OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011981
	) CDTFA Case No. 489934
GRAND CLASSIC OIL CO. INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Walter Weiss, Attorney
For Respondent:	Jason Parker, Chief of Headquarters Operations
For Office of Tax Appeals	Lisa Burke, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Grand Classic Oil Co. Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) denying appellant's untimely petition for redetermination (administrative protest) of the Notice of Determination (NOD) issued on December 10, 2008.[1] The NOD is for $162,102.40 in tax, plus applicable interest, and a negligence penalty of $15,901.37 for the period October 1, 2004, through December 31, 2007 (audit period). CDTFA added a finality penalty of $16,210.24.

Appellant waived its right to an oral hearing; therefore, the matter is being decided based on the written record.

[1] Under regulations promulgated by CDTFA, if a taxpayer files a petition for redetermination after the 30-day time period specified in R&TC section 6561, CDTFA may, in its discretion, accept it as an administrative protest. (See Cal. Code Regs., tit. 18, § 35019(a).). Also, sales taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

ISSUES

1. Whether appellant has established that a reduction to the measure of unreported taxable sales is warranted.
2. Whether appellant was negligent.

FACTUAL FINDINGS

1. Appellant operated a gasoline station with a mini-mart in Los Angeles, California. The effective start date for appellant's seller's permit was August 15, 2004.
2. During the audit period, appellant reported total sales of $9,576,346 and claimed deductions totaling $1,171,259,[2] which resulted in reported taxable sales of $8,405,087.
3. Upon audit, appellant provided the following: its federal income tax return for 2005; gasoline purchase invoices for 2006 and 2007; bank statements for the period December 9, 2005, through July 10, 2006; canceled checks for the period August 1, 2006, through December 31, 2007; vendor confirmations of gasoline purchases for the period July 1, 2005, through December 31, 2007, and diesel fuel purchases for the period January 1, 2006, through June 30, 2006.
4. CDTFA obtained weekly average fuel selling prices in the Los Angeles area published by the United States Department of Energy (DOE) for the audit period.[3]
5. Appellant failed to provide sales records for the audit period. CDTFA used an alternative audit method to establish audited taxable sales of gasoline and diesel.
6. CDTFA observed the selling prices at appellant's pumps for each grade of gasoline on December 5, 2007, and April 17, 2008, and obtained appellant's gasoline selling prices for June 10, 2008 from the Internet.[4] CDTFA found that appellant's selling prices were $0.10 per gallon higher, on average, than the DOE weekly average selling prices. CDTFA initially added a price differential of $0.10 per gallon to the DOE weekly average selling prices when it computed taxable sales of gasoline. Appellant, however,

[2] The deductions included the following: exempt sales of food products of $462,084; exempt sales to the United States government of $15,759; and $693,416 for sales tax reimbursement included in reported total sales.

[3] The DOE surveys gasoline stations in various areas one day each week (typically a Monday), and computes an average selling price for that day, which we refer to here as the weekly average selling price.

[4] The gasoline grades appellant sold include unleaded, mid-grade, and premium.

contended that its gasoline selling prices were much lower than average prices earlier in the audit period because it wanted to attract new customers. CDTFA reduced the price differential from $0.10 per gallon to negative $0.05 for the period July 1, 2005, through December 31, 2005, zero for the year 2006, $0.05 for the period January 1, 2007, through September 30, 2007, and $0.0905 for the fourth quarter of 2007.[5] After applying the price differentials to the DOE average selling prices, which were computed for each quarter of the audit period, CDTFA made adjustments to exclude sales tax reimbursement from the average selling prices.

7. CDTFA used the pre-paid sales tax reported by appellant's fuel vendor to compute that appellant purchased 3,639,923 gallons of gasoline during the audit period. Multiplying the audited average gasoline selling prices, excluding sales tax reimbursement, by the number of gallons appellant purchased resulted in audited taxable sales of gasoline of $9,860,476 for the audit period.

8. CDTFA's examination of appellant's purchases of diesel fuel from the vendor showed that appellant purchased 7,177 gallons of diesel fuel during the period of January 1, 2006, through June 30, 2006. Appellant was not selling diesel fuel when the audit was conducted. As such, CDTFA was unable to observe appellant's posted prices. CDTFA added an estimated price differential of $0.10 per gallon to the DOE weekly average selling prices for diesel fuel, and then made adjustments to exclude sales tax reimbursement and the state excise tax on diesel fuel from the audited selling prices.[6] Multiplying the audited average diesel selling prices, excluding sales tax reimbursement and the excise tax, by the number of gallons appellant purchased resulted in audited taxable sales of diesel fuel of $17,975 for the audit period.

9. Appellant provided no documentation to support any exempt sales to the United States government. CDTFA, therefore, determined that no adjustments were warranted to allow for appellant's claimed exempt sales.

[5] Based on an examination of appellant's gasoline and mini-mart merchandise purchases shown in vendor confirmations, CDTFA concluded that appellant did not operate the business during the first three quarters of the audit period, and therefore, no measure of tax was computed for the period October 1, 2004, through June 30, 2005.

[6] CDTFA states that the price differentials for diesel fuel sold by two nearby gas stations operated by corporations with the same corporate officer as appellant were $0.23 and $0.281 per gallon.

10. Based on its analysis of appellant's canceled checks for the period of August 1, 2006, through December 31, 2007, CDTFA computed that approximately 60 percent of the merchandise purchased for the mini-mart was taxable merchandise and 40 percent was exempt food products. CDTFA computed a ratio of taxable mini-mart sales to exempt food sales of 150 percent (60 percent ÷ 40 percent), and multiplied appellant's claimed exempt sales of food products for the audit period by a factor of 1.5 to establish audited taxable sales of mini-mart merchandise ($462,084 * 1.5 = $693,126).
11. CDTFA compared audited taxable sales of $10,571,577 ($9,860,476 + $17,975 + $693,126) with appellant's reported taxable sales of $8,405,087 to establish unreported taxable sales of $2,166,489 (rounded). Tax of $178,735.40, computed on unreported taxable sales of $2,166,489, was reduced by $16,633.00 for under-claimed credits for sales tax pre-paid to fuel distributors, which left a tax balance of $162,102.40 in the NOD. CDTFA determined that a negligence penalty was warranted, which CDTFA added to the NOD because appellant failed to maintain and provide adequate records and appellant's reporting errors were substantial when compared to its reported taxable sales.
12. Appellant did not file a petition for redetermination within 30 days after the NOD was served. As such, the determination became final on January 10, 2009. Appellant failed to pay the liability when it became final; therefore, CDTFA imposed a finality penalty of $16,210.24. On May 21, 2009, appellant sent CDTFA a letter protesting the amount of unreported taxable sales, which CDTFA accepted as an administrative protest. CDTFA issued a Decision and Recommendation denying the appeal. This appeal followed.[7]

DISCUSSION

Issue 1: Whether appellant has established that a reduction to the measure of unreported taxable sales is warranted.

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) "Sale" means

[7] Appellant did not expressly dispute the negligence penalty in its protest filed with CDTFA or in its appeal filed with OTA. Appellant, however, implicitly raised the issue; out of an abundance of caution we address it below. Appellant has not requested relief of the finality penalty.

and includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (R&TC, § 6006(a).)

If CDTFA is not satisfied with the accuracy of the sales and use tax returns filed, it may base its determination of the tax due upon the facts contained in the returns or upon any information that comes within its possession. (R&TC, § 6481.) It is the retailer's responsibility to maintain and make available for examination on request all records necessary to determine the correct tax liability, including bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules or regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484.) Negligence is the failure to act with due care and to do what the average prudent businessperson would do under the same or similar circumstances. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

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*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, appellant provided an income tax return, bank statements, canceled checks, and purchase information for examination, but failed to provide any records of its sales. In the absence of sales records, we find that it was reasonable for CDTFA to use alternative audit methods to establish audited taxable sales. We have reviewed the audit working papers. We have found that the methods used were reasonable and rational. Furthermore, we have found no errors in the audit procedures or material inaccuracies in the calculations. Therefore, the burden of proof shifts to appellant to establish that a reduction to the amount of unreported taxable sales is warranted.

Appellant contends that the audited average selling prices for gasoline were higher than its actual prices and resulted in overstated audited taxable fuel sales. According to appellant, it regularly sold gasoline at prices that were $0.25 to $0.50 per gallon lower than the gasoline selling prices at neighboring stations because it wanted to attract customers to shop in its mini-mart, which had higher profit margins. Toward the end of 2007, appellant allegedly realized that its business model was not producing the intended profits. Thereafter, appellant raised its gasoline prices to a profitable level. In support, appellant provided sales receipts showing gasoline sales at a separate related business on November 4, 2006, through November 6, 2006, a gasoline purchase invoice dated November 6, 2006, issued to the related business, and several declarations from employees stating that their employer sold gasoline at prices that were $0.25 to $0.50 cents per gallon lower than prices at other businesses in the area. Additionally, appellant contends that the method used to estimate an audited taxable merchandise ratio of 60 percent for the mini-mart was unreasonable and resulted in overstated audited taxable sales of mini-mart merchandise.

With respect to the audited gasoline selling prices, we note that CDTFA compared appellant's actual gasoline selling prices on three different days with the DOE average prices in the Los Angeles area. CDTFA found that appellant's selling prices were $0.10 per gallon higher, on average, than the DOE weekly average selling prices. CDTFA reduced the audited gasoline selling prices for the earlier periods in the audit period by as much as $0.15 per gallon to acknowledge appellant's contention regarding its business strategy even though appellant provided no supporting evidence. The only records provided by appellant to support its contention that it sold gasoline at prices that were $0.25 to $0.50 cents per gallon lower than other businesses in the area consist of sales receipts showing gasoline selling prices at a related business, at a different location, for three consecutive days and a gasoline purchase invoice for the other business. The sales receipts do not show appellant's selling prices. As such, we find that the evidence is not relevant, and therefore disregard it.

Regarding the declarations from employees provided by appellant, we note that most of the declarations pertain to other related businesses, not to appellant. The declarations that pertain to appellant contain virtually identical pre-typed statements that also are identical to the declarations pertaining to other businesses. All of the declarations with identical statements are prefilled with blank spaces for the declarants to insert their identifying information by hand. In

the declaration of K. Ortega, he indicates that he was employed from approximately 2005 to 2014. This declarant states, "During my employment at [Chevron],[8] our gas station **always** sold gas at approximately $0.25 to $0.50 less than the competitors in the area." (Emphasis added.) Likewise, B. Corea worked for appellant from approximately 2005 to 2010. She declared, "[d]uring my employment at [gas stations],[9] our gas station **always** sold gas at approximately $0.25 to $0.50 less than the competitors in the area." (Emphasis added.) In contrast, appellant indicated in briefing that "[s]ometime toward the end of 2007 [appellant] realized that this business model did not produce the intended profits, and he soon thereafter raised the gasoline prices to a profitable level." Since the declarations are identical and contradict appellant's position as well as the evidence in the record, we give them little weight. We conclude that the available documentation is not sufficient to support a reduction to the audited gasoline selling prices used to establish audited taxable sales.

Appellant argues that the information shown in the canceled checks was too limited to enable CDTFA to accurately determine that 60 percent of its merchandise purchases were purchases of taxable merchandise. In rebuttal, CDTFA asserts that in its experience most gas station mini-marts sell 75 to 80 percent taxable merchandise. We note that appellant has failed to provide merchandise purchase invoices or other documents from which a more accurate determination could be made. In the absence of evidence, from which a more accurate determination may be made, we find that CDTFA relied on the best information available in establishing audited taxable sales of mini-mart merchandise.

Issue 2: Whether appellant was negligent.

With respect to the negligence penalty, appellant contends that CDTFA failed to consider that appellant relied in good faith on the professional services of its bookkeeper. Appellant states that it provided the bookkeeper with sales records and purchase invoices, which were used to prepare the tax returns. Appellant contends that the copies of these records were lost when the bank foreclosed on the property and locked it out of the properties. It is appellant's responsibility to maintain books and records, not the bookkeeper's responsibility. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) To the extent that any duty was delegated

[8] Chevron was hand-written by the declarant.

[9] Gas stations was hand-written by the declarant.

to the bookkeeper, appellant has failed to provide evidence. Furthermore, as a general matter, acts of fraud or negligence of an agent, such as a bookkeeper, would be imputed to the corporation. (See, e.g., Sales and Use Tax Annotation 320.0110 [citing *Rutherford v. Rideout Bank* (1932) 11 Cal.2d 479; *Ghiglione v. American Trust Co.* (1942) 49 Cal.App.2d 633]; see also, CDTFA Audit Manual section 320.0110.)[10] Likewise, appellant did not provide evidence of the bank foreclosure or when the alleged foreclosure occurred. Although this is appellant's first audit, the $2,166,489 understatement is a significant amount. Likewise, the error ratio is approximately 25.78 percent. Despite its unsupported contentions, appellant failed to provide purchase invoices, cash register tapes, and other source documentation from which a more accurate determination could be made. Based on the foregoing, we find the application of the negligence penalty to be proper.

Appellant has failed to meet its burden. Thus, we conclude that no reduction is warranted.

[10] CDTFA's Audit Manual summarizes CDTFA's audit policies and procedures. It is a useful resource that OTA may look to for guidance in interpreting the law; however, the Audit Manual is not binding legal authority. As such, OTA must exercise its own independent judgement in determining the weight, if any, to afford CDTFA's construction of the law, as set forth in the Audit Manual. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) For the weight afforded to a CDTFA Annotation, see *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.

HOLDINGS

1. Appellant has not established that a reduction to the amount of unreported taxable sales is warranted.
2. Appellant has not established that the imposition of the negligent penalty was improper.

DISPOSITION

Sustain CDTFA's decision to deny the administrative protest.

DocuSigned by:
Josh Aldrich
48745BB806914B4...
Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
8A4294817A67463...
Andrew Wong
Administrative Law Judge

DocuSigned by:
715CE19AD48041B...
Andrew J. Kwee
Administrative Law Judge

Date Issued: 11/18/2020