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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **DIRECTV, INC.**	OTA Case No. 20096628 CDTFA Case ID 028-017

OPINION

Representing the Parties:

For Appellant:	Wade M. Downey, C.P.A., Representative Steve Bixler, Representative
For Respondent:	Jarrett Noble, Attorney Scott Claremon, Attorney Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Casey Green, Tax Counsel III

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) 6901, DirecTV, Inc. (appellant) appeals a Decision and a Supplemental Decision issued by the California Department of Tax and Fee Administration (respondent)[1] denying appellant's claim for refund of overpaid taxes and credit interest for the period January 1, 2006, through December 31, 2011 (claim period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Ovsep Akopchikyan, Josh Aldrich, and Michael F. Geary held an oral hearing for this matter in Cerritos, California, on February 16, 2023. At the conclusion of the hearing, the parties submitted the matter and the

[1] Prior to July 1, 2017, sales and use taxes (and other business taxes and fees) were administered by respondent's predecessor, the State Board of Equalization (board). When this Opinion refers to events that occurred before July 1, 2017, "respondent" refers to the board.

[2] On September 28, 2016, respondent granted appellant refunds of $492,801 overpaid for the fourth quarter of 2011 (4Q11) and $1,690,257.39 overpaid for the claim period. Respondent offset $86,467.95 in debit interest for the claim period and issued a net refund to appellant of $2,096,590.54. Appellant's timely December 2, 2016 claim seeks an additional refund of $402,390 overpaid as state and district taxes and the $86,467.95 in debit interest that respondent offset against appellant's earlier refund. Appellant also requests credit interest on the refunds issued for the claim period and for 4Q11.

record was closed. On May 1, 2023, OTA reopened the record to allow the parties to address additional matters.[3] The parties submitted additional briefing, and OTA again closed the record on June 6, 2023.[4]

ISSUES

1. Did respondent incorrectly offset time-barred state or district taxes for the period January 1, 2006, through December 31, 2011?[5]
2. Is appellant entitled to credit interest on the refund granted for the claim period?
3. Is appellant entitled to credit interest on the separate refund granted for the fourth quarter of 2011 (4Q11)?[6]

FACTUAL FINDINGS

1. At all times pertinent to this appeal, appellant sold and distributed television programming and other entertainment content to residential and commercial customers via satellite transmission. During at least some of the period at issue, appellant also sold (or leased) and installed equipment that was required to access the content.[7] For the claim period, appellant reported gross and taxable sales of $1,155,112,678 and $318,541,174 in purchases subject to use tax.

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[3] In its post-hearing, additional briefing request, OTA asked the parties to address questions concerning the following: the burden of proving the bases for respondent's denial of credit interest; the difference between "negligence" and "carelessness," as those terms are used in California Code of Regulations, title 18, section 1703(b)(6)(B); and whether the various claimed or conceded overpayments were intentional or the result of fraud, negligence, or carelessness.

[4] Appellant also filed what it characterized as an objection to respondent's post-hearing brief. In fact, the document was an unauthorized reply to respondent's post-hearing brief.

[5] "Time-barred" in this context refers to taxes for which respondent did not issue a determination prior to expiration of the statute of limitations.

[6] As explained below, appellant filed a claim for refund for the claim period and a separate claim for refund for 4Q11 only. This Issue 3 is not addressed in either the Decision or the Supplemental Decision. Generally, a taxpayer cannot bring an issue to OTA unless there has first been an adverse determination on the issue by respondent. (Cal. Code Regs., tit. 18, § 30103(b)(1).) However, in this instance, it appears that appellant did bring the issue to respondent's attention in appellant's brief (filed during respondent's internal appeals process) dated November 4, 2019. OTA, therefore, views the Decision's denial of credit interest to include appellant's separate claim for refund for 4Q11.

[7] Appellant's seller's permit was closed effective December 31, 2011, when it was merged into a related company, DirecTV LLC.

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2. Respondent audited appellant for two periods before the period at issue in this appeal: October 1, 1997, through September 30, 2000 (prior audit 1); and October 1, 2000, through December 31, 2005 (prior audit 2).
3. An April 7, 2004 audit report for prior audit 1 documents a reported state taxable measure of $29,076,003, overreported purchases subject to use tax totaling $9,931,896, and a net credit measure of $9,814,304.[8] Appellant filed a claim for refund dated May 19, 2003, for the prior audit 1 period for use tax paid in error.[9] The portions of the audit report in the record for prior audit 1 indicate that the audit required 651 hours. The report's Jurisdiction Sales Tax Calculation Summary (Summary) refers to only two district taxes, LACT and LATC,[10] with every quarter showing net overreporting for all jurisdictions.[11] By comparison, the audit at issue here required 1,137 hours, and the Summary refers to approximately 135 local, county, and district taxing entities.
4. Respondent informed appellant in 2004 that similar errors in the future might result in the imposition of penalties. Appellant informed respondent at that time that appellant had instituted changes to prevent such errors.

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[8] The audit report states that the total determined credit measure of $9,814,304 consisted of two audit items: (1) purchases of fixed assets subject to use tax measured by $7,450,114 and purchases examined in the paid bills test subject to use tax measured by $2,364,190. However, according to Schedule 12A, the "fixed asset" measure was actually the result of the part of the paid bills test that respondent determined on an actual basis. Furthermore, the $7,450,114 measure represents $7,567,706 in over-accrued use tax on 13 transactions offset by $167,592 in use tax underpaid on two transactions. Thus, appellant actually overreported use tax measured by $9,931,896 for the period then under consideration, assuming that audit did not determine and offset any deficiency in its determination of audit item 2.

[9] The claim for "$1.00, or such other amounts as may be established" appears to be a protective claim, which are commonly filed to protect a taxpayer's right to a refund or offset when the fact or amounts of overpayments are uncertain.

[10] The taxes designated LATC and LACT were both for the Los Angeles County Transportation Commission.

[11] The district tax portion of any district tax ordinance adopted pursuant to the Transactions and Use Tax Law is required to include provisions identical to those imposing the Sales and Use Tax Law. (R&TC, §§ 7261, 7262.) As such, in any case in which the state sales tax is applicable, the state-administered district tax is also applicable, if the place of sale is in a district imposing a district tax. (Cal. Code Regs., tit. 18, § 1823(a)(1).) For purposes of the district tax, all retail transactions are consummated at the place of business of the retailer unless the property is delivered by the retailer to an out-of-state destination, or to a common carrier for shipment outside this state. (R&TC, § 7263.) CDTFA collects this tax on behalf of the districts. (R&TC, § 7270; Cal. Code Regs., tit. 18, § 1821.)

5. Schedule 12 from the managed audit[12] for prior audit 2, the period immediately preceding the one at issue here, indicates a reported taxable measure of $448,118,927 – more than 15 times the amount reported for prior audit period 1 – debit measures totaling $12,171,951, credit measures totaling $77,829,828, and a net credit (refund) measure of $65,657,877. The audit included the following items: (1) a credit for use tax overpayments, measured by $29,462,285; (2) ex-tax purchases[13] subject to use tax, measured by $10,912,523;[14] (3) credit for tax-paid purchases resold, measured by $7,161,542; (4) taxable sales of premiums, measured by $885,342; (5) tax accrued in excess of tax paid, measured by $ 374,086; (6) a credit for tax accrued in error on exempt printed sales, measured by $ 2,090,743; (7) a credit for tax-paid purchases resold ("related to satellite"), measured by $27,758,123; (8) a credit for excess sales tax reimbursement offset against tax liability on the same transaction (per California Code of Regulations, title 18, (Regulation) section 1700(b)(4)), measured by $11,322,844; and (9) use tax accrued and reported in error, measured by $34,291.
6. The statute of limitations for respondent's issuance of a determination to appellant for 1Q06 was about to expire on April 30, 2009, when appellant filed a timely claim for refund dated April 27, 2009, for the period 1Q06 through 2Q06. The claim sought an unspecified amount as a refund of an overpayment of use tax accrued or paid on items not subject to tax.
7. Appellant executed a series of consecutive written waivers of the statute of limitations applicable to respondent's issuance of a determination (waivers), the last of which, executed by appellant on June 21, 2016, confirmed appellant's agreement that respondent would have until August 31, 2016, to issue a determination to appellant for the period July 1, 2006, through December 31, 2011, which was the date respondent closed appellant's seller's permit.

[12] According to respondent's Sales and Use Tax Audit Manual, section 0435.05, "a managed audit is essentially a self-audit. Under the direction of the auditor, an eligible taxpayer is provided written and oral instructions to enable the taxpayer to perform the audit verification and prepare the [audit workpapers] necessary to complete a particular portion of the audit."

[13] As used in this Opinion, "ex-tax purchases" refers to purchases made without payment of tax to the retailer or respondent.

[14] This is a combination of audit items 2 and 3.

8. Appellant filed other timely claims for refund of overpayments made during other reporting periods within the claim period. Respondent does not argue that any claim is barred by the statute of limitations or that any reporting period within the claim period is without a corresponding, timely claim for refund.

9. Respondent's audit of appellant for the claim period determined a net credit (refund) measure of $15,333,929, consisting of the following audit items: (1) an unreported measure of sales tax for leased receiver boxes, measured by $37,184,535; (2) use tax due on inventory withdrawals, measured by $98,356,245; (3) use tax due on self-consumed equipment and supplies, measured by $14,283,989; (4) a credit for tax-paid purchases resold, measured by $3,721,297; (5) a credit for excess sales tax reimbursement for 1Q06 measured by $2,267,303; (6) a credit for overpaid use tax for 1Q10 based on reconciliation of tax accrual account, measured by $3,712,230; (7) an overclaimed Line 2 ex-tax reduction on 4Q11 return, measured by $838,835; (8) a credit for overpaid use tax resulting from appellant's aggregate set-up of use tax accrual accounts in error for the period January 1, 2006, through December 31, 2011, measured by $136,700,145; (9) a credit for overpaid use tax due to Delta[15] tax journal entry adjustment errors for the period January 1, 2008, through December 31, 2011, measured by $12,035,472; and (10) overpaid use tax measure per the difference between Delta tax adjustments and payments for the period January 1, 2008, through December 31, 2011, measured by $7,561,086. The debit measures (items 1, 2, 3, and 7) totaled $150,663,604 while the credit measures (items 4, 5, 6, 8, 9, and 10) totaled $165,997,533.

10. Respondent offset the above-described deficiencies amounting to underpaid tax of $13,281,572 against appellant's tax overpayments totaling $14,971,834 to calculate a net refund for the claim period of $1,690,262 in tax (rounded, measured by $15,333,929). Respondent also determined that appellant was due an additional refund of excess prepayments for 4Q11 totaling $492,801.[16]

[15] The reference to "Delta" is explained in more detail below.

[16] This refund of $492,801 for 4Q11 is not in dispute, though appellant contends that respondent erred in denying credit interest in connection with the refund.

11. According to appellant, there were net overpayments of 19 district taxes for the claim period totaling $1,062,188.[17] Over 97 percent of those were to three Los Angeles County district taxes designated LACT, LATC, and LAMT. For the period January 1, 2006, through June 30, 2006, respondent refunded $133,274 in district taxes to appellant. This amount consisted of 16 of those net overpayments in their entirety, $53,235 from LACT, and the same amount from LATC.[18] Appellant does not dispute the amount of tax refunded for this period or how that amount was calculated.
12. After refunding the above-stated amounts for the period January 1, 2006, through June 30 2006, there were net district tax overpayments for the periods after June 30, 2006, remaining totaling $955,718, $399,006 each for LACT and LATC and $157,706 for LAMT. Respondent offset $403,870[19] of that total for taxes underpaid to other districts and refunded the remainder ($551,848), along with other overpaid state and local taxes, to appellant.
13. On July 7, 2016, respondent issued its audit report for the claim period. Although a general comment to the report recommends that credit interest be denied because the current refund was attributable to errors similar to those encountered in the prior audit, with the amounts being even greater than those previously encountered, the face page of the report identified the above-described credits, deficiencies, and net tax refund, and *includes* credit interest in the amount of $119,518.28, for a total refund of $1,809,775.67.
14. On July 28, 2016, respondent reissued its July 7, 2016 audit report for the claim period. This reissued report refers to the refund of tax in the amount of $1,690,257.39 but includes no credit interest. Instead, it includes debit interest of $86,496.12 (through July 31, 2016), for a total refund of $1,603,761.27.
15. Respondent did not issue a Notice of Determination (NOD). Instead, on September 28, 2016, 28 days after the expiration of appellant's final statute of limitations waiver, respondent issued to appellant a Billing and Refund Notice, or Notice of Refund (NOR),

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[17] By "net overpayments," this Opinion is referring to tax overpayment to the district less offset for that district's taxes owed for the claim period.

[18] There was no claimed overpayment to LAMT for this period.

[19] These offset district taxes totaling $403,870 are the taxes at issue in this appeal.

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of $2,096,590.54, consisting of $1,690,257.39 tax, minus $86,467.95 in debit interest, plus the additional refund of $492,801 tax for the period 4Q11.[20]

16. On October 5, 2016, the State Controller's Office issued to appellant a pay warrant for $2,096,590.54.

17. By letter dated December 2, 2016, appellant filed a timely claim for refund for the claim period.[21]

18. By letter dated December 26, 2018, respondent notified appellant that it intended to deny the December 2, 2016 claim for refund, and by letter dated January 22, 2019, respondent explained the bases for its denial. By letter dated February 20, 2019, appellant requested an appeals conference.

19. On September 18, 2019, the parties participated in an appeals conference as part of respondent's internal appeals process.

20. On February 3, 2020, respondent issued its Decision finding that appellant was entitled to an additional refund of $488,857.95, consisting of $402,390.00 in overpaid district taxes, which respondent had offset from appellant's claim in error, and the $86,467.95 in debit interest assessed and offset against appellant's claim in error, but that appellant was not entitled to credit interest for any part of the claim period.[22] The Decision relied, in part, on Sales and Use Tax Annotation (annotation) 802.0090 (4/28/1997), which had been removed from the Business Tax Law Guide in 2019 during appellant's appeal.[23]

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[20] The NOR also included an unspecified penalty credit of $0.10, which neither party addressed in argument or evidence. Given the amount, OTA need not discuss it further.

[21] The December 2, 2016 claim for refund was timely because it was filed within six months of the September 28, 2016 NOR. (R&TC, § 6902(a)(1).)

[22] OTA interprets this denial to include appellant's claim for credit interest in connection with the separate refund for 4Q11.

[23] Annotations are brief summaries of legal opinions written by respondent's legal department and are usually based on specific circumstances described in a document, such as an opinion letter or decision (backup). They are published by respondent in its Business Taxes Law Guide as an aide to taxpayers and tax practitioners. Annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) Nevertheless, OTA may still afford weight to an annotation. (See *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.)

21. By memorandum dated March 3, 2020, respondent requested reconsideration of the Decision insofar as it concluded that respondent incorrectly offset taxes underpaid to some districts against overpayments to other districts.[24] Appellant opposed the request.
22. On May 22, 2020, respondent issued its Supplemental Decision, reversing its finding in its earlier Decision regarding both the offset and debit interest, in effect denying appellant all requested relief.
23. Appellant requested reconsideration of the Supplemental Decision. Respondent did not reconsider, instead directing appellant to appeal to OTA.
24. This timely appeal followed.
25. Respondent now concedes that the debit interest ($86,467.95) is not due and that respondent's determination did not include $1,610.61 in overpayments of a Fresno County Transportation Authority district tax. On that basis, respondent agrees that appellant is entitled to an additional refund of $88,078.56.

DISCUSSION

Preliminary Matter

It is clear from the arguments and evidence that appellant believes that respondent did not properly handle appellant's claims.[25] To be clear, in this context, at least, OTA's function is to determine whether appellant is entitled to an additional refund of tax and/or interest, which will necessarily entail an examination of the three issues identified above. OTA is not a court. (Govt. Code, § 15672(b).) It is an administrative tribunal whose jurisdiction is specifically delineated by statute and regulation. (See Cal. Code Regs tit. 18, §§ 30103 and 30104.) OTA's primary responsibilities are to process and decide taxpayers' administrative appeals. (Govt. Code, §§ 15672(a), 15674.) To the extent appellant asserts that respondent's alleged failure to provide documents or other information was a violation of the Taxpayers' Bill of Rights, R&TC section 7083 provides that the Taxpayers' Rights Advocate office is "responsible for facilitating resolution of taxpayer complaints and problems, including any taxpayer complaints regarding

[24] It does not appear from the evidence that respondent requested reconsideration of the Decision's conclusion regarding debit interest.

[25] As an example, in his opening comments, appellant's representative stated, "As information and separate from the issues being decided here, we've asked the Taxpayers Rights Bureau to listen to this appeal and to review the complete record to address potential violations of the taxpayer's rights and adherence to the Department's audit policies and regulatory requirement[s]."

unsatisfactory treatment of taxpayers by board employees, and staying actions where taxpayers have suffered or will suffer irreparable loss as the result of those actions." There is nothing in the Taxpayers' Bill of Rights or OTA's enabling legislation, Assembly Bill Nos. 102 and 131 (2017-2018 Reg. Sess.), that grants OTA the authority to consider such claims.[26] If a taxpayer can show that an officer or employee of respondent recklessly disregarded respondent's published procedures, that taxpayer's remedy is to seek damages in an action filed with the Superior Court. (R&TC, § 7099.) Thus, if this Opinion fails to address an argument or evidence about a perceived wrong, that omission will likely be due to OTA's limited jurisdiction.

Issue 1: Did respondent incorrectly offset time-barred state or district taxes for the period January 1, 2006, through December 31, 2011?

As relevant to this appeal, when a taxpayer claims a refund of tax overpaid, respondent must confirm that a refund is in fact due and determine the amount that was paid in excess of the amount legally due. (R&TC, § 6901(a).) Having determined the amount of the refund due and to whom the refund is due, respondent must first credit the overpayment against any amounts then due and payable from the claimant, and only then pay the remainder to the claimant. (*Ibid*.)

When respondent determines that it will disallow a claim in whole or in part, it is required to give the claimant written and timely notice of its decision. (R&TC, § 6486.) If respondent fails to mail or personally deliver a notice of action on a claim for refund within six months after the claim is filed, the claimant may consider the claim denied and file an action against respondent on the grounds set forth in the claim. (R&TC, § 6934.)

In addition to the authority, just cited, to credit an overpayment against any amounts "then due and payable" from a claimant, R&TC section 6483 states that when auditing a claim for refund, respondent may offset overpayments for a period or periods, together with interest on the overpayments, against underpayments for another period or periods. In addition, the courts have recognized that respondent has the equitable authority to offset a taxpayer's liabilities against a claimed refund even when the liabilities are time-barred. (*Sprint Communications Co. v. State Bd. of Equalization* (1995) 40 Cal.App.4th 1254 (*Sprint*).)

In *Sprint*, the taxpayer (Company) overpaid use tax in connection with its purchases of tangible personal property (TPP) purchased for use exclusively outside of California. It filed a

[26] OTA does have jurisdiction to consider and decide taxpayers' claims to reimbursement of fees and expenses. (R&TC, § 7091; Cal. Code Regs., tit. 18, § 30705 et seq.)

timely claim for refund for the period October 1, 1986, through September 30, 1988, which respondent undertook to audit. Company executed two waivers: the first added 4Q88 to the audit period and extended the time within which respondent was required to issue an NOD to Company for the claim period and the first extension period (for which there was no claim); and the second added the first two quarters of 1989 and again extended the time within which respondent was required to issue an NOD to Company for the claim period and both extension periods (for which there were no claims) through October 31, 1992. Respondent then unilaterally (i.e., without Company's agreement) extended the audit period one additional quarter, through 3Q89.[27] Respondent did not issue its determination (for the entire audit period) to Company until November 20, 1992, almost three weeks after the statute of limitations for the entire audit period had expired. Respondent determined that Company had overpaid approximately $744,000 for the period of its claim, and it added to the refund additional amounts overpaid by Company during the periods covered by the two extensions.[28] Respondent then offset against those credit amounts approximately $230,000 in underpayments for the claim period and approximately $14,000 in use tax that Company had underpaid for 3Q89. It was undisputed in *Sprint* that all the deficiencies offset by respondent were valid; that is, all had been accurately calculated and would have been properly assessed against Company had respondent timely issued its determination. The issue was whether respondent had the authority to offset against deficiencies on other transactions after the time for enforcing those deficiencies had expired.

The court first examined respondent's retention of overpaid taxes to satisfy Company's deficiencies for the claim period. It acknowledged that there is no clear statutory authorization for offsetting time-barred deficiencies against a taxpayer's refund but then went on to discuss the long history of judicial acceptance of such offsets based on the sound equitable principle that a taxpayer is not entitled to a refund unless it has overpaid its taxes.[29] (*Sprint*, *supra*, at p. 1260.) Ultimately, the court in *Sprint* concluded that respondent correctly offset liabilities from the

[27] Pursuant to R&TC section 6487, the statute of limitations for issuing an NOD to Company for 3Q89 would also expire on October 31, 1992.

[28] There were no underpayments during the extension periods.

[29] The U.S. Supreme Court recognized this principle in 1932 in *Lewis v. Reynolds* (1932) 284 U.S. 281, 283.

claim period, stating, "When a taxpayer files a use tax refund claim for a stated period, the running of the statute of limitations does not abrogate [respondent's] power to set off, against any refund due, that taxpayer's time barred underpayments of use tax for the same period." (*Sprint*, *supra*, at p. 1262.) Furthermore, the court held that respondent's power to offset deficiencies against a claim for refund is not limited to deficiencies that arose in the same quarter as the overpayment. (*Sprint*, *supra*, at p. 1262.) The court stated, "[Respondent] could properly credit and set off underpayment of taxes barred by the statute of limitations in one quarter against an overpayment of taxes in another quarter, so long as both set-offs and overpayments occurred during the period put at issue by the taxpayer's refund request. The rule that 'he who seeks equity must do equity' applies to a taxpayer's claim for refund." (*Sprint*, *supra*, at p. 1264.)

The court in *Sprint* then considered respondent's offset for the deficiency from 3Q89. It found that the same equitable principles did not apply because that period was not included in Company's claim period or in any waiver signed by Company. On that basis, the court concluded the offset for 3Q89 could not be upheld.[30]

Appellant has made a number of arguments throughout the course of its appeal. Because none has been expressly abandoned, this Opinion will attempt to address all of them.[31]

Appellant contends that but for the pending claims, respondent could not have issued a determination regarding taxes for the time-barred periods. This is not correct. As the entity responsible for the administration of sales and use tax in this state, respondent correctly verified the amount of tax overpaid and underpaid by appellant. The expiration of the statute of limitations applicable to respondent's issuance of an NOD does not render a determination unnecessary or invalid. It renders it unenforceable, except by way of offset. (See R&TC, § 6487; *Owens–Corning Fiberglas Corp. v. State Bd. of Equalization* (*Owens-Corning*) (1974) 39 Cal.App.3d 532, 536.) As recognized by the court in *Sprint,* a taxpayer is not entitled to a refund of taxes unless it has, in fact, overpaid its taxes.

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[30] Because respondent did not determine a deficiency for the two waived periods, encompassing October 1, 1988, through July 31, 1989, no offset for those periods was at issue. Nevertheless, the court in *Sprint* noted that offsets for those periods, if any existed, would have been appropriate. (*Sprint*, *supra*, at p. 1265, fn. 6.)

[31] Arguments about respondent's violation of appellant's taxpayer rights will not be addressed because those are not within OTA's jurisdiction. Arguments directed to the debit interest will not be discussed because that issue is moot.

Appellant also argues that respondent's Supplemental Decision lacks an essential legal foundation to the extent it relies on the offset authority granted by R&TC section 6481 because that statute does not apply to the district taxes at issue here.[32] Yet, as appellant concedes, each taxing jurisdiction incorporates into its ordinance(s) provisions identical to those contained in Division 2, Part 1 (commencing with section 6001) of the R&TC, including section 6481. (See, for example, R&TC, §§ 7261, 7261.) Thus, OTA finds this argument lacks merit.

Appellant asserts that respondent's deletion of annotation 800.0090 is invalid. Although this opinion has already explained that OTA's role is to determine the correct tax and refund amount, it is worth noting here that annotations are essentially published summaries of legal opinions of respondent, which, while typically based on specific facts shown in the backup document (backup), are propounded to provide guidance to taxpayers and tax practitioners in general.[33] The issuance and deletion of annotations are respondent's prerogative. Current annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) Nevertheless, OTA may consider and afford some weight to an annotation. (See, for example, *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.) While a deleted annotation should not be cited as support for a proposition, there is nothing to prevent a taxpayer from framing an argument based on the reasoning shown in a former backup. It simply cannot be cited as respondent's legal opinion. Thus, respondent's deletion of annotation 800.0090 was not invalid, but it also does not impair appellant's ability to use the reasoning formerly shown by the annotation.

Appellant's core argument concerns the facts stated in Factual Finding 12, above. Appellant contends that respondent's use of underpayments of taxes to districts other than LACT, LATC, and LMT to offset appellant's claim to overpayments made to those three districts was not authorized by law. It reasons as follows: it is undisputed that the statute of limitations barred the determination that taxes, including district taxes, had been underpaid for the period in question; *Sprint* confers on "the taxing authority" the equitable power to offset against a claim for refund a deficiency that is uncollectable due to expiration of the statute of

[32] The Sales and Use Tax Law is found Division 2, Part 1 of the R&TC; the Bradley-Burns Uniform Local Sales and Use Tax Law is found in Part 1.5 of Division 2; and the Transaction and Use Tax Law is found in Part 1.6 of Division 2.

[33] OTA notes that, while annotations may be viewed in the context of the backup from which they came, the backup is not part of the annotation.

limitations; according to annotation 800.0090 and its backup, the taxing authorities here were each taxing jurisdiction, including LACT, LCTC, and LAMT; and there were no underpayments due to these districts when respondent exceeded its equitable power by offsetting underpayment to districts other than those from which appellant sought the refund; therefore, the offsets should be reversed.

Appellant's analysis is fatally flawed. First, as already stated, the determination that taxes, including district taxes, were underpaid was valid and enforceable by equitable setoff. Second, the court in *Sprint* did not use the term "taxing authority" to refer to each individual taxing jurisdiction in the state. It used the term to refer to respondent and to the IRS, which was the taxing authority involved in *Lewis v. Reynolds* (1932) 284 U.S. 281, a U.S. Supreme Court case upon which the court relied. Appellant has not pointed to anything in the court's language to support its interpretation to the contrary. Third, appellant's reliance on the reasoning found in the former annotation 800.0090 and its backup is misplaced, not just because it is no longer the opinion of respondent, but also because the facts upon which the former annotation was based are not apposite.

Regarding appellant's adoption of some of the reasoning expressed in the backup to the former annotation, an analysis should begin with the holding in *Owens–Corning*, *supra*. There, during an audit but before a determination was issued, the taxpayer sent a check to respondent "in advance payment of estimated liability, for the purpose of stopping the running of interest on this amount." (*Owens-Corning*, *supra*, at p. 534.) Respondent eventually issued several notices of determination, two of which were not timely issued because the statute of limitations waivers expired before issuance. The taxpayer did not disagree with the amounts determined or with respondent's application of a portion of its deposit to periods for which timely determinations were issued. It argued that it did not owe the taxes determined for the periods covered by the time-barred determinations and made a claim for refund of those amounts. Respondent denied the refunds, and the taxpayer filed an action. The trial court found for the taxpayer, but the appellate court reversed, relying in large part on *Lewis v. Reynolds*, *supra*, and quoting from that U.S. Supreme Court case as follows: "Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded." (*Owens-Corning*, *supra*, at p. 536.)

Here, appellant voluntarily made payments in excess of the amounts due. Appellant claimed refunds of overpaid taxes. Before paying the refunds, respondent offset *all underpayments*, which required it to offset some of the underpaid taxes against overpayments to the three districts that received over 97 percent of the overpayments. The end result was that all taxes were paid and appellant received refunds of the taxes it overpaid. This is precisely how equitable offset should work.

This was not the situation from which the deleted annotation arose. The backup, which describes the facts presented as "somewhat reversed" compared to *Sprint*, indicates the taxpayer's claim for refund was not timely for part of the audit period and, therefore, it was partially time-barred. A time-barred overpayment cannot be used to pay later-assessed taxes because respondent cannot grant either a refund or a credit where the claim is barred by the statute of limitations. (R&TC, § 6902.) The backup indicates that, contrary to these principles, audit staff incorrectly allowed offsets attributable to time-barred claims against all periods within the audit period. Furthermore, when the backup states that "the reaudit was computed to apply state and [local] taxes against deficiencies for [district] taxes," the clear implication is that respondent offset district tax deficiencies (i.e., district taxes the taxpayer owed) using claimed overpayments to state and local jurisdictions, including some for which the claim was time-barred. In other words, at least according to the facts stated in the backup, respondent used district taxes to refund tax overpayments to state and local jurisdictions. This action would have been contrary to the interests of the districts whose deficiencies were used to reduce the taxpayer's claimed overpayment to any other taxing jurisdiction and a clear violation of respondent's obligation to administer tax funds for the benefit of the entity imposing the tax. If all taxes due to the various taxing jurisdictions had been paid in full, as they have in this case, there would have been no such violation.

The author of the backup to the former annotation notes that respondent "is, thus, contractually obligated to act in good faith and fair dealing to ensure that each taxing entity receives the revenues properly due it." There is no evidence in this appeal that any district received less than was due. There is no evidence that equitable offsets under these or similar circumstances will ever require respondent to take a position relative to other taxing jurisdictions that favors one jurisdiction over another. There is no evidence that respondent has used its equitable offset power for anything other than the benefit of all taxing jurisdictions in this case.

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On the contrary, using other district's liabilities to offset overpayments to LACT, LATC, and LAMT ensured that those other districts would receive $403,870 in taxes that they would not otherwise have received. In short, appellant gave respondent the funds to pay its taxes, and respondent used the funds to pay all the taxes due for the claim period, refunding the excess to appellant. On the basis of the foregoing, OTA concludes that respondent did not incorrectly offset time-barred state or district taxes for the period January 1, 2006, through December 31, 2011.[34]

Issue 2: Is appellant entitled to credit interest on the refund granted for the claim period?

R&TC section 6907 provides that interest shall be paid on an overpayment of tax. However, R&TC section 6908 states that no credit interest will be allowed if respondent determines that an overpayment has been made intentionally or by reason of carelessness. R&TC section 6908 does not define carelessness. However, the regulation that interprets and implements (implements) R&TC section 6908 provides some guidance.

Regulation section 1703(b)(6)(B) states that there is an exception to the general rule requiring the payment of credit interest. As relevant to this appeal, the exception is when the overpayment is intentional or the result of negligence or carelessness.[35] (Cal. Code Regs., tit. 18, § 1703(b)(6)(B).) Regulation section 1703(b)(6)(B) goes on to state:

> Carelessness occurs if a taxpayer makes an overpayment which:
>
> 1) is the result of a computational error on the return or on its supporting schedules or the result of a clerical error such as including receipts for periods other than that for which the return is intended, failing to take allowable deductions, or using an incorrect tax rate; and
> 2) is made after the taxpayer has been notified in writing by the Board of the same or similar errors on one or more previous returns.

Thus, R&TC section 6908 does not refer to negligence. It refers to carelessness. The implementing regulation refers to careless and negligence without defining the latter.

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[34] Appellant specifically requested that this issue be stated in the alternative (i.e., state or district taxes). There was no argument or evidence that respondent incorrectly offset any taxes other than the district taxes analyzed above. Nevertheless, OTA's states its conclusion in terms consistent with the phrasing requested by appellant.

[35] The regulation also excepts overpayments due to fraud, but there is no evidence of fraud here.

Respondent concedes that it has the burden of proving that an exception to the general rule (to allow credit interest) applies here and that it must pay credit interest unless the evidence establishes a valid basis for denial of credit interest.

Appellant contends that respondent's denial of credit interest should be overruled. It argues that respondent consistently took the position after it reissued the July 7, 2016 audit report, at least until around the time of the appeals conference on September 18, 2019, that credit interest should be denied because of "carelessness;" and it asserts that respondent should not now be allowed to allege negligence as an additional and separate ground for denial of credit interest. Appellant further argues that its erroneous overpayments of use tax were not careless; they were unavoidable results of appellant's tremendous growth into multiple markets and taxing jurisdictions or were due to unusual events, such as a spike in overpayments due to a single software purchase during 1Q06 and a 2Q08 spike that was due to new system implementation.[36] Appellant contends that there were amendments to Regulation section 1703, which were intended to make clear to taxpayers that interest would no longer be granted if errors similar to those that were the subject of the prior written notice, that the errors in the instant audit are not similar to the prior errors, that "use tax overpayment" is too broad a basis for comparison, and that the prior notice requirement (to support a finding of carelessness) has not been met. Appellant asserts that an annotation upon which respondent relied to deny interest predated the amendments to Regulation section 1703 and should therefore be given little, if any, weight. It argues that respondent allowed credit interest for the 2000-2005 audit and the Field Billing Order[37] for 1Q06-2Q06, and that it is inexplicable and inconsistent for respondent to now deny credit interest based on notice allegedly given in 2004, which appellant disputes. Appellant contends that it has a 99 percent compliance rate reporting its taxable measure and that the trend for refunds to appellant is down. Finally, it asserts that respondent may have denied credit interest as a way to make appellant pay for the many audit hours it took to create all the district schedules, which is not an appropriate reason to deny credit interest.

Appellant provided testimony from a witness who worked in appellant's accounting department during the claim period as an occasional outside consultant. The witness testified

[36] Appellant characterizes the growth as going from a measure of $30 million for the 1997 through 2000 audit to a measure of $4.5 billion in the subject audit.

[37] A field billing order is often used by respondent to notify a taxpayer regarding an additional tax liability or refund determined using procedures other than a completed audit.

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that appellant always endeavored to not overpay use tax "to save out-of-pocket expense," but he conceded that appellant grew so quickly and across so many taxing jurisdictions, that some errors were inevitable and did occur, despite the periodic in-house review of the automated systems that appellant used for tax management. The witness disagreed with some of respondent's justifications for denying credit interest, which this Opinion will address below. Finally, the witness testified that there was no net refund for the period following the one at issue here, though the evidence does not show whether that was the result of higher deficiency amounts, lower use tax overpayment amounts, or a combination of both.

Regarding the witness's statement that it was always appellant's goal to minimize out-of-pocket expenses, OTA sees a difference between normal operating expenses and overpaid use tax. Normal operating expenses, including taxes actually due, are just part of the cost of doing business; the money is paid and gone, usually in exchange for value received. Overpaid use tax, though, is essentially deposited against future liabilities, with the excess being returned to the taxpayer, often with interest, if timely claimed. Overpayments of use tax can substantially complicate the administration of sales and use tax, often unnecessarily.

R&TC section 6907 states that credit interest *shall* be paid unless respondent determines that the overpayment was intentional or due to carelessness. The term "negligence" is not specifically defined in the Sales and Use Tax Law; but it is a common legal concept and is generally defined as a failure to act as a reasonably prudent person would have acted under similar circumstances. (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal.App.5th 1129, 1157.) Although a negligence penalty is not at issue here, the law regarding such penalties is instructive. A penalty for negligence should not be added to deficiency determinations made in the first audit of a taxpayer in the absence of evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were in substantial compliance with the requirements of the Sales and Use Tax Law or authorized regulations. (Cal. Code Regs., tit. 18, § 1703(c)(3)(A).) Conversely, though, a negligence penalty can be upheld in a first audit if there is evidence establishing that any bookkeeping and reporting errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. (*Ibid.*)

Regulation section 1703(b)(6)(B), which implements R&TC section 6908, defines "carelessness" quite specifically as a computational or clerical error that is repeated by a taxpayer after being notified by respondent in writing that the same or similar errors had occurred on prior returns. In OTA's view, a computational error is a mathematical mistake, and a clerical error, at least one that is not also a computational error, is one that does not involve an error of judgment or a mistake of law. It appears to OTA that, in drafting the regulation, at least as it has existed since 2002, respondent equated the reference to "carelessness" in R&TC section 6907 as a reference to negligence, which could include a mistake of judgment or an error of law, and then set up a definition of "carelessness," as essentially something less than negligence, that requires proof of the above two elements (i.e. computational or clerical error and prior notice) only. The parties appear to agree that carelessness, at least as that term is used in Regulation section 1703(b)(6)(B), is reasonably thought to be a subset of negligence.[38]

OTA is not persuaded by appellant's argument that OTA can only consider carelessness as a possible ground for denial of credit interest. As relevant here, Regulation section 1703(b)(6)(B) states that credit interest should be denied if the overpayment is intentional or the result of negligence or carelessness.[39] Appellant is entitled to adequate notice of the claimed bases for respondent's denial of credit interest and an opportunity to be heard. It has had such notice.

The record is replete instances showing that appellant was on notice that negligence was a possible ground for denying credit interest, including the following:

- Respondent notified appellant that negligence was an issue when it presented its schedule 12K, at the appeals conference.[40]
- Respondent's Decision states that appellant argued that credit interest should be allowed, or partially allowed, because respondent's stated

[38] In post-hearing briefing the parties were asked to state the difference between "negligence" and "carelessness," as used in Regulation section 1703(b)(6)(B). Appellant stated, in part, that negligence includes a degree of carelessness but the opposite is not true. Respondent stated, in part, that carelessness is less than negligence and requires prior written notice of same or similar errors.

[39] Fraud is not an issue.

[40] Schedule K contains the following language: "The lack of internal control to account for use tax for proper tax reporting and consistent practice of making additions of tax each quarter in significant amount provides clear evidence for the presence of carelessness or even gross negligence."

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reasons for denying credit interest, including that a negligence penalty would have applied if tax was due, exist in this case.

- There was a specific discussion regarding schedule 12K at the hearing, when appellant stated that its witness (Mr. Manzano) would address the comments made in that document.
- Appellant pointed out at the hearing that the Decision concludes with the following statement: "We find from the above that claimant's overpayments at issue were the result of recurring clerical or computational errors or repeated errors in similar transactions, which claimant failed to correct in successive quarters."
- Much of Mr. Manzano's testimony, at least that which was not specifically to refute statements made by respondent's audit staff, appears to have been to show that DirecTV acted reasonably.
- Respondent argued at the hearing that examples of carelessness include in audit situations where there is a net refund but a negligence penalty would have been assessed if there had been a deficiency.
- Finally, the post-hearing AB request makes clear that OTA might consider negligence as a basis for denial of credit interest.[41]

There are also other things to be considered. The law, as this Opinion lays out, allows respondent to deny credit interest when the overpayment has been intentional or due to negligence or carelessness. Appellant is presumed to know the law. Also, it is OTA's responsibility to determine the legally correct tax or refund due. OTA cannot fulfill that responsibility if it confines itself to the specific contentions made by the parties.

OTA concludes that respondent's denial of credit interest should be sustained if OTA finds that it is more likely than not that the subject overpayments were intentional, the result of negligence, or the result of carelessness, as defined in Regulation section 1703(b)(6)(B).[42]

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[41] The parties filed their post-hearing briefs concurrently, and respondent's post-hearing brief argued negligence in connection with the overpayments shown in audit items 9 and 10, only; consequently, appellant cannot persuasively argue that it failed to address negligence as a possible basis for denial of credit interest for any or all of the audit items.

[42] Prior written notice is only required for denials of credit interest on overpayments that were the result of carelessness.

Regarding the question of notice to appellant, appellant filed a May 19, 2003 protective claim for refund for $1.00 or more overpaid during prior audit period 1 for use tax accrued and paid in error on purchases not subject to tax or upon which tax had been assessed by the vendor. The April 7, 2004 audit report documents appellant's overpayment of use tax totaling $9,931,896,[43] respondent's notice to appellant that similar errors in the future might result in the assessment of penalties, and appellant's representation to respondent that appellant had instituted changes to prevent such errors in the future. There is no question that appellant received written notice and was aware by at least 2004 that it was overpaying use tax and that it could be "penalized" if the errors continued. OTA rejects appellant's argument that if respondent allows credit interest in an audit after giving the written notice required by Regulation section 1703(b)(6)(B), the notice becomes a nullity. There nothing in the controlling statutes or regulation that supports that argument. However, the inquiry into the prior notice requirement does not end here.

There may be some validity to appellant's argument that a notice regarding "similar errors" in a prior audit involving overpayment of use tax is too broad a basis for determining whether the same taxpayer should be denied credit interest on later use tax overpayments on the grounds of carelessness. For example, a prior notice regarding a taxpayer's overpayment of use tax in connection with withdrawals of inventory may not be sufficient when the post-notice overpayment is solely in connection with ex-tax purchases of fixed assets. But there may also be circumstances where a taxpayer's lack of attention to the details of its tax accrual is such that a general warning about overpayment of use tax may be sufficient to support a subsequent denial of credit interest. Every appeal must be judged on the particular facts shown by the evidence.

It should be noted that appellant reported a taxable measure of $20,635,193 for the prior audit 1 period, but respondent determined that the audited taxable measure was only 52.4 percent of that amount due to overpaid use tax. The use tax was overpaid to just two vendors on 13 transactions that were not subject to use tax.[44] In other words, these were mistakes of judgment or misapplications of the law, and not merely computational or clerical errors, though this distinction may have had no particular significance to the parties at the time. Here, the

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[43] See Factual Finding 3, above.

[44] Appellant's argument in this appeal suggests that appellant had incorrectly accrued use tax on its program guide.

evidence identifies six audit items that make up the credit measures, items 4, 5, 6, 8, 9, and 10. This Opinion will examine each.

Respondent argues that all overpayments were due to carelessness. In addition, in its post-hearing brief, respondent asserts that the overpayments shown in audit item 6 were also intentional, and the overpayments shown in audit items 9 and 10 were also intentional or due to negligence.

Appellant argues that OTA should not consider any claimed basis for its denial of credit interest other than carelessness because this was the only basis argued by respondent throughout the appeal. It denies that it intentionally overpaid tax and that it was negligent or careless, as that term is defined in Regulation section 1703(b)(6)(B). While it concedes in its post-hearing brief that some of the overpayments "could potentially include elements of carelessness based on the number of journal entries and reversals," it argues that all adjustments were in good faith and with the intent to report the tax more accurately, which is not carelessness.

Audit items 4 and 5, with a combined measure of $5,988,600, are described in respondent's Verification Comments (in the audit work papers) as related to an issue that occurred in prior audit 2 and carried over into 1Q06. It involved appellant purchasing TPP tax-paid and then reselling the TPP to its customers at retail, collecting sales tax reimbursement and remitting it to respondent, thus paying tax twice. Appellant was entitled to a tax-paid purchases resold deduction but did not claim it. OTA does not view this as a use tax overpayment issue. Respondent did not explain – and there is nothing in the evidentiary record to show – how these audit items relate to overpaid use tax. However, these also were not computational or clerical errors. These were errors of judgment or misapplications of the law that reasonable care would have and should have avoided. Appellant offered no reasonable explanation for the overpayment that does not necessarily include an element of negligence.[45] On these bases, OTA finds that the errors cannot be attributed to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. They were the result of negligence, and respondent correctly denied credit interest on these items.

[45] OTA does not doubt that appellant had difficulties that were the direct result of the tremendous growth of appellant's business. A reasonably prudent business person plans for growth and for how growth affects all parts of the business.

Audit item 6 is a credit for overreported use tax for 1Q10 based on reconciliation of tax accrual account, measured by $3,712,230. According to the Verification Comments, appellant should have deducted the debit balance of $180,971, but instead appellant added it, in effect overreporting use tax due in connection with ex-tax purchases subject to use tax by a factor of two. OTA finds that this overpayment was the result of a computational error. There is no evidence that this type of error occurred before, that either party would have had this type of error in mind when respondent cautioned appellant about errors in 2004, or that the prior notice should have prevented this type of error. OTA finds that respondent should have allowed credit interest in connection with this item.

The Verification Comments go into some detail to describe the $136,700,145 measure of audit item 8. One states:

> [Appellant]'s use tax accrual system relied on the purchasing department's knowledge of taxability in setting the taxability of specific [purchase orders] . . . and where costs were charged within the general ledger. Based on the aggregate set-up of that account as taxable or exempt, [the accounts payable] system automatically applied taxability to all activity within a [general ledger] account. Also the tax jurisdiction assigned by purchasing was generally the headquarters location of [appellant] in El Segundo, resulting in much [California] tax accrued on purchases from vendors who shipped the goods via common carriers to [appellant's] locations outside [California].
>
> When the purchase was coded to a taxable [general ledger], use tax was accrued automatically. There was no human interaction for detail analysis, no decision-making process, and no internal control in place to assure accuracy of use tax accruals for proper tax reporting on return line 2. During the course of the current audit, [appellant engaged] . . . an outside tax consulting firm[46] . . . to audit the use tax accruals transaction by transaction and found significant amount[s] of over-reported use tax resulting from the accrual systems' error. . . .
>
> Per review of the claim for refund schedules, it is noted that over 15 [percent] of the over-reported ex-tax is for purchases that were shipped via common carriers by vendors to [appellant's] nationwide locations for its consumption out-of-state (not in California), 10 [percent] on repair/installation labor and various exempt services, and 15 [percent] on electronic software or optional maintenance contracts without the transfer of tangible media. The biggest mistake, nearly 60 [percent] of the over-reported tax, is related to the complex and creative product/service

[46] The outside firm is the one that represented appellant in prior audits, in the instant audit, and during this appeal.

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> promotion and marketing transactions, such as advertising campaign sponsorship, online/digital ad, printed sales messages, direct mail of promotional and DTV subscription materials as described under Annotation 423.0073 item (1), and etc. Based on mere review of the vendor billings, it is difficult to determine the taxability for each type of [activity] properly without in-depth research and more than basic tax law knowledge.

As with the errors discussed above, these were not computational or clerical errors, so they do not qualify as carelessness as that term is used in Regulation section 1703(b)(6)(B). They were the result of negligent errors in judgment or misapplication of the law. Reasonably knowledgeable accounting staff, given time to do the job the law required, would have known and should have known that use tax was not due in connection with approximately 40 percent of the transactions included within audit item 8 (out-of-state use of TPP, repair labor, installation labor, exempt services, purchases of software without tangible media, and optional maintenance agreements). In addition, respondent's opinion that almost 60 percent of the overpayments were due to "complex and creative" promotional and marketing transactions does not negate the fact that appellant planned these transactions in advance to promote growth but did not adequately consider and plan for how these kinds of transactions and the tremendous growth of its business would affect its ability to accurately report its taxes.

The documentary evidence clearly establishes that appellant's treatment of the transactions did not comply with the Sales and Use Tax Law. While appellant's witness spoke in general terms about appellant's rapid growth across many taxing jurisdictions, its "periodic review" of use tax accruals, and its focus on saving the out-of-pocket expense of overpaid use tax, the witness did not testify to facts that tend to rebut what the documentary evidence shows: the overreporting shown in item 8 was the result of appellant prioritizing growth while failing to maintain accounting resources sufficient to accurately report taxes due. The evidence does not persuade OTA that the overpayments are fairly attributable to the taxpayer's good faith and reasonable belief that its bookkeeping and reporting practices were substantially compliant with the requirements of the Sales and Use Tax Law. On these bases, OTA finds that the overpayment shown in item 8 was the result of negligence and that respondent's decision to deny credit interest in connection with this item should be sustained.

According to the Verification Comments, audit items 9 and 10, with a combined measure of $19,596,558, grew from appellant's effort to pay all tax that was due, not just the tax stated on

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the vendors' invoices. Appellant's witness states that these overpayments were the result of appellant's efforts to correct for accounting errors discovered in earlier audits. The witness describes the situation in testimony, in part, as follows:

> The Delta, ironically, was set up to try and capture additional tax as a result of prior audits. So the Delta is really the difference between the tax that a vendor [charged appellant] and the tax that our system determine[d was] due. So if the vendor charges $100.00, but our system says we owe $150.00, that $50.00 is the delta or the difference that would be accrued within the system.

The witness went on to explain that appellant's software would make the tax determination based on the purchase orders and the general ledger accounts, in conjunction with the way that the vendor submitted invoices, and any difference that was identified became the delta that was reported (incorrectly) as additional use tax due.

According to respondent's Verification Comments, the program was primarily intended to automatically determine amounts by which appellant's purchases were undertaxed and then to automatically accrue the additional tax for reporting purposes. However, respondent found that the program did not function that way, at least in part because it was unable to distinguish between actual underpayments of tax and purchases that included nontaxable components, such as intangibles or nontaxable services. Appellant offered no argument or evidence to refute this characterization and there is no dispute regarding the amounts of the overpayments.

The evidence shows that the overpayments identified in audit items 9 and 10 were not the result of mere computational or clerical errors. As with some of the other audit items discussed above, they were the result of negligence. A reasonably prudent businessperson would try to correct for accounting errors discovered in tax audits, and OTA has insufficient information to criticize appellant's decision to embark on this effort to identify under-accrued use tax. However, the effort appears to have been untested and unmonitored. That was negligent, and as a result, appellant overpaid tax on a measure of $19.5 million between January 1, 2008, and December 31, 2011, with an overpayment in every quarter measured by between $150,956 and $7,583,703. OTA therefore finds that respondent correctly denied credit interest for audit items 9 and 10.

Issue 3: Is appellant entitled to credit interest on the separate refund granted for 4Q11?

As relevant to this issue, respondent is required to pay interest on any overpayment of tax from the first day of the calendar month following the month during which the overpayment was made to the last day of the calendar month following the date upon which the claim is approved by respondent. (R&TC, § 6907.) As previously stated, no credit interest will be allowed if respondent determines that an overpayment has been made intentionally or as a result of negligence or carelessness. (R&TC, § 6908; Cal. Code Regs., tit. 18, § 1703(b)(6)(B).)

The September 28, 2016 NOR included a refund of $492,801 for 4Q11 only.[47] Appellant argues that it made prepayments toward its 4Q11 liability in October and November and only later realized that it had prepaid more than what it would owe for the quarter. Appellant states that respondent substantially accepted appellant's 4Q11 return as accurate, essentially conceding that appellant had overpaid for that quarter. Appellant asserts that, rather than granting the refund then (and immediately releasing the funds to appellant), respondent held the funds for 57 months pending completion of the audit for the claim period.

Respondent's argument and evidence barely mention this refund. OTA found a single reference to the refund in Exhibit 3 to respondent's Decision. On page 35 of that exhibit, which is part of audit schedule 414A-P5, respondent states that the excess tax prepayments for October and November 2011 did not consider "the significant amount of tax reduction adjustment in December 2011." It is not clear what this means, and respondent has not really addressed this issue in its arguments or evidence. OTA does not find sufficient evidence in the record to conclude that appellant intentionally made excess prepayments or that it was negligent or careless in connection with its prepayments for 4Q11. Therefore, OTA finds that respondent has failed to establish a valid basis for its denial of credit interest on the 4Q11 refund. Therefore, appellant is entitled to credit interest on that refund.

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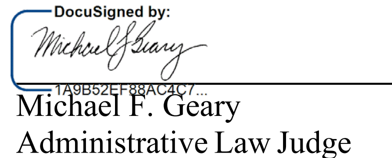
[47] The refund for the claim period, addressed in Issues 1 and 2, above, also included 4Q11, but that refund is unrelated to the refund addressed in Issue 3.

HOLDINGS

1. Respondent correctly offset time-barred state or district taxes for the claim period.
2. Appellant is entitled to credit interest on only a portion of the refund granted for the claim period: the refund of overreported use tax for 1Q10, based on reconciliation of tax accrual account, measured by $3,712,230 (audit item 6).
3. Appellant is entitled to credit interest on the refund granted for 4Q11.

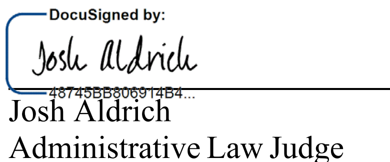
DISPOSITION

Appellant is entitled to an additional refund of $88,078.56 for the claim period, as agreed by respondent, and to credit interest on the refund of overreported use tax for 1Q10, based on reconciliation of tax accrual account, measured by $3,712,230 (audit item 6) and on the separate refund of $492,801 for 4Q11 only. In all other respects, respondent's action denying appellant's claim for refund and credit interest is sustained.



Michael F. Geary
Administrative Law Judge

I concur:



Josh Aldrich
Administrative Law Judge

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O. AKOPCHIKYAN, dissenting in part:

My only disagreement with the outcome of this appeal relates to Issue 2—whether DirecTV, Inc. (appellant) is entitled to interest on the refund granted for period January 1, 2006, through December 31, 2011.

Revenue and Taxation Code (R&TC) sections 6907 and 6908 provide that respondent California Department of Tax and Fee Administration (CDTFA) must pay credit interest unless a taxpayer's overpayment of tax was intentional or due to carelessness. California Code of Regulations, title 18, (Regulation) section 1703(b)(6)(B) provides that "credit interest will be allowed on all overpayments, except when statutorily prohibited or in cases of intentional overpayment, fraud, negligence, or carelessness." I agree with the majority and the parties that CDTFA has the burden of proving its bases for denying credit interest by a preponderance of the evidence.

After the hearing in this appeal, the Office of Tax Appeals (OTA) asked the parties the following two questions regarding CDTFA's denial of credit interest:

1. What is the difference between "negligence" and "carelessness," as used in Regulation section 1703(b)(6)(B)?

2. Which overpayments, if any, were intentional; which overpayments, if any, were the result of fraud; which overpayments, if any, were the result of negligence; and which overpayments, if any, were the result of carelessness?

In response to question 1, CDTFA stated that: (1) a "finding of carelessness requires a lower standard than negligence but with the added limitation that a taxpayer must be notified in writing of the same or similar errors in prior returns" and (2) "carelessness may be found in situations that do not rise to the level of negligence," such as when overpayments are caused by clerical or computational errors. In response to question 2, CDTFA asserted that: (1) the overpayments related to audit items 4, 5, and 8 were the result of only carelessness; (2) the overpayment related to audit item 6 was intentional and due to carelessness; and (3) the overpayments related to audit items 9 and 10 were due to negligence and carelessness.

In response to OTA's post-hearing questions, appellant stated that CDTFA has not asserted on appeal that any of the overpayments were intentional or due to negligence and

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requested "the ability to respond should the CDTFA now raise in its additional briefing any of these as the basis for denying credit interest."

In summary, CDTFA's position on appeal is that only the overpayments related to audit items 9 and 10 were due to negligence. However, the majority found that CDTFA met its burden of proving that the overpayments related to audit items 4, 5, 8, 9, and 10 were due to negligence. Because CDTFA never argued on appeal or explained why the overpayments related to audit items 4, 5, and 8 were due to negligence, I find that CDTFA did not carry its burden of proving by a preponderance of the evidence that it denied credit interest for those overpayments on the basis of negligence.

DocuSigned by:
Ovsep Akopchikyan
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Ovsep Akopchikyan
Administrative Law Judge

Date Issued: 9/14/2023