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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011872
MOVEEL FUEL, LLC	CDTFA Case ID: 917755

OPINION

Representing the Parties:

For Appellant:	Haig Keledjian, Attorney
For Respondent:	Randy Suazo, Hearing Representative Jason Parker, Chief of Headquarters Ops. Chad Bacchus, Tax Counsel IV
For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561 Moveel Fuel, LLC (appellant) appeals a Decision and Recommendation (decision) issued by respondent California Department of Tax and Fee Administration (CDTFA) in response to appellant's timely petition for redetermination of a Notice of Determination (NOD) dated September 2, 2015.[1] The NOD is for tax of $984,521.95, plus applicable interest, and a negligence penalty of $98,452.23, for the period January 1, 2010, through December 31, 2012 (liability period). In its decision, CDTFA reduced the taxable measure from $2,667,858.00 to $2,539,948.00, deleted the negligence penalty, and otherwise denied the petition.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Sheriene Anne Ridenour, and Daniel K. Cho held an oral hearing for this matter in Cerritos, California, on

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

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August 17, 2022. At the conclusion of the hearing, the record was held open until September 30, 2022, when it was submitted for an Opinion.[2]

ISSUES

1. Whether the liability as determined by CDTFA is overstated.
2. Whether OTA has jurisdiction to allow Schedule G credits under appellant's Sales and Use Tax (SR) account (SR AA 101-201774) based on alleged errors in appellant's Prepaid Sales Tax (SG) account (SG AS 078-020932).
3. If OTA finds it has jurisdiction pursuant to issue 2, whether an allowance is warranted in connection with the disallowed Schedule G credits for sales tax prepaid to fuel suppliers.
4. Whether appellant is entitled to a bad debt deduction for prepaid sales tax amounts found worthless and charged off for income tax purposes.

FACTUAL FINDINGS

1. Appellant is a wholesaler and retailer of diesel fuel in Los Angeles, California. Appellant began operating on February 29, 2009.[3]
2. Appellant holds an SR account. Appellant filed sales and use tax returns for the liability period under the SR account to report and pay sales and use tax for its retail sales to consumers.
3. Appellant also holds an SG account. Appellant filed SG returns for the liability period to report the collection of prepayments of the retail sales tax (sales tax prepayments) on sales to other fuel wholesalers and retailers as required by R&TC section 6480.1.[4]
4. During the liability period, appellant made the required sales tax prepayments to its fuel vendors at the time appellant purchased diesel fuel. Appellant resold the diesel fuel to other wholesalers for purposes of resale. Appellant also made retail sales of the diesel fuel directly to consumers.

[2] The record was held open at appellant's request to allow appellant time to submit additional briefing. Appellant failed to submit its additional briefing and the record was closed.

[3] Appellant did not make any sales of fuel as part of a consolidated fuel network or CFN system.

[4] When this Opinion refers to an SG return, this reference is to Form 401-DB "Prepayment of Sales Tax on Fuel Sales" (www.cdtfa.ca.gov/formspubs/cdtfa401db.pdf) and Schedule A and Schedule B to the SG return (www.cdtfa.ca.gov/formspubs/cdtfa531ab.pdf).

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5. When appellant sold diesel fuel to another wholesaler, appellant charged its customer for the prepaid sales tax, and reported the amount to CDTFA under its SG account, Schedule A, as required by R&TC section 6480.1. For each wholesaler, appellant was required to report the amount of prepaid sales tax appliable, gallons sold to the wholesaler, and the wholesaler's SG account number, on Schedule A of its SG returns. This in turn allowed the wholesaler to claim a credit for the sales tax that it prepaid to appellant.[5]
6. When appellant sold diesel fuel directly to a consumer, appellant sold the diesel fuel on a tax-included basis and collected the applicable sales tax reimbursement from its customers. For these retail transactions, appellant claimed a Schedule G credit on its sales and use tax return to reduce its sales tax liability by the amount of prepaid sales tax that appellant paid to its diesel fuel suppliers.[6]
7. In addition to claiming a Schedule G credit for retail sales, appellant concedes that it erroneously claimed a Schedule G credit to reduce its sales tax liability by the amount of prepaid sales tax that appellant charged to its wholesale customers on transactions which were not subject to sales tax.[7]
8. During the liability period, appellant reported total diesel fuel sales of $78,563,321, claimed deductions totaling $21,887,143, and reported taxable sales of $56,676,178 under its SR account.
9. CDTFA audited appellant for the liability period.
10. Appellant recorded sales tax reimbursement that appellant collected from its retail customers in its sales journals. CDTFA compared appellant's recorded and reported sales tax and found discrepancies. CDTFA found that for seven quarterly periods in the

[5] Such a credit is claimed on Line 6 of the SG return, "Amount of sales tax prepaid to others," and reduces the wholesaler's liability for prepaid sales tax on the SG return. In other words, a wholesaler remits the prepaid sales tax to its supplier, and is reimbursed when it in turn collects prepaid sales tax from the retailer. Further, an SG liability to CDTFA may arise if there is a difference between gallons purchased and gallons sold.

[6] This is technically a two-step process; first, appellant would need to itemize prepaid sales tax to its SR account on Schedule A of the SG return. Second, under the SR account, appellant would need to claim a Schedule G credit for the same amount. This is necessary so as not to create a discrepancy between gallons purchased and gallons sold. In any event, it is undisputed that appellant claimed the Schedule G credits.

[7] The phrasing of appellant's concession is that appellant's tax "preparer did not fill out the sales tax forms properly [and] took credit on [appellant's] return for prepaid sales taxes that belong to other wholesalers. [Appellant] has admitted to the mistake."

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liability period, appellant's recorded sales tax collected exceeded reported sales tax by $267,498. This represents unreported taxable sales of $2,667,858 (audit item 1).[8]

11. Using Adhoc Reconciliation Reports, CDTFA determined that appellant's fuel suppliers reported to CDTFA that they collected $4,863,408 in prepaid sales tax from appellant during the liability period.[9] On its sales and use tax returns, appellant claimed Schedule G credits for sales tax prepaid to these same suppliers totaling $4,876,676. As a result of the difference, CDTFA determined that appellant overclaimed its Schedule G (prepaid sales tax) credits by $13,268 ($4,876,676 - $4,863,408) in amount. CDTFA disallowed Schedule G credits totaling $13,268.

12. CDTFA also determined that appellant made nontaxable sales for resale to other fuel wholesalers. CDTFA found that appellant claimed Schedule G prepaid tax credits of $706,990, on nontaxable sales for resale for which appellant also invoiced its customers $706,990 for prepaid sales tax (which would erroneously result in a double credit to appellant). CDTFA disallowed the $706,990 in Schedule G credits claimed on nontaxable sales.

13. In total, for both discrepancies involving prepaid sales tax ($13,268 + $706,990), CDTFA's audit disclosed a liability of $720,258 (audit item 2).

14. On September 2, 2015, CDTFA timely issued the NOD to appellant for the liability disclosed by audit, which appellant petitioned on September 7, 2015.[10]

15. CDTFA subsequently allowed an adjustment for five quarters of the liability period. In those quarters, appellant's reported sales tax exceeded recorded sales tax by a total of $13,711, representing a taxable credit measure of $127,910. The adjustment reduced the measure of unreported taxable sales (audit item 1) from $2,667,858 to $2,539,948.

[8] CDTFA's decision lists $2,667,859 and $2,667,858; however, the former appears to be a typographical error or rounding difference because the source documentation, CDTFA's Report of Field Audit, uses $2,667,858.

[9] Fuel wholesalers are required to collect prepayment of the retail sales tax from their customers and to report those amounts to CDTFA on Schedule A of their SG return. As relevant to this appeal, an Adhoc Reconciliation Report is a CDTFA report summarizing the prepaid sales tax itemized on the respective Schedule A of each wholesaler making sales to a particular customer (in this case, appellant).

[10] The NOD is timely because appellant signed a waiver of the three-year statute of limitations.

16. On April 26, 2017, CDTFA issued its decision ordering a reduction of $127,910 to the measure of tax for audit item 1, deleting the negligence penalty, and otherwise denying the petition. This timely appeal to OTA followed.

17. On appeal, appellant concedes that it incorrectly claimed Schedule G credits on its SR account for nontaxable sales for resale to other fuel vendors. Instead, on that item, appellant contends that CDTFA made errors in calculating additional taxable sales under appellant's SG account.

18. CDTFA contends that OTA lacks jurisdiction to address issues concerning the SG account. In support, CDTFA submitted as an exhibit, the following documents:
    a. A letter dated April 28, 2016, addressed to appellant, stating that appellant failed to report all its fuel sales on its SG returns for the second quarter of 2013 (2Q13) through 3Q15 (April 1, 2013, through September 30, 2015);
    b. Copies of several determinations issued to appellant for reporting periods on and after 2Q13, including a determination issued to appellant's SG account on October 31, 2016, for $233,680 in prepaid sales tax, plus interest, for the period March 1, 2014, though 2Q15; and
    c. A decision issued by CDTFA on November 14, 2017, denying, in pertinent part, appellant's petition of the October 31, 2016 NOD issued to appellant's SG account.

DISCUSSION

Issue 1: Whether the liability as determined by CDTFA is overstated.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) The law presumes that 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 verify the accuracy of any return made and to make them available to CDTFA 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, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481,

6511.) 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*.)

In this case, the measure of unreported taxable sales represents differences between appellant's recorded and reported taxable sales, as reflected in appellant's sales journals. Calculation of this audit liability did not involve an indirect audit approach. Instead, CDTFA accepted appellant's own recorded taxable sales and the difference between what appellant reported and what appellant recorded represents the unreported taxable sales in audit item 1. This Opinion finds that CDTFA has met its burden of showing that its determination was reasonable and rational. Accordingly, appellant has the burden of establishing that adjustments are warranted.

Appellant's primary argument with respect to this issue is that its sales journals were incorrect and overstated its liability. In support, appellant has provided copies of "Error Reports," which allegedly list various recording errors, including double entries. However, the error reports are not supported with any type of schedule or clarifying information. Instead, for various entries, appellant handwrote wrote "Diff QTY & $," "not on original," or "Missing - [with a customer name]." Appellant did not provide further explanation for these entries. However, during the oral hearing appellant argued that the accounting system was archaic and created the problem. In addition, appellant contends that appellant's recorded taxable sales amount results in a profit of 70 to 74 cents a gallon, which appellant states is impossible. Therefore, appellant contends, there was an error in appellant's accounting system.

In a letter dated January 23, 2019, OTA requested additional briefing from appellant, specifically asking for "a schedule listing each recording error, explaining the nature of the error and what the correct entry should have been" along with a list of the amounts of reduction appellant seeks for each error. Appellant responded via letter dated February 21, 2019, but failed to provide any documentation or information responsive to OTA's request. Instead, appellant stated that it currently owes $321,382.69 under its SG account, and is therefore requesting a credit of $321,382.69 under its SR account.

Here, appellant has the burden to establish error with CDTFA's determination. On appeal, appellant merely presented oral arguments that errors in its accounting system existed and identified entries in its own sales journals without providing an explanation for the alleged errors or source documentation to support the alleged error. When asked by OTA to provide source documentation for the alleged errors, appellant merely provided the alleged total of its unpaid tax liabilities for its SG account, along with a statement that: "It is impossible for [appellant] to ever owe" money to CDTFA under its SG account.[11] Under these facts, this Opinion finds that appellant failed to establish that there were errors in its accounting system which caused appellant's SR account liability to be overstated, or to otherwise establish error in CDTFA's determination.

Issue 2. Whether OTA has jurisdiction to allow Schedule G credits under appellant's SR account (SR AA 101-201774) based on alleged errors in appellant's SG account (SG AS 078-020932).

As a preliminary matter, appellant's contention is that "[CDTFA] errored [sic] in the accounting and created more fuel than [appellant] bought[,] and this is reflected on the sales tax bill as well." The error that appellant alleges is that CDTFA billed appellant $321,382.69 under its SG account for "phantom fuel" sales that CDTFA created "from the air." As such, appellant asks OTA to offset the SG account liability with a "phantom credit" of $321,382.69 under its SR account for "phantom fuel" sales that appellant alleges it never made.

In other words, it appears that appellant contends that errors in its accounting system created an understatement for both its SR account (issue 1) and its SG account (issue 2). Specifically, it appears appellant is arguing that its accounting system overstated its SR account liability (issue 1), which in turn resulted in a difference between gallons purchased and gallons sold under its SG account. According to appellant, that difference, in turn, created a prepaid sales tax liability because it caused a difference to exist between prepaid taxes collected, versus allowable credits on the SG return (for prepaid taxes paid to fuel suppliers). Therefore, for issue 2, appellant asks that OTA create "phantom" purchases that appellant admits it never made (i.e., to increase SG credits) to offset the "phantom" fuel sales (i.e., sales subject to prepaid sales tax) that it allegedly never made but are being asserted by CDTFA under issue 1. Appellant did not

[11] This Opinion does not address the SG account argument here because this issue, and jurisdiction over this issue, are discussed as issues 2 and 3, below.

provide any source documentation or audit schedules to support its contention that CDTFA erred in calculating prepaid sales tax due under its SG account.

CDTFA contends that OTA lacks jurisdiction because the SG account liability was not appealed to OTA. In support, CDTFA provided documentation establishing that the NOD issued to appellant's SG account is now final.

With respect to OTA's jurisdiction to resolve an appeal, OTA's Rules for Tax Appeals require, in pertinent part, a timely appeal of an adverse CDTFA decision to establish jurisdiction. (Cal. Code. Regs., tit. 18, § 30103(b).)

Here, CDTFA issued an NOD to appellant's SG account on October 31, 2016, which appellant timely petitioned. CDTFA denied that petition in an adverse decision dated November 14, 2017. There is nothing in the evidentiary record indicating that appellant ever filed an appeal of the November 14, 2017 CDTFA decision to either the board or to OTA. As such, the time to file an appeal of the CDTFA decision dated November 14, 2017, has now lapsed. (Cal. Code. Regs., tit. 18, §§ 30106(a), 30203(b)(1).) The appeal presently before OTA involves an NOD issued to appellant's SR account for a different liability period. Thus, appellant is asking OTA to grant a deduction in the current liability period to address appellant's disagreement with a final tax liability for a subsequent audit period which is not before OTA. While the SR account is at issue before OTA in the current appeal, there is no provision in the R&TC which authorizes a taxpayer to claim a deduction to offset a final liability owed by a different account for a different audit period. In other words, there is no provision in the R&TC which authorizes OTA to grant a deduction to appellant's SR account, even if appellant were able to prove that the SG account liability is overstated. Under these facts, addressing the SG account issue would result in an advisory opinion, and OTA does not issue advisory opinions. (*Appeal of Body Wise International, LLC*, 2022-OTA-340P.)

Issue 3: If OTA finds that it has jurisdiction pursuant to issue 2, whether an allowance is warranted in connection with the disallowed Schedule G credits for sales tax prepaid to fuel suppliers.

Above, this Opinion concluded that OTA lacks jurisdiction to issue an advisory opinion on a dispute concerning appellant's SG account. As such, OTA will not address this issue.

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Issue 4: Whether appellant is entitled to a bad debt deduction for prepaid sales tax amounts found worthless and charged off for income tax purposes.

As discussed above, this Opinion concludes that OTA lacks jurisdiction to order any adjustments to appellant's SG account. As such, this issue addresses only whether a bad debt deduction is allowable under the facts of this case to appellant's SR account for the liability period at issue.

The law provides, in pertinent part, that retailers may generally take a bad debt deduction for amounts reported as taxable and thereafter found worthless and charged off for income tax purposes. (R&TC, §§ 6055(a), 6203.5(a).) A retailer may claim a bad debt deduction provided that the sales tax was actually paid to the state. (Cal. Code. Regs., tit. 18, § 1642(a).) This deduction should be taken on the return filed for the period in which the amount was found worthless and charged off for income tax purposes. (Cal. Code. Regs., tit. 18, § 1642(a).)

Bad debt deductions and prepaid sales taxes

First, R&TC section 6055 only authorizes a bad debt deduction for bad debts which were reported as taxable. The prepaid sales tax by its terms applies to *nontaxable* sales to wholesalers. (R&TC, § 6480.1.) The prepaid sales tax does not apply to retail sales reported as taxable. (*Ibid*.) Instead, it is a prepayment of the tax that will be imposed on a later, subsequent retail sale (i.e., sales which were not made or reported by appellant). Second, R&TC section 6055 requires that the tax must actually be "paid to the state." The prepaid sales tax was paid to appellant's fuel supplier, as opposed to the state. The prepaid sales tax amount that appellant remitted to its fuel suppliers was allowable as a *deduction* on line 6 of the SG return, to *reduce* appellant's prepaid sales tax liability to the state with respect to appellant's subsequent sale of the fuel to its customers. Based on the above, this Opinion finds that a bad debt deduction within the meaning of R&TC section 6055 is only allowable with respect to taxable sales reported under an SR account and, as such, bad debts associated with uncollected prepaid sales taxes are statutorily ineligible for deduction.

Here, appellant filed income tax returns and claimed a bad debt deduction of $450,000 on its 2013 federal income tax return, which is for a tax period after the liability period at issue. Appellant does not contend that this bad debt deduction was incurred with respect to taxable sales that it made. To the contrary, the bad debts were incurred in connection with appellant's

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nontaxable wholesale transactions subject to the prepaid sales tax. Under these facts, this Opinion finds that appellant's bad debts are not deductible under appellant's SR account within the meaning of R&TC section 6055.

HOLDINGS

1. Appellant failed to establish that the liability as determined by CDTFA is overstated.
2. OTA lacks statutory authority to grant appellant's SR account a deduction based on alleged errors with a final NOD issued to appellant's SG account for a later liability period.
3. The third issue is moot based on the conclusion on the second issue.
4. Appellant is not entitled to a bad debt deduction for its SR account.

DISPOSITION

CDTFA's decision is sustained.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 12/19/2022