

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:)
)
The Motor Fuels tax proposed)
assessment)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2003-13

This matter was heard before Eugene J. Cella, Assistant Secretary for Tax Administrative Tax Hearings, at the North Carolina Department of Revenue in Raleigh, North Carolina on January 21, 2003 upon Taxpayer's request for an administrative hearing. [Vice President for Risk Management for a company] represented taxpayer. Scotty Miller, Division Auditor and Christopher E. Allen, General Counsel represented the Motor Fuels Tax Division.

ISSUE

Whether the Division properly calculated the taxpayer's operational miles and fuel consumption resulting in the proposed assessment for tax, penalty, and interest issued August 1, 2002 in the amount of \$514,754.80.

EVIDENCE

1. Screen print from the Division's VISTA system showing Taxpayer's credential information for tax years 1998 through 2001.
2. Decal reconciliation sheet indicating the number of fuel decals issued minus number of decals on units indicating number of unaccounted for or missing decals.
3. Computer-generated copy of letter from Scotty Miller to [Corporate Controller] sent January 3, 2002, confirming the audit date, outlining the planned methodology, and requesting information.
4. Field Audit Report dated May 10, 2002 and posted August 1, 2002.
5. Notice of Tax Assessment dated August 1, 2002 for tax, penalty, and interest totaling \$514,754.80.
6. Letter dated August 27, 2002 from [Taxpayer Representative] to the Accounting Unit of the Division, requesting an additional thirty (30) days to review the audit.

7. Letter dated August 29, 2002 from Christopher E. Allen, Division Counsel to [Taxpayer Representative] allowing the requested extension of time to review the audit.
8. Letter dated October 1, 2002 from [Taxpayer Representative] to Christopher E. Allen contesting the miles per gallon (mpg) range used by Division auditors and supplying additional information "Appendix A" regarding mpg ranges for units currently operated by [a company]
9. Letter dated November 25, 2002 from Eugene J. Cella, Assistant Secretary of Revenue to [Taxpayer Representative] scheduling an administrative tax hearing for January 21, 2003 at 2:00 p.m. in Raleigh, North Carolina.
10. Handwritten contemporaneous notes dated April 17, 2002 taken by Christopher E. Allen and John Panza of the Division during a teleconference with [Corporate Controller] and [Director of Equipment] of [a company].
11. Audit work papers prepared by Scotty Miller of the Division during the course of the audit of Taxpayer's operation.
12. Copy of IFTA Audit Manual, Section A550.100.
13. Memorandum dated May 16, 2001 from E. Norris Tolson to Eugene J. Cella delegating authority to conduct administrative tax hearings pursuant to G.S. 105-260.1.
14. Division's brief for tax hearing submitted at the hearing, with copy presented to Taxpayer.
15. Letter dated April 17, 2003 from Christopher E. Allen to [Taxpayer Representative] acknowledging receipt of post-hearing information, which was forwarded to Division auditors upon receipt.

The Division filed a reply to the post-hearing submittal of Taxpayer on May 20, 2003.

The following is evidence presented by the Taxpayer:

1. Graph prepared by [a company] showing the mean miles-per-gallon for various types of vehicles.
2. Letter dated March 21, 2003 from [Taxpayer Representative] to Eugene J. Cella discussing Taxpayer's methodology respecting fuel tax reporting based upon information provided by [Director of Safety for Taxpayer] during the audit period.
3. Copy of Notice of Tax Assessment issued by the Division to Taxpayer dated March 24, 1994 in the amount of \$143,546.37
4. Letter dated July 5, 1994 to [Director of Safety for Taxpayer] from William T. Ellis, Assistant Director, Motor Fuels Tax Division waiving one-half of the assessed penalty.

FINDINGS OF FACT

Based upon the foregoing evidence of record, the undersigned makes the following findings of fact:

1. During all times relevant to the audit and assessment herein, Taxpayer was a "motor carrier" as defined by G.S. 105-449.37.
2. Taxpayer was registered with the Division as a motor carrier subject to the International Fuel Tax Agreement (IFTA) pursuant to N.C.G.S. 105-449.47.
3. [A company] purchased Taxpayer effective the first quarter of 1995 and sold the company at the close of the second quarter of 2001.
4. The total number of decals the Division issued to Taxpayer were 625, 700, and 700 for years 1999, 2000, and 2001, respectively, but the company operated 252, 340 and 310 qualified units during these periods.
5. Division auditors notified Taxpayer by letter dated January 3, 2002 that the audit would commence on April 8, 2002.
6. [The Corporate Controller] completed the pre-audit questionnaire on February 6, 2002, and Division auditors met with Taxpayer's representatives at an opening conference on April 8, 2002.
7. Division auditors completed the audit on May 10, 2002 and the Division issued a notice of tax assessment on August 1, 2002.
8. By letter dated August 27, 2002, Taxpayer requested an extension of time to review the audit papers and the assessment, and the Division allowed Taxpayer's request for an extension of time to request a hearing.
9. Taxpayer challenged the miles-per-gallon (MPG) factor used by the auditors to determine total fuel usage as too low, and submitted post-audit information comparing two of their fleets of solo drivers, contending that owner-operator units achieve higher mpg factors than solo driven company-owned units.
10. The information submitted contained vehicles that were operated by [a company] and not by Taxpayer, and included none of the vehicles that were contained in the audit.
11. Specific topics of discussion at that meeting included the nature of Taxpayer's business and the manner in which it compiled, processed and reported motor fuel tax information.
12. Taxpayer's representatives stated that they could only speculate as to how mileage and fuel information was compiled, as they were not directly involved with [Taxpayer's] daily North Carolina-based operation.
13. During an April 17, 2002 teleconference [the Corporate Controller] and [the Director of Equipment] explained to John Panza, Scotty Miller and Christopher Allen of the Motor Fuels Tax Division that [a company] purchased Taxpayer in 1995.

14. [The Corporate Controller] and [the Director of Equipment] stated during the teleconference that [a company] operated Taxpayer as an independent entity (wholly-owned subsidiary), and further explained that Taxpayer was a flatbed trucking company that trucked goods directly to customers.
15. [The Corporate Controller] stated during the discussion that [a company] sold the company's assets to [Taxpayer's Holding Company] June 18, 2001, writing off previous losses, and that [Taxpayer's Holding Company] purchased from [a company] agreements, contracts, fixed assets, and rights to future business from [a company].
16. Prior to conducting the audit, Division auditors sent Taxpayer a sample audit list detailing the units and quarters that they wanted to use as samples for the audit.
17. The auditors also requested quarterly odometer readings (beginning and ending), quarterly mileage and fuel receipts (by unit and jurisdiction), and all trip reports.
18. Taxpayer advised the auditors that it did not record and maintain odometer readings, but used a mileage software program to report total and jurisdictional miles, although IFTA requires that licensees maintain odometer readings for each qualified unit.
19. The North Carolina IFTA Compliance Manual requires a written and approved waiver request before any IFTA record-keeping requirement is abandoned.
20. The auditors discovered that the quarterly mileage and fuel summaries provided by Taxpayer did not balance with the mileage and fuel figures listed on its respective tax returns.
21. Taxpayer's representative stated that they were aware that for reporting purposes, mileage and fuel were adjusted quarterly, but could not supply the basis for how the adjustments were made or the documentation concerning these adjustments.
22. The auditors proceeded with the audit using the best information available.
23. Taxpayer' representatives and Division auditors mutually agreed to conduct the audit employing a sampling methodology.
24. Taxpayer experienced no major changes in business operations during the audit period, therefore the auditors elected to use the 1st quarter 1999, the 3rd quarter 2000, and the 2nd quarter 2001 as the sample periods.
25. Taxpayer's representatives agreed to the sample periods, both before and during the audit, however, at the conclusion of the audit [the Corporate Controller] raised concerns that the quarter ending June 30, 2001 was not representative because the company was in the process of being sold.
26. Taxpayer's business operations were not materially altered, and that this fact alone did not warrant exclusion of that quarter from the sampling.
27. Division auditors conducted a total and jurisdictional mileage audit based upon the operations of individual IFTA-qualified units and the respective quarters as selected from the "Audit Sample List."

28. The auditors used individual trip reports, quarterly mileage and fuel summaries supplied by Taxpayer, and also reviewed Taxpayer's previously filed IFTA tax returns.
29. Although Taxpayer reported total and jurisdictional miles based on a prepackaged mileage software program, the auditors found actual odometer readings for unit numbers 6901 (1st quarter 1999), 974630 (3rd quarter 2000), and units 243063 and 970212 (2nd quarter 2001).
30. Total miles for the entire stated quarters were available for each of these units, as the drivers of these units recorded odometer readings on their fuel receipts and daily trip reports.
31. Comparisons between recorded odometer readings and reported miles on Taxpayer's mileage and fuel summaries revealed that Taxpayer had understated total miles by 5.67%, and the auditors projected this error factor through the entire audit period.
32. The auditors then reviewed trips taken by twelve (12) units; numbers 4169, 226, 243063, 9408, 700583, 970212, 974630, 527, 252010, 4143, 9770, and 6901, each through an entire quarter.
33. These IFTA-qualified vehicles were selected from the sample periods noted above, including the 1st quarter 1999, 3rd quarter 2000, and the 2nd quarter 2001.
34. These trips were audited using the routes traveled (sometimes listed on the daily trip reports) and fuel stop locations indicated on fuel receipts.
35. Results of this survey revealed numerous, and often large, differences between reported and audited jurisdictional miles, as Taxpayer understated miles in some jurisdictions and overstated miles in others.
36. The differences were then used to calculate jurisdictional error percentage factors.
37. The auditors found that a number of differences were due to isolated circumstances which were removed from the survey, adjusted separately, and a revised percentage of error adjustment was then calculated on a jurisdictional basis and projected through the audit period.
38. Division auditors reviewed all documented fuel receipts representing fuel purchases from various retail outlets associated with the above-referenced units and quarters surveyed.
39. This review revealed that Taxpayer had overstated fuel credit in some jurisdictions and likewise understated credit in others.
40. As in the mileage audit, Division auditors used the differences to calculate respective jurisdictional error percentage factors.
41. After subtracting isolated differences for which adjustments to the error percentage factors were made, the auditors performed a revised percentage of error adjustment on a jurisdictional basis and projected this adjustment through the audit period.

42. Based upon the mileage and fuel records provided by Taxpayer, and employing the sampling methodologies outlined above, the auditors concluded that Taxpayer was not accurately accounting for total and jurisdictional fuel consumption.
43. This accounting defect ultimately resulted in inaccurate reported miles-per-gallon (mpg) factors, therefore, Division auditors conducted a mpg analysis of Taxpayer's operation.
44. This analysis involved a review of total operational miles and fuel reported on Taxpayer's quarterly mileage and fuel summaries for all selected units during the sample quarters.
45. The auditors determined that the acceptable mpg range of tolerance was 4.25 to 6.25, and all units within the range of tolerance were accepted and used to calculate an average mpg for each sample period, which was then combined to calculate an average mpg factor for all other quarters outside those sampled.
46. Section A550.100 of the International Fuel Tax Agreement (IFTA) Audit Manual states that "[u]nless the auditor finds substantial evidence to the contrary...in the absence of adequate records, a standard of 4 MPG/1.7KPL will be used."
47. However, the auditors did not employ a flat mpg factor of 4.00 to the sample periods, authorized pursuant to the IFTA in the absence of adequate records.
48. Division auditors used a more generous MPG factor than that specified by the IFTA Audit Manual, employing a range from 4.25 MPG to 6.25 MPG.
49. The matter remained unresolved after the Division reviewed the additional information, and was referred to the Assistant Secretary for Administrative Tax Hearings, who scheduled this proceeding, notifying Taxpayer by letter dated November 25, 2002.
50. The Division previously proposed an assessment against Taxpayer for \$143,546.37 on March 24, 1994, and the matter was resolved for \$65,361.06 on July 5, 1994.
51. Taxpayer routinely discovered that its independent contractor and owner-operator drivers did not fully report operational miles at the end of each quarter.
52. Taxpayer admitted that when it filed IFTA quarterly reports to the Division, it did not have all of the information it needed at the time.
53. Taxpayer tracked operational activity for each quarter for an additional nine (9) months, expecting that the miles and fuel would be accurately accounted, and would then file amended quarterly IFTA reports to the Division.
54. The IFTA Articles of Agreement, Article VII, R700 states that "[e]very licensee shall maintain records to substantiate information reported on the quarterly and annual tax returns... Record keeping requirements [of carriers] shall be specified in the IFTA Procedures Manual."
55. The IFTA Procurement Manual, P510.100 states that "[t]he licensee is required to preserve the records upon which the quarterly tax return is based for four years from the return due date or filing date. Whichever is later, plus any time period included as a result of waivers or jeopardy assessments."

56. The IFTA Procedures Manual, P540.100 states that "licensees shall maintain detailed distance records which show operations on an individual-vehicle basis. The operational records shall contain, but not be limited to taxable and non-taxable usage of fuel; distance traveled for taxable and non-taxable use; and distance recaps for each vehicle for each jurisdiction in which the vehicle operated."
57. The IFTA Procedures Manual, P540.200 also specifies that a licensee's distance accounting system must include, at a minimum, distance data on each individual vehicle for each trip and be recapitulated in monthly fleet summaries.
58. The IFTA Procedures Manual, P550.100 through .400 detail licensee record keeping requirements for fuel purchased, received, and used in the conduct of its business.

CONCLUSIONS OF LAW

Based upon the foregoing findings of fact, the undersigned entered the following conclusions of law:

1. During all times relevant to the matter herein, Taxpayer was properly registered with the Division as an IFTA motor carrier, and was subject to IFTA reporting and records keeping requirements in accordance with G.S. §§105-449.37, .39, .44, .45, .47 and .57.
2. Taxpayer was an IFTA licensee and filed timely IFTA returns to the Division.
3. Post-audit information presented to Division auditors did not contain the same units that were reviewed in the audit and were not operated by the same company, and was therefore not relevant to establish Taxpayer's operational miles or miles-per-gallon factors for the audit period.
4. Taxpayer did not record and maintain odometer readings as required by the International Fuel Tax Agreement and the North Carolina IFTA Compliance Manual, but instead used a computer software program.
5. Taxpayer used the computer software program rather than maintaining odometer readings for each IFTA-qualified unit without obtaining written approval or waiver from the Division as required.
6. The sampling methodology employed by Division auditors was mutually accepted by the Taxpayer and the auditors, and was a proper and approved IFTA auditing practice performed in accordance with the IFTA Audit Manual, other IFTA governing documents, and G.S. §105-449.57.
7. Taxpayer did not maintain or preserve records of fuel purchased, received, and used, or distance records to substantiate information reported on the quarterly returns as required by the IFTA Articles of Agreement, the IFTA Procedures Manual, and the Motor Fuels Tax Laws.
8. The inaccurate accounting of fuel consumption resulted in the inaccurate reporting of MPG factors on Taxpayer's North Carolina IFTA returns.

9. Division auditors properly employed a MPG factor range from 4.25 to 6.25 for Taxpayer's units during the audit period, rather than placing Taxpayer's vehicles on the more stringent IFTA-authorized 4.00 MPG for all vehicles during the audit period.
10. Taxpayer was placed on notice by virtue of the previous assessment issued by the Division in 1994 that their records keeping and reporting practices were not in accord with Division and IFTA requirements.
11. Division auditors properly concluded that Taxpayer failed to accurately account for total and jurisdictional fuel consumption on its IFTA returns during the audit period.
12. The Division properly calculated the taxpayer's operational miles and fuel consumption resulting in the proposed assessment for tax, penalty, and interest issued August 1, 2002 in the amount of \$514,754.80.

DECISION

At the outset, Division auditors and Taxpayer mutually agreed that the audit would be conducted based upon a sampling methodology consistent with the guidelines contained in the IFTA Audit Manual. Taxpayer provided the auditors with quarterly mileage and fuel summaries, but had little supporting documentation for many of the quarters during the audit period. The requirements of motor carriers to maintain records and accurately report operational miles to the base jurisdiction are clear. The International Fuel Tax Agreement states that "[e]very licensee shall maintain records to substantiate information reported on the quarterly and annual tax returns....Recordkeeping requirements [of carriers] shall be specified in the IFTA Procedures Manual." (*IFTA Articles of Agreement*, Article VII, Section R700).

The IFTA Procedures Manual states as follows:

An acceptable distance accounting system is necessary to substantiate the information reported on the tax return filed quarterly or annually. A licensee's system at minimum must include distance data on each individual vehicle for each trip and be recapitulated in monthly fleet summaries.

IFTA Procedures Manual, Section P540.200.

This section also specifies what information must be included on each trip sheet. (See *Procedures Manual*, Sections P540.200.005 through .050). These IFTA record keeping requirements are consistent with the requirements contained in N.C.G.S §§ 105-449.39, 44 and

.45 for credit for taxes paid other jurisdictions, maintaining operational miles, and for maintaining miles-per-gallon records on each vehicle.

Taxpayer's record keeping fell short of the record keeping and reporting requirements of both the IFTA and State statutes. Taxpayer readily admitted that it filed reports without properly documenting operational miles. The fact that it accumulated information from its drivers, routinely months after filing its quarterly reports bolsters the findings of the Division's auditors that its internal controls were inadequate.

Taxpayer also contends that it adopted its admittedly deficient methodology because its drivers were independent owner-operators, arguing that it could not implement satellite or global positioning equipment like larger fleets. However, the use of on-board computers and GPS systems may not supplant traditional record keeping requirements that include trip sheets without the express permission of the Division. (See N.C. Department of Revenue IFTA Compliance Manual, Part XI.A.). In the face of inadequate and incomplete information, Taxpayer "*elected to go ahead and timely file its quarterly fuel tax reports even though it did not have all of the information it needed at the time to do so.*" (Emphasis added). In so doing, taxpayer employed an inadequate business system with apparent little regard for accuracy, choosing to update its reporting if or when additional information became available.

Against this backdrop, Taxpayer continued to collect and report jurisdictional mileage, relying upon its drivers to update records well after the reporting period, often up to three (3) quarters later. Rather than improve its internal control structure, Taxpayer took a chance with respect to the availability of these records, and now states that "[T]axpayer would have liked to have been able to continue to revise its three quarterly reports ending June 2001, thereafter as it previously had done...."

Taxpayer asserts that its drivers achieved a MPG factor of approximately 6.22, and likewise asks that the undersigned accept its "conservative" 6.1-MPG as its fleet average. However, even acknowledging the alleged unavailability of some of the records for the audit

period, the auditor performed a sampling audit based upon the records that Taxpayer provided consisting of quarterly mileage and fuel summaries. Taxpayer agreed to the sample periods. Moreover, as noted above, the auditors found actual mileage figures for several of the units, and they likewise computed an average MPG factor, using vehicles from 4.25 to 6.25 MPG as an acceptable range.

The Division placed Taxpayer on notice in early 1994 that its business practices respecting mileage and fuel purchase accounting was deficient. The fact that the Division reduced the 1994 assessment in no way ratified Taxpayer's deficiencies. On the contrary, that the Division issued a previous assessment that included penalties nearly a decade ago based upon substantially similar circumstances is an indication that Taxpayer should have corrected the flaws in its operation.

WHEREFORE, the undersigned Assistant Secretary of Revenue **HEREBY AFFIRMS** in all respects the assessment proposed herein for \$344,017.69 tax, \$86,004.42 penalty, and interest of \$126,014.81 through August 31, 2003, for a total of \$556,036.92, plus accrued interest at the rate of \$113.53 per day at the statutory rate of one percent (1%) per month until paid.

This the 20th day of August 2003.

Signature _____

Eugene J. Cella
Assistant Secretary of Revenue