

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petitions for)
Redetermination Under the Cigarette and)
Tobacco Products Tax Law Of:)
)
LOH SUN INTERNATIONAL, INC.,)
KENT LA, NANCY LA, AND JOHN LA)
)
Petitioner)
_____)

Account Number CR STF 02-002372
Case ID's 480987, 480989, 506428
Oral hearing date: February 28, 2013

Representing the Parties:

For Petitioner: John La, Partner
Nancy La, Partner
For Sales and Use Tax Department: Pamela Mash, Tax Counsel
For Appeals Division: Jeffrey G. Angeja, Tax Counsel IV

LEGAL ISSUE 1

Whether Loh Sun International, Inc., Kent La, Nancy La, and John La operated as a partnership liable for unreported distributions of cigarettes in California.

FINDINGS OF FACT AND RELEVANT CONTENTIONS

Loh Sun International, Inc. (Loh Sun) operated as an importer of Chinese-manufactured cigarettes and as a licensed wholesale distributor of cigarettes under Cigarette Distributor's License CR ET 02-000922 from December 1, 1988, through November 7, 2007. Loh Sun's corporate officers are Kent La (president), Nancy La (secretary), and John La (vice-president). Kent La and Nancy La are married, and John La is their son. The Investigations and Special Operations Division (ISOD) found that, separate from the sales activities Loh Sun performed on its own behalf, Loh Sun and its corporate officers constituted a partnership operating as an unlicensed distributor of cigarettes and making sales of untaxed cigarettes in California. ISOD thus concluded that the partnership is liable for the taxes, interest, and penalties at issue, with the partners jointly and severally liable.

1 Based on documents discovered when ISOD and special agents with the Bureau of Alcohol,
2 Tobacco, and Firearms (ATF) executed a search warrant on a customer of Loh Sun, ISOD determined
3 that Loh Sun did not include the cigarette excise tax due on distributions of cigarettes to that customer.
4 ISOD noted that the majority of the invoices to the customer were generic invoices or were
5 handwritten on pieces of lined paper rather than on Loh Sun's standard invoices. Many of the seized
6 invoices specified that payment for the purchase was to be deposited into the personal bank accounts of
7 Kent La, Nancy La, or John La rather than Loh Sun's corporate bank account. ISOD also became
8 aware of various other shipments of unstamped cigarettes to Loh Sun's business address. In
9 cooperation with ATF and investigators from the California Highway Patrol, a search warrant was
10 executed on Loh Sun's business location and the corporate officers' residence, during which ISOD
11 discovered unstamped cigarettes and counterfeit California tax stamps located in the basement of the
12 Loh Sun business location. During the search ISOD found rental agreements for two storage units, one
13 of which was rented to John Lim (an employee of Loh Sun), with Nancy La named as a person with
14 access to it.¹ ISOD found unstamped counterfeit cigarettes in both storage units, but it concluded that
15 the partnership controlled only the storage unit to which Nancy La had access. In addition, during its
16 investigation ISOD interviewed Nancy La, and she admitted that she sold unstamped cigarettes and
17 that she affixed counterfeit stamps on cigarettes that she sold.

18 During the search of Loh Sun's business premises, ISOD found that the business of Loh Sun
19 was conducted on the first and second floors of the business location, but that an inventory of
20 counterfeit cigarettes was located in the basement of the building, separate from any legitimate
21 inventory and hidden from inspections. ISOD found that purchases of this counterfeit inventory did
22 not flow through Loh Sun's books, that payment for the purchases was made from accounts other than
23 Loh Sun's, and that many customers were instructed to pay for sales of this inventory directly to
24 personal bank accounts, rather than making payment to Loh Sun. ISOD concluded that Loh Sun was a
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27 ¹ The second storage unit was rented to Mr. Yopie Sioeng, the son-in-law of Kent La and Nancy La, and a separate
28 determination has been issued in connection with the distribution of the untaxed cigarettes found in the second storage unit.
That determination is not at issue in these appeals.

1 partner in the partnership because some of the illegal activity occurred in the basement of Loh Sun's
2 business location.

3 In September 2004, the Los Angeles County District Attorney's office filed criminal
4 complaints against Kent La, Nancy La, and John La. Nancy La pled no contest to all charges against
5 her. The charges against John La were dropped as part of Nancy La's agreement to plead no contest.²

6 In 2009, after the conclusion of the criminal proceedings, ISOD issued three Notices of
7 Determination (NOD's) to the partnership. ISOD issued the first NOD on January 30, 2009, for the
8 period January 1, 2001, through June 30, 2003, for \$2,049,540 in tax, plus applicable interest and a 25-
9 percent fraud penalty of \$512,385, based on ISOD's conclusion that the partnership failed to report the
10 distribution of cigarettes measured by 47,115,800 sticks. Also on January 30, 2009, ISOD issued a
11 second NOD to the partnership for the period July 1, 2003, to July 31, 2003, for \$60,117 in tax, plus
12 applicable interest and a 25-percent fraud penalty of \$15,029.25, based on ISOD's conclusion that the
13 partnership failed to report the distribution of cigarettes measured by 1,382,000 sticks. Finally, on
14 July 13, 2009, ISOD issued a third NOD to the partnership for the period July 1, 2003, through July 31,
15 2003, for \$133,110 in tax, plus applicable interest and a 25-percent fraud penalty of \$33,277.50, based
16 on ISOD's finding that the partnership distributed an additional 3,060,000 sticks of counterfeit
17 cigarettes from an unlicensed location. These timely appeals followed.

18 Petitioner contends that no partnership existed and that, even if a partnership did exist, there is
19 no evidence that the storage unit to which Nancy La had access belonged to the partnership since the
20 rental agreement only allowed Nancy La access to the storage unit. In particular, John La contends he
21 had no official duties for Loh Sun and was not a partner in any conspiracy to sell illegal or untaxed
22 cigarette products. He asserts that ISOD is attempting to attribute to him the illegal acts of his mother.
23 John La explains the funds flowing in and out of his bank account by the assertion that they either
24 relate to a day trading stock market business he operated or represent personal loans from his mother to
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27 ² The status of the criminal charges against Kent La was not disclosed in the record of this appeal.
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1 cover margin calls on some of his investments. John La has also argued that his mother was secretly
2 depositing funds from the cigarette distribution business into his account.

3 APPLICABLE LAW

4 The Cigarette and Tobacco Products Tax Law (Law) requires every person desiring to engage
5 in the sale of cigarettes or tobacco products to apply with the Board for a distributor's license. (Rev. &
6 Tax. Code, § 30140.) The Law additionally imposes upon every distributor a tax, based on the
7 wholesale cost of the tobacco products, upon the distribution of tobacco products. (Rev. & Tax. Code,
8 §§ 30101, 30123, 30131.2.) "Distributor" includes every person who distributes cigarettes or tobacco
9 products, or who sells or accepts orders for cigarettes or tobacco products that are to be transported
10 from a point outside this state to a consumer within this state. (Rev. & Tax. Code, § 30011.) The term
11 "distribution" includes: (1) the sale of untaxed cigarettes or tobacco products in this state; (2) the "use
12 or consumption" of untaxed cigarettes or tobacco products in this state; and (3) the placing in this state
13 of untaxed cigarettes or tobacco products in a vending machine or in a retail stock for the purpose of
14 selling the products to consumers. (Rev. & Tax. Code, § 30008.) "Use or consumption" includes the
15 "exercise of any right or power over cigarettes or tobacco products incident to the ownership thereof,
16 other than the sale of the cigarettes or tobacco products or the keeping or retention thereof by a
17 licensed distributor for the purpose of sale." (Rev. & Tax. Code, § 30009.)

18 A partnership is an association of two or more persons to carry on as co-owners of a business
19 for profit, whether or not the parties intended to create a partnership. (Corp. Code, § 16202, subd. (a).)
20 A partnership is an entity distinct from its partners. (Corp. Code, § 16201.) The ultimate test of the
21 existence of a partnership is the intention of the parties to carry on a business as co-owners, and such
22 intention may be determined from the terms of the parties' agreement, or from surrounding
23 circumstances. (*Greene v. Brooks* (1965) 235 Cal.App.2d 161, 166.) A partnership need not be
24 evidenced by writing. (*Calada Materials Co. v. Collins* (1960) 184 Cal.App.2d 250, 253.) Further, it
25 is immaterial if the parties do not designate the relationship as a partnership or realize that they are
26 partners, for the intent may be implied from their acts. (*Constans v. Ross* (1951) 106 Cal.App.2d 381,
27 386; *Singleton v. Fuller* (1953) 118 Cal.App.2d 733, 743.) Generally, all partners are jointly and
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1 severally liable for all the debts and obligations incurred by the partnership. (Corp. Code, § 16306,
2 subd. (a).)

3 ANALYSIS & DISPOSITION

4 Nancy La has admitted to selling unstamped cigarettes to customers in California, and she used
5 Loh Sun's business location to conduct those activities. Considering the nature of her position in Loh
6 Sun, the corporation must be regarded as having knowledge of her activities on the premises, and
7 having consented to them. The evidence shows that Kent La used his personal bank account to hide
8 proceeds obtained from the partnership's unreported distribution of cigarettes and his involvement in
9 the purchase and importation of counterfeit cigarettes. We therefore find that Loh Sun, Kent La, and
10 Nancy La were in a partnership that operated as an unlicensed distributor of cigarettes.

11 Regarding John La, we note that payments for counterfeit and unstamped cigarettes were
12 sometimes made to John La's personal bank account, and at least one wire transfer for \$180,000 was
13 made from John La's personal bank account to a Hong Kong tobacco company from which the
14 partnership made purchases of counterfeit and unstamped cigarettes. John La has not presented
15 evidence sufficient to establish that Nancy La used his personal bank account without his knowledge,
16 and, in any case, it is not reasonable to conclude that the \$180,000 wire transfer could have escaped
17 John La's notice. Accordingly, we conclude that John La was also a partner in the scheme.

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

25 LEGAL ISSUE 2

26 Whether adjustments are warranted to the amounts of unreported distributions.
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1 FINDINGS OF FACT AND RELEVANT CONTENTIONS

2 To establish the deficiency for January 1, 2001, through June 30, 2003, ISOD used records
3 seized during the various searches, including a partial general ledger, handwritten daily sales journals,
4 sales invoices, shipping documents, import and customs documents, purchase invoices, bank
5 statements and deposit slips, generic sales invoices, and inventory sheets for cigarettes. For the month
6 of July 2003, ISOD established the unreported distributions based on generic sales invoices for that
7 month and the number of cigarettes seized from Loh Sun's business location on July 24, 2003, and on
8 the number of cigarettes found in the storage unit controlled by the partnership.

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

17 APPLICABLE LAW

18 Revenue and Taxation Code section 30201 provides, in relevant part, that if the Board is not
19 satisfied with the report or returns of a taxpayer, it may compute and determine the amount required to
20 be paid upon the basis of any information available to it. Moreover, it is the distributor's responsibility
21 to maintain and make available for examination on request all records necessary to determine the
22 correct tax liability, including receipts, invoices, and other pertinent papers. (Rev. & Tax. Code, §§
23 30453, 30454; Cal. Code Regs., tit. 18, § 4026, subs. (a) & (b).) If a taxpayer's records are proven
24 unreliable, it is appropriate for ISOD to compute and estimate that taxpayer's liability by alternative
25 means. (Rev. & Tax. Code, § 30201; *Maganini v. Quinn* (1950) 99 Cal.App.2d 1, 7.) Where the
26 Board establishes a deficiency through an alternative method, the burden is ultimately upon the
27 taxpayer to explain the disparity between the books and records and the results of the Board's audit.
28 (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 615-616.)

ANALYSIS & DISPOSITION

We find that ISOD appropriately utilized the information available to it and allowed exempt distributions of cigarettes that were documented (ISOD found that only two of the 19 customers listed by petitioner as licensed distributors were in fact licensed distributors). We find no allowance can be made for funds seized by the ATF unless the ATF releases those funds to the Board for application toward the determined liabilities, which it has not done. There is no requirement that a criminal restitution order reflect the amount of damages that might be recoverable in a civil action, and we find that order is irrelevant here, except to the extent payments made per the order are applied to the liability. Additionally, we find that the duplicated transactions identified by petitioner have already been deleted from the deficiency. Regarding the unavailability of invoices and characterization of purchases as sales, we find that ISOD properly used the generic sales invoices and the number of unstamped cigarettes seized as the basis for determining the number of underreported sticks, and that petitioner has offered no evidence to support further adjustments. We find further that no adjustment is warranted for sales of cigarettes with legitimate tax stamps because the audited amounts are based on the generic invoices which represent sales of cigarettes *without* legitimate tax stamps. Nor is any adjustment warranted for returned cigarettes since the subject return occurred after the periods at issue here. In sum, we find no adjustments are warranted.

LEGAL ISSUE 3

Whether ISOD has supported fraud by clear and convincing evidence.

FINDINGS OF FACT AND RELATED CONTENTIONS

ISOD imposed fraud penalties because it found that the partnership intended to commit fraud. ISOD bases its conclusion on several items of evidence, such as Nancy La's admission that she sold unstamped cigarettes and applied counterfeit stamps, the fact that she pled no contest to several criminal charges, the seizure of significant amounts of cigarettes with no stamps or with counterfeit tax stamps, various documents showing that the partnership intentionally concealed purchases of counterfeit domestic-brand cigarettes, a double set of records maintained by the partnership (with one showing the legal distributions of cigarettes only and the other showing all distributions, both legal and

1 illegal), the fact that customers were required to make payments through deposits into the personal
2 bank accounts of Kent, Nancy, and John La, and the substantial understatement. ISOD also considered
3 that the partners were knowledgeable regarding the applicable laws and that Loh Sun had held a
4 Cigarette Distributor's License since December 1988 and had been audited twice before.

5 Petitioner contends that the fraud penalties are not supported by clear and convincing evidence.

6 APPLICABLE LAW

7 Revenue and Taxation Code section 30224 provides for the addition of a 25-percent penalty if
8 any part of a deficiency determination is due to fraud or intent to evade the law or authorized rules or
9 regulations. Fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to
10 avoid a tax known to be owing. (*Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307
11 (*Bradford*); see also Sales and Use Tax Department Audit Manual (Audit Manual) § 0509.10.)³ Fraud
12 must be established by clear and convincing evidence. (*Cal. State Bd. of Equalization v. Renovizor's*
13 *Inc.* (9th Cir. 2002) 282 F.3d 1233, 1241; *Marchica v. State Bd. of Equalization* (1951) 107
14 Cal.App.2d 501, 508; see also Cal. Code Regs., tit. 18, § 1703, subd. (c)(3)(C).)⁴ Although fraud may
15 not be presumed, it is rare to find direct evidence that fraud has occurred and thus it is often necessary
16 to make the determination based on circumstantial evidence. (*Bradford, supra*, 796 F.2d at p. 307;
17 *Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30; see also Audit Manual § 0509.25.) Where there is
18 a substantial deficiency that cannot be explained satisfactorily as being due to an honest mistake or to
19 negligence and where the only reasonable explanation is a willful attempt to evade the payment of tax,
20 the penalty for fraud or intent to evade the tax should apply. The size of the deficiency in relation to
21 the tax reported should be taken into account, and the indication that a deficiency is due to intent to
22 evade increases in direct proportion to the ratio of the understatement, when it cannot otherwise be
23 satisfactorily explained. Certain facts or actions are by nature evidence of a deliberate attempt to evade
24 the payment of tax, including falsified records and failure to follow the requirements of the law, the

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27 ³ Although the Audit Manual was issued for the Sales and Use Tax Department, for purposes of consistent tax
administration, the Board applies the same standard in Cigarette and Tobacco Products Tax cases.

28 ⁴ Although this is a Sales and Use Tax Regulation, for purposes of consistent tax administration, the Board applies the same
standard in Cigarette and Tobacco Products Tax cases.

1 knowledge of which is evidenced by permits or licenses held by taxpayer in prior periods. (*Bradford,*
2 *supra*, 796 F.2d at p. 307; see also Audit Manual §§ 0509.20, 0509.25.)

3 In addition, the legal effect of a plea of nolo contendere to a crime punishable as a felony is the
4 same as that of a plea of guilty for all purposes. (Pen. Code, § 1016, subd. 3.) A plea of nolo
5 contendere to a crime punishable as a felony is an admission to all elements of the crime charged
6 against the defendant in a subsequent civil action. (*Rusheen v. Drews* (2002) 99 Cal.App.4th 279, 284
7 (*Rusheen*.) While a plea of nolo contendere is not conclusive evidence of guilt, it is evidence against
8 the party and the party may contest the truth of the matters admitted by his plea and explain why he
9 entered the plea. (*Rusheen, supra*, 99 Cal.App.4th at p. 284.)

10 ANALYSIS & DISPOSITION

11 There is ample evidence that petitioner (i.e., the partnership) intentionally failed to report the
12 tax due on distributions of cigarettes, despite the partners' thorough knowledge of the reporting and
13 stamping requirements applicable to a distributor. The sale of cigarettes with no stamps or with
14 counterfeit stamps is itself compelling evidence of an intent to evade tax. Also, Nancy La's
15 admissions that she sold unstamped cigarettes to customers in California, and that she used Loh Sun's
16 business location to conduct those activities, clearly show an intent to evade tax. In addition, the fact
17 that she pled no contest to criminal charges for felony cigarette tax evasion without refuting the truth
18 thereof in these proceedings is additional, strong evidence of an intent to evade tax. Petitioner's intent
19 to evade the cigarette excise taxes is further evidenced by the partners' efforts to hide their illegal
20 operations, concealing them in the basement of Loh Sun's business location, separate from Loh Sun's
21 legitimate business operations, and maintaining an inventory of cigarettes with no stamps or with
22 counterfeit stamps at an undisclosed and unlicensed location (the rented storage unit). The double set
23 of records maintained by petitioner offers additional compelling and uncontroverted evidence of
24 petitioner's intent to conceal the illegal activity and unreported distributions. In sum, we find that clear
25 and convincing evidence of fraud has been amply supplied, and that the fraud penalties were properly
26 applied.

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ORDER

It is hereby ordered that the tax and penalty be redetermined without further adjustment.

Adopted at Sacramento, California, on August 13, 2013.

Jerome E. Horton _____, Chairman

George Runner _____, Member

Marcy Jo Mandel _____, Member*

*For John Chiang, pursuant to Government Code section 7.9.