

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petitions for)
 4 Redetermination Under the Cigarette and)
 Tobacco Products Tax Law of:)
 5 LOH SUN INTERNATIONAL, INC., KENT LA,) Account Number: CR ET 02-002372
 6 NANCY LA, AND JOHN LA) Case ID's 480987, 480989, 506428
 7 Petitioner) San Gabriel, Los Angeles County

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 9 Type of Business: Distribution of cigarettes
 10 Liability periods: 01/01/01 – 06/30/03 (480987)
 07/01/03 – 07/31/03 (480989 and 506428)

<u>Item</u>	<u>Disputed Amount</u>		
12 Unreported distributions of cigarettes	47,115,800 sticks (480987)		
	1,382,000 sticks (480989)		
	3,060,000 sticks (506428)		
14 Fraud penalties	\$512,385 (480987)		
	\$ 15,029 (480989)		
	\$ 33,278 (506428)		
	<u>480987</u>	<u>480989</u>	<u>506428</u>
17 Tax as determined and protested	\$2,049,540.00	\$ 60,117.00	\$133,110.00
Interest through 05/25/12	1,668,868.31	43,985.50	84,257.21
18 Fraud penalty	<u>512,385.00</u>	<u>15,029.25</u>	<u>33,277.50</u>
19 Total tax, interest, and penalty	\$4,230,793.31	\$119,131.75	\$250,644.71
Payments	- 134,345.62	00.00	- 73,654.38
20 Balance Due	<u>\$4,096,447.69</u>	<u>\$119,131.75</u>	<u>\$176,990.33</u>
21 Monthly interest beginning 05/26/12	<u>\$ 11,171.97</u>	<u>\$ 350.68</u>	<u>\$ 346.82</u>

22 This matter was scheduled for Board hearing in June 2011 and October 2011, but was
 23 postponed both times at petitioner's request for medical reasons. It was rescheduled for hearing on
 24 February 1, 2012, but was postponed to allow time to properly notice all parties 75 days in advance.

25 UNRESOLVED ISSUES

26 **Issue 1:** Whether Loh Sun International, Inc., Kent La, Nancy La, and John La operated as a
 27 partnership liable for unreported distributions of cigarettes in California. We conclude that they did
 28 operate as a partnership liable for the unreported distributions.

1 Loh Sun International, Inc. (Loh Sun) operated as an importer of Chinese-manufactured
2 cigarettes and as a licensed wholesale distributor of cigarettes under Cigarette Distributor's License
3 CR ET 002-000922 from December 1, 1988, through November 7, 2007. Loh Sun's corporate officers
4 are Kent La (president), Nancy La (secretary), and John La (vice president). Kent La and Nancy La
5 are married, and John La is their son. The Investigations and Special Operations Division (ISOD)
6 found that, separate from the sales activities Loh Sun performed on its own behalf, Loh Sun and its
7 corporate officers constituted a partnership operating as an unlicensed distributor of cigarettes and
8 making sales of untaxed cigarettes in California. ISOD thus concluded that the partnership is liable for
9 the taxes, interest, and penalties at issue, with the partners jointly and severally liable.

10 Based on documents discovered when ISOD and special agents with the Bureau of Alcohol,
11 Tobacco, and Firearms (ATF) executed a search warrant on a customer of Loh Sun, ISOD determined
12 that Loh Sun did not include the cigarette excise tax due on distributions of cigarettes to that customer.
13 ISOD noted that the majority of the invoices to the customer were generic invoices or were
14 handwritten on pieces of lined paper rather than on Loh Sun's standard invoices. Many of the seized
15 invoices specified that payment for the purchase was to be deposited into the personal bank accounts of
16 Kent La, Nancy La, or John La rather than Loh Sun's corporate bank account. ISOD also became
17 aware of various other shipments of unstamped cigarettes to Loh Sun's business address and, along
18 with investigators from the California Highway Patrol, it executed a search warrant in July 2003 on
19 Loh Sun's business location and the corporate officers' residence, during which ISOD discovered
20 unstamped cigarettes and counterfeit California tax stamps located in the basement of the Loh Sun
21 business location. Other evidence as described in the D&R supports that there was a scheme to avoid
22 payment of tax. During the search of the corporate officers' residence, ISOD found rental agreements
23 for two storage units, one of which was rented to John Lim, with Nancy La named as a person with
24 access to it. Although ISOD found unstamped counterfeit Marlboro- and Newport-brand cigarettes in
25 both storage units, it concluded that only the unit Nancy La could access was controlled by the
26 partnership. That unit held approximately 3,060,000 sticks of cigarettes.

27 In September 2004, the Los Angeles County District Attorney's office filed criminal
28 complaints against Kent La, Nancy La, and John La. Nancy La pled no contest to all charges against

1 her. The charges against John La were dropped as part of Nancy La's agreement to plead no contest.
2 Kent La was out of the country at the time the search warrant was executed and was a fugitive at the
3 time the D&R was issued.

4 During the search of Loh Sun's business premises, ISOD found that the business of Loh Sun
5 was conducted on the first and second floors of the business location, but that an inventory of
6 counterfeit cigarettes was located in the basement of the building, separate from any legitimate
7 inventory and hidden from inspections. ISOD found that purchases of this counterfeit inventory did
8 not flow through Loh Sun's books, that payment for the purchases was made from accounts other than
9 Loh Sun's, and that many customers were instructed to pay for sales of this inventory directly to
10 personal bank accounts, rather than making payment to Loh Sun. ISOD concluded that Loh Sun was a
11 partner in the partnership because some of the illegal activity occurred in the basement of Loh Sun's
12 business location.

13 Petitioner contends that no partnership existed and that, even if so, there is no evidence that the
14 storage unit located in San Gabriel belonged to the partnership since the rental agreement only allowed
15 Nancy La access to the storage unit. John La contends he had no official duties for Loh Sun and was
16 not a partner in any conspiracy to sell illegal or untaxed cigarette products. He asserts that ISOD is
17 attempting to attribute to him the illegal acts of his mother. John La explains the funds flowing in and
18 out of his bank account by the assertion that they either relate to a day trading stock market business he
19 operated or represent personal loans from his mother to cover margin calls on some of his investments.
20 John La has also argued that his mother was secretly depositing funds from the cigarette distribution
21 business into his account.

22 Nancy La has admitted to selling unstamped Marlboro-brand cigarettes to customers in
23 California, and she used Loh Sun's business location to conduct those activities. Considering the
24 nature of her position in Loh Sun, the corporation must be regarded as having knowledge of her
25 activities on its premises, and having consented to them. We therefore conclude that Nancy La and
26 Loh Sun were in a partnership that operated as an unlicensed distributor of cigarettes. The evidence
27 shows that Kent La used his personal bank account to hide proceeds obtained from the partnership's
28

1 unreported distribution of cigarettes and his involvement in the purchase and importation of counterfeit
2 domestic-branded cigarettes. We therefore find that Kent La was also part of the partnership.

3 Regarding John La, we note that payments for the counterfeit and unstamped cigarettes were
4 sometimes made to John La's personal bank account, and at least one wire transfer for \$180,000 was
5 made from John La's personal bank account to a Hong Kong tobacco company from whom the
6 partnership made purchases of counterfeit and unstamped cigarettes. Accordingly, we conclude that
7 John La was also a partner in the scheme, and that one of his roles in the partnership was to receive
8 proceeds from unreported distributions of cigarettes and to channel those funds to others. We find
9 John La's contentions that all relevant acts were perpetrated solely by Nancy La and that the flow of
10 money through his account was due to loans and secret deposits made by Nancy La to be unsupported
11 by the evidence and without merit.

12 In sum, we find that Loh Sun, Kent La, Nancy La, and John La were partners in a partnership
13 that operated as an unlicensed distributor of cigarettes in California and that they are jointly and
14 severally liable for the tax due on the untaxed tobacco products distributed by the partnership in
15 California. We find further that the cigarettes seized during the execution of the search warrant were
16 owned by the partnership, and that the partnership distributed these cigarettes since distribution
17 includes the use or consumption of untaxed cigarettes in this state, which here includes the
18 partnership's storage of the cigarettes. (Rev. & Tax. Code, § 30009 (the keeping or retention of
19 cigarettes by a *licensed* distributor for the purpose of sale is excluded from the definition of "storage or
20 use," but this exclusion is not applicable here because the partnership was not licensed).)

21 Regarding the cigarettes found in the storage unit, we note that they were the same type of
22 illegal cigarettes that the partnership was importing and selling through the basement of Loh Sun's
23 business location, which links the cigarettes in the storage unit with the rest of the partnership's
24 operation. In addition, while Kent La and John La were not identified as having direct access to the
25 storage unit, Nancy La did have access and could have removed inventory at any time. We find that
26 ISOD properly regarded the inventory in that storage unit as belonging to the partnership.

27 **Issue 2:** Whether adjustments are warranted to the amounts of unreported distributions. We
28 find no adjustments are warranted.

1 To establish the deficiency for January 1, 2001, through June 30, 2003, ISOD used records
2 seized during the various searches, including a partial general ledger, handwritten daily sales journals,
3 sales invoices, shipping documents, import and customs documents, purchase invoices, bank
4 statements and deposit slips, generic sales invoices, and inventory sheets for cigarettes. ISOD used
5 these records to make adjustments for the tax value of stamps purchased by Loh Sun and for exempt
6 sales. ISOD also made adjustments for duplication and scheduling errors. For the month of July 2003,
7 ISOD established unreported distributions of 1,382,000 cigarette sticks based on generic sales invoices
8 for that month and the number of cigarettes seized from Loh Sun's business location on July 24, 2003
9 (case ID 480989), and unreported distributions of 3,060,000 cigarette sticks based on the cigarettes
10 found in the storage unit controlled by the partnership (case ID 506428).

11 Petitioner contends that the liabilities are overstated because: 1) no allowance was made for
12 sales by Loh Sun, as the original importer, to 19 licensed distributors; 2) no credit was given for
13 \$247,000 in cash seized by the ATF during execution of the search warrant; 3) the civil liabilities
14 exceed the amount of the criminal restitution order issued against Nancy La; 4) two transactions are
15 duplicated; 5) there are no copies of invoices for certain transactions, with some items on individual
16 invoices scheduled twice; 6) the audits include transactions that are purchases, not sales; 7) there
17 should be a reduction for sales of cigarettes with legitimate tax stamps; and 8) an allowance of
18 \$204,450 should be made for cigarettes returned by one customer.

19 We find that ISOD utilized the information available to it and allowed exempt distributions of
20 cigarettes that were documented (ISOD found that only two of the 19 customers listed by petitioner as
21 licensed distributors were in fact licensed distributors). We find no allowance can be made for funds
22 seized by the ATF unless the ATF releases those funds to the Board for application toward the
23 determined liabilities, which it has not done. There is no requirement that a criminal restitution order
24 reflect the amount of damages that might be recoverable in a civil action, and we find that order is
25 irrelevant here, except to the extent payments made per the order are applied to the liability. We find
26 that the duplicated transactions identified by petitioner have already been deleted from the deficiency.
27 Regarding the unavailability of invoices and characterization of purchases as sales, we find that ISOD
28 properly used the generic sales invoices and the number of unstamped cigarettes seized as the basis for

1 determining the number of under-reported sticks, and that petitioner has offered no evidence to support
2 further adjustments. We find further that no adjustment is warranted for sales of cigarettes with
3 legitimate tax stamps because the audited amounts are based on the generic invoices which represent
4 sales of cigarettes *without* legitimate tax stamps. Nor is any adjustment warranted for returned
5 cigarettes since the subject return occurred after the periods at issue here. In sum, we find no
6 adjustments are warranted.

7 **Issue 3:** Whether ISOD has supported fraud by clear and convincing evidence. We find that it
8 has.¹

9 ISOD imposed fraud penalties because it found that the partnership intended to commit fraud,
10 as evidenced by Nancy La's admission that she sold unstamped cigarettes and applied counterfeit
11 stamps, the fact that she pled guilty to several criminal charges, the seizure of significant amounts of
12 cigarettes with no stamps or with counterfeit tax stamps, the various documents showing that petitioner
13 intentionally concealed purchases of counterfeit domestic-brand cigarettes, the double set of records
14 maintained by petitioner, the fact that customers were required to make payments through deposits into
15 the personal bank accounts of Kent, Nancy, and John La, and the substantial understatement. ISOD
16 also considered that the partners were knowledgeable regarding the applicable laws and that Loh Sun
17 had held a Cigarette Distributor's License since December 1988 and had been audited twice before.

18 Petitioner contends that the fraud penalties are not supported by clear and convincing evidence.
19 Petitioner specifically disputes the fraud penalty applied with respect to the cigarettes seized at the
20 storage unit, arguing that the tax related to those cigarettes was based on the storage of cigarettes at an
21 unlicensed facility rather than on the sale and distribution of cigarettes with no stamps or with
22 counterfeit stamps. Also, petitioner states ISOD has not established that any of the partners had
23 knowledge of the provision requiring permits not only for selling locations but also for strictly storage
24 locations.

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27 ¹ Since the partnership did not file returns, in the absence of fraud the applicable statute of limitations for issuing a Notice
28 of Determination is eight years from the date the return or report was due. (Rev. & Tax. Code, § 30207.) Since each
determination here was issued within that period (the determination for January 1, 2001, through June 30, 2003, was issued
in January 2009 and the two determinations for the month of July 2003 were issued in July 2009), the determinations were
timely for all assessed liabilities, without regard to whether the fraud penalties are upheld.

