

MF 95-7

Tax Type: MOTOR FUEL TAX

Issue: Fuel Credits

Trip Leases

Reported Illinois Mileage

STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
SPRINGFIELD, ILLINOIS

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THE DEPARTMENT OF REVENUE )  
OF THE STATE OF ILLINOIS )

v. )

) Docket #

) MCFT Permit #

XXXXX )

) Taxpayer )  
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX, represented Taxpayer A (hereinafter the "Taxpayer"), through April, 1995, when an order granting Mr. XXXXX's motion to withdraw as counsel was issued, XXXXX has represented the taxpayer in this matter since June, 1994.

SYNOPSIS: This case involves Taxpayer A, a corporation who hauled loads for-hire on Illinois highways in commercial motor vehicles during the audit period, and whose timely protest of a fuel tax audit generated assessment produced this contested case.

On June 15, 1990, the Department of Revenue (hereinafter "Department") issued Notice of Tax Liability (NTL) No. XXXXX for Illinois Special Fuel Use Tax for the period of January 1, 1986, through December 31, 1989, in the amount of \$274,765.27, inclusive of tax, penalty and interest. The Department imposed liability following a Motor Fuel Use Tax audit it conducted upon taxpayer for the period of January 1, 1986 through December 31, 1989, and the liability is based upon adjustments the auditor made in the quarterly Motor Fuel Tax Returns (IDR-280's) filed by taxpayer. These adjustments are the contested issue in this case and specifically involve:

- 1) Illinois fuel credits;
- 2) Trip leases; and
- 3) Reported Illinois mileage.

A hearing was initially held in this matter on June 9, 1993 and a further proceeding was conducted on June 10, 1994. Evidence was taken by way of documentary evidence and testimony. Because of common ownership and personnel, as well as a similarity of issues, it was agreed between the parties that this hearing would be consolidated with the hearing on Taxpayer B NTL No. XXXXX, Permit No. XXXXX and it was also stipulated that evidence in each matter would also apply to the taxpayer in the other matter.1 (6/93 Tr. p. 6)

Mr. Steve Olson, the Department auditor who performed the audit on Taxpayer A, testified about his proposed changes to taxpayer's return based upon his audit work. (6/93 Tr. pp. 36-42) Mr. Paul Gramlich, the Department auditor who performed the audit upon Taxpayer B (hereinafter "Taxpayer B") testified regarding his determinations made in that audit. (6/93 Tr. pp. 44-50)

Mr. XXXXX, Office Manager, testified on behalf of the taxpayer. Mr. XXXXX testified about taxpayer's exhibits and also that XXXXX had bought fuel tax-paid. Both XXXXX, taxpayer's agents, testified for the taxpayer and emphasized they had purchased fuel for their bulk storage tanks tax-paid. Mrs. XXXXX testified to this effect. Taxpayer A, owner, testified about taxpayer's business practices.

Mr. Cy Henshaw, Department Special Investigator, testified about the investigation he conducted on Taxpayer A and Taxpayer B. (6/93 Tr. pp. 31-35) Mr. Henshaw testified the initial purpose of his investigation was to verify fuel receipts that Taxpayer A had presented to the Department Auditors to substantiate fuel purchase credits. Mr. Henshaw testified he discovered the fuel "receipts" were not original documents but had been

fraudulently prepared by XXXXX who presented them to Taxpayer A as fuel tickets for fuel that was supposedly used in transporting product loads for Taxpayer A. (6/93 Tr. pp. 32-35) Mr. Henshaw testified that he verified that the purchase of bulk fuel made by XXXXX had been made tax-paid.

At the initial proceeding, the Department's two group exhibits were admitted into evidence (6/93 Tr. p. 8) and these are the Taxpayer A file (Dept. Ex. No. 2) and the TAXPAYER B file (Dept. Ex. No. 1). At this same proceeding taxpayer introduced its Ex. Nos. 1 through 3 into the record (6/93 Tr. p. 50). Taxpayer Ex. No. 2 is a summary schedule of fuel purchases and usages that XXXXX testified he prepared specifically for the 6/93 hearing. At the subsequent proceeding, taxpayer Exs. 4 through 14 were received into the record subject to the right of the Department Auditors to review them. (6/94 Tr. p. 180) As a result of this review, the Auditors prepared a revised summary analysis of tax liability (the "re-audit") that decreases the tax liability from the initial assessment. Counsel for the taxpayer states taxpayer does not object to the re-audit workpapers being admitted into the record, (Brief p. 10), therefore, I consider them to be admitted in this matter.

Throughout the entire hearing process, taxpayer has attempted to portray this case as having a single issue, that being the Department's disallowance of tax-paid fuel purchased by XXXXX, brothers, and that if only the Department would grant credits for that fuel, then the entire reason for the assessment would be void.

However, this case is composed of more elements than the credits for XXXXX fuel issue. The record shows that the XXXXX brothers' bulk fuel purchases were primarily in the final two years of the audit - 1988 and 1989. For the first two audit years, of 1986 and 1987, almost all of the taxpayer's fuel acquisitions were from retail filling stations or retail truck stops. When the Auditors, during the original audit, requested

documentation as support for credits taxpayer had taken for the retail purchases, taxpayer's agents supplied certain purported purchase invoices. Among the documents submitted were some the XXXXX XXXXX claimed to be invoices for bona fide retail purchases of fuel but after the Auditors became suspicious and a Department criminal investigator determined certain "invoices" to be false, taxpayer's agents dropped the pretense of authenticity and acknowledged that they or their drivers had falsified them.

The auditor documented that some records for the first part of the audit period were inadequate to audit. (Dept. Ex. No. 2, EDC-5, p. 1) The auditor did compare the mileage that was reported by taxpayer for a sample of trucks to information contained in the records of taxpayer. A small mileage error of slightly less than 1% was calculated and this caused the original auditor to make an adjustment to Illinois mileage which resulted in additional tax of \$3,220.00.

FINDINGS OF FACT:

1. The taxpayer, during the audit period, was engaged in the business of hauling loads for hire on the highways, including those of Illinois. All of the tractor-trailer units that were operated by the taxpayer were leased, however, approximately 65 to 70% of the units were leased from the taxpayer, Taxpayer A, himself. (6/93 Tr. p. 10; Dept. Ex. No. 2)

2. Many lessors (other than Taxpayer A himself) engaged in operations with taxpayer pursuant to short-term (less than 30 days) trip lease agreements. (Dept. Ex. No. 2)

3. Taxpayer's headquarters were located in Missouri and taxpayer operated under interstate carrier authority granted by the Interstate Commerce Commission. Taxpayer did not have Illinois intrastate carrier authority during the audit period. (6/94 Tr. pp. 78-79; Dept. Ex. No. 2)

4. XXXXX XXXXX, who owned and operated a bulk fuel terminal and trucking company named XXXXX, at , Illinois, leased approximately 25 to 30 semitractor trailer units to Taxpayer A in the years 1986 through 1989. (6/93 Tr. pp. 10-11)

5. XXXXX, brother of XXXXX, owned and operated a bulk fuel terminal and the XXXXX. He leased at least three semitractor trailer units to TAXPAYER B during the audit period. XXXXX also trip-leased units to Taxpayer A (6/94 Tr. pp. 148-149)

6. The taxpayer filed Motor Fuel Tax Returns (IDR-280's) for each quarter within the audit period. For the first six quarters of the audit period (86/1 - 87/2), the taxpayer included both the mileage and fuel information for the short-term lessors involved in his operations. For the final ten quarters of the audit period (87/3 - 89/4), the taxpayer included the fuel of the short-term operators on Line 7a of his returns for credit purposes, but did not include the mileages run by these operators. (6/93 Tr. p. 40, 6/94 Tr. pp. 144-146; Dept. Ex. No. 2, Auditor Narrative Report, pp. 2, 6)

7. On several occasions, a truck leased by one of the XXXXX would begin a trip leased to either TAXPAYER B or Taxpayer A and then before returning home would change the truck door sign placards to indicate the other company. This means that for one trip away from home, the trip sheets for a truck unit for the same or successive days would show hauling runs for both companies. (6/93 Tr. pp. 20-21; 6/94 Tr. pp. 41-42, 170-171, 176, Dept. Ex. No. 2; Taxpayer Ex. Nos. 4A-4C)

8. As a result of single trucks running trips under lease to the two companies, some of the taxpayer mileage and fuel data was reported on the TAXPAYER B fuel tax returns. (Dept. Ex. No. 2)

9. An example of the intermingling of truck trip lease data are the trip sheets for truck unit R101 during the month of August, 1988.

(Taxpayer Ex. No. 4C)

10. Both XXXXX XXXXX allowed withdrawals of fuel to be made from their bulk terminal by drivers for their brother. This "trading" of fuel was done without accounting for withdrawn amounts or truck usage. (6/94 Tr. pp. 64, 73, 163).

11. Taxpayer has not submitted documentary evidence in the form of books and records that show accurate withdrawal data for fuel from the XXXXX terminals during the audit period. Instead of records showing definite amounts withdrawn and the actual trucks that received the fuel, only estimates were submitted. (6/93 Tr. p. 3, 6/94 Tr. p. 14, 170)

CONCLUSIONS OF LAW: Section 13a.3 of the Motor Fuel Tax Law (35 ILCS 501/13a.3) sets out the following filing and fuel credit documentation requirements for motor carriers who operate in Illinois:

Every motor carrier who operates in Illinois shall, on or before the last day of the month next succeeding any calendar quarter, file with the Department a report, in such form as the Department may by rule or regulation prescribe, setting forth a statement of the number of miles traveled in every jurisdiction and in this State during the previous calendar quarter, the number of gallons and type of fuel consumed on the highways of every jurisdiction and of this State, the number of gallons and type of fuel purchased within this State during said previous calendar quarter, and which may include both gallons of fuel purchased and miles operated that were unavailable for the 2 immediately preceding calendar quarter reports, upon which a tax was paid under this Act, and such other information as the Department may reasonably require. Such other information shall include, but not be limited to, original tax paid receipts as evidence of the number of gallons purchased, which were omitted from the reports for the 2 immediately preceding calendar quarters and are now included in the current filed report.

When the Department originally audited taxpayer for the instant audit period, some audit work could not be performed for the initial audit quarters as some mileages could not be traced due to incomplete taxpayer records. (Dept. Ex. No. 2, Auditor Narrative Report p. 9, EDC-5 p. 1) I find the taxpayer reported inaccurate information on its fuel tax returns for the quarters prior to 87/3 as it used an exact 4.5 or 5.0 as its miles per gallon (MPG), and it is highly unlikely that a carrier's fleet would be

getting this exact 4.5 or 5.0 MPG number quarter after quarter.

As noted in my findings of fact, taxpayer and TAXPAYER B intermingled fuel and mileage information because XXXXX Truck units ran certain trips as a lessor to both companies. This is corroborated by various TAXPAYER B unit trip sheets mixed in with the taxpayer's sheets in Taxpayer Exhibits 4A, 4B, and 4C. The auditor in reviewing these exhibits in the re-audit did a detail segregation analysis of TAXPAYER B truck units so taxpayer's mileage data reported under TAXPAYER B returns could be transferred to taxpayer's returns. This transfer of the data for units 101 and 102, located at Illinois into taxpayer's returns resulted in a mileage increase of 1.335%. This transfer of mileages allowed the auditor to give taxpayer credit for bulk fuel purchased by XXXXX for storage at XXXX, all of which had been denied as credits in the original audit. Therefore, I find this a reasonable procedure considering that taxpayer had mixed data with TAXPAYER B on their returns. In the re-audit, the auditor established a percentage of bulk fuel purchases that were going into trucks hauling taxpayer loads and this percentage was used to give a credit of bulk purchases during the audit period.<sup>2</sup>

The record in this case shows there was considerable short-term trip leasing occurring. The original auditor discovered taxpayer was including fuel credits from loads hauled on its short-term trip lease agreements, but that it was not reporting their mileages for the final ten quarters of the audit period. (6/93 Tr. p. 38; Dept. Ex. No. 2, p. 4) The auditor in the original audit removed the fuel on these short-term trip leases from the credits taxpayer had taken on its returns. (Dept. Ex. No. 2, Schedules MCFTA-1, 2 and 3) In the re-audit the auditor also removed the everywhere fuel associated with trip leases. (Schedules B1 and C1) Despite taxpayer's argument that this everywhere trip lease data should not be removed because of its purported effect upon MPG, I find it was correct for

the Auditors to remove this trip lease data from the everywhere lines as taxpayer, as the lessee, was not responsible for reporting this data because 86 Admin. Code, ch. I, Sec. 500.175 states in part:

Where the term of a lease is less than 30 days, the lessor of a commercial motor vehicle shall be responsible for the reporting of mileage and the liability for tax arising under Section 13a.3 of the Motor Fuel Tax Law, and for registration, furnishing of bond, carrying of identification cards, and external motor fuel decals under Section 13a.4 of the Motor Fuel Tax Law and for all other duties imposed by Sections 13a, 13a.1, 13a.2, 13a.3, 13a.4 and 13a.5 of the Motor Fuel Tax Law.

Taxpayer argues that the information shown on its exhibits is sufficient to cancel the assessment liability. For the reasons cited below, I cannot agree.

Taxpayer contends that its Exhibit No. 7 is the key exhibit because the data amounts and numbers thereon, other than the bulk fuel and its usage, were already accepted by the Department auditors. Despite this contention, taxpayer's office manager was unable to answer in the affirmative when questioned whether his Exhibit 7 retail purchase amounts would comport with the figures of the Auditors. (6/94, Tr. p. 101)

When the Department file on this taxpayer was entered into evidence, the prima facie case of the Department was established. (6/93 Tr. p. 8) This file is Dept. Ex. No. 2 and this group exhibit consists of the assessment, the corrected return, the auditor's report with accompanying schedules and workpapers and copies of fuel purchase invoices. After the introduction of the corrected tax return into evidence at an Administrative Hearing before the Department the burden then shifts to the taxpayer to establish by competent documentary evidence through its books and records that the adjustments performed by the Department are incorrect. This requirement for taxpayers in Department administrative tax hearings was restated by the Illinois Appellate Court in a case involving a Motor Fuel Tax assessment, Lakeland Construction Company v. Department of Revenue, 62

Ill. App.3d 1036, 1039 (2nd Dist. 1978). In Lakeland, the court cited the Illinois Supreme Court case Copilevitz v. Department of Revenue, 41, Ill.2d 154 (1968), in which it was held that until a taxpayer provides such documentary evidence at an Administrative Hearing to establish the inaccuracy of the Department's corrected returns, these corrected returns are presumed to be legally correct.

While taxpayer submitted in their exhibits photocopies of bulk purchase invoices showing tax-paid fuel being purchased by the XXXXX XXXXX, this is not by itself dispositive of the issue. The Department, through its auditors and criminal investigator, has acknowledged that certain bulk purchases were made tax-paid. What is also necessary for the allowance of credits is being able to trace the fuel to the particular trucks that used it. These invoices were reviewed by the original auditor when he conducted his audit upon taxpayer and he documented that some of these were already listed by taxpayer on its Schedule B's and used to take other fuel credits on Line 7 of its returns. (Dept. Ex. No. 2, Auditor Narrative Report, p. 5)

I cannot agree with taxpayer (Brief p. 7) that its evidence shows that none of the bulk fuel was used by another entity and that its only use was for taxpayer's operations as taxpayer submitted no documentary evidence at hearing that accurately traces the bulk fuel to its trucks during the audit period. While Taxpayer Ex. Nos. 12-A, 12-B and 13 were offered as examples of how the XXXXX record withdrawals now, Nos. 12-A and B are blank and 13 only contains data for a short time in 1994. Although (XXXXX) XXXXX and XXXXX testified about these and earlier withdrawal records kept at the XXXXX terminal, (6/94 Tr. pp. 17-18, 31-33, and 38-40), taxpayer offered none that covered or accounted for any withdrawals made to fuel XXXXX trucks for Taxpayer A loads hauled during the audit time frame.

There is evidence in the record that certain drivers had keys to the

terminals and could have gained access to the fuel anytime during the 24-hour day, (6/94 Tr. p. 39), meaning fuel could have been used for a non-taxpayer truck or load. There is also the testimony regarding the practice of each XXXXX brother trading fuel with each other but not accurately tracking or accounting for it. (6/94 Tr. pp. 64, 73, 163) The original auditor documented in his workpapers (Dept. Ex. No. 2, Auditor Narrative Report, p. 5, EDC-5 p. 3) that taxpayer and TAXPAYER B together had claimed more in fuel credits than was supported by bulk purchase invoices. (6/93 Tr. pp. 40-42)

Because accurate contemporaneous withdrawal records were not maintained, both XXXXX and XXXXX were not in compliance with Section 12 of the Motor Fuel Tax Act (35 ILCS 505/12) that requires a bulk user to keep records that include the "...distribution and use of motor fuel." Under standards established in the above-cited Illinois case law, general testimony is not sufficient proof on behalf of a taxpayer in a hearing like this unless it is tied to competent documentary evidence, and the "withdrawal" documents submitted here in conjunction with the trip sheets (Taxpayer Ex. Nos. 4A-4C, 11) are not accurate according to taxpayer's own witnesses as they do not contain accurate amounts or the truck number into which the fuel went but were only written to estimate an amount of fuel that might approximate some mileage. (6/94 Tr. pp. 43, 45, 166-167) I also note that in its Ex. Nos. 7 and 9, taxpayer, without explanation, added bulk purchases to the original Illinois gallons purchased numbers as they were filed on its returns, yet these original "as filed" numbers were supposed to contain all bulk purchases.

My examination of Taxpayer Ex. Nos. 4A, 4B and 4C reveals that in addition to the XXXXX Terminal ones there are "tickets" attached that are not in the name of the XXXXX Terminal but instead are in the name of retail stations that Investigator Henshaw determined to be fraudulent. The trip

sheet tapes in Taxpayer Exhibits 4A-4C contain retail purchase numbers that have no backup source documents or supporting schedules to verify their accuracy and I also note these same retail purchase numbers were copied, totaled and then transferred and used by taxpayer on its Ex. Nos. 7 and 9.

Another adjustment made by the auditors in both the original and re-audits was to disallow an amount of credits taxpayer claimed on its returns but not supported by retail purchase invoices. All out-of-State fuel purchase invoices were disallowed for the entire audit period and certain quarters were checked in detail to verify fuel credits claimed as Illinois tax-paid purchases. In the original audit the auditor examined three quarters in detail and used an average disallowance percentage of 8.9%. The auditor in the re-audit uses the data for the 86/3 quarter, and thusly allows 92.37% of retail purchases based upon the detailed examination's resultant disallowance of 7.63% of the purchases claimed as Illinois tax-paid fuel purchases. Taxpayer objects to this because the auditor ignored the 86/4 quarter where taxpayer had more tax-paid fuel on invoices than the gallons they had reported on the return.

Because the original auditor examined three quarters in detail and his average disallowed percentage of error was 8.9%, I find the re-audit's use of the somewhat lower 7.63% is actually favorable to taxpayer. Although I conclude the auditor's use of the 7.63% disallowance percentage is supported by the record, I also find that the taxpayer should get credit for the 35,087 specific gallons it did not report in 86/4 and I recommend the final assessment be adjusted for the tax attributable to this amount.

Another adjustment in dispute is the "bogus" retail tickets for the audit period and this is a separate and distinct item from the above discussed retail fuel credit adjustment, as the above disallowance is based upon missing or out-of-State invoices, and not the "bogus" ones. The above-disallowed percentages were calculated by the auditors before the

Department's discovery that some invoices being accepted as bona fide were actually false. This "bogus" adjustment involves the alleged retail purchase invoices for the XXXXX, XXXXX and other stations submitted to the auditors as actual retail purchases but whose investigation by Investigator Henshaw determined they had been fraudulently prepared. These bogus tickets also included ones showing an alleged transaction with one of the XXXXX XXXXX, but it is important to remember here that these XXXXX terminal tickets are not the same as the "withdrawal tickets" or "memos" discussed earlier that taxpayer submitted in conjunction with the trip sheets relative to their bulk fueling operations.

The auditor used a different bogus disallowance percentage for each half of the audit period, the earlier one being larger because the fuel in the first two years was obtained almost exclusively from retail stations. The auditor's detail examination of fuel invoices for the test quarters (86/3, 86/4 and 88/3) shows the percentage of false retail invoices was 35.1693% for the first two calendar years (1986 and 1987) and 5.75% for 1988-1989. Because these Illinois purchase credits claimed by taxpayer are not supported by an actual retail invoice, I find this adjustment made by the auditor to be proper. I also find it was proper for the Auditors to disallow a percentage of bogus retail credits for the final two audit years because the original auditor's examination of quarter 88/3 turned up some of the bogus retail invoices, and taxpayer's own exhibits also contain some, an example being in Taxpayer Ex. 4C where a XXXXX "invoice" is attached to R101 8/88 trip sheet and this "invoice" is in the same color pen ink and handwriting as the trip sheets.

Counsel has pointed out how the auditor made a math error in the re-audit regarding his development of a percentage of allowable bulk fuel credits. (Brief p. 11) I agree with taxpayer that the allowable percent should have been calculated as 95.76% instead of 91.63%, translating into

an additional 21,680 gallons credit, but I do not find that this destroys the reliability of the entire audit and re-audit workpapers. Taxpayer did not keep complete or adequate records and did not file their fuel tax returns with accurate information thereon. Taxpayer's agents also submitted fabricated documents under false pretenses and only changed their story about them after their genuineness was disproved. The Auditors used the best information available and listed fuel by both retail and bulk acquisitions, quarter by quarter, and gave taxpayer percentage credits for amounts supported by documentary evidence - either accurate bulk withdrawal records or actual purchase invoices. This was scheduled in conjunction with adjusting taxpayer's mileage by the addition for the amount erroneously reported under TAXPAYER B and after expunging the short-term trip lease miles.

In light of all this, I am not going to recommend the rejection of all the audit work because of one math error, and I find the audit and re-audit work meets a minimum standard of reasonableness.

In addition to these 21,680 bulk gallons, I find the taxpayer should get credit for 35,087 gallons it did not report for credit in quarter 88/4. At an average tax rate of .197, I find the re-audit liability should be decreased by \$11,183.00:

35,087.00
21,680.00
56,767.00
.197
\$11,183.00

In summary, I find the re-audit liability should stand after the recommended adjustments.

RECOMMENDATION: Based upon my aforementioned findings of fact and conclusions of law, I recommend the Department reduce NTL No. XXXXX and issue a final assessment.

Karl W. Betz

Administrative Law Judge

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1. References to the June, 1993 hearing proceeding are denoted by "6/93" and references to the June, 1994 proceeding are denoted by "6/94".
  2. Taxpayer objected to the auditor's use of certain documents that were provided to the auditor in the TAXPAYER B audit that has been consolidated with this matter. It is these documents that allows me to approve giving taxpayer a credit for its usage of the bulk fuel. I presume taxpayer's counsel does not mean to object to my use of documents that allows me to decrease the liability against the taxpayer.