

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
MAX EXPRESS, INC.) Account Number: SR AA 100-687716
Petitioner) Case ID 464061
Carson, Los Angeles County

Type of Business: Retailer of diesel fuel

Audit period: 11/14/05 – 12/31/07

<u>Item</u>	<u>Disputed Amount</u>
Understatement of reported sales of diesel fuel	\$567,077
Tax as determined and protested	\$37,230.09 ¹
Interest	<u>5,534.95</u>
Total tax and interest	\$42,765.04
Payments	<u>-42,765.04</u>
Balance Due	<u>\$ 00.00</u>

UNRESOLVED ISSUE

Issue: Whether adjustments are warranted to the understatement of reported sales of diesel fuel.

We find adjustments are not warranted.

Petitioner is in the business of transporting shipping containers in and out of the Los Angeles harbor, and it hires independent tractor/truck owner-operators. Petitioner pays the owner-operators a flat fee for shipping the containers to agreed destinations. In addition, petitioner provides diesel fuel, exclusively to the owner-operators it hires, at a price below its cost (which is thus obviously also below the going market rate). During the audit period, petitioner computed the amounts it reported for its

¹ Petitioner protests the entire amount of determined tax, measured by \$475,528, which is net of a concurred credit for unclaimed tax-paid purchases resold deductions of \$91,549. Petitioner has not filed a claim for refund with respect to the deductions it did not claim on returns. The last date for filing a timely claim for refund of an overpayment for the most recent quarterly period in the audit was January 31, 2011 (three years from the end of the month following December 31, 2007, or six months from the date the return was paid). (Rev. & Tax. Code, § 6902, subdivision (a)(1) (since the overpayment was made on returns by not claiming allowable deductions and was not paid per the determination, the issuance of the determination does not affect the timeliness of any claim).) Thus, if petitioner prevails in this matter, a refund will not be made.

1 sales of diesel fuel by applying a selling price of \$1.80 per gallon to the number of gallons sold to
2 owner-operators.

3 The Sales and Use Tax Department (Department) found that \$1.80 was significantly less than
4 the average selling prices for diesel fuel that were reported by the U.S. Department of Energy. The
5 Department concluded that petitioner was selling the fuel to the owner-operators below market prices
6 in exchange for making lower fee payments to the owner-operators, which the Department considered
7 a form of bartering. To establish the audited sales of diesel fuel, the Department used the number of
8 gallons of diesel fuel purchased, adjusted for inventories, and the average selling prices for diesel fuel
9 reported by the U.S. Department of Energy, reduced by \$0.0980 (based on the Department's
10 observation of selling prices charged by a local competitor).

11 Petitioner contends that it reported its actual receipts from the sale of diesel fuel, and that the
12 understatement should be deleted. Petitioner concedes that it sold diesel fuel to its owner-operators at
13 selling prices below its costs. However, petitioner asserts that it never intended to make a profit from
14 its sales of diesel fuel, as evidenced by the fact that it does not sell fuel to the general public and does
15 not advertise fuel sales. Petitioner states that it offered the lower selling prices for diesel fuel to entice
16 owner-operators to work for petitioner. Petitioner also claims that the flat fees it paid the owner-
17 operators were the then-existing market rate, and that it did not sell fuel at a discount to the owner-
18 operators in exchange for paying those individuals less than they would receive from someone else.

19 A reasonable business does not make sales at a sale price below cost on a continuous basis for
20 the sake of making those below cost sales. That is, a business does not engage in the business of
21 selling property below cost (even with significant volume, there is still no profit to be made).
22 However, it may be reasonable for a business to sell a particular item below cost, or even to give the
23 item away for no charge at all, for the *other* benefits it receives as a result. Where the business gives
24 the item away at no charge, the business is clearly the consumer of the item and cannot purchase it for
25 resale, or else must report and pay tax on its cost. Where the business does make some charge, but that
26 charge is always below cost, then the business is either the consumer of the items, in which the
27 measure of tax due is its cost of the item not the below-cost selling price, or it is the retailer, in which
28 case tax is due on the total gross receipts it receives for the sale. Thus, petitioner's liability for tax is

1 not measured by an amount less than its cost (if it were the consumer, it would owe tax measured by
2 the difference between its cost and the \$1.80 per gallon on which it reported tax). However, based on
3 the facts here, we agree with petitioner that it was reselling the diesel to the owner-operators. As such,
4 it owes tax on the full amount of gross receipts it received, both the amounts received in money and the
5 amounts received in additional value (i.e., the services of the owner-operators).

6 Petitioner concedes that it sold the diesel fuel to owner-operators at a price below its cost in
7 order to entice them to work for petitioner, meaning that one of the portions of the consideration
8 package petitioner offered the owner-operators for their services of transporting shipping containers
9 was that petitioner would sell diesel fuel to them prices well below market prices. That is, in exchange
10 for the diesel fuel it provided, petitioner received \$1.80 per gallon plus the continuing transportation
11 services from the owner-operators. The additional benefit petitioner received by securing those
12 services was the additional consideration for the sales, which supports petitioner's assertion that these
13 were indeed sales of diesel to the owner-operators (rather than petitioner's consumption of the fuel).
14 As such, this additional consideration was part of the taxable gross receipts petitioner received for its
15 sales of diesel fuel.

16 The most reasonable method to quantify this additional consideration paid by owner-operators
17 for the fuel they purchased (that is, providing their services to petitioner rather than to someone else,
18 such as one of petitioner's competitors) is the difference between market prices for diesel fuel and the
19 \$1.80 charged by petitioner. We conclude that the Department has used the best available evidence to
20 compute the prevailing market prices throughout the audit period, and that the audited understatement
21 represents the amount of sales related to the differential between \$1.80 and those market prices.
22 Accordingly, we find that the Department's determination of the amount of understatement of reported
23 sales of diesel fuel was reasonable and correct and that no adjustments are warranted.

24 **OTHER DEVELOPMENTS**

25 None.

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27 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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