

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:	)	OTA Case No. 19054812
<b>DOOMID, INC. (REHEARING)</b>	)	CDTFA Case ID 681012
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**OPINION ON REHEARING**

Representing the Parties:

For Appellant:	Shahriar (Shawn) Nazari, President
For Respondent:	Nalan Samarawickrema, Hearing Rep. Christopher Brooks, Attorney Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III
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A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) sections 6561, Doomid, Inc. (appellant) appeals an adverse decision of respondent California Department of Tax and Fee Administration (CDTFA).<sup>1</sup> The CDTFA Appeals Bureau decision partially granted appellant’s petition for redetermination of a Notice of Determination (NOD) dated October 25, 2012.<sup>2</sup> The NOD is for \$492,441.57 in tax, plus applicable interest, and a negligence penalty of \$49,244.17, for the period January 1, 2009, through June 30, 2012 (liability period).

On appeal to the Office of Tax Appeals (OTA), appellant agrees with the CDTFA Appeals Bureau decision and, as such, appellant now wants to accept the decision. However,

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

<sup>2</sup> The CDTFA Appeals Bureau issued a decision dated January 29, 2015, which directed a reaudit, and a supplemental decision dated April 27, 2016, which recommended adjustments. CDTFA ultimately decided not to make any adjustments and now asserts the full amount of the NOD. Unless otherwise noted, this Opinion uses the term “decision” to refer, collectively, to the original decision, as revised by the supplemental decision, and as further revised by CDTFA’s decision not to follow the supplemental decision.

CDTFA is now asserting the full amount of the NOD and, as such, CDTFA will not let appellant accept its decision. CDTFA no longer agrees with the adjustments previously granted by its Appeals Bureau and is instead asserting an increase to the CDTFA Appeals Bureau decision is warranted.

On December 13, 2017, the State Board of Equalization (board) voted to partially grant appellant's petition. The board adopted the CDTFA Appeals Bureau decision and ordered reductions of the same amount as allowed in the decision. The board also deleted the negligence penalty. In summary, the board's decision would have reduced the tax by \$136,819.07, deleted the \$49,244.17 negligence penalty, and sustained the balance of the NOD.

CDTFA timely petitioned OTA to rehear this matter on the basis that, during the oral hearing, a board member allegedly distributed CDTFA audit schedules, which the board member or the member's staff altered so as to favor appellant's position, and because the board members may have relied upon altered evidence in reaching its decision to partially grant the appeal.<sup>3</sup> OTA granted a rehearing due to a material irregularity in the appeals proceedings.

OTA Administrative Law Judges Andrew J. Kwee, Sheriene Anne Ridenour, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on July 13, 2023. At the conclusion of the oral hearing, the record was closed, and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

### ISSUES

1. Whether adjustments are warranted to the audited understatement of reported taxable sales.
2. Whether CDTFA properly imposed the negligence penalty.

### FACTUAL FINDINGS

1. Appellant operated a diesel fuel station with a convenience store in Mojave, California, from July 1, 2003, until December 31, 2012. The convenience store sold miscellaneous sundry items, including food.

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<sup>3</sup> The board concurrently voted to deny a related claim for refund of \$532 in tax in this matter (board case 626011) for the period January 1, 2012, through March 31, 2012. CDTFA withdrew its petition for rehearing of the board's decision to deny the refund claim in its entirety; and this matter is not before OTA in the instant rehearing.

2. During the liability period, appellant reported total sales of \$19,511,037, claimed deductions totaling \$3,119,327, for reported taxable sales of \$16,391,710. Appellant reportedly obtained these figures for its sales and use tax returns (SUTRs) using data compiled from reports generated by its point-of-sale system.
3. On October 5, 2012, CDTFA completed an audit of appellant for the liability period. This was CDTFA's second audit of appellant. Appellant did not provide any records to the auditor during the field audit.
4. CDTFA observed the business on three occasions and recorded the cash selling prices for diesel fuel on those days. The cash prices observed by CDTFA were \$4.179 per gallon on Thursday, August 16, 2012; \$4.339 on Monday, August 27, 2012; and \$4.359 on Monday, September 17, 2012. CDTFA also observed that appellant added an additional premium of 8 to 10 cents per gallon for diesel fuel purchased with a credit card.
5. CDTFA compared appellant's posted cash selling prices per gallon to the average selling prices per week published by the United States Energy Information Administration (average weekly EIA price).<sup>4</sup> CDTFA found that, for those three days, appellant's cash selling prices averaged 7.1 cents less than the average weekly EIA price.
6. CDTFA used adjusted average weekly EIA prices to compute audited selling prices for each quarter in the liability period. When making this calculation, CDTFA adjusted (reduced) the average weekly EIA prices to account for the 7.1 cent per gallon price differential.<sup>5</sup>
7. CDTFA established audited taxable sales of diesel fuel of \$21,568,029, by multiplying the audited numbers of gallons sold at retail by the audited selling price for each quarter of the liability period.
8. In the absence of records, CDTFA estimated taxable and non-taxable convenience store sales ratios of 59 percent and 41 percent, respectively, which were percentages CDTFA observed in audits of similar businesses. To compute audited taxable convenience store

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<sup>4</sup> The Department of Energy surveys retailers of diesel fuel in various areas of the state on one day each week and computes and publishes a statewide average selling price of diesel for that day, which is referred to in this Opinion as the average weekly EIA price.

<sup>5</sup> CDTFA reduced the average weekly selling price by 7.1 cents and by the California excise tax per gallon to establish the selling price net of the California excise tax. It then reduced that figure by the amount of sales tax included to establish the selling price per gallon, net of tax.

- sales, CDTFA multiplied claimed nontaxable convenience store sales by 1.43902 ( $0.59 \div 0.41 = 1.43902$ ) to compute taxable sales of \$495,570 ( $\$344,380 \times 1.43902 = \$495,570$ ).
9. CDTFA added audited taxable sales of diesel and audited taxable convenience store sales to establish audited taxable sales of \$22,063,599 ( $\$21,568,029 + \$495,570$ ). This exceeded reported taxable sales of \$16,391,710 by \$5,671,889.
  10. On October 25, 2012, CDTFA issued an NOD for the liability disclosed by audit, plus a 10 percent negligence penalty.
  11. By letter postmarked November 21, 2012, appellant timely petitioned the NOD.
  12. On January 29, 2015, CDTFA issued a decision directing a reaudit to allow appellant to submit, and CDTFA to consider, additional new documentation.
  13. For the reaudit, appellant provided sales data, including information for the second quarter of 2011 (2Q11). Appellant otherwise provided very limited records.<sup>6</sup>
  14. CDTFA contacted one of appellant's diesel fuel suppliers to compare appellant's newly furnished sales data to the purchase invoices that appellant's supplier issued to appellant for 2Q11. The data comparison disclosed that appellant sold diesel fuel at a loss of \$600,000 during 2Q11, and CDTFA projected a loss of \$7,000,000 for the liability period using the above data.
  15. By memorandum dated November 10, 2015, addressed to its Appeals Bureau, CDTFA's audit staff stated that the sales information provided by appellant was unreliable and declined to perform a reaudit based on appellant's newly provided sales information.
  16. On April 27, 2016, the Appeals Bureau issued a supplemental decision, which recomputed the differential between appellant's selling prices and the average weekly EIA price. The supplemental decision used the selling prices observed by CDTFA audit staff for Mondays August 27, 2012, and September 17, 2012, and the selling prices reflected on appellant's sales data (which audit staff found unreliable) for Mondays April 5, 2010, and June 21, 2010, to compute a differential of 31.8 cents between

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<sup>6</sup> Appellant also provided the following: a copy of the 2Q11 SUTR; sales summary worksheets for the months of April, May and June 2011; daily sales reconciliation reports for April 5, 2010, April 6, 2010, June 21, 2010, June 22, 2010, and June 30, 2011; clearing house settlement transmittals from T-Check for July 20, 2011, and January 1, 2012, and from Fleet One for July 10, 2010; fuel purchase invoices from Ramos/Strong Inc. for June 10, 2011, and June 15, 2011; five photos of stacks of documents; data for 2007 and 2009 crude oil prices from an unspecified source; and diesel fuel prices for December 1, 2015, published on the website California Gas Buddy.

appellant's selling prices and the average weekly EIA price. The supplemental decision computed audited selling prices for diesel for each quarter of the liability period by reducing the average weekly EIA price by 31.8 cents per gallon. The supplemental decision calculated a reduction to reported taxable sales of \$1,618,032 (from \$5,671,889 to \$4,053,857) and sustained the negligence penalty.

17. CDTFA completed a first reaudit to make the changes provided in the CDTFA Appeals Bureau decision, which reduced the tax to \$355,622.45, and made a corresponding reduction of the negligence penalty to \$35,562.26.
18. On April 26, 2017, the board heard this matter. Appellant argued that CDTFA declined to review its records. The board continued the oral hearing and directed CDTFA staff to review appellant's records.
19. At the time the board continued this matter, appellant's records did not include purchase invoices for diesel fuel for the liability period.<sup>7</sup>
20. CDTFA contacted appellant's fuel suppliers and obtained purchase invoices from four fuel suppliers, including both of appellant's primary fuel suppliers. Three fuel suppliers provided purchase invoices for the period July 1, 2010, through June 30, 2012, and one fuel supplier provided purchase invoices for the period January 1, 2009, through August 30, 2010. For each quarter examined, the average purchase price per gallon computed from suppliers' purchase invoices exceeded the selling prices established in the first reaudit. For example, based on the information, the average quarterly price differentials achieved using the appellant-provided sales information are as follows:
  - a. 3Q10: appellant purchased the fuel for \$2.693<sup>8</sup> per gallon, and sold it for \$2.151 per gallon, resulting in an average loss of 54 cents per gallon of fuel sold (i.e., a negative markup of 20.13 percent).<sup>9</sup>

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<sup>7</sup> During the reaudit, appellant provided fuel purchase invoices for only two days. CDTFA also separately obtained 2Q11 data from one fuel supplier.

<sup>8</sup> For the calculation for 3Q10 in Statement 9 of the second reaudit, CDTFA made a mistake and listed an average cost per gallon of \$3.450 for 3Q10, and incorrectly calculated a negative markup of -37.67 percent. However, this is the average cost per gallon for the entire period examined in statement 8, which appears to have been erroneously transcribed. The cost per gallon for 3Q10 (\$2.693) was correctly used in the calculation schedules and did not impact any audit calculations.

- b. 4Q10: appellant purchased the fuel for \$2.939 per gallon, and sold it for \$2.151 per gallon, resulting in an average loss of 78.9 cents per gallon of fuel sold (i.e., a negative markup of 26.84 percent).
  - c. 1Q11: appellant purchased the fuel for \$3.411 per gallon, and sold it for \$2.259 per gallon, resulting in an average loss of \$1.152 per gallon of fuel sold (i.e., a negative markup of 33.77 percent).
  - d. 2Q11: appellant purchased the fuel for \$3.716 per gallon, and sold it for \$2.496 per gallon, resulting in an average loss of \$1.220 per gallon of fuel sold (i.e., a negative markup of 32.84 percent).
  - e. 3Q11: appellant purchased the fuel for \$3.517 per gallon, and sold it for \$2.860 per gallon, resulting in an average loss of 65.7 cents per gallon of fuel sold (i.e., a negative markup of 18.68 percent).
  - f. 4Q11: appellant purchased the fuel for \$3.582 per gallon, and sold it for \$2.924 per gallon, resulting in an average loss of 65.8 cents per gallon of fuel sold (i.e., a negative markup of 18.36 percent).
  - g. For the period October 1, 2010, through December 31, 2011, appellant purchased the fuel for an average price of \$3.450 per gallon, and sold it for \$2.549 per gallon, resulting in an average loss of 90.1 cents per gallon of fuel sold (i.e., a negative markup of 26.11 percent).
21. CDTFA also noted that for the entire liability period, appellant purchased the fuel for an average price of \$3.095 per gallon and sold it for an average price of \$2.191 per gallon (i.e., resulting in an average loss of 90.4 cents per gallon sold during the liability period).
22. After considering the information CDTFA obtained from appellant's fuel suppliers, CDTFA concluded that the CDTFA Appeals Bureau decision erred in allowing an average selling price per gallon that was less than appellant's average cost per gallon. Using the supplier furnished diesel fuel purchase invoices, CDTFA increased the audited average selling price per gallon from 31.8 cents per gallon below the average weekly EIA price, to 7.1 cents per gallon below the average weekly EIA price (i.e., the amount

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<sup>9</sup> "Markup" is the amount by which the cost of fuel is increased to set the retail price. For example, if the retailer's cost is \$3.45 per gallon of diesel fuel, and it charges customers \$2.15 per gallon, the markup is -\$1.30. The formula for determining the markup percentage is  $\text{markup amount} \div \text{cost}$ . Here, the markup percentage is negative, meaning the retailer is selling at a loss (i.e.,  $\$1.30 \div -\$3.45 = -37.67\%$ ). A "book markup" (sometimes referred to as an achieved markup) is one that is calculated from the retailer's records.

- originally asserted in the field audit). Using this information resulted in gross profit ranging between 6.6 cents to 23.3 cents per gallon of fuel sold.
23. CDTFA completed a second reaudit report, dated July 14, 2017, which incorporated CDTFA's revised position, and increased the liability back to the amount stated in the NOD.
  24. On November 16, 2017, the board resumed the oral hearing for this matter. Before concluding the hearing, the board voted to continue the hearing a second time, to allow the Chairwoman of the board time to review material provided by appellant.
  25. On December 13, 2017, the board resumed the oral hearing for this matter. At the conclusion of the hearing, the board voted to redetermine the liability in accordance with the first reaudit (i.e., pursuant to the CDTFA Appeals Bureau decision) and to delete the negligence penalty.
  26. On March 23, 2018, CDTFA timely petitioned for a rehearing.
  27. On May 9, 2019, OTA granted CDTFA's petition.

#### DISCUSSION

##### Issue 1: Whether adjustments are warranted to the audited understatement of reported taxable sales.

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

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once

CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

For sales of diesel fuel, the selling price per gallon generally includes sales tax and other excise taxes.<sup>10</sup> (Cal. Code Regs., tit.18, § 1598(f).) Certain excise taxes on diesel fuel, although included in the selling price per gallon, are not included in the measure of sales and use tax. (Cal. Code Regs., tit. 18, § 1598(c)(2)(B)-(C).)

#### The burden of proof

With respect to any new matter first raised by CDTFA during an appeal before OTA, the burden with respect to the new matter shall be on CDTFA. (Cal. Code Regs., tit. 18, § 30219(a).) As explained in *Appeal of Praxair*, 2019-OTA-301P, it would be unfair to place the burden on the taxpayer to establish error in circumstances where the tax agency appears on the day of the oral hearing asserting an increase to the liability on a previously conceded matter. In the instant appeal, the underlying jurisdictional document is the adverse CDTFA Appeals Bureau decision. (Cal. Code Regs., tit. 18, § 30103(b)(1)(A).) Appellant would like to accept the decision (i.e., appellant wants to withdraw the appeal and accept the outcome of the CDTFA Appeals Bureau decision). However, during the pendency of the appeal before OTA (and its predecessor the board), CDTFA asserted an increase to the CDTFA Appeals Bureau decision. The basis for the increase is new information that CDTFA obtained from appellant's fuel suppliers while preparing the matter for the oral hearing before the board. Appellant disagrees with the increase and wishes to dispute any increase to the amount asserted in the CDTFA's Appeals Bureau decision. Thus, because CDTFA is asserting an increase to the jurisdictional document based on new information obtained during an appeal before OTA (which would include OTA's predecessor, the board) the burden is on CDTFA to establish that appellant's liability includes the \$136,819.07 tax increase.

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<sup>10</sup> Motor vehicle fuel retailers are statutorily required to sell motor vehicle fuel, including diesel, on a tax-included basis and specify on a sign or price indicator that taxes are included in the advertised selling price per gallon. (Bus. & Prof. Code, § 13470.) It is undisputed that appellant complied with this statutory requirement.

The increase to the CDTFA Appeals Bureau decision

As discussed, CDTFA has the burden of establishing that the additional audited taxable sales are warranted by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(a), (b).) Here, appellant provided its diesel fuel sales data. Comparing the purported selling price per gallon of diesel fuel (per appellant's data) to appellant's purchase price per gallon (per invoices furnished by appellant's fuel suppliers), results in an average loss to appellant of approximately 96.0 cents for every gallon of fuel that appellant sold. Appellant sold approximately 7.5 million gallons of diesel fuel at retail during the liability period. If OTA were to accept appellant's asserted selling price per gallon (i.e., that appellant lost almost a dollar on every gallon of fuel that it sold), appellant would have operated at a net fuel sale loss of over \$7 million for the three-and-a-half-year liability period. It is not plausible that a fuel station losing over \$2 million a year on fuel sales (and not including expenses for overhead such as rent, employee salaries, insurance, utilities, etc.) to continue operating at such a rate for over three years. In light of the supplier-furnished fuel purchase invoices, it is clear that the CDTFA Appeals Bureau decision understated appellant's fuel sales prices. The understated selling prices, of an average price of 31.8 cents below the average weekly EIA prices, would have resulted in appellant continually operating at a substantial loss throughout the liability period. OTA finds that CDTFA established that an adjustment is warranted to, at a minimum, increase appellant's selling prices such that it was not operating at a loss.

CDTFA observed the selling prices of appellant's business at various times. Based on its observations, appellant did not sell its diesel fuel at a loss. To the contrary, appellant sold its fuel at an average gross profit of 7.1 cents below the average weekly EIA prices (which translates to an average profit of approximately 16.6 cents per gallon). CDTFA applied the observed selling prices to the liability period to calculate the liability as determined (including the increase). OTA finds that CDTFA established that it is more likely than not that appellant underreported this additional liability. Furthermore, through its audit, CDTFA established a rational, fair, and reasonably accurate estimate of appellant's liability. As such, CDTFA established, by a preponderance of the evidence, that there is an additional audited taxable sales liability in the amount stated by the NOD. As such, an increase is warranted.

Additional adjustments and arguments

Appellant argues that the audit should be redetermined in accordance with the first reaudit (using a price differential of 31.8 cents per gallon rather than 7.1 cents per gallon). According to appellant, it timely notified CDTFA that it agreed with the CDTFA Appeals Bureau decision.

OTA has jurisdiction because there was an adverse supplemental CDTFA Appeals Bureau decision dated April 27, 2016, which appellant timely appealed to the board (OTA's predecessor). (Cal. Code Regs., tit. 18, § 30106(a).)<sup>11</sup> The board's summary for oral hearing states that the matter was first scheduled for an oral hearing "in November 2016, but was postponed at petitioner's request to allow additional time to prepare." It is undisputed that appellant appeared at the oral hearing and argued the case before the board. Thus, there is insufficient evidentiary basis to conclude that appellant did not appeal the CDTFA Appeals Bureau decision to the board.

Regardless, subject to certain limitations, R&TC section 6563 authorizes CDTFA to assert an increase to an NOD before the determination becomes final and at or before the oral hearing. In this case, CDTFA is not asserting an increase to the NOD; rather, CDTFA is asserting an increase to the jurisdictional document (the Appeals Bureau decision) to the full extent of the NOD. As such, the time limitations on asserting an increase in R&TC section 6563 are inapplicable to the amount asserted by CDTFA. The NOD is not yet final. There is an adverse CDTFA Appeals Bureau decision which is also not yet final. Furthermore, appellant disagrees with the amount being asserted by CDTFA. Thus, there is a valid appeal before OTA. CDTFA can assert the "additional" liability (i.e., the increase asserted in the jurisdictional document at issue) to the full extent of the NOD in the instant appeal before OTA.

Appellant's assertion that CDTFA compared costs, including taxes, to selling prices net of taxes, is not accurate. CDTFA provided detailed computations of the average costs per quarter, using invoices provided by appellant's fuel suppliers. First, CDTFA listed each of the invoices, and it computed the cost per gallon for each invoice. That cost excludes the prepaid sales tax and includes the excise taxes which are exempt from the measure. The cost also includes the underground storage tank fee of 2.0 cents per gallon, which is paid by appellant on a

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<sup>11</sup> This language was also included in OTA's Emergency Rules for Tax Appeals effective January 5, 2018, through January 1, 2019. (See former Cal. Code Regs., tit. 18, § 30305(b).)

separate return, since the fee is part of appellant's cost for each gallon of fuel. CDTFA then computed an average cost per gallon for each quarter. CDTFA compared the average costs per quarter to the audited selling prices, using a price differential of 31.8 cents. In reaching the conclusion that the audited selling prices in the first reaudit were unreasonably low, CDTFA compared the selling prices, including the diesel fuel excise tax and excluding the sales tax, to known costs (from purchase invoices provided by suppliers), including the excise tax and excluding sales tax prepayments. In calculating costs, CDTFA also included the 2.0 cents per gallon underground storage tank fee, which was not reflected in the costs shown on the purchase invoices but represented an additional cost related to the diesel fuel. Therefore, there is no basis to find that CDTFA incorrectly compared costs, including taxes, to selling prices, net of taxes.

In addition, appellant argues that it is improper to use average weekly EIA prices to establish appellant's audited selling prices. Appellant argues that there are many areas in the state where the selling prices are higher than prices in Mojave. It also argues that the average weekly EIA prices are generally not reliable since they are compiled from figures collected during the entire week. In addition, appellant observes that, as the prices are being compiled, there will be outliers (i.e., prices that are much lower or higher than the average). For all these reasons, appellant maintains that the average weekly EIA prices are not representative of the fuel sales in Mojave.

While appellant has not documented that the selling prices in Mojave are generally lower than in most other areas in California, it is correct that selling prices and tax rates vary throughout the state. Appellant is also correct that there will be outliers in some areas. It is precisely for these reasons that the average weekly EIA prices are published (compiling many different prices to compute a statewide average that reflects prices throughout the state, including those that approximate the average and outliers). The average weekly EIA price is calculated using selling prices from numerous retailers throughout California. Further, the average weekly EIA prices are the most reliable data available. Moreover, CDTFA has the statutory authority to determine the audited taxable sales of fuel using the average weekly EIA prices. (See R&TC, §§ 6481, 6511.)

Regarding appellant's assertion that the average weekly EIA prices differ from prices in Mojave, CDTFA's audit process accounts for the difference between appellant's prices and the

average weekly EIA prices. Specifically, CDTFA observed appellant's posted prices on three days and found that appellant's cash selling prices were less than the average selling prices by 3.6 cents (on August 16, 2012), 7.0 cents (on August 27, 2012), and 10.6 cents (on September 17, 2012). CDTFA computed an average differential of 7.1 cents (i.e.,  $(3.6 + 7 + 10.6) \div 3$ ). CDTFA did not make any adjustment for appellant's higher-priced sales by credit card, which is in appellant's favor. Through this process, CDTFA adjusted the average weekly EIA prices to account for appellant's lower than average selling prices. Therefore, no adjustments are warranted on this basis.

Appellant raises another argument regarding the audited selling prices, implying that the selling prices for 2012 were used as audited selling prices throughout the liability period. On this issue, appellant misunderstands the audit process. CDTFA did not use its observation of appellant's selling prices in August and September 2012 to establish the audited selling prices for the entire liability period. It compared appellant's selling prices to the average weekly EIA prices to develop the audited differential (the difference between appellant's selling prices and the average weekly EIA prices). CDTFA then recorded the average weekly EIA price for each week of the liability period. CDTFA used the average weekly prices to compute the audited selling price for each quarter of the liability period, and it then reduced those selling prices by 7.1 cents. Since CDTFA's base for its computation of the audited selling prices is the average weekly prices for each week of the liability period, the process has fully accounted for the fluctuations of gasoline prices throughout the liability period.

Finally, appellant argues that it received rebates from its fuel suppliers for purchasing fuel, to offset the low selling price per gallon of diesel fuel reflected in the sales data appellant provided for the reaudit. Appellant offers this as an explanation for the calculated negative markup achieved using appellant's sales data. First, the available documentation in the evidentiary record shows no evidence of such rebates, or even the specific terms and conditions upon which they may have been paid. Furthermore, absent supporting documentation, an adjustment is not warranted on this basis because rebates and incentives offered in exchange for price reductions are generally includible in the measure of tax.<sup>12</sup> (See Cal. Code Regs., tit. 18, § 1671.1(c)(3).)

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<sup>12</sup> This Opinion does not address arguments related to the prior audit because the prior audit file is not in the evidentiary record.

In summary, CDTFA established a substantial underreporting to the full extent of the NOD,<sup>13</sup> and OTA finds there is no basis for any adjustments.

Issue 2: Whether CDTFA properly imposed the negligence penalty.

R&TC section 6484 provides that if any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto.

Taxpayers are required to maintain and make available for examination on request by CDTFA, or its authorized representative, all records necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax returns. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include but are not limited to: (a) the normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (b) bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account; and (c) schedules or working papers used in connection with the preparation of the tax returns. (Cal Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records, including all bills, receipts, invoices, or other documents of original entry supporting the entries in the books of account, will be considered evidence of negligence and may result in the imposition of penalties. (Cal Code Regs., tit. 18, § 1698(k).)

Appellant disputes the negligence penalty on the basis that it properly reported its sales and use taxes to CDTFA. OTA concluded above that no adjustments are warranted to the audited understatement of reported taxable sales of \$5,671,889, which represents an error rate of 34.6 percent in comparison to reported taxable sales of \$16,391,710. This level of understatement is significant, and it is evidence of negligence. Further, appellant was previously audited. Accordingly, appellant had reason to be fully aware of the requirement to maintain complete records and provide them for audit. However, even after many requests, appellant

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<sup>13</sup> The burden of proof was on CDTFA with respect to the new matter (the increase) and the burden of proof was on appellant as to the amount asserted in CDTFA's decision. (Cal. Code Regs., tit. 18, § 30219; *Appeal of Talavera, supra*.) The finding that CDTFA established the liability by a preponderance of the evidence exceeds the requisite "minimal, initial burden" of proof threshold set forth in *Appeal of Talavera, supra*, and thus it is not necessary to separately discuss the minimum burden threshold.

provided only limited records. Appellant’s failure to maintain and keep complete and accurate records is probative of negligence. Furthermore, the percentage of understatement in this audit period, approximately 35 percent (rounded), was substantially higher than the percentage of understatement in the prior audit, approximately 20 percent (rounded). Thus, the accuracy of appellant’s returns declined despite being previously audited and informed of the proper reporting requirements for its business. This regression is probative of negligence.

In summary, the negligence penalty was properly imposed.

HOLDINGS

1. No adjustments are warranted to the audited understatement of reported taxable sales.
2. CDTFA properly imposed the negligence penalty.

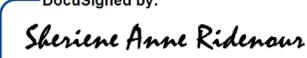
DISPOSITION

Sustain CDTFA’s action to increase the liability from the amount previously asserted in the supplemental CDTFA Appeals Bureau decision to the full extent of the NOD; deny appellant’s petition; and redetermine the NOD without any adjustment.

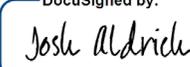
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Andrew J. Kwee  
Administrative Law Judge

We concur:

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Josh Aldrich  
Administrative Law Judge

Date Issued: 10/10/2023