

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Administrative Hearing on)
 4 the Jeopardy Determination Under the Cigarette)
 and Tobacco Products Tax Law of:)
 5 SAID T. SAAD, dba TNB Snacks) Account Number: CP ET 50-003570
 6) Case ID 273001
 7 Applicant) Alta Loma, San Bernardino County

8 Type of Business: Unlicensed tobacco products distributor

9 Audit Period: 1/1/99 – 3/31/03

10 <u>Items</u>	<u>Amounts</u>	
11 Taxable measure understated (wholesale cost)	\$5,201,241	
12 25 percent penalty for fraud	\$ 673,490	
10 percent penalty for failure to file a return	\$ 269,396	
13 10 percent penalty for failure to timely pay	\$ 268,963	
	<u>Tax</u>	<u>Penalties</u>
14 As determined	\$2,693,961.04	\$942,886.42
15 Adjustment: Finality penalty		+268,963.16
16 Protested	<u>\$2,693,961.04</u>	<u>\$1,211,849.58</u>
17 Proposed tax redetermination	\$2,693,961.04	
Interest through 7/25/09	1,778,611.19	
18 Penalties	942,886.42	
Finality penalty	<u>268,963.16</u>	
19 Total tax, interest, and penalties	\$5,684,421.81	
20 Payments	- 4,360.29	
Balance due	<u>\$5,680,061.52</u>	
21 Monthly interest beginning 7/26/09	<u>\$17,930.67</u>	

22 Applicant did not appear at the scheduled appeals conference even though the Notice of
 23 Appeals Conference was mailed to his address of record and was not returned as undeliverable. After
 24 the conference, which was held as scheduled, we wrote applicant to offer him the opportunity to
 25 provide any documentation and contentions he wanted us to consider, but we received no response.
 26 This matter was scheduled for Board hearing on October 4, 2007, but was postponed because
 27 applicant's representative could not attend the meeting and needed more time to work with the courts.
 28 The matter was then scheduled for February 27, 2008, but was again postponed because petitioner

1 could not attend the meeting since he was incarcerated. The matter was rescheduled for February 26,
2 2009, but was postponed because taxpayer's representative needed time to prepare for the oral hearing.

3 UNRESOLVED ISSUES

4 **Issue 1:** Whether applicant is liable for the determined tax on purchases and distributions of
5 untaxed tobacco products. We find that applicant is liable and no adjustment is warranted.

6 Applicant obtained a seller's permit, effective August 31, 1996, to sell new baby clothes at
7 swap meets in Southern California. On November 9, 1998, the Excise Taxes and Fees Division of the
8 Property and Special Taxes Department (Department) investigated applicant and determined that in
9 addition to non-grocery merchandise and cigarettes, he was selling at wholesale tobacco products
10 without the proper tobacco products license. By letter dated November 13, 1998, the Department
11 informed applicant that wholesalers and distributors of cigarettes and tobacco products are required to
12 obtain an excise tax license. In response, applicant stated the he purchased inventory from in-state
13 suppliers. On November 23, 1998, the Department issued applicant a tobacco products wholesaler's
14 license.

15 Subsequently, the Department determined from surveillance of applicant's operations that he
16 was receiving numerous deliveries of tobacco products from out-of-state vendors. On March 21, 2003,
17 the Department served a search warrant on applicant and seized his business records that included
18 purchase records showing untaxed purchases of tobacco products from out-of-state suppliers Quality
19 Fresh Cigars (Michigan), Harold Levinson, Inc. (New York), and House of Oxford (New York). Since
20 the records seized from applicant were incomplete, the Department also subpoenaed records including
21 sales summaries, invoices, payment records, money order remittances, bills of lading, and delivery
22 receipts from the out-of state vendors. The Department also obtained delivery records from ABF
23 Freight and United Parcel Service, as well as income tax returns from the Internal Revenue Service and
24 California Franchise Tax Board.

25 Based on these records, the Department found that from January 1, 1999, through March 31,
26 2003, applicant operated as an unlicensed tobacco products distributor purchasing untaxed tobacco
27 products from out-of-state vendors who were not licensed in California, and subsequently distributing
28 those products to customers in the Los Angeles and San Gabriel Valley areas in California, using either

1 a white truck registered in applicant's name or a rented truck. The Department issued applicant a
2 tobacco products distributor's license with a start date of January 1, 1999, and a close out date of
3 March 31, 2003, for the purpose of issuing the jeopardy determination at issue. The Department
4 concluded that applicant had made distributions of tobacco products because they were no longer in his
5 possession. (Rev. & Tax. Code, §§ 30008, subd. (b), 30009.) Based on the records seized, the
6 Department concluded that applicant purchased and distributed untaxed tobacco products in the
7 amount of \$5,201,241, and assessed tax on this amount.

8 According to the Department, applicant admitted during a post-search interview that he
9 purchased tobacco products from the out-of-state vendors to whom he placed direct orders for the
10 tobacco products and used money orders to pay for the purchases. Money order companies (Travelers'
11 Express, Western Union, and Continental Express) verified that the money orders applicant remitted to
12 Quality Fresh Cigars were purchased from California agents, some of whom were his customers.
13 Harold Levinson Associates and House of Oxford representatives also indicated that applicant remitted
14 money orders in payment of the tobacco purchases. Applicant stated that he discarded the out-of-state
15 purchase records and ripped shipping labels off the packages prior to delivering the products to his
16 customers, in accordance with instructions from his Los Angeles customers.

17 Applicant also claimed during the interview that his major suppliers were L.A. International
18 and L.A. Direct Source, in-state wholesalers located in downtown Los Angeles, and that seized sales
19 invoice booklets recorded in-state purchases of tobacco products from these suppliers. However, no
20 additional purchase information relating to applicant or his business name (TNB Snacks) were found
21 during a supplemental search warrant served on L.A. International on April 21, 2004. Additionally,
22 seized purchase invoices reveal that in year 2002, applicant purchased \$19,030.29 in tobacco products
23 from known in-state sources but, per sales invoices, made sales of tobacco products of \$556,140.56.
24 Examination of the sales invoices and bank deposits revealed that identified customers were all
25 California-based businesses known to be selling tobacco products, such as liquor stores, markets, gas
26 stations, and smoke shops. The Department found no evidence that applicant was selling to customers
27 outside California.

1 Based on the foregoing, we conclude that applicant is liable for the tobacco products tax, and
2 that the determined liability is not excessive.

3 **Issue 2:** Whether there is clear and convincing evidence of fraud. We conclude that there is
4 clear and convincing evidence of fraud, and that the fraud penalty has been properly imposed.

5 Applicant has not provided a specific challenge to the fraud penalty. Applicant has been in the
6 business of selling tangible personal property in California and has had a seller's permit with the Board
7 since 1996, demonstrating that he has some knowledge of the requirement to file returns. As a seller's
8 permit holder, applicant also should have received the informational bulletins sent to permit holders
9 with their returns that regularly include information about licensing requirements. More importantly,
10 before the audit period, in November 1998, the Department specifically informed applicant that he
11 needed a tobacco products distributor's license if he were importing tobacco products into this state for
12 sale. Applicant responded that he purchased tobacco products from in-state suppliers only and
13 therefore was issued a tobacco products wholesalers license, not a distributor's license. Despite this
14 knowledge, applicant thereafter made substantial untaxed purchases of tobacco products from
15 unlicensed out-of-state suppliers. It is notable that the amount of applicant's purchases increased
16 quickly and dramatically during the audit period: \$198,856 for July 1, 1999, through June 30, 2000,
17 \$534,726 for the next twelve months, \$1,961,686 for the next twelve months, and \$2,425,202 for the
18 next nine months.. We find that applicant knew or should have known that the tobacco products were
19 untaxed because he purchased from unlicensed vendors and the vendor invoices noted no separate
20 charge for the state excise tax.

21 Applicant's actions during the audit period establish that he acted intentionally to conceal the
22 untaxed purchases of tobacco products from out-of-state suppliers and the subsequent distribution of
23 the products in California. Applicant admitted that he destroyed and discarded purchase records for his
24 out-of-state purchases, that he intentionally ripped shipping labels from the out-of-state deliveries, and
25 that he conducted his business on a mostly cash basis (thereby preventing the formation of a clear
26 paper trail between purchase and distribution and making it impossible to determine the true extent of
27 his distributions of tobacco products). Despite purchasing \$5,201,241 of tobacco purchases for
28 distribution in a little over three years, he wholly failed to report any distributions or pay any amount

1 of tax. The complete failure to report anything at all is certainly well beyond negligent error and
2 instead is a very strong indication of fraud. Applicant has not provided any supportable explanation
3 for his failure to report, or any evidence to show that the measure should have been different from that
4 determined by the Department.

5 Finally, we note that a criminal complaint was filed against applicant on August 5, 2005, by the
6 San Bernardino District Attorney's office for felony tax evasion (Rev. & Tax. Code § 30480),
7 distributing tobacco products without a license (Rev. & Tax. Code, § 30140), failure to file a tobacco
8 products tax return (Rev. & Tax. Code, § 30183), and money laundering (Penal Code, § 186.10, subd.
9 (a)(1)). At the April 26, 2007 pre-trial hearing, applicant pled no contest to the charges for felony tax
10 evasion, distributing tobacco products without a license, and failure to file a tobacco products tax
11 return, and the charge for felony money laundering was dropped.¹ The legal effect of a nolo
12 contendere (or no contest) plea to a felony is the same as a guilty plea. (Penal Code, § 1016, subd.
13 (3).) Thus, applicant's plea is admissible in this appeal as an admission. While that admission is not
14 *conclusive* evidence of his fraud, it does constitute evidence against him, and the party may contest the
15 truth of the matters admitted by his plea and explain why he entered the plea. (*Rusheen v. Drews*
16 (2002) 99 Cal.App.4th 279, 284.) In other words, applicant has admitted his fraud, and has not
17 explained why that admission should be disregarded. In any event, even without this admission, we
18 find that there is clear and convincing evidence of applicant's fraud, and conclude that the fraud
19 penalty was properly imposed.

20 **Issue 3:** Whether applicant has established reasonable cause to abate the 10-percent penalty for
21 failure to file returns. We recommend no relief.

22 A 10-percent failure-to-file penalty was added to the determination because applicant did not
23 file any returns for the purchases made during the audit period. (Rev. & Tax. Code, § 30221.)
24 Section 30282 provides for relief of a failure-to-file penalty if the Board finds that a person's failure to
25 file returns was due to reasonable cause and circumstances beyond the person's control, and occurred

26
27 ¹ On June 20, 2007, the San Bernardino Superior Court ordered applicant to pay restitution to the Board in the amount of
28 \$803,000, and sentenced him to three years in jail for each felony charge, to be served concurrently. The restitution ordered
by the court remains unpaid.

1 notwithstanding the exercise of ordinary care and in the absence of willful neglect. A person seeking
2 relief must submit a statement under penalty of perjury setting forth the facts on which he or she bases
3 the claim for relief. (Rev. & Tax. Code, § 30282, subd. (b).) In our letter to applicant after his failure
4 to appear at the appeals conference, we explained the requirements for requesting relief of this penalty
5 and provided him a copy of the appropriate form, but he has not requested relief, nor has he provided
6 any explanation, reasonable or otherwise, for his failure to file returns for the periods at issue. We
7 therefore have no basis to consider recommending relief of the penalty.

8 **Issue 4:** Whether relief from the penalty for failure to timely pay the determination (finality
9 penalty) is warranted. We recommend that relief from this penalty be denied.

10 A 10-percent delinquency penalty was added to the jeopardy determination because applicant
11 failed to pay or petition the determination within 10 days of service of the determination. (Rev. & Tax.
12 Code, § 30241.) Section 30282 provides for relief of a delinquency penalty if the Board finds that a
13 person's failure to timely pay or petition the determination was due to reasonable cause and
14 circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care
15 and in the absence of willful neglect. A person seeking relief must submit a statement under penalty of
16 perjury setting forth the facts on which he or she bases the claim for relief. (Rev. & Tax. Code,
17 § 30282, subd. (b).) In our letter to applicant after his failure to appear at the appeals conference, we
18 also discussed the requirements for relief of this penalty, but he has not submitted a request for relief.
19 We note that based on a letter dated August 11, 2004, from attorney Alan G. Novodor, it appears that
20 applicant was out of the country and his attorney was out of state when the Notice of Determination in
21 this matter was issued, but nevertheless, no specific explanation has been provided to explain how and
22 why these circumstances might have led to applicant's failure to timely pay or petition the
23 determination. We therefore have no basis to consider recommending relief of the penalty.

24 **OTHER DEVELOPMENTS**

25 None.

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27 Summary prepared by Rey Obligacion, Business Taxes Specialist III
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EVIDENCE OF FRAUD RELIED ON BY DEPARTMENT

1.	Substantial deficiency, which cannot be explained as due to negligence or honest mistake.	Yes
2.	More than one set of records.	No
3.	Falsified records.	Yes ²
4.	Substantial discrepancies between recorded and reported amounts for which there is no valid explanation.	Yes ³
5.	Seller's permit and tobacco products wholesaler's license held by applicant for prior periods indicating that applicant was knowledgeable about the requirements of law.	Yes
6.	Tax properly charged to customers, evidencing knowledge of the requirements of the law, but not reported.	No
7.	Transfers of amounts of unpaid tax from the tax accrual account to another income account.	No
8.	Consistent substantial underreporting.	Yes
9.	No contest pleas to criminal fraud charges.	Yes.

² We consider applicant's discarding of his out-of-state purchase records and the removal of shipping labels from boxes to hide that the deliveries originated from out-of-state vendors the equivalent of falsifying records.

³ Applicant reported no amounts, but he purchased an average of \$266,000 of tobacco products per month while depositing only \$7,000 per month into his bank account. Applicant also paid his vendors in cash and money orders and his customers also paid him in cash and money order, thereby attempting to make it difficult or impossible to determine the revenue he was generating from the distribution of tobacco products.