OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **BLUE LABEL ELIXIR, INC.,** **dba Blue Label Elixir Distro**	OTA Case No.: 250923107 CDTFA Case IDs: 5-514-291, 5-514-292,5-514-293

OPINION

Representing the Parties:

For Appellant: David Nicothodes, Representative

For Respondent: Eric Anderson, Hearing Representative

For Office of Tax Appeals: Crystal Spratley, Business Taxes Specialist

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 30261, Blue Label Elixir, Inc., dba Blue Label Elixir Distro (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent) denying appellant's timely petition for redetermination of three Notices of Determination (NODs) issued on December 19, 2023 (NOD-1), December 20, 2023 (NOD-2), and December 26, 2023 (NOD-3).[1] NOD-1 is for tax of $33,561, plus applicable interest, and a negligence penalty of $3,356.10 for the period January 1, 2020, through December 31, 2020.[2] NOD-2 is for tax of $28,359, plus applicable interest, and a negligence penalty of $2,835.90 for the period February 1, 2021, through December 31, 2021. NOD-3 is for tax of $9,275, plus applicable interest, and a negligence penalty of $927.50 for the period March 1, 2022, through June 30, 2022.[3]

[1] For the liability periods being appealed, appellant's license was valid from January 1, 2020, through June 30, 2022. Appellant operated while unlicensed during two separate time periods within that date range, which led respondent to divide the licensed periods into three separate liability periods.

[2] Respondent timely issued NOD-1 because on November 21, 2023, appellant waived the otherwise applicable three-year statute of limitations by signing a series of waivers, which gave respondent until December 31, 2023, to issue NOD-1 for the period of January 1, 2020, through October 31, 2020. (See R&TC, §§ 30207, 30208.)

[3] For purposes of this Opinion, when referring to all three liability periods collectively, 'entire liability period' will be used (i.e., covering the dates of January 1, 2020, through June 30, 2022).

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

ISSUES

1. Whether adjustments are warranted to the unreported taxable distributions of tobacco products.
2. Whether adjustments are warranted to the disallowed claimed nontaxable distributions of tobacco products in interstate commerce.
3. Whether respondent properly imposed the negligence penalty.

FACTUAL FINDINGS

1. During the entire liability period, appellant operated as a tobacco products distributor and manufacturer located in Rancho Cucamonga, California. Appellant manufactured some, but not all, of the tobacco products it distributed during the entire liability period.
2. While appellant was a licensed distributor of tobacco products for the three liability periods being appealed, appellant's license was not valid from January 1, 2021, to February 23, 2021, and January 1, 2022, to March 14, 2022. Appellant did not appeal these periods.
3. Appellant filed monthly tobacco products distributor tax returns from January 2020 through June 2022 and reported gross wholesale cost of tobacco products distributed in the amount of $95,894, claiming $45,916 of non-taxable interstate commerce, resulting in total taxable distributions of $49,977,[4] with tax rates varying between 56.93 percent to 63.49 percent, for total tax due of $31,996.[5]
4. Upon audit, appellant provided the following books and records: federal income tax returns for 2020 and 2021; sales invoices for the month of April 2022; sales reports[6] for the entire liability period; wholesale cost amounts per item for the entire liability period; a list showing shipping-related information on a transaction basis for customers with out-of-state addresses for the entire liability period; purchase invoices from one vendor;

[4] These totals are for the appealed liability periods only. For periods where appellant was unlicensed (which appellant did not appeal), reported amounts were allocated on a percentage basis.

[5] The tax rate is subject to change, effective each fiscal year. (R&TC, §§ 30123(b), 30126, 30131.5.)

[6] Sales reports consists of recorded sales of tobacco products by date with related cost of goods sold.

commercial lease agreement; payroll records; overhead expenses summary for the entire liability period.

5. Based on appellant's records, respondent calculated a wholesale cost of taxable distributions of $169,625 for the liability period.
6. For the products that appellant manufactured, respondent used the provided cost details[7] to calculate a wholesale cost per item per year. Additionally, respondent calculated an average wholesale cost as a percentage of selling price for each year: 43.46 percent for 2020, 45.33 percent for 2021, and 49.91 percent for 2022. To estimate the wholesale costs for those items that appellant did not provide cost details for, respondent applied these percentages to the average sales price per item, for each year, to arrive at the estimated wholesale cost by item for those items without cost details. Thereafter, respondent used the wholesale costs, from cost details and estimates, to arrive at the total wholesale cost of distributions of $84,333 for 2020, $66,465 for 2021, and $18,827 for 2022, for a total of $169,925 for the entire liability period.
7. Respondent disallowed the claimed exempt interstate commerce distributions in the amount of $45,916,[8] due to lack of supporting documentation.
8. Respondent compared the total audited wholesale cost of taxable distributions of $169,625 to the reported amounts for the three liability periods of $95,894, to arrive at unreported total wholesale cost of total distributions of $73,731 for the three liability periods.
9. Respondent issued three separate NODs for the three liability periods: NOD-1 on December 20, 2023, NOD-2 on December 21, 2023, and NOD-3 on December 27, 2023.
10. Appellant filed a timely petition for redetermination disputing the three NODs.
11. Respondent issued a Decision on July 24, 2025, denying appellant's petition for redetermination.
12. This timely appeal followed.

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[7] Appellant provided the cost of the base liquid. Respondent then added the cost formulas for nicotine, bottle, label, labor, and overhead, either on an actual basis if provided or on a weighted average basis if not provided, to calculate the total wholesale cost for each item.

[8] This is the amount for the appealed liability periods only. Claimed exempt interstate commerce distributions for unlicensed periods totaled $50,525, which is the figure shown on the transcript of returns.

DISCUSSION

Issue 1: Whether adjustments are warranted to the unreported taxable distributions of tobacco products.

The Cigarette and Tobacco Products Tax Law requires every person desiring to engage in the sale of tobacco products as a distributor to apply with respondent for a distributor's license for every place of business in which it engages in the business of distributing tobacco products. (R&TC, § 30140.) Every distributor is required to pay a tax upon distribution of tobacco products based upon the wholesale cost[9] of these products. (R&TC, §§ 30101, 30123(b), 30131.2(b).) "Distributor" includes every person who distributes tobacco products, or who sells or accepts orders for tobacco products which are to be transported from a point outside this state to a consumer within this state. (R&TC, § 30011.) The term "distribution" includes: (1) the sale of untaxed tobacco products in this state; (2) the use or consumption of untaxed tobacco products in this state; and (3) the placing in this state of untaxed tobacco products in a vending machine or in retail stock for purposes of selling these items to consumers. (R&TC, § 30008.) "Use or consumption" includes the exercise of any right or power over cigarettes or tobacco products incident to the ownership thereof, other than the sale of cigarettes or tobacco products or the keeping or retention thereof by a licensed distributor for the purpose of sale. (R&TC, § 30009.) Unless the contrary is established, it shall be presumed that all tobacco products acquired by a distributor are untaxed tobacco products, and that all tobacco products manufactured in this state or transported to this state, and no longer in the possession of the distributor, have been distributed. (R&TC, § 30109.)

Every distributor must keep records, receipts, invoices, and other pertinent papers that pertain to dealing in, transporting, or storing cigarettes or tobacco products in this state, and the distributor must provide those records to respondent for examination upon request. (R&TC, §§ 30453, 30454; Cal. Code Regs., tit. 18, § 4026.) A taxpayer must maintain and make available all records necessary to determine the correct tax liability and for the proper completion of the required tax return or report, including but not limited to, bills, receipts,

[9] R&TC section 30017 states, in part, that "'Wholesale cost' means the cost of tobacco products to the distributor prior to any discounts or trade allowances." Regulation section 4076(b)(2) states, in part, that "If a manufacturer…is also a distributor, the wholesale cost of tobacco includes all manufacturing costs, the costs of raw materials…prior to any discounts or trade allowances, the cost of labor, and any deferral excise and U.S. Customs taxes paid….overhead expenses that are directly or indirectly attributable to the production of finished tobacco products…all freight or transportation charges for shipment of materials and unfinished product . . . "

invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account. (Cal. Code Regs., tit. 18, § 4901(b)(1)(B).)

If respondent is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, respondent 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, respondent has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once respondent has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from respondent's determination is warranted. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Here, respondent used appellant's records to calculate the unreported taxable distributions of tobacco products. These records include appellant's purchase information, sales reports, cost formulas, and wholesale cost detail information. In addition, respondent included in the wholesale cost calculations manufacturing costs which were calculated using the overhead cost information (administrative costs information, lease information, depreciation), labor costs, label costs, bottle costs, nicotine, and other raw materials to manufacture the vape products. Additionally, for the items appellant manufactured where cost formulas were not provided, respondent estimated the cost of these products using appellant's records. Thus, OTA finds that respondent has met its initial burden to show that its determination was reasonable and rational. Therefore, the burden of proof shifts to appellant to show errors in the audit.

On appeal, appellant argues that it provided complete documentation including a detailed cost breakdown data sheet supporting appellant's figures. OTA reviewed the document in the record titled, "*CDTFA Reported Distro Tax Totals vs. Acct Audit"* along with the report titled "*Sales Detail per Quarter & COGS Annual Detail 9-14-2023 MOD 1-23-24*." These documents both appear to be reports created and/or generated by appellant but they include no source items, such as detailed sales data, invoices to show shipping to other states, the cost details for the sales and or claimed interstate sales. Without a way to verify this data appellant has provided, OTA cannot accept the unsubstantiated figures as accurate. Therefore, based on the foregoing, OTA concludes that appellant has failed to meet its burden of proof, and no adjustments are warranted to the audit for this item.

Issue 2: Whether adjustments are warranted to the disallowed claimed credits for tax-paid distributions of tobacco products in interstate commerce.

Tobacco products excise tax does not apply to the sale of tobacco products which are delivered to a point outside this state pursuant to a contract of sale, if the delivery is made by the seller by means of: (1) facilities operated by the seller, (2) a carrier for shipment to a consignee at a point outside the state, or (3) a customs broker or forwarding agent for shipment outside this state. (Cal. Code Regs., tit. 18, § 4080(a).) A distributor must retain bills of lading or other documentary evidence of the delivery of the tobacco products to a carrier, customs broker, or forwarding agent for shipments outside the state, and provide such evidence to respondent for inspection. (Cal. Code Regs., tit. 18, § 4080.)

R&TC section 30176.1 provides that respondent shall refund or credit to a distributor the tax imposed on tobacco products which is paid on the distribution of tobacco products which are shipped to a point outside the state for subsequent use or sale out of the state. (See also Cal. Code Regs., tit. 18, § 4063.5.) Any applications for refund under R&TC section 30176.1 based on the exportation of tax-paid tobacco products from this state shall be filed with respondent within three months after the close of the calendar month in which the tobacco products are exported. (See also Cal. Code Regs., tit. 18, § 4063.5) In lieu of the refund of the tax on tobacco products pursuant to R&TC section 30176.1, a distributor eligible for that refund may elect to claim a credit against taxes which would have been refunded if a claim had been made pursuant to R&TC section 30176.1. (R&TC, § 30178.2.) Regulation section 4063.5 further states, "Any application for refund *or credit* based upon the exportation of the tax-paid tobacco products from this state shall be filed with [respondent] within three months after the close of the calendar month in which the tobacco products are exported." (Emphasis added.)

On appeal, appellant argues that all documentation that is available to appellant has been submitted, and that the claimed nontaxable out-of-state sales should be allowed. Appellant claims that some of the tracking numbers associated with these out-of-state sales are no longer available to be traced and that appellant does not have the authority to subpoena the carrier UPS for this information; however, these exempt sales are listed on the documents provided and should still be allowed.

OTA reviewed the two reports provided, "*QuickBooks Online Out of State Sales*"[10] and "*Shipstation Out of State Customers*," and notes that although both of these reports contain a lot of information regarding claimed out-of-state sales and shipping information, no source

[10] This document covers the period of January 2020 through June 2022.

documentation[11] was provided to validate the reports provided. Furthermore, even though appellant contends that not all shipping documents are available due to the time lapse, no documentation has been provided to support any of the listed transactions. Based on the foregoing, OTA concludes that appellant failed to meet its burden of proof, and no adjustments are warranted.

Issue 3: Whether respondent properly imposed the negligence penalty.

R&TC section 30204 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. Negligence is generally defined as a failure to exercise such care that a reasonable and prudent person would exercise under similar circumstances. (*Appeal of HM Carpet Inc.,* 2025-OTA-595P.)

Every distributor must keep records, receipts, invoices, and other pertinent papers that pertain to dealing in, transporting, or storing cigarettes or tobacco products in this state, and the distributor must provide those records to respondent for examination upon request. (R&TC, §§ 30453, 30454; Cal. Code Regs., tit. 18, § 4026.) A taxpayer must maintain and make available all records necessary to determine the correct tax liability and for the proper completion of the required tax return or report. Such records include but are not limited to: (1) normal books of account ordinarily maintained by the average prudent businessperson engaged in the activity in question; (2) bills, receipts, invoices, cash register tapes, or other documents of original entry; and (3) schedules or working papers used in connection with the preparation of the tax returns. (Cal. Code Regs., tit. 18, § 4901(b)(1).) All records required to be retained under Regulation section 4901 must be preserved for at least four years unless respondent authorizes otherwise in writing. (Cal. Code Regs., tit. 18, § 4901(i).) Failure to maintain and keep complete and accurate records is evidence of negligence and may result in the imposition of a negligence penalty. (Cal. Code Regs., tit. 18, § 4901(k).)

Respondent imposed the negligence penalty after finding that appellant failed to maintain and provide adequate books and records for review, and the audit disclosed substantial understatement of taxable distributions as explained above.

On appeal, appellant argues that the negligence penalty is not applicable as appellant was in communication with respondent and was simply following the advice provided as it

[11] Source documents include but are not limited to shipping invoices, shipping charge payments, bills of lading, delivery receipts, etc.

pertains to the filing of returns. In support, appellant points to call logs by respondent, but the logs are not part of the record before OTA.

OTA notes that although the negligence penalty can be imposed in relation to negligence in the preparation of the returns filed, in the instant case respondent imposed the negligence penalty for failure to maintain and provide records. Therefore, appellant's argument that appellant relied on respondent's guidance on tax return filing process lacks merit for purposes of requesting deletion of the negligence penalty.

Additionally, OTA notes that appellant failed to provide respondent with complete books and records, to validate shipping information. Appellant failed to provide documentation such as complete sales invoices, purchase invoices, complete cost details of all items manufactured, or other detailed documents to show the calculation of its reported distribution costs, which is evidence that appellant did not maintain adequate books and records. Accordingly, OTA finds that appellant was negligent because it did not exercise the care that a reasonable and prudent businessperson would exercise under similar circumstances.

Although this was appellant's first audit, OTA concludes that the negligence penalty was properly imposed and that appellant has failed to establish that it was not negligent.

HOLDINGS

1. Adjustments are not warranted to the unreported taxable distributions of tobacco products.
2. Adjustments are not warranted to the disallowed claimed nontaxable distributions of tobacco products in interstate commerce.
3. Appellant was negligent, and respondent properly imposed the negligence penalty.

DISPOSITION

Respondent's action denying appellant's petitions for redetermination is sustained.

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

We concur:

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

DocuSigned by:
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Andrew Wong
Administrative Law Judge

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