

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of: SHAM GAS EXPRESS, INC., dba Express Gas & Mart))))))	OTA Case No. 21027198 CDTFA Case ID 814-669
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OPINION

Representing the Parties:

For Appellant:	Patrick Finnegan, CPA
For Respondent:	Ravinder Sharma, Hearing Representative Stephen Smith, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Craig Okihara, Business Taxes Specialist III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Sham Gas Express, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant’s petition for redetermination of a Notice of Determination (NOD) dated April 10, 2019. The NOD is for tax of \$34,795 and applicable interest, for the period July 1, 2015, through June 30, 2018 (liability period).²

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Michael F. Geary, and Keith T. Long held an oral hearing for this matter on April 20, 2023.³ At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

¹ Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to BOE.

² The NOD was timely because appellant signed a waiver of the otherwise applicable three-year statute of limitations period. (R&TC §§ 6487 and 6488.)

³ This matter was originally scheduled to be held in Sacramento, California. However, at appellant’s request the hearing was held electronically. The parties appeared via Webex to accommodate witness availability.

ISSUE

Whether adjustments to the measure of unreported taxable sales are warranted.

FACTUAL FINDINGS

1. Appellant, doing business as Express Gas & Mart, operated a gasoline station with a mini-mart in Porterville, California. In the mini-mart, appellant sold beer, wine, liquor, soda, cigarettes and tobacco products, and miscellaneous sundry items, including nontaxable food products. Appellant was issued its seller's permit with an effective start date of January 1, 2015.
2. For the liability period, appellant filed sales and use tax returns reporting total sales of \$14,209,749. Appellant claimed deductions of \$607,094 for nontaxable sales of food products, \$270,675 for sales for resale, and \$540,682 for sales tax reimbursement included in reported total sales. After accounting for deductions, appellant reported \$10,351,663 in taxable gasoline sales subject to a partial exemption,⁴ and \$2,439,635 in taxable mini-mart sales. In addition, appellant claimed prepaid sales tax credits of \$206,908.
3. Appellant did not sell diesel fuel during the liability period.
4. For audit, appellant provided federal income tax returns for 2015, 2016, and 2017; and profit and loss (P&L) statements for the liability period.
5. CDTFA compared total sales (excluding sales tax reimbursement) that appellant reported on its sales and use tax returns for 2015, 2016, and 2017 to the corresponding gross receipts (excluding sales tax reimbursement) that appellant reported on its federal income tax returns, and noted immaterial differences.
6. CDTFA also compared the sales and sales tax reimbursement that appellant reported on its sales and use tax returns to the corresponding sales and sales tax reimbursement that

⁴ The partial exemption relates to a change in the law, which was effective July 1, 2010, to allow for a state excise tax rate increase and a corresponding sales and use tax rate decrease on sales of motor vehicle fuel (gasoline). (R&TC, §§ 6357.7, 7360.) Under these provisions, the statewide sales and use tax rate on gasoline sales decreased from 8.25 percent to 2.25 percent, plus applicable district taxes, and, as relevant here, the state excise tax increased from 18.0 cents per gallon prior to July 1, 2010, up to 27.8 to 41.7 cents per gallon during the liability period. This statutory change is referred to as the fuel tax swap.

- appellant recorded in its P&L statements, and noted no material differences for the liability period.⁵
7. CDTFA used the P&L statements to compare recorded sales to the corresponding recorded merchandise purchases and computed book markups for 2015, 2016, and 2017. CDTFA found that the book markups for mini-mart sales were within the expected markup ranges for businesses similar to appellant and concluded that appellant's recorded mini-mart sales were reliable. However, CDTFA found that the book markups for appellant's gasoline sales⁶ were lower than the expected markup ranges for similar businesses, and source documentation was not provided. Based on this, CDTFA concluded that further analysis was warranted to verify reported gasoline sales.
 8. CDTFA used its own ad hoc reconciliation reports⁷ for the liability period to compile the prepaid sales tax that appellant's fuel vendor collected of \$206,908. CDTFA compared the ad hoc reconciliation report results to the prepaid sales tax on gasoline that appellant claimed on its sales and use tax returns (also \$206,908) and noted no differences. CDTFA divided the prepaid sales tax for each quarterly reporting period by the applicable prepaid sales tax rate to compute 4,138,160 gallons of gasoline purchased for the liability period.
 9. Next, CDTFA visited appellant's business location on ten Mondays during the period August 6, 2018, through December 17, 2018 (test period), and recorded the current selling prices of gasoline posted on appellant's signage. Appellant sold three grades of gasoline: regular, mid-grade, and premium. The credit card sales prices were \$0.10 greater per gallon than the cash sales prices during the periods observed by CDTFA.
 10. CDTFA scheduled the statewide average weekly selling price per gallon as reported by the U.S. Department of Energy Information Administration (EIA)⁸ and calculated an

⁵ Where applicable, sales amounts included the respective sales tax reimbursement.

⁶ CDTFA computed gasoline book markups of 9.41 percent for 2015, 6.36 percent for 2016, 7.79 percent for 2017, and 7.81 percent for the three years combined.

⁷ A report generated by CDTFA which, for each reporting period, compares the prepaid sales tax that fuel vendors reported to have collected from a given taxpayer, with the amounts of prepaid sales tax claimed by that same taxpayer, in order to identify differences or errors in the amount of the taxpayer's claimed prepaid sales tax.

⁸ EIA surveys gasoline stations in various areas one day each week (typically a Monday), and computes an average selling price for that day, which OTA refers to here as the average weekly selling prices. The average weekly selling price is weighted to account for different grades of gasoline.

overall weighted average selling price of \$3.607 per gallon for the test period. CDTFA also scheduled appellant's weighted average selling prices for each Monday of the test period based on an estimation that 70 percent of appellant's gasoline sales were regular grade, 15 percent were mid-grade, and 15 percent were premium grade.⁹ From this, CDTFA calculated appellant's overall weighted average selling price of \$3.428 per gallon for the test period. Appellant's fuel prices were \$0.179 less than the EIA sales price. CDTFA noted that appellant charged \$0.10 per gallon less on its cash sales of gasoline. Thus, CDTFA found that the price difference between appellant's cash sales price of gasoline and the EIA sales price was \$0.279, because appellant charged \$0.10 more than its advertised price for credit card sales. CDTFA then used an estimated credit card sales ratio of 50 percent to calculate a weighted average pricing differential of \$0.23.

11. CDTFA took the statewide average weekly selling prices per gallon as reported by the EIA for the liability period and reduced them by the pricing differential to compute audited sales prices of gasoline. CDTFA multiplied appellant's audited gasoline purchases for each quarterly reporting period by the corresponding audited sales prices to compute gasoline sales, including sales tax reimbursement, of \$11,793,448 for the liability period. CDTFA divided appellant's gasoline sales, including sales tax reimbursement, for each quarterly reporting period by one plus the applicable partial sales tax rate (3.25 percent) to compute audited taxable gasoline sales of \$11,422,227 for the liability period. CDTFA compared the audited taxable gasoline sales to appellant's reported taxable gasoline sales for the liability period and calculated audited unreported taxable sales of gasoline of \$1,070,564.
12. CDTFA issued an NOD to appellant on April 10, 2019, based on the above-mentioned audit, with a tax liability of \$34,795, plus applicable interest.
13. Appellant filed a timely petition for redetermination disputing the NOD. CDTFA issued a decision on January 14, 2021, denying appellant's petition for redetermination.
14. Appellant timely appealed to OTA.

DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property sold

⁹ CDTFA asserts that this estimation was made due to appellant's failure to provide sales documentation. CDTFA also asserts that this estimation was based on its knowledge of audits of similar businesses in the area.

in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, 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 support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

When 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.) CDTFA is not required to accept as conclusive evidence the taxpayer's books and records, even if adequate business records are maintained and support reported taxable sales, where CDTFA, using recognized and standard accounting procedures, established in an audit that the books and records did not disclose the correct amount of tax liability. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 615.)¹⁰ 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.*)

Initially, the evidence shows that appellant failed to provide detailed records such as cash register tapes, or complete gasoline purchase invoices, to CDTFA for audit. In the absence of source documentation, CDTFA was unable to verify the gasoline sales that appellant reported on its sales and use tax returns using a direct audit method (that is, compiling audited sales directly from appellant's records). Thus, it was appropriate for CDTFA to use an indirect audit approach to calculate the taxable measure. (*See Appeal of Las Playas #10, Inc.*, 2021-OTA-204P.)

For the audit, CDTFA examined appellant's P&L statements and divided recorded gasoline sales (including sales for resale) by appellant's recorded gasoline purchases to calculate

¹⁰ The court held that "[R&TC sections 6481 and 7054] ... clearly contemplate an examination 'behind the books,' so to speak, in which original records, such as purchase invoices, sales slips, cash register tapes, and inventory records may be audited and analyzed. There is no requirement that such audit be restricted to pointing out falsifications, errors or omissions, if any, in the books of account themselves." (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 615.)

book markups of 9.41 percent for 2015, 6.36 percent for 2016, and 7.79 percent. Because appellant's book markups were lower than expected and considering appellant's failure to provide source documentation to support the book markups, it was reasonable for CDTFA to continue the audit.

To calculate the taxable measure, CDTFA conducted an analysis of gasoline sales based on EIA average sales prices data and the number of gallons appellant purchased. In addition, CDTFA reviewed appellant's actual prices for a ten-week period and found that, on average, appellant's sales prices were 23 cents less than the EIA average sales price data. CDTFA adjusted the taxable measure to account for this fact. Based on these facts, OTA finds that the resulting calculation was reasonable. Thus, the burden of proof shifts to appellant to show errors in the audit. (*Appeal of Talavera, supra.*)

On appeal, appellant asserts that the audited book markups are incorrect because they do not account for appellant's beginning and ending inventories. Appellant asserts that the correct markup rates are 10.04 percent for 2015, 7.91 percent for 2016, and 8.41 percent for 2017. Appellant also contends that CDTFA accepted markup rates of 9.41 percent and 11.14 percent from a similarly situated gas station, which CDTFA was auditing at the same time. Appellant asserts that CDTFA never disclosed the expected markup rate for appellant's business. Appellant contends that the audit measure results in markups of 20.23 percent for 2016, and 17.80 percent for 2017, which are too high for a business in this area.

Initially, OTA notes that the audit measure was not based on CDTFA's markup analysis. Rather, the markup analysis was used as part of the audit investigation. When it disclosed information that CDTFA found inadequate, a different method was used for the audit. As discussed, CDTFA calculated the taxable sales based on an adjusted EIA average sales price data for each year of the liability period and appellant's fuel purchases. Nevertheless, OTA will consider appellant's contentions that CDTFA incorrectly calculated the markup.

Chapter 4 of CDTFA's Audit Manual (Audit Manual) uses the following equation to calculate a markup percentage for audit: gross profit divided by cost of goods sold (COGS). (Audit Manual § 0407.10.)¹¹ COGS is defined as beginning inventory plus purchases less ending

¹¹ CDTFA's Audit Manual is an advisory publication providing direction to CDTFA staff administering the Sales and Use Tax Law and Regulations. OTA is not required to follow CDTFA's Audit Manual; however, OTA may look to it for guidance, such as when evaluating the reasonableness of CDTFA's determination. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

inventory. (*Ibid.*) COGS may be adjusted for additional items, such as self-consumption or pilferage. (*Ibid.*) However, where beginning and ending inventories cannot be verified, the cost of purchases may be considered if there is evidence that inventory was substantially constant. (*Ibid.*) Based on this, there is some substance to appellant's contentions. CDTFA did not take beginning and ending inventories into account when calculating the book markups. However, there is no evidence that appellant provided documentation from which COGS could be verified. By comparison, there is evidence that appellant's inventory was substantially constant. For example, appellant provided a schedule of fuel invoices for the period August 2018 through December 2018, which shows consistent and similar fuel purchases on a monthly basis. Accordingly, OTA finds that CDTFA calculated appellant's markup in accordance with its Audit Manual, and that the calculation is correct.

With respect to the other gas station's audit, appellant provided a schedule purportedly showing markups for a different gas station in a similar geographic area of 16.10 percent for the period July 1, 2015, through December 31, 2015, 9.18 percent for 2016, 11.16 percent for 2017, and 20.58 percent for the period January 1, 2018, through June 30, 2018. OTA first notes that it was not informed of the complete facts and circumstances of that audit, which is not at issue here. There is also no indication from appellant's submission that CDTFA accepted the other gas station's markups. Thus, this schedule carries little, if any, evidentiary value. Even if CDTFA did accept these markups as accurate, they are generally greater than appellant's markup rates, and, in some cases, are within a range that appellant asserts to be unrealistic for the area. Thus, OTA finds no reason to accept that appellant's book markups are accurate based on the other gas station's audited markup rates.

Next, OTA considers the taxable measure, which is based on the EIA-reported pricing and appellant's purchases of gasoline. Here, appellant argues that it was forced to have low prices to compete with a nearby Arco station. Appellant argues that "branded" gas stations, such as Arco, are less susceptible to fuel price fluctuations because they benefit from oil futures contracts. By comparison, appellant contends that independent gas stations, like itself, must pay the current price for oil. Appellant contends that oil price fluctuations cause the business's markup on gasoline to fluctuate. Appellant asserts that during the test period the business's markup on gasoline was higher, and thus, appellant's gasoline sales prices were higher.

In considering this contention, OTA finds no dispute that appellant's sales prices were below average. Indeed, CDTFA found that appellant's sales prices were less than the EIA average state sales price data by a weighted average of 23 cents. CDTFA's determination is both reasonable and rational. Appellant has not provided any evidence that its markup fluctuated at a rate that would allow for a greater price differential. Appellant asserts that CDTFA's calculation of the 23 cents price differential is inaccurate. During the oral hearing, appellant provided testimony that it used a fuel pump register, which was unable to charge different prices for gasoline sales paid by cash and gasoline sales paid by credit card prior to June 2018. As a result, appellant asserts that there was no difference between the credit card sales price of gasoline and the cash sales price of gasoline until after the liability period. Thus, appellant appears to contend that the 23 cents price differential is inadequate because it is based on the finding that appellant charged a different price for credit card sales of gasoline.

However, appellant has not provided any evidence that it charged the same price for credit card and cash sales during periods prior to June 2018 (for example, appellant did not provide a complete set of cash register receipts showing the amounts charged). Appellant also has not provided evidence that its prices were discounted even further below the EIA average state sales price data at any time during the liability period. Appellant's unsupported assertions are not sufficient to carry its burden of proof. (See *Appeal of Talavera, supra.*) Accordingly, OTA finds no basis to adjust the audit measure.

HOLDING

Appellant has not shown that adjustments to the measures of unreported taxable sales are warranted.

DISPOSITION

CDTFA’s action is sustained in full.

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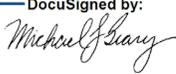
Keith T. Long
Administrative Law Judge

We concur:

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Andrew J. Kwee
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Michael F. Geary
Administrative Law Judge

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