OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21057793
	CDTFA Case ID: 841144
Z & R OIL CORPORATION	

OPINION

Representing the Parties:

For Appellant:	Jafar Rashid, President Omar Sharif, CPA
For Respondent:	Jason Parker, Chief of Headquarters Operations
For the Office of Tax Appeals:	Deborah Cumins, Business Taxes Specialist III

J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Z & R Oil Corporation (appellant) appeals a Decision and Recommendation (decision) issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] in response to appellant's petition for redetermination of the Notice of Determination (NOD) dated July 28, 2014.[2] The NOD is for tax of $549,099.37, applicable interest, and a negligence penalty of $54,909.97, for the period January 1, 2010, through December 31, 2012 (audit period). In its subsequent decision, CDTFA reduced the tax from $549,099.37 to $532,906 and the penalty from $54,909.97 to $53,290.61, and denied the remainder of the petitioned amount.

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

[2] The NOD was timely issued because on September 7, 2013, appellant signed the most recent in a series of waiver of the otherwise applicable three-year statute of limitations, which allowed CDTFA until October 31, 2014, to timely issue a NOD. (See R&TC, §§ 6487(a), 6488.)

Appellant waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides this matter on the written record.

ISSUES

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

FACTUAL FINDINGS

1. Appellant has operated a Chevron gasoline station with a mini-mart in Los Angeles since November 2004, selling three grades of gasoline (i.e., regular, midgrade, and premium) and diesel fuel (diesel).[3] In the mini-mart, appellant sells taxable merchandise, exempt food products, and lottery tickets.
2. Appellant was previously audited for the period January 1, 2007, through December 31, 2009 (prior liability period). CDTFA issued an NOD for the prior liability period on April 28, 2010. The April 28, 2010 NOD was for tax of $502,938.50, applicable interest, and a negligence penalty of $50,294.88. That NOD was based on an audit wherein CDTFA determined unreported taxable sales of $9,394,886, which was subsequently reduced to $7,790,063 with a corresponding reduction to the negligence penalty. CDTFA imposed the negligence penalty because of the large measure of unreported taxable gasoline and diesel sales, the error ratio of 102.77 percent, and incomplete records (i.e., only incomplete cash register tapes, which were provided after CDTFA held an appeals conference).
3. For the audit period at issue, appellant reported total sales of $23,179,538 and claimed deductions of $190,530 for exempt sales of food products, $137,094 for the California excise tax on diesel and sales of lottery tickets, and $20,131,037 for the exempt portion of the sales of motor vehicle fuel.[4] Appellant reported taxable sales of $2,720,877 subject to

[3] In its appeal with CDTFA, appellant argued that it did not sell diesel fuel. According to CDTFA, the evidence showed that appellant did sell diesel fuel during the audit period, and appellant has not argued otherwise in its opening brief.

[4] Effective July 1, 2010, legislation increased the state excise tax rate on sales of motor vehicle fuels (i.e., gasoline, not diesel fuel) while correspondingly decreasing the sales and use tax rate on the same. (See R&TC, §§ 6357.7, 7326 & 7360.) This legislation is referred to as the "fuel tax swap."

the state portion of the sales and use tax and taxable sales of $22,851,914 subject to the local tax and transactions and use tax.[5]

4. Appellant did not report any sales of diesel during the audit period.

5. For audit, appellant only provided federal income tax returns (FITRs) for 2010, 2011, and 2012.

6. CDTFA found that the sales amounts appellant reported on its FITRs reconciled with the amounts it reported on sales and use tax returns. However, in the absence of records, CDTFA concluded that it needed to investigate further. To establish the audited number of gallons of gasoline purchased, CDTFA used the total amount of sales tax appellant prepaid to vendor(s), as reported to CDTFA by the vendor, and the per gallon prepayment rate in effect for each quarter of the audit period.[6]

7. CDTFA found that appellant had claimed $715,386 in prepayment to vendors, while the vendors had reported receiving prepayments from appellant of $679,273. CDTFA used the lower figure to compute the audited number of gallons purchased.

8. To establish audited selling prices for gasoline, CDTFA used the average weekly prices published by the United States Department of Energy (DOE),[7] adjusted for an observed differential between the average weekly prices and the prices charged by appellant.

    a. To establish the differential, CDTFA observed appellant's posted prices for each the three grades of gasoline it sold on the following five days: one Tuesday

[5] On and after July 1, 2010, sales of gasoline are exempt from the state portion of the sales and use tax. (R&TC, § 6357.7(a).) The exemption does not apply with respect to tax levied in accordance with the Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with R&TC, § 7200) or the Transactions and Use Tax Law (commencing with R&TC, § 7251). The exemption also does not apply with respect to tax levied pursuant to temporary sales tax increases (R&TC, §§ 6051.2, 6051.5), temporary use tax increases (R&TC, §§ 6201.2, 6201.5), or temporary local or transactions tax increases (Section 35 of Article XIII of the California Constitution). On and after July 1, 2011, in addition to the sales and use taxes imposed on retail sales of tangible personal property in general, an additional tax is imposed upon retailers of diesel fuel. The rate of increase was originally 1.75 percent, and the rate of increase has varied in subsequent years. (R&TC, § 6051.8.) R&TC sections 6357.7, 6051.8 add a level of complexity to the computation of the amount of tax. However, it is not necessary to incorporate that complexity into our analysis of appellant's arguments.

[6] CDTFA concluded that appellant's reported taxable mini-mart sales were substantially accurate. Accordingly, OTA will address only the audited understatements of sales of gasoline and diesel.

[7] The DOE surveys gasoline stations in various areas one day each week (typically on Monday) and computes an average selling price for that day for each grade of gasoline. OTA refers to the DOE prices herein as the average weekly prices.

(April 2, 2013) and four Mondays (April 8, 15, and 29, 2013, and May 13, 2013).[8] For each day of observation, CDTFA compared the DOE average weekly price and appellant's posted price for each grade of gasoline, computing the difference. CDTFA then used the ratio of the sales of each grade to total gasoline sales, published by DOE, to compute a volume-weighted price difference for all grades of gasoline for that day.[9] For each observation day, appellant's selling prices for gasoline were less than the DOE prices, and CDTFA computed an average differential of 2.7 cents per gallon.[10]

b. For each week of the audit period, CDTFA scheduled the DOE average weekly prices for regular, mid-grade, and premium gasoline. It used the percentages of sales of each grade of gasoline, published by DOE, to compute the volume-weighted average selling price for each week. CDTFA then computed the average selling price for each quarter of the audit period, using the selling prices for each week in each quarter.

c. CDTFA reduced the average selling price per quarter, computed from the DOE data, by $0.027 to compute the audited selling price, including sales tax reimbursement.[11]

9. CDTFA established the audited sales of gasoline for each quarter using the audited number of gallons purchased for the quarter and the audited selling price, including sales tax reimbursement. It then reduced the amount for each quarter by the amount of sales tax reimbursement included, using the sales tax rate in effect for gasoline for each quarter.

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[8] The days of CDTFA's observations are relevant because DOE typically conducts its price surveys on Mondays. Thus, prices observed on Monday are most comparable to the DOE average weekly prices.

[9] The DOE publishes ratios of sales of each grade of gasoline (e.g., for 2010, DOE published sales ratios of 75.60 percent regular grade, 9.81 percent mid-grade, and 14.59 percent premium).

[10] Appellant's selling prices for gasoline were less than the DOE prices: by 3.7 cents on April 2, 2013, by 4.7 cents on April 8, 2013, by 3.9 cents on April 15, 2013, by 1.8 cents on April 29, 2013, and by 0.8 cents (less than one cent) on May 13, 2013.

[11] Sales or use tax applies to retail sales of fuel taxed under the Motor Vehicle Fuel License Tax Law. The tax applies to the total selling price of such motor vehicle fuel, inclusive of federal and state excise taxes. (See Cal. Code of Regs., tit. 18, § 1598(c)(1); https://www.cdtfa.ca.gov/lawguides/vol3/mvftl/motor-vehicle-fuel-tax-law.html.) For this reason, CDTFA did not deduct excise taxes from the selling price.

10. CDTFA established an understatement of reported taxable gasoline sales of $9,836,700 ($32,528,779 audited - $22,692,079 reported). CDTFA then computed an understatement of tax of $451,731, using a 9.75 percent tax rate for the period January 1, 2010, through June 30, 2010, and a 3.75 percent tax rate for the remainder of the audit period, as a result of the exemption from the state portion of the sales and use tax established by R&TC section 6357.7, mentioned in footnote 5, above.

11. CDTFA used essentially the same process to establish the audited sales of diesel.[12] Although appellant had not reported sales of diesel during the audit period, its fuel vendors had reported sales tax prepayments made by appellant related to purchases of diesel.

12. To establish the audited number of gallons of diesel purchased, CDTFA used the total amount of sales tax prepaid to vendors for diesel fuel and the prepayment rate in effect for each quarter of the audit period. CDTFA then used the average weekly prices published by DOE, adjusted for an observed differential.

    a. CDTFA observed the posted diesel prices on the same days that it observed the gasoline prices. For each day of observation, CDTFA computed the difference between the DOE average weekly price and the prices charged by appellant. The price charged by appellant was less than the DOE average weekly price for three of the five weeks and greater than the DOE price for the other two weeks.[13] CDTFA computed an average differential of 3.5 cents per gallon less than the DOE prices.

    b. For each week of the audit period, CDTFA scheduled DOE average weekly prices for diesel. It computed the average selling price for each quarter, using the selling prices for each week in each quarter.

    c. CDTFA reduced the average selling price per quarter, computed from DOE data, by the excise tax rate per gallon in effect in each quarter and by the 3.5 cent price

[12] Beginning July 1, 2011, retail sales of diesel fuel are taxed at a higher sales and use tax rate than sales of other tangible personal property. (R&TC, § 6051.8.)

[13] Appellant's selling prices per gallon were less than the DOE prices: by 10 cents on both April 2, 2013 and April 8, 2013, and by 5 cents on April 15, 2013. Appellant's selling prices per gallon were higher than the DOE prices: by 1 cent on April 29, 2013, and by 6 cents on May 13, 2013.

differential to compute the audited selling price, including sales tax reimbursement.[14]

13. CDTFA established the audited sales of diesel for each quarter using audited purchases for the quarter and the audited selling price, including sales tax reimbursement. It then reduced the amount for each quarter by the amount of sales tax reimbursement included, using the sales tax rate in effect for diesel for each quarter.

14. CDTFA established unreported taxable sales of diesel of $1,576,252. CDTFA computed tax of $161,598, using a tax rate of 9.75 percent for the period January 1, 2010, through June 30, 2011, and a tax rate of 10.62 percent for the remainder of the audit period (after the increase in sales tax applicable to diesel pursuant to R&TC section 6051.8).

15. CDTFA found that the sales tax prepayments reported by appellant's vendors of fuel exceeded the amount appellant had claimed on returns by $64,299.

16. CDTFA concluded that the understatement resulted from negligence because of the following: appellant had previously been audited, and similar errors occurred in the present audit; the large understatement; the high error ratio, and appellant failed to maintain and make its records available.

17. On July 28, 2014, CDTFA issued the NOD ($451,731 tax related to the understatement of reported gasoline sales + $161,598 tax related to unreported diesel sales - $64,229 unclaimed prepayments of sales tax to fuel vendors).[15]

18. On August 14, 2014, appellant filed a timely petition for redetermination.

19. CDTFA held a conference on March 1, 2016. Based on documentation provided after the appeals conference, CDTFA concluded that an adjustment was warranted for pilferage.

20. On June 28, 2016, CDTFA issued a decision recommending a reduction in the audited measure of tax from $11,412,951 ($9,836,702 for gasoline and $1,576,249 for diesel) to $11,071,602 ($9,511,113 for gasoline and $1,560,489 for diesel), which was computed by reducing the audited number of gallons sold by 1 percent, an estimated amount of pilferage.

[14] Unlike motor vehicle fuels like gasoline, discussed in footnote 11 above, the selling price is reduced by the excise tax rate because excise tax on diesel is not part of the measure. (See Cal. Code of Regs., tit. 18, § 1598(c)(2)(C)-(D).)

[15] OTA computes a tax liability of $549,100; the minimal difference is the result of rounding.

21. CDTFA prepared a reaudit and it notified appellant on December 15, 2020, via letter that it had reduced the tax and the negligence penalty to $532,906 and $53,290.61, respectively.[16]

22. This timely appeal followed.

DISCUSSION

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

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 purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)1).)

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.) If CDTFA carries 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*.)

Here, appellant provided only FITRs. It did not provide profit and loss statements; sales journals, purchase journals, or other summary records; cash register tapes, purchase invoices, or other source documents; bank statements; or any other records. In other words, appellant provided virtually no evidence to show that its reported taxable sales were accurate. Under those circumstances, CDTFA had no option other than to use an alternate audit method. CDTFA

[16] Based on the December 15, 2020 letter it is unclear whether interest continued to accrue. However, appellant has not raised interest relief as an issue. Therefore, OTA does not discuss it further. The letter also indicates that CDTFA applied $87,780 in credits towards the tax liability.

conducted a standard audit of a retailer of gasoline and diesel that provides inadequate records. In this audit, CDTFA computed the numbers of gallons of gasoline and diesel sold each quarter using amounts reported to CDTFA by appellant's vendor(s) of total prepayments of sales and use tax to fuel suppliers and the prepayment rates per gallon in effect in each quarter. Both elements of that computation are objective, documented figures. Further, CDTFA noted that appellant had reported a lower total of prepayments than its suppliers had reported. CDTFA used appellant's figure, thus computing fewer gallons of gasoline available for sale than if it had used the prepayments reported by the suppliers. To establish the audited selling prices, CDTFA began with average weekly prices published by DOE, which is a reliable source for gasoline prices. CDTFA then reduced those prices by a 2.7 cent differential for gasoline and by a 3.5 cent differential for diesel, and further reduced for sales tax reimbursement included, as described above. OTA finds that CDTFA used a standard audit procedure, based on objective, verifiable figures. In light of the absence of appellant's business records, OTA finds that CDTFA has shown that its determination is reasonable and rational. Therefore, appellant has the burden to establish that further adjustments are warranted.

Appellant disputes both the audited selling prices and the audited number of gallons of gasoline sold, each of which OTA addresses individually below.

Audited selling prices

Appellant disputes the audited selling prices. Appellant first notes that the differential used to establish audited selling prices was based on five days of field observation. Appellant acknowledges that most of the observation days were Mondays, which correspond to the typical day of the DOE survey. However, appellant asserts that its selling prices change every day to compete with other stations. On that basis, appellant asserts that five days of observation is not a sufficient test of the difference between its selling prices and the average weekly prices published by DOE.

Appellant is correct that CDTFA compared appellant's selling prices to DOE average weekly prices for five days. The purpose of CDTFA's observation of prices on Mondays was to compare "apples to apples" (Monday average weekly prices compared to Monday prices at appellant's gas station). As appellant notes, fuel selling prices do change frequently, perhaps every day. It is for that very reason that it is preferable to compare the station's selling prices on Monday to the average weekly selling prices also established for the same day.

Appellant also observes that, in the prior audit of the period 2007-2009, CDTFA used a price differential of almost 26 cents. Appellant argues that a similar differential should be used in this audit because, according to appellant, nothing has changed in its business operations since 2009.

It is unclear whether appellant is arguing that the price differential should be increased to 26 cents for both gasoline and diesel selling prices. However, in the prior liability period, CDTFA found that appellant's selling prices for diesel were 41.70 cents higher than the average DOE prices. Further, appellant has not provided any evidence to establish that the audited selling prices for diesel should be decreased.

Next, OTA analyzes whether appellant has provided convincing evidence that the audited selling prices for gasoline should be decreased.

CDTFA clarifies that the price differentials for sales of gasoline in the prior liability period were 25.73 cents per gallon for 2007, 37 cents per gallon for 2008, and 20.28 cents for 2009. Those price differentials were established after CDTFA reviewed cash register tapes presented by appellant during the appeals process for the prior liability period.

CDTFA asserts that the sales reported in each audit period are evaluated based on the available books and records for that period. CDTFA also observes that, while appellant provided cash register tapes for the prior liability period that supported higher price differentials than CDTFA had established based on its observation of posted prices, appellant has not provided a single cash register tape or any other reliable evidence for this audit period. Thus, CDTFA argues that no further adjustments are warranted to the audited selling prices.

Here, appellant has not provided records to support its argument that the price differential should be increased to 26 cents. OTA notes that appellant had been audited previously, and appellant has not provided a credible rationale for the absence of records in this audit period. In the absence of records, CDTFA used a logical process to evaluate the relationship of appellant's selling prices to DOE average weekly prices. CDTFA observed appellant's actual, posted selling prices on five separate days over a period of about seven weeks. The price differentials for the test weeks were all less than 5 cents (3.7 cents, 4.7 cents, 3.9 cents, 1.8 cents, and 0.8 cents, as noted in footnote 10, above). The highest differential is 4.7 cents. There is no evidence of any price differentials approaching 26 cents in this audit period. If there were other weeks during the audit period for which appellant's price differentials were greater, it was appellant's

responsibility to provide records to support those lower selling prices. Since it has not done so, OTA finds no further adjustments to the audited selling prices for gasoline are warranted.

Audited number of gallons of gasoline and diesel sold

Appellant has not disputed the audited number of gallons of gasoline or diesel purchased. Appellant argues, however, that the audited allowance of 1 percent for pilferage should be increased. Appellant states that its gas station is located in a neighborhood with an unusually high crime rate. Appellant also asserts that gasoline theft is very common, and that its cashiers are afraid to confront thieves, especially at night. Appellant argues that the adjustment for theft should be 10 percent of the number of gallons purchased.

In response to appellant's assertion that the pilferage allowance should be increased to 10 percent, CDTFA states that the allowance of 1 percent represents an adjustment of 92,059 gallons of gasoline or 84 gallons per day (92,059 ÷ 1095), and 4,801 gallons of diesel, or 4 gallons per day (4,801 ÷ 1095). CDTFA asserts that an allowance of 1 percent for pilferage is reasonable and sufficient, and it refers to Section 0407.10 of its Audit Manual, which provides that an allowance of 1 percent for shrinkage may be allowed without specific documentation.[17] CDTFA argues that appellant has provided no police reports or other evidence to support a pilferage allowance in excess of 1 percent, and therefore no further adjustment is warranted.

OTA finds that the pilferage allowance represents regular losses of gasoline of about 84 gallons per day, which would be five to eight "fill-ups" for which appellant did not receive payment, every single day.[18] In contrast, appellant asserts that the allowance should be 10 times higher, or 840 gallons per day (about 50 to 80 unpaid sales). However, appellant has provided

[17] Section 0407.10 of CDTFA's Audit Manual provides that the taxpayer must provide evidence of losses in excess of 1 percent. CDTFA's Audit Manual is an advisory publication providing direction to CDTFA staff administering the Sales and Use Tax Law and Regulations. OTA is not required to follow CDTFA's Audit Manual. (See *Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)

[18] The pilferage allowance for diesel represents a much more modest amount, 4 gallons per day, because appellant purchased only about 480,000 gallons of diesel during the audit period, while it purchased over 9 million gallons of gasoline.

no documentation of the allegedly numerous daily thefts, such as police reports or insurance claims.[19] In the absence of supporting evidence, no further adjustment for pilferage is warranted.

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. Although the term "negligence" in not specifically defined in the Sales and Use Tax Law, 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.[20] (*Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal. App. 5th 1129, 1157; *Warner v. Santa Catalina Island Co.* (1955) 44 Cal.2d 310, 317.) The pertinent circumstances here are that of a corporate entity operating as a retailer with a seller's permit. Therefore, the question is whether the underreporting occurred despite appellant's exercise of ordinary business care and prudence.

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

[19] Appellant asserts that it provided a point of sale (POS) report for another gas station (RD 786) which showed a difference of about five percent between purchased gallons and sold gallons. However, an audit of RD 786 Enterprises, Inc. was appealed for a prior audit period, (RD 786 Enterprises Inc. is one of the related appeals listed in CDTFA's April 24, 2012 decision regarding the audit of appellant for the years 2007 through 2009), but there is no current appeal for RD 786 Enterprises, Inc. Moreover, the POS report referred to by appellant is not in the record, and, if it were, it would be applicable to a different business. Thus, OTA will not discuss it further herein.

[20] Similarly, among the definitions for the term provided by Black's Law Dictionary (11th ed. 2019) is: "the doing of what a reasonable and prudent person would not do under the particular circumstances, or the failure to do what such a person would do under the circumstances."

negligence and may result in the imposition of penalties. (Cal. Code Regs., tit. 18, § 1698(k).) Imposition of a negligence penalty is warranted where errors are continued from one audit to the next. (*Independent Iron Works, Inc. v. State Board of Equalization* (1959) 167 Cal.App.2d 318, 321-324.)

Appellant argues that CDTFA conducted the audit of the prior period and the audit under consideration here concurrently and that following completion of the prior audit, there was not enough time for it to comply with the requirement to maintain and provide records for the present audit. However, CDTFA issued the NOD for the prior period on April 28, 2010. Thus, by the end of April 2010, appellant had been fully informed that it was required to maintain records and reminded of its obligation to make them available for audit. The audit period under consideration here was from January 1, 2010, through December 31, 2012. Appellant had ample time during those three years to establish procedures to maintain records. Moreover, OTA notes that appellant had been in business since November 2004, and, during this audit period it reported taxable sales of almost $23 million (audited sales were almost $34 million).[21] A businessperson operating with ordinary business care and prudence when making sales of that volume would recognize that records are required, and appellant is presumed to know the law. (*Diaz v. Grill Concepts Services, Inc.* (2018) Cal.App.5th 859, 869.) Thus, OTA is not persuaded by appellant's argument that it was unaware that records were required and that it simply did not have time to comply with the requirement to maintain and make available records for audit.

Appellant also states that in 2013 and 2014 it updated its gas pumps and installed a point-of-sale system. According to appellant, an audit of the period 2015 through 2017 resulted in no understatement. Appellant asserts that it complied with CDTFA's "request" (to maintain records) within a reasonable time. The requirement to keep records is not a request by CDTFA; the requirement is established by law. (See R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).) Subsequent remedial improvements in recordkeeping for subsequent periods are not relevant to the analysis of negligence for the period under consideration here.

The only records appellant provided for this audit were its FITRs for 2010, 2011 and 2012. It provided no summary records, source documents or bank statements. Appellant had

[21] Reported taxable sales of $22,851,914 plus an understatement of reported taxable sales of $9,511,113 (gasoline) and $1,560,489 (diesel) total $33,923,516.

been audited previously and was notified of the requirement to provide complete records for audit. OTA finds that appellant's failures to maintain and make records available are evidence of negligence in recordkeeping.

The understatement of reported taxable sales after the reaudit was $11,071,602, and appellant reported taxable sales of $22,851,914.[22] Thus, the understatement represents 48 percent of reported amounts. Both the amount of understatement and the percentage of error are substantial and represent clear evidence of negligence in reporting. Moreover, the errors CDTFA identified in this audit are the same types of errors found in the audit of the prior period (severely inadequate records, along with substantial understatements of reported taxable sales of fuel). For the prior liability period, the audited understatement was $7,790,063. The understatement for this audit period was $11,071,602 ($9,511,113 for gasoline and $1,560,489 for diesel). While OTA would expect a taxpayer's recordkeeping and reporting to improve after an audit, appellant's actually worsened. As noted above, imposition of a negligence penalty is warranted where errors are continued from one audit to the next. (*Independent Iron Works, Inc. v. State Board of Equalization, supra*, 167 Cal.App.2d at pp. 321-324.)

In sum, there is ample evidence that understatement is resulted from negligence. OTA finds that appellant was negligent, and that CDTFA properly imposed the negligence penalty.

[22] Both the understatement and the reported taxable sales are the total amounts, without any adjustment for the sales that were not subject to the state portion of the sales and use tax pursuant to R&TC section 6357.7.

HOLDINGS

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

DISPOSITION

Sustain CDTFA's decision to reduce the tax and penalty to $532,906 and $53,290.61, respectively, and to otherwise deny the petition.

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:
Michael F. Geary
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
8A4294817A67463...
Andrew Wong
Administrative Law Judge

Date Issued: 3/25/2024