OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21027297
	CDTFA Case ID: 173-057
DAY RIVERSIDE PETROLEUM, LLC	

OPINION

Representing the Parties:

For Appellant: Gilbert L. Tauberg, Managing Member

For Respondent: Randy Suazo, Hearing Representative
Christopher Brooks, Attorney
Jason Parker, Chief of Headquarters Ops.

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

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Day Riverside Petroleum, LLC (appellant) appeals respondent California Department of Tax and Fee Administration's (CDTFA's) Decision denying appellant's petition for redetermination of a Notice of Determination (NOD) dated July 19, 2016.[1] The NOD is for taxes totaling $141,790.33, plus applicable interest, and a negligence penalty of $14,179.05 for the period October 1, 2012, through September 30, 2015 (liability period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Suzanne B. Brown, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on May 10, 2023. At the conclusion of the hearing, the record remained open so appellant could request from CDTFA relief of interest, which began accruing effective February 1, 2013. In response, CDTFA conceded to relieve interest accrued from February 1, 2018, through

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE.

[2] CDTFA timely issued the July 19, 2016 NOD with respect to the period of October 1, 2012, through March 31, 2013, because, for that period, appellant waived the applicable three-year statute of limitations and consented to an extended deadline per R&TC section 6488.

November 30, 2018, because of an unreasonable delay by its Settlement and Taxpayer Services Bureau. Following CDTFA's concession, the evidentiary record in this matter closed on June 28, 2023, and the matter was submitted for an opinion.

ISSUES

1. Whether a reduction to the measures of either unreported taxable diesel fuel sales or unreported taxable minimart sales is warranted.
2. Whether a reduction to the measure of excess tax reimbursement collected is warranted.
3. Whether a reduction to the measure of unreported taxable rebates is warranted.
4. Whether appellant was negligent or intentionally disregarded relevant legal authorities.
5. Whether further relief of interest is warranted.

FACTUAL FINDINGS

1. Appellant operates an ARCO-branded gasoline station franchise with a minimart in Riverside, California. Appellant's gasoline station sells both gasoline and diesel fuel, and appellant's minimart sells beer, wine, soda, cigarettes, tobacco products, miscellaneous taxable items, and nontaxable food products. Appellant's seller's permit had an effective start date of July 1, 2009.
2. As relevant here, CDTFA previously audited appellant for the period of October 1, 2009, through September 30, 2012. In that prior audit, CDTFA tested appellant's March 2011 minimart purchases and computed a taxable purchase ratio of 66 percent (i.e., 66 percent of minimart purchases were of taxable goods). Based on a shelf test, CDTFA also computed a weighted markup of 31.69 percent on taxable minimart sales.[3] Ultimately, CDTFA's prior audit of appellant disclosed a tax liability of $437,286.81, which was based on an aggregate deficiency measure of $8,351,748 consisting of the following five audit items: (a) unreported taxable gasoline sales of $4,804,954; (b) unreported taxable diesel fuel sales of $395,906; (c) unreported taxable minimart sales of $3,007,870; (d) unreported taxable rebates of $125,108; and (e) uncollected tax on recorded taxable

[3] "Markup" is the amount by which the cost of merchandise is increased to set the retail price. For example, if the retailer's cost is $0.70 and it charges customers $1.00, the markup is $0.30. The formula for determining the markup percentage is markup amount ÷ cost. In this example, the markup percentage is 42.86 percent (0.30 ÷ 0.70 = 0.42857). A "shelf test" is an accounting comparison of known costs and associated selling prices used to compute markups.

minimart sales of $17,910. CDTFA determined that these audit items resulted from the following: differences between sales tax accrued/collected/recorded versus reported; additional fuel sales based on a mark-up of taxable purchases; and unreported taxable rebates. CDTFA later issued an NOD for the liability disclosed in the prior audit, which is now final.[4]

3. On its sales and use tax returns (SUTRs) for the liability period at issue, appellant reported total sales of $30,877,508. Appellant also claimed total deductions of $29,321,691, which consisted of the following: $26,249,230 for gasoline sales exempted from states sales and use taxes due to the "fuel tax swap";[5] $1,883,782 for nontaxable sales of food products; $6,800 for bad debt losses; $117,380 for nontaxable labor;[6] and $1,064,499 for "other" deductions, which consisted of exempt state excise taxes on sales of diesel fuel, lottery sales, and operating expenses.[7] Ultimately, appellant reported taxable sales of $1,555,817.[8] CDTFA could not determine appellant's method for reporting sales on its SUTRs.

4. According to appellant, near the end of the liability period, in the third quarter of 2015 (3Q15), it replaced its point-of-sale (POS) system.

5. CDTFA commenced the audit at issue at the end of 4Q15, contacting appellant on December 29, 2015, to schedule an audit appointment.

6. For the audit, appellant provided the following books and records: federal income tax returns (FITRs) for 2013 and 2014; fuel sales tax summary reports for the liability period;

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[4] Appellant does not dispute that it did not file a petition for redetermination of the NOD for the prior audit period.

[5] Effective July 1, 2010, legislation was enacted providing for a state excise tax rate increase and a corresponding sales and use tax rate decrease on sales of motor vehicle fuels (gasoline, not diesel fuel). (See R&TC, §§ 6357.7, 7326, and 7360.) Under these provisions, the statewide sales and use tax rate on gasoline sales decreased from 8.25 percent to 2.25 percent, plus applicable district taxes, and, as relevant here, the state excise tax increase ranged from 30 cents per gallon to 39.5 cents per gallon during the liability period. This legislation is referred to as the "fuel tax swap."

[6] Appellant does not provide carwash, repair, or smog services and could not explain the basis for the claimed nontaxable labor.

[7] Appellant stated that it claimed deductions for operating expenses such as permits, fees and commissions, service charges, and internet access fees, but CDTFA determined that appellant did not include these expenses in reported total sales.

[8] Appellant also claimed total tax credits of $502,458 for prepaid sales tax on gasoline purchases of $471,709 and prepaid sales tax on diesel fuel purchases of $30,749.

"tax summary by department" reports for the liability period; profit and loss statements for January 1, 2013, through September 30, 2015; and fuel purchase invoices for the liability period. Appellant did not provide sales tax worksheets supporting the amounts reported and claimed on its SUTRs.

7. Initially, CDTFA compared total sales reported on the SUTRs for 2013 and 2014 to the gross receipts reported on the FITRs for the corresponding years, and noted that reported total sales exceeded reported gross receipts for each year. Appellant could not explain why there was a difference. Because of this, as well as erroneously claimed deductions for labor and operating expenses on appellant's SUTRs,[9] CDTFA decided to perform additional testing to verify reported taxable sales.

Determining the Reliability of the Books and Records Provided by Appellant Upon Audit

8. Using the fuel sales tax summary reports, CDTFA compiled recorded total fuel sales of $26,172,638 and diesel fuel sales of $383,430, and computed gasoline sales of $25,789,208 ($26,172,638 - $383,430) for the liability period.

9. Using the tax summary by department reports, CDTFA compiled recorded taxable minimart sales of $2,895,263 and nontaxable minimart sales of $2,153,235 for the liability period.

10. Using the profit and loss statements, CDTFA compiled recorded purchases of fuel of $10,316,026 for 2013, $7,565,062 for 2014, and $4,354,974 for January 1, 2015, through September 30, 2015; and recorded total minimart purchases of $1,183,479 for 2013, $1,157,555 for 2014, and $831,590 for January 1, 2015, through September 30, 2015. CDTFA applied the taxable purchase ratio of 66 percent that it established in its prior audit of appellant to recorded total minimart purchases and computed taxable minimart purchases of $781,096 for 2013, $763,986 for 2014, and $548,849 for January 1, 2015, through September 30, 2015.

11. CDTFA compared recorded fuel sales to the corresponding recorded fuel purchases, excluding prepaid sales tax, and computed a book markup on fuel of 5.77 percent for January 1, 2013, through September 30, 2015.[10] CDTFA compared recorded taxable

[9] See footnotes 6 and 7, *ante*, page 3.

[10] A "book markup" (sometimes referred to as an "achieved markup") is a markup that is calculated from the retailer's records.

minimart sales to the corresponding recorded taxable minimart purchases and computed a taxable minimart book markup of 26.41 percent for January 1, 2013, through September 30, 2015. CDTFA noted that the taxable minimart book markup was generally consistent with the taxable minimart shelf test markup of 31.69 percent it computed in the prior audit. Because these book markups were within the markup ranges it expected for businesses like appellant's, CDTFA concluded that recorded fuel sales and taxable minimart sales were reliable.

12. Next, CDTFA performed a markup analysis using the prior audit's taxable minimart shelf-test markup of 31.69 percent. CDTFA reduced taxable minimart purchases of $2,093,931 ($781,096 + $763,986 + $548,849) for January 1, 2013, through September 30, 2015, by self-consumption (1 percent) and pilferage (1 percent) to calculate the audited cost of taxable goods sold for January 1, 2013, through September 30, 2015. CDTFA added the prior audit's weighted taxable minimart shelf-test markup of 31.69 percent to the audited taxable cost of goods sold and computed taxable minimart sales of $2,702,623 for January 1, 2013, through September 30, 2015. Upon comparison to recorded taxable minimart sales of $2,646,871 for January 1, 2013, through September 30, 2015, CDTFA computed a difference of $55,752, which translated to an error ratio of 2.11 percent.[11] CDTFA considered the error ratio within an acceptable range and concluded that this was further evidence that recorded taxable minimart sales were reliable.

13. CDTFA performed a secondary analysis of recorded taxable sales as follows. For the period January 1, 2015, through June 30, 2015, CDTFA divided the recorded gasoline and diesel fuel sales by the corresponding recorded number of gallons of gasoline and diesel fuel sold, and computed the recorded price per gallon of gasoline and diesel fuel for each month. CDTFA then compared the recorded price per gallon of gasoline and diesel fuel for each month to the corresponding average selling prices per gallon for the Los Angeles area as reported by the U.S. Department of Energy Information Administration (EIA), and computed "price differentials." In this case, appellant's prices were lower than the EIA prices. For each quarter in the liability period, CDTFA reduced

[11] That is, the "error ratio" here is the percentage of the difference between audited taxable minimart sales and recorded taxable minimart sales as compared to recorded taxable minimart sales.

the EIA prices by the price differential and respective sales tax included to compute audited sales prices of gasoline and diesel fuel. CDTFA multiplied the audited sales prices by the respective reported number of gallons of gasoline or diesel fuel sold, and computed expected gasoline sales of $25,702,018 and expected diesel fuel sales of $384,956 for the liability period. CDTFA combined the expected gasoline and diesel fuel sales with the expected taxable minimart sales, and computed expected taxable sales for the liability period of $29,040,989. Upon comparison to recorded taxable sales of $29,067,901 for the liability period, CDTFA computed a difference of $26,912, or less than one-tenth of 1 percent.[12] CDTFA concluded that this was further evidence that recorded taxable sales were reliable.

Audit Items at Issue: Relevant Methods and Results[13]

14. Diesel Fuel Sales: using the fuel sales tax summary reports, CDTFA compiled the recorded quantity of diesel fuel sold of 110,239 gallons for the liability period. CDTFA multiplied the number of gallons of diesel fuel sold for each quarter by the corresponding state excise tax rate, and computed the exempt state excise tax of $11,583 on diesel fuel sales for the liability period. CDTFA reduced recorded diesel fuel sales of $383,430 by the exempt state excise tax of $11,583, and computed taxable diesel fuel sales of $371,847 for the liability period. CDTFA compared recorded taxable diesel fuel sales (excluding exempt state excise taxes) of $371,847 to reported diesel fuel sales of $322,776 per the SUTRs, and found a difference of $49,071. CDTFA attributed the difference to appellant's errors in preparing the SUTRs, resulting in unreported taxable diesel fuel sales of $49,071 for the liability period.

15. Minimart Sales: CDTFA compared reported taxable minimart sales of $1,233,041 (reported taxable sales of $1,555,817 – reported diesel fuel sales of $322,776) to recorded taxable minimart sales of $2,895,263 for the liability period, and noted a difference of $1,662,222. CDTFA attributed the difference to appellant's errors in preparing the SUTRs, resulting in unreported taxable minimart sales of $1,662,222 for the liability

[12] $26,912 ÷ $29,040,989 = 0.00092669.

[13] On appeal to OTA, appellant did not contest the following audit items: overreported gasoline sales of $460,020 and disallowed claimed tax credit of $4,792 for prepaid fuel sales. Accordingly, OTA will not discuss them further in this Opinion.

period.

16. Excess Tax Reimbursement (minimart sales only): using the tax summary by department reports, CDTFA compiled recorded accrued/collected sales tax of $238,550 on minimart sales for the liability period. CDTFA then multiplied recorded taxable minimart sales for each quarter of the liability period by the corresponding quarterly sales tax rate to compute expected sales tax of $231,000 for the liability period. CDTFA compared recorded accrued/collected sales tax of $238,550 on minimart sales for the liability period to expected sales tax of $231,000 for the liability period, and found that recorded accrued/collected sales tax exceeded expected sales tax for each quarter of the liability period except for 4Q12, which had a credit difference of only $80. CDTFA concluded that the remaining debit differences represented "excess tax reimbursement," which appellant had collected from, but not refunded to, appellant's customers. For the liability period (excluding 4Q12), CDTFA computed excess tax reimbursement of $7,630 ($238,550 - $231,000). Because excess tax reimbursement must be remitted to the state (when not refunded to customers),[14] CDTFA divided the excess tax reimbursement of $7,630 by 4.75 percent, the state portion of the overall sales tax rate, and computed a measure of excess tax reimbursement collected of $160,637 for the liability period.[15]

17. Rebates: using the profit and loss statements, CDTFA compiled recorded but unreported payments of $60,333 to appellant from beer, soda, and cigarette/tobacco vendors.[16] CDTFA determined that these payments were rebates paid by these vendors to appellant and constituted taxable gross receipts. As a result, CDTFA included a separate measure of $60,333 for unreported taxable rebates.

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[14] When CDTFA ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax collections to the customers from whom they were collected. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(2).) In the event of failure or refusal of the retailer to make such refunds, the retailer must pay the excess tax reimbursement to the State. (*Ibid*.)

[15] To illustrate, for a taxable sale of $100 subject to an 8 percent sales tax rate (combining state, county, local, and district rates), the customer would pay $8 in sales tax reimbursement. If the retailer charges 10 percent sales tax in error, the retailer would collect $10 in sales tax reimbursement resulting in excess tax reimbursement of $2 ($10 - $8). Thus, the measure of tax subject only to the state portion of the sales tax is $42.11 ($2 ÷ 4.75 percent).

[16] Some documents in the record list $60,331 as the total amount of payments. OTA ascribes the $2 difference to rounding and finds it immaterial.

18. Negligence Penalty: CDTFA added a 10 percent negligence penalty because of substantial differences between appellant's recorded and reported taxable sales and because, since its last audit, appellant had failed to correct its recordkeeping and reporting errors.

Post-Audit Events

19. Based on the audit described above, on July 19, 2016, CDTFA issued to appellant an NOD with a tax liability of $141,790.33, plus applicable interest, and a negligence penalty of $14,179.05.
20. Appellant filed a timely petition for redetermination, protesting the NOD in its entirety.
21. CDTFA denied the petition, and appellant timely appealed to OTA.

DISCUSSION

Issue 1: Whether a reduction to the measures of either unreported taxable diesel fuel sales or unreported taxable minimart sales is warranted.

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of all tangible personal property in this state unless a sale is specifically exempted or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, it is presumed 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 on request by CDTFA. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax or other amount required to be paid by any person, or if any person fails to make a return, CDTFA may compute and determine the amount required to be paid upon the basis of any information within its possession or that 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 Amaya*, 2021-OTA-328P.) If CDTFA meets its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must

establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.)

Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Amaya, supra*.) To satisfy the burden of proof, a taxpayer must prove that: (1) the tax assessment is incorrect; and (2) the proper amount of the tax. (*Appeal of AMG Care Collective*, *supra*.)

Here, appellant erred in claiming deductions for labor and operating expenses on its SUTRs.[17] Appellant also did not provide evidence, such as sales tax worksheets, that would support the amounts reported and claimed on its SUTRs. Accordingly, OTA finds that it was appropriate for CDTFA to question appellant's reported taxable sales. On the other hand, appellant's own fuel sales tax summary reports, tax summary by department reports, and profit and loss statements all constitute evidence of its taxable sales, and CDTFA determined that these records were reliable. Following review of CDTFA's audit working papers, OTA finds that CDTFA reasonably relied upon them in calculating appellant's audited liability. Thus, OTA concludes that CDTFA has met its initial burden to show that its determination was reasonable and rational, and the burden of proof now shifts to appellant to show that a different result is warranted.

On appeal, appellant asserts that the software used in its POS system during the liability period was produced by a company called Retalix and then modified by appellant's franchisor, who then provided the software to appellant. Appellant contends that the Retalix software generated erroneous, inflated sales data. Specifically, appellant argues that the sales data input into the Retalix POS system was different from the allegedly inflated sales data the Retalix POS system subsequently sent to its franchisor. Appellant asserts that the amount of sales tax it remitted to the state was the amount recorded by the Retalix POS system and thus the amount required to be paid. However, appellant states that it is unable to provide documentation of the discrepancies in the sales data because the Retalix POS system was taken, destroyed, and replaced by appellant's franchisor in 3Q15, shortly before the audit commenced at the end of 4Q15.[18] Since the Retalix POS system was replaced, appellant asserts that there have been no

[17] See footnotes 6 and 7, *ante*, page 3.

[18] At the oral hearing, appellant's managing member stated that he was an experienced computer consultant and had offered to work with the franchisor to fix the Retalix POS system, but the franchisor refused to let him help.

recordkeeping or reporting errors, and appellant suggests that the Retalix POS system was at fault for any such errors disclosed by the audit at issue.

In support of its assertion that the Retalix POS system was faulty, appellant provided four legal documents relating to cases initiated by various franchisees (including appellant) against the franchisor and Retalix: (1) a complaint filed on October 23, 2012; (2) another complaint filed on January 27, 2014; (3) an appellate brief filed on December 16, 2015; and (4) a California Court of Appeal opinion issued on May 2, 2018. Appellant was only a party to the complaint filed on October 23, 2012, not the one filed on January 27, 2014. Appellant also provided a log of what it asserts are service tickets appellant opened with Retalix, from November 9, 2009, through July 10, 2013, reporting problems with its POS system.[19]

Because the two complaints and appellate brief contain allegations and arguments rather than facts, OTA will analyze only the California Court of Appeal opinion, which summarizes factual findings and a jury's verdict following a July 2015 trial. OTA first notes that appellant was not among the four plaintiff-franchisees listed or mentioned in that opinion.[20] Those plaintiff-franchisees asserted several causes of action, but only one related to the Retalix POS system: the franchisor breached the implied warranty of merchantability by selling the plaintiff-franchisees defective Retalix POS systems. According to the opinion, each of the four plaintiff-franchisees experienced issues with the Retalix POS system within the first year and a half following installation (i.e., during 2009 and 2010). These issues included various software and hardware problems that interfered with the system's ability to operate gasoline pumps and to accept credit and debit card transactions. Plaintiff-franchisees experienced partial or complete shutdowns due to problems with the Retalix POS system, which prevented them from transacting business for periods of time. Specifically, shutdowns included the inability to operate one or more gasoline pumps, the inability to accept credit or debit cards, and the inoperability of one or

[19] At the oral hearing, appellant also speculated that the data from the Retalix system in place during the liability period and used to report taxable sales differed from the data appellant subsequently submitted for audit. Appellant asserted that, by the time of CDTFA's audit in 4Q15, appellant was using a new POS system that the franchisor had reloaded with data and from which appellant had pulled data for the audit. Appellant speculated that the discrepancy between recorded and reported taxable sales somehow arose from the use of two different POS systems, but acknowledges that it cannot prove this. Because appellant concedes that it cannot prove this theory, OTA will not address this particular argument any further.

[20] At the oral hearing, appellant's managing member stated that appellant settled the October 23, 2012 complaint to which it was a party in or around 2020 or 2021, but he could not find or produce the settlement document.

more POS terminals. According to the opinion, many of the problems described were fixed by rebooting the system, a process that took between 30 minutes and several hours, which prompted customers to complain or leave. Plaintiff-franchisees testified that the Retalix software problems were most severe during 2009 and 2010, and were mostly resolved from 2011 to 2014. The jury returned a verdict in favor of each plaintiff-franchisee on its implied warranty of merchantability claim, finding that the Retalix POS system was unfit for its ordinary purpose and harmed plaintiffs. The jury awarded the plaintiff-franchisees damages ranging from $20,643 to $34,281 each. In its opinion, the California Court of Appeal affirmed the jury's verdict on the issue of the implied warranty of merchantability.

According to the opinion, the Retalix POS system mainly caused problems for the plaintiff-franchisees during 2009 and 2010, which predates the liability period at issue, and these problems were largely resolved from 2011 to 2014, a timeframe that overlaps with most of the liability period. Further, the problems with the Retalix POS system recounted in the opinion (i.e., shutting down gasoline pumps or interfering with the ability to process credit/debit card transactions, which caused customers to complain or leave) would tend to reduce sales, not inflate them as appellant alleges. Finally, the opinion makes no mention of any recording errors or errors in transmitting sales data, which is the main thrust of appellant's argument. Accordingly, OTA finds that the California Court of Appeal opinion does not provide evidence that appellant's sales records are unreliable and should not be used to establish audited taxable sales.

Regarding appellant's Retalix service ticket log, OTA reviewed the service tickets for the period of October 1, 2012, through July 10, 2013, which coincides with the earlier part of the liability period. Upon review, OTA identified only two instances that involved sales prices and sales tax. On April 4, 2013, nontaxable items, such as candy and lottery, were showing as taxable, and, on June 10, 2013, tobacco prices were ringing up lower. These errors appear to have been corrected the same day they were called in. Accordingly, OTA finds that appellant has not shown that there were widespread errors in the sales data that occurred throughout the liability period. Thus, OTA rejects appellant's contention that its sales records are unreliable and should not be used to establish audited taxable sales.

As for appellant's general claim that the Retalix POS system was faulty and generated erroneous, inflated data, appellant has not identified any errors in its fuel sales tax summary

reports, tax summary by department reports, or profit and loss statements, which CDTFA mainly utilized in its determination of the audit items at issue. Further, appellant has not identified any errors in CDTFA's computations or provided any evidence from which a more accurate determination could be made. Accordingly, OTA has no basis upon which to reduce the measures of either unreported taxable diesel fuel sales or unreported taxable minimart sales.

In summary, OTA finds that CDTFA computed audited taxable diesel fuel and minimart sales based on the best-available evidence. However, appellant has not provided any evidence supporting a more accurate determination of these audited taxable sales or identified any errors in CDTFA's computations. Accordingly, OTA concludes that no reduction to the measures of either unreported taxable diesel fuel sales or unreported taxable minimart sales are warranted.

Issue 2: Whether a reduction to the measure of excess tax reimbursement collected is warranted.

In the audit at issue, CDTFA determined that appellant had collected excess tax reimbursement of $7,630 on its minimart sales.

On appeal, appellant argues that it does not know what excess tax reimbursement is or that it collected any money for it.

When an amount represented by a person to a customer as constituting reimbursement for sales taxes due is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid is excess tax reimbursement. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).) Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when reimbursement is computed on an amount in excess of the amount subject to tax, when tax reimbursement is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the tax reimbursement on a billing. (Cal. Code Regs., tit. 18, § 1700(b)(1).) Whenever CDTFA ascertains that a person has collected excess tax reimbursement, the person will be afforded an opportunity to refund the excess collections to the customers from whom they were collected. (Cal. Code Regs., tit. 18, § 1700(b)(2).) In the event of failure or refusal of the person to make such refunds, CDTFA will make a determination against the person for the amount of the excess tax reimbursement collected and not previously paid to the state, plus applicable interest and penalty, and the person will remit that amount to the state. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(2).)

Here, using the tax summary by department reports, CDTFA compared, on the one hand, recorded accrued/collected sales tax for minimart sales for the liability period to, on the other hand, expected sales tax based on recorded minimart sales for the same period, and noted that the former exceeded the latter. CDTFA concluded that the difference represented excess tax reimbursement, and there was no evidence that appellant had refunded the excess to its customers. Unless appellant refunds the excess tax collected to the customer from whom it collected the excess tax reimbursement, appellant must pay the excess tax reimbursement to the state. (R&TC, § 6901.5; Cal. Code Regs., tit. 18, § 1700(b)(1).) CDTFA computed the amount of excess tax reimbursement collected and then divided the excess tax by 4.75 percent (the state portion of the overall sales tax rate) to compute the state measure.

OTA has reviewed the evidentiary record (including CDTFA's audit working papers), CDTFA's audit method and calculations, as well as the applicable law regarding excess tax reimbursements, and finds that CDTFA's determination is reasonable and rational. Accordingly, the burden of proof now shifts to appellant to show that a different result is warranted. However, appellant has not provided any evidence from which a more accurate determination could be made or identified any errors in CDTFA's computation of the excess tax reimbursement. Rather, appellant only states that it does not know what excess tax reimbursement is. Taxpayers are charged with knowledge of the law, and ignorance of the law is no defense for failing to comply with statutory requirements. (See, e.g., *Macfarlane v. Dept. of Alcoholic Beverage Control* (1958) 51 Cal.2d 84, 90.) Accordingly, OTA concludes that appellant has not carried its burden to show, and OTA has no basis upon which to recommend, that a reduction to the measure of excess tax reimbursement is warranted.

Issue 3: Whether a reduction to the measure of unreported taxable rebates is warranted.

Based on appellant's profit and loss statements, CDTFA determined that appellant received unreported payments of $60,333 from beer, soda, and cigarette/tobacco vendors for the liability period, and that these were rebate payments, which constituted taxable gross receipts.

All of a retailer's gross receipts are presumed subject to tax unless the retailer can prove otherwise. (R&TC, § 6091.) Gross receipts include all amounts received with respect to the sale, with no deduction for the cost of materials, service, or expense of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (R&TC, § 6012(d).) Gross receipts specifically include all receipts, cash, property of any kind, and any amount for which credit is

allowed by the seller to the purchaser. (R&TC, § 6012(b).) Thus, gross receipts are not limited solely to amounts collected from the purchaser, but instead may also include amounts the retailer receives from other sources.

Manufacturers, vendors, and other third parties often engage in various programs that result in credits or payments made to retailers with respect to a retailer's taxable sale of products to an end-use customer. (Cal. Code Regs., tit. 18, § 1671.1(a).) These payments and credits include rebates. (*Ibid*.) Under certain conditions, payments received by the retailer in the form of rebates or other types of payments or credits for products sold at retail are included in the retailer's gross receipts or sales price from the sale of the product. (*Ibid*.) It is rebuttably presumed that any consideration received by retailers from third parties related to promotions for sales of specified products is subject to tax until the contrary is established. (Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).)

The types of documentation that will generally rebut this presumption include, but are not limited to, the following: (1) a copy of an agreement or contract between the retailer and a third party that requires the retailer to give specified products preferential shelf space or to display the products in specific areas of the retailer's establishment in exchange for the payment received; (2) a copy of an agreement or contract between the retailer and a third party that provides the retailer with an advertising allowance, equal to or in excess of the payment received, when the retailer advertises the third-party's products; (3) a copy of an agreement or contract between the retailer and a third party that provides that the retailer will only receive the payment if the retailer sells a certain quantity of the products within a specified price range during a particular period, or if the retailer purchases a certain quantity of the products during a particular period; or (4) in the absence of a written agreement or contract, the retailer may use any verifiable method of establishing that the consideration received from the third party was not subject to tax, such as a signed and dated letter or other type of documentation provided by the third party, subsequent to the contract or agreement, verifying that the payment received was not paid pursuant to a contract requiring a reduction in the selling price of specified products on a transaction-by-transaction basis. (Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).)

On appeal, appellant argues that the payments at issue are not part of sales but are monies received from vendors for selling products with low profit margins. Appellant asserts that the payments are an incentive to sell the products at issue (i.e., beer, soda, cigarettes, and tobacco

products) and is neither a part of, nor a factor in, the retail price paid by its customer. Appellant adds that the sales price is dictated by its vendors, and the rebates are part of its profit margin on the product. At the oral hearing, appellant indicated that it had no written agreements with respect to these payments because such agreements were between its franchisor and the vendors, adding that the vendor payments at issue first went to its franchisor, who then forwarded them to appellant.

In response, CDTFA argues that appellant has not provided any evidence showing either that it included the rebates at issue in the amount of reported taxable sales or that the rebates are exempt from taxation, so no adjustment is warranted.

Here, per appellant's profit and loss statements, appellant received payments from beer, soda, and tobacco vendors during the liability period. Thus, it is rebuttably presumed that these payments are subject to tax until appellant establishes the contrary via written agreement, contract, or other verifiable documentation. (See Cal. Code Regs., tit. 18, § 1671.1(c)(3)(A).) However, appellant indicated at the oral hearing that it possesses no written agreement with respect to these payments, and has also not supplied any documentation regarding them. Further, appellant has not identified any errors in CDTFA's computation of unreported taxable rebates. Accordingly, OTA concludes that a reduction to the measure of unreported taxable rebates is not warranted.

Issue 4: Whether appellant was negligent or intentionally disregarded relevant legal authorities.

CDTFA added a 10 percent negligence penalty of $14,179.05 to the determination because of substantial differences between appellant's recorded and reported taxable sales and because, since its last audit, appellant had failed to correct its recordkeeping and reporting errors.

If any part of the deficiency for which a deficiency determination is made is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations, a penalty of 10 percent of the amount of the determination shall be added thereto. (R&TC, § 6484; Cal. Code Regs., tit. 18, § 1703(c)(3)(A).)

Taxpayers are required to maintain and make available for examination on request by CDTFA all records necessary for the proper completion of SUTRs. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Such records include, but are not limited to, the following: (a) 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 tax returns. (Cal. Code Regs., tit. 18, § 1698(b)(1).) Failure to maintain and keep complete and accurate records will be considered evidence of negligence or intent to evade the tax and may result in penalties. (Cal. Code Regs., tit. 18, § 1698(k).)

If a taxpayer has been notified of reporting errors committed during an audit period, and continues to commit the same reporting errors during a subsequent audit period, then that is also evidence of negligence. (*Independent Iron Works, Inc. v. State Bd. of Equalization* (1959) 167 Cal.App.2d 318, 321-323.) Further, a taxpayer's failure to report numerous transactions is evidence of negligence if the failure had nothing to do with the taxpayer's accounting system. (*Id*. at p. 323.)

On appeal, appellant argues that it was not negligent because it reported taxable sales based on what the Retalix POS system recorded.

Here, upon audit, appellant did not provide CDTFA with any sales tax worksheets, which are working papers used in preparing SUTRs. This is evidence of negligence.

Further, appellant continued to commit reporting errors identified in a prior audit. Previously, CDTFA audited appellant for the period of October 1, 2009, through September 30, 2012. This prior audit disclosed an aggregate deficiency measure of $8,351,748, which, as relevant here, was partly comprised of unreported taxable diesel fuel sales of $395,906, unreported taxable minimart sales of $3,007,870, and unreported taxable rebates of $125,108. CDTFA largely based unreported taxable sales of diesel fuel and minimart sales on the differences between what appellant reported versus what it recorded. Similarly, the current audit disclosed unreported taxable diesel fuel sales of $49,071, unreported taxable minimart sales of $1,662,222, and unreported taxable rebates of $60,333. As with the prior audit, CDTFA based unreported taxable sales of diesel fuel and minimart sales on the discrepancies found between what appellant reported and its records. Appellant was notified of reporting errors with respect to its diesel fuel sales, minimart sales, and taxable rebates in the prior audit, but appears to have continued to commit the same reporting errors with respect to these types of transactions. Accordingly, this is also evidence of negligence.

Finally, although comparing the results of the two audits discloses that appellant has reduced the amounts of unreported taxable diesel fuel sales (from $395,906 in the prior audit to

$49,071 in the current audit) and unreported taxable minimart sales (from $3,007,870 to $1,662,222), the underreported amounts for each remain significant, especially for minimart sales. Appellant's failure to report numerous transactions is evidence of negligence if the failure had nothing to do with the taxpayer's accounting system. (See *Independent Iron Works, Inc. v. State Bd. of Equalization*, *supra*, at p. 323.) Although appellant argues that it was not negligent because it merely reported what its faulty Retalix POS system recorded, OTA has already rejected appellant's contention that its sales records are unreliable and should not be used to establish audited taxable sales. Accordingly, OTA finds that appellant's underreporting of numerous diesel fuel and minimart transactions is unrelated to a faulty accounting system, and concludes that, based on the evidence recounted above, appellant was negligent.

Issue 5: Whether further relief of interest is warranted.

Interest began accruing in this matter effective February 1, 2013.

The imposition of interest is mandatory. (R&TC, § 6482.) There is no statutory right to interest relief. (R&TC, § 6593.5(a).) CDTFA, in its discretion, may relieve all or any part of the interest imposed on a person by the Sales and Use Tax Law where the failure to pay tax is due in whole or in part to an unreasonable error or delay by a CDTFA employee acting in his or her official capacity. (R&TC, § 6593.5(a)(1).) Such a delay means, for example, an unreasonable failure to work on an appeal. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) An unreasonable error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or failure to act by, the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(c).)

In its statement submitted after the oral hearing, appellant requests interest relief because of alleged delays by both CDTFA and OTA. Specifically, appellant alleges delays by CDTFA during its audit, settlement process, transition from the Board of Equalization, and internal appeals process. Appellant claims that COVID-19 and lack of resources are the reasons cited by CDTFA for delays during its internal appeals process. Appellant also notes that its appeal to OTA took over two years from the date it submitted its appeal until the oral hearing on May 10, 2023.

In response, CDTFA analyzed the amount of time appellant's case spent with CDTFA, provided its analysis to OTA in timeline format, and conceded to relieve interest accrued from

February 1, 2018, through November 30, 2018, due to an unreasonable delay by its Settlement and Taxpayer Services Bureau.

The issue now is whether further relief of interest is warranted.

Alleged Delay by CDTFA

For purposes of considering discretionary interest relief, OTA will generally not second-guess the standard timeframes determined by CDTFA, and will instead defer to CDTFA's decision absent evidence of an abuse of discretion. (*Appeal of Micelle Laboratories, Inc.*, *supra*.) To show an abuse of discretion, a taxpayer must establish that, in refusing to relieve interest, CDTFA exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Eichler*, 2022-OTA-029P.) Where the administrative record is silent regarding the actions taken on a taxpayer's matter and CDTFA does not come forth with evidence to show that the employees assigned to the matter or involved in its review were actively working on it, there may be no apparent basis to support CDTFA's determination not to relieve interest, and the unsupported determination may constitute an abuse of discretion. (*Ibid*.)

Upon review of CDTFA's analysis and timeline of events, OTA finds no other unreasonable delays attributable to CDTFA apart from the conceded period of February 1, 2018, through November 30, 2018. Additionally, appellant has not supplied any evidence, nor otherwise shown, that CDTFA abused its discretion in denying appellant's request for interest relief with respect to the balance of time that appellant's case was with CDTFA. Thus, OTA concludes that no further interest relief is warranted for the time this appeal was with CDTFA apart from interest accrued from February 1, 2018, through November 30, 2018.

Alleged Delay by OTA

R&TC section 6593.5(a)(1) and (d), as amended by Statutes 2022, chapter 474, section 6, and in effect as of January 1, 2023, specifically empowers the "department" with the discretionary authority to grant relief of interest imposed on tax liabilities arising on or after July 1, 1999, for unreasonable errors or delays by an employee of the "department" acting in their official capacity. Here, "department" refers to CDTFA, not OTA. Unlike CDTFA, OTA is not authorized by any statute to grant interest relief for any period of time that an appeal is with OTA. Accordingly, OTA cannot grant relief of interest accrued during the time appellant's case was with OTA even assuming there was an unreasonable error or delay by an OTA employee.

In summary, no further relief of interest is warranted apart from the interest accrued from February 1, 2018, through November 30, 2018.

HOLDINGS

1. Appellant has not shown that any reduction to the measures of either unreported taxable diesel fuel sales or minimart sales is warranted.
2. Appellant has not shown that any reduction to the measure of excess tax reimbursement collected is warranted.
3. Appellant has not shown that any reduction to the measure of unreported taxable rebates is warranted.
4. Appellant was negligent.
5. Appellant has not shown that further relief of interest is warranted apart from relief of the interest accrued from February 1, 2018, through November 30, 2018.

DISPOSITION

Per CDTFA's concession, interest accrued for the period of February 1, 2018, through November 30, 2018, is relieved. Otherwise, CDTFA's action in denying appellant's petition is sustained.

DocuSigned by:
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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

Date Issued: 10/2/2023