average of 20 people per hour.
5. During CDTFA's April 12, 2019 visit to the business location, the business was still operating under appellant's dba, "The Fav." On May 8, 2019, CDTFA visited the business and saw a sign with appellant's dba, "The Fav." CDTFA observed one customer making a purchase and spoke with an individual identified as "John," who claimed to be a patient. CDTFA gave John a copy of the audit engagement letter, and John stated he would pass the letter along to appellant.
6. On May 6, 2019, CDTFA mailed an audit engagement letter to appellant at the business address, and two weeks later appellant's former accountant, Ms. Harootunian, called CDTFA and stated that appellant instructed her to prepare documents for the audit.
7. On May 24, 2019, appellant contacted CDTFA and requested the seller's permit be closed effective January 1, 2019. CDTFA did not do so while the audit was underway and there was a question of whether appellant was still operating the business.

³ The permit was issued on or about April 18, 2018, following a visit by the Statewide Compliance and Outreach Program, with a retroactive start date of February 4, 2018.

8. On July 26, 2019, August 27, 2019, and September 19, 2019, CDTFA issued appellant letters and a formal demand requesting books and records for audit.
9. On March 11, 2020, appellant filed a form CDTFA-65, Notice of Closeout, stating the business was closed on January 3, 2019. The same day, CDTFA visited the business and confirmed it was closed.
10. For audit, appellant submitted a federal income tax return for 2018, and daily sales summaries for 2018.⁴
11. CDTFA computed a markup of 66.67 percent based on appellant's 2018 federal income tax return.⁵ Based on audits of similar businesses, CDTFA believed the markup was low for appellant's type of business. Appellant's 2018 sales records were incomplete because data was missing for some days and was thus unreliable and inadequate to support appellant's reported taxable sales.
12. Using the results of the observation tests, CDTFA estimated that two out of three people observed entering the business were customers, or 13 customers per hour. Based on appellant's operating hours of 10:00 a.m. to 10:00 p.m.,⁶ CDTFA estimated a total of 156 customers per day, seven days a week. CDTFA also estimated average sales per customer of \$41.95 based on audits of similar businesses. Therefore, CDTFA estimated average taxable sales of \$6,544 per day. CDTFA determined that appellant operated the business for 330 days during the 11-month period from February 4, 2018, through January 3, 2019, when appellant allegedly stopped operating the business,⁷ resulting in estimated taxable sales of \$2,159,520. After accounting for appellant's reported taxable sales of \$187,649, CDTFA determined unreported taxable sales of \$1,971,871.

⁴ Appellant's daily sales summaries only show the total sales amount on a given day.

⁵ Appellant reported total sales of \$186,807 and cost of goods sold of \$112,084, resulting in gross profit of \$74,723 and a markup of 66.67 percent.

⁶ CDTFA verified the hours using online reviews of appellant's business.

⁷ Despite evidence that the business continued to operate after January 3, 2019, CDTFA gave appellant the benefit of the doubt and did not include January 4, 2019, through March 31, 2019, the period for which appellant disputed ownership of the business. CDTFA determined that appellant operated for 56 days in the first quarter of 2018 (1Q18), 87 days in 2Q18, 92 days in 3Q18, 92 days in 4Q18, and 3 days in 1Q19.

13. CDTFA's notes dated December 31, 2019, indicate that Ms. Harootunian informed CDTFA that appellant's business closed around May 2019.
14. CDTFA issued appellant the November 2, 2020 NOD.
15. Appellant timely filed a petition for redetermination with CDTFA, disputing the NOD.
16. On April 7, 2022, CDTFA issued a decision ordering a reaudit to reduce the number of observed customers by approximately 30 percent (from 13 to approximately 9) and reduced the business's operating days from 330 days to 321 days,⁸ but otherwise denying the petition for redetermination.
17. CDTFA conducted a reaudit, reducing the measure of unreported taxable sales to \$1,266,481.
18. On June 7, 2022, CDTFA issued appellant a letter proposing tax of \$187,328 plus accrued interest, credits of \$67,012, payments of \$24.81, and a negligence penalty of \$12,031.59.⁹
19. Appellant filed a timely request for reconsideration of CDTFA's decision. CDTFA issued a supplemental decision ordering that the liability be redetermined in accordance with the reaudit but otherwise denying the request for reconsideration.
20. Appellant filed a timely request for reconsideration of CDTFA's supplemental decision. CDTFA issued a second supplemental decision denying the request for reconsideration of the supplemental decision.
21. Appellant filed this timely appeal.
22. On appeal, appellant provides photos from cameras in the business showing police cars, police, damage to a wall, and a crate. The camera photos are dated August 22, 2018.

⁸ To account for holidays when the business was likely to be closed, CDTFA reduced appellant's operating days from 92 days to 90 days for 3Q18, from 92 days to 86 days for 4Q18, and from 3 days to 2 days for 1Q19.

⁹ The audit liability is only for the period from February 4, 2018, through January 3, 2019.

DISCUSSION

Issue 1: Are any adjustments to the measure of unreported taxable sales warranted?

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

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may determine the amount required to be paid based on any information which is in its possession or may come into its possession. (R&TC, § 6481.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) The taxpayer must prove both: (1) the tax assessment is incorrect, and (2) the correct amount of tax. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b); *Appeal of Estate of Gillespie*, 2018-OTA-052P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, *supra*.)

Upon audit, appellant only provided minimal records upon audit, consisting of a 2018 federal income tax return and an incomplete set of daily sales summaries. Appellant did not provide any supporting documentation, such as general ledgers, sales receipts, sales reports, or purchase invoices. CDTFA also noted that appellant's markup of 66.67 percent appeared to be low for a cannabis dispensary. Thus, appellant failed to provide sufficient books and records

with which CDTFA could verify appellant's reported taxable sales using a direct audit method.¹⁰ Accordingly, CDTFA estimated the unreported taxable sales measure based on three factors: (1) an estimated average purchase amount per customer based on CDTFA's audits of similar businesses; (2) an estimated number of customers per hour based on CDTFA's observation of appellant's business; and (3) the number of hours the business operated. In circumstances such as this, where appellant fails to maintain or provide adequate books and records, an indirect audit method estimating unreported taxable sales based on these three factors is reasonable and rational. (*Appeal of AMG Care Collective, supra.*) Accordingly, the burden shifts to appellant to prove that adjustments are warranted.

Appellant argues that he closed out the business on January 3, 2019, and thus, the results of the observation tests (conducted on March 19, 2019, and March 21, 2019) were not representative of his sales. Appellant states SCOP never verified that appellant was operating the business during the observation test, or during a subsequent visit on May 8, 2019. Appellant also asserts that he was not present at the business during CDTFA's visits, he did not have any employees or helpers because he "was running his business alone," and he does not know "John," who represented himself to be a patient. Appellant argues that CDTFA assumed appellant was operating the business during the CDTFA visits without any proof.¹¹

Here, there is no dispute that appellant operated the business through January 3, 2019. Appellant's central argument is that he was no longer operating the business at the time CDTFA conducted the observation tests; and thus, the observation tests were not representative of the business. However, appellant has not offered sufficient evidence to prove he was not operating the business during the time of the observation tests. Appellant did not provide supporting documents, to show that the lease had been terminated before CDTFA's observation tests.

Although the business appeared to be closed with a "for lease" sign during CDTFA's April 12, 2019 visit, CDTFA observed that the business was still operating under appellant's dba, "The Fav," which was still posted on the door during CDTFA's May 8, 2019 visit.

¹⁰ When CDTFA is unable to verify a taxpayer's sales using a direct audit method, CDTFA may use an indirect audit approach to estimate sales from whatever information is available. (R&TC, § 6481.)

¹¹ Appellant also alleges that another individual, who has since fled the country, was conducting business during the observation tests. However, appellant has not provided any evidence in support of this allegation, and there is no evidence in the record indicating that individual was involved with the business. Thus, OTA does not address this argument further.

Furthermore, appellant first contacted CDTFA about closing out the seller's permit on May 24, 2019, more than four months after appellant allegedly walked away from the business on January 3, 2019, but just a few weeks after CDTFA issued appellant the May 6, 2019 audit engagement letter at his business address.¹² Additionally, appellant's former accountant, Ms. Harootunian, called CDTFA on May 20, 2019, and stated that appellant instructed her to prepare documents for the audit, which strongly suggests that appellant received either the audit engagement letter mailed to the business address or the copy left with "John," or both. Ms. Harootunian's knowledge of CDTFA's audit, and her statement that appellant directed her to work with CDTFA, supports a finding that appellant was likely still operating the business through May 2019.

Appellant argues that Ms. Harootunian never informed CDTFA that appellant's business closed around May 2019. Appellant submitted a declaration Ms. Harootunian signed under penalty of perjury on February 7, 2023, stating she did not make such a statement to CDTFA, and that appellant closed the business on January 3, 2019. However, CDTFA's notes dated December 31, 2019, indicate that Ms. Harootunian informed CDTFA that appellant's business closed around May 2019. The CDTFA note was created contemporaneously with the December 2019 conversation between CDTFA and Ms. Harootunian and is more reliable than Ms. Harootunian's recollection of the event over three years later. Nonetheless, OTA does not rely on either piece of evidence in its analysis.

Appellant also submitted a declaration signed under penalty of perjury stating that the business closed on January 3, 2019. At the oral hearing, appellant alleges that all his sales products were either confiscated by the police or stolen, so he just "walked away" because he had nothing to sell. In support, appellant provides photos from cameras in the business showing police cars, police, damage to a wall, and a crate. The camera photos are dated August 22, 2018. Based on the date of the photos, OTA finds appellant's argument to be unpersuasive and unsupported.

¹² A seller's permit shall be held only by persons actively engaging in or conducting business as a seller of tangible personal property, and any person not actively engaged in or conducting such business must surrender the seller's permit to CDTFA for cancellation. (R&TC, § 6072; Cal. Code Regs., tit. 18, § 1699(f).)

Here, the record shows that appellant made conflicting statements during CDTFA's appeals process and upon appeal at OTA. For instance, appellant previously asserted he was a silent partner of the business, and that his business partner might have been operating the business without his consent during the time of CDTFA's visits in 2019.¹³ Appellant now argues that he ran the business by himself, and he did not have any employees or helpers to run the business. Because of appellant's conflicting statements about who was operating the business, and the lack of evidence showing appellant stopped operating the business on January 3, 2019, OTA finds appellant's declaration to be unreliable. Moreover, appellant does not refute that the business continued to operate even after the photos establish a police presence at the business on August 22, 2018. Appellant could not present any receipts for confiscated property or any police reports showing theft of business property.

Appellant also submitted bank statements for January 3, 2018, through May 20, 2019.¹⁴ Appellant alleges that those bank statements show CDTFA made an error because he was not making as much money as the audit measure suggested. CDTFA asserts that the bank statements do not appear to establish appellant's sales during the liability period. OTA notes that the bank statements do not appear to be for business purposes as there is no regularity of deposits; for example, daily, end-of-day deposits, as would be expected with a business bank account. The bank statements also do not show any purchases for products sold by the business. Moreover, OTA has no way to know whether appellant had any other checking or savings accounts where he was depositing money or whether appellant maintained cash and only deposited it when needed for personal expenditures. Thus, OTA finds that the bank statements do not show error in CDTFA's determination.

Furthermore, CDTFA made additional adjustments to more accurately estimate appellant's unreported taxable sales based on the available information. CDTFA recognized that the two one-hour observation test periods (both conducted from 1:35 p.m. to 2:35 p.m.) might be unrepresentative of appellant's business hours, and that not every person entering the business made a purchase. Thus, CDTFA reduced the estimated number of customers per hour from the 20 customers observed to approximately 9 customers per hour. To estimate appellant's operating days during the liability period, CDTFA did not include any days from January 4, 2019, to

¹³ Appellant has not provided any explanation for operating the business as a sole proprietorship under his own name if he was simply a silent partner.

¹⁴ A review of the bank statements show that appellant continued to make similar cash deposits in this account well after he claimed he ceased operating the business.

March 31, 2019. CDTFA further reduced the number of operating days during the liability period, from 330 days to 321 days, to account for holidays when the business was likely to be closed.

Based on the foregoing, OTA finds it likely that appellant continued to operate the business during the observation tests. Even if OTA were to accept that appellant did not own the business during the observation tests, appellant has not shown how the immediate successor to appellant's business, that operated the same type of business, at the same location, and for the same hours, was not representative of appellant's business during the liability period. In the absence of books and records supporting appellant's reported taxable sales, OTA finds the results of the observation tests to be the best source of information for estimating appellant's tax liability during the liability period.

Appellant has only submitted arguments asserting that he was not operating the business after January 3, 2019; that appellant had no employees, and the business was closed whenever he was not present; and that the business operated fewer hours or days than estimated by CDTFA. Appellant fails to submit evidence in support of these assertions. Appellant has failed to establish that CDTFA's determination is incorrect. Accordingly, OTA finds no further adjustments are warranted to the unreported taxable sales measure.

Issue 2: Did CDTFA properly impose the negligence penalty?

If any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law, a penalty of 10 percent of the amount of the determination must be added. (R&TC, § 6484.) Negligence is generally defined as a failure to act as a reasonable and prudent person would have acted under similar circumstances. (*Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d.310, 317.)

A taxpayer must maintain and make available for examination, on request, all records necessary to determine the correct tax liability and all records necessary for the proper completion of the sales and use tax return. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (A) normal books of account ordinarily managed by the average prudent businessperson engaged in the activity in question; (B) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of accounts; and (C) schedules or working papers used in connection with the preparation of tax returns. All records required to be retained under this regulation must

be preserved for a period of at least four years. (Cal. Code Regs., tit. 18, § 1698(i).) Failure to maintain and keep complete and accurate records is evidence of negligence and may result in imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 1698(k).)

Generally, a penalty for negligence should not be added to determinations associated with the first audit of a taxpayer. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Nonetheless, a negligence penalty should be upheld in a first audit if there is evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that the bookkeeping and reporting practices were sufficiently compliant with the requirements of the Sales and Use Tax Law. (*Ibid.*)

Here, CDTFA imposed the negligence penalty for the following reasons: (1) appellant provided inadequate books or records upon audit; and (2) appellant substantially understated its taxable sales for the liability period (as of the reaudit the taxable measure is \$1,266,481 with an error rate of approximately 674 percent).

On appeal, appellant argues that his property was either stolen by thieves or seized by the police. Appellant argues that the police ignored appellant's requests for the return of any seized property.

Here, OTA finds appellant's failure to maintain and make available complete and accurate records is evidence of negligence. (Cal. Code Regs., tit. 18, § 1698(k).) Appellant provided nothing in response to CDTFA's two letters and formal demand requesting books and records for audit. Appellant also has not provided evidence showing that the police seized his books and records (such as a receipt or inventory of seized property) or that his property was stolen (such as a police report). Appellant submitted a screenshot purporting to show a police raid of the business on August 22, 2018, but the screenshot fails to establish that the police seized any property and failed to return it. Appellant also has not explained why he did not provide any books and records created after August 22, 2018. Moreover, appellant has not provided any evidence that he attempted to recover any seized property from the police. Furthermore, appellant underreported taxable sales by 675 percent ($\$1,266,481 \div \$187,649$), which strongly suggests that appellant knew taxable sales were unreported.

While this was appellant's first audit, OTA finds that appellant's failure to maintain complete and accurate records, together with appellant's substantial underreporting, cannot be

attributed to a good faith and reasonable belief that his bookkeeping and reporting practices were in substantial compliance with the Sales and Use Tax Law.

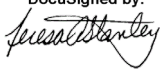
Accordingly, OTA concludes that appellant was negligent, and CDTFA properly imposed the negligence penalty.

HOLDINGS

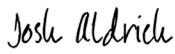
1. No further adjustments to the taxable measure are warranted.
2. The negligence penalty was properly imposed.

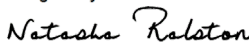
DISPOSITION

OTA sustains CDTFA's action.

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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:

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Josh Aldrich
Administrative Law Judge

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Natasha Ralston
Administrative Law Judge

Date Issued: 5/14/2025