DEPARTMENT OF STATE REVENUE

42-20080229.LOF

Letter of Findings: 08-0229
International Fuel Tax Agreement (IFTA)
For the Tax Periods 2004 and 2005

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ISSUES

I. 7.00 MPG "Capping" Methodology.

Authority: IC § 6-8.1-3-14; IC § 6-8.1-5-4(a); IC § 6-8.1-5-4(b); IFTA Articles of Agreement, R1210.300 (1998); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue's International Fuel Tax Association audit erred when it employed a "cut-off of 7.00 MPG" after the audit found that "there were many [trucks] with excessively high mpg's."

II. Annualized MPG.

Authority: IC § 6-8.1-5-1(b); IFTA Articles of Agreement, R1210.300.

Taxpayer argues that it is entitled to an adjustment of "annualized" mpg calculations for vehicles which attain an average annual mpg of 7.30 or less.

III. Division 500 Deadhead Miles.

Authority: IC § 6-8.1-5-1(b).

Taxpayer maintains that its 32 "Division 500" vehicles mpg figures should be "capped" at 7.85 mpg instead of the 6.99 mpg figure relied on in the audit report.

IV. Separate Company Vehicles.

Authority: IC § 6-8.1-5-1.

Taxpayer argues that certain vehicles acquired by taxpayer in 2004 from a former competitor should be removed from the 2004 audit calculation.

STATEMENT OF FACTS

Taxpayer is a "general commodities" motor carrier with an out-of-state home office and a base of operations in Indiana. Taxpayer chose Indiana as its base jurisdiction for purposes of the International Fuel Tax Association (IFTA). Taxpayer owns vehicles operated by its employee drivers. In addition, taxpayer leases vehicles operated by independent contractors commonly referred to as "owner-operators."

The Department of Revenue (Department) conducted an IFTA audit. Taxpayer's own description of the audit process follows:

> [T]here are essentially five elements to the IFTA calculation that are reviewed and potentially adjusted during an audit. First, on a quarterly basis, the taxpayer reports its total miles incurred by all subject vehicles in all jurisdictions, and second, the taxpayer reports all fuel purchased and consumed in all jurisdictions during the same quarter. Third, total miles are then divided by total gallons to determine a fleetwide mpg for the quarter, which is in turn applied to the fourth element of the calculation – the taxpayer's "jurisdictional miles" in each state individually to determine the number of taxable gallons consumed in each state. After applying each state's tax rate to the taxable gallons for that state, the taxpayer is then entitled as the fifth element of the calculation to report and claim a credit for all tax paid at the pump when the fuel was originally purchased. The net result is reported and paid as the taxpayer's IFTA liability.

However, in determining the "taxpayer's IFTA liability," the Department found that "[t]he scope of [the] audit was limited by the inadequate or non-existent records presented by the licensee." In addition, the Department found that many of the taxpayer's vehicles throughout the sampled quarter had "excessively high mpg's." As an example, noted that one of the vehicles reported that it obtained "95 mpg." In addition, other trucks reported miles but did not report any fuel for one of the audited quarters. As a result of the audit's review, the Department "adjusted for all units that had a mpg over 7.00 mpg in both sample[d] quarters."

As a result of the audit adjustments, the Department concluded that taxpayer owed additional fuel tax. Taxpayer disagreed and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. 7.00 MPG "Capping" Methodology.

DISCUSSION

IFTA (International Fuel Tax Association) is an agreement between various United States jurisdictions and Canada allowing for the equitable apportionment of motor fuel taxes. The agreement's goal is to simplify the tax, licensing, and reporting requirements of interstate motor carriers such as taxpayer. The agreement itself is not a statute but was implemented in Indiana pursuant to the authority granted under IC § 6-8.1-3-14.

Taxpayer argues that the audit's methodology – adjusting for all vehicles that had reported mpg in excess of

7.00 – was flawed and that this flawed methodology resulted in a significant increase in the taxpayer's total gallons of fuel consumption. According to taxpayer, the total fuel figures in each quarter were increased by 100,000 gallons which represented fuel consumption increases ranging from 5.3 percent to 11 percent. Taxpayer states that the audit report reduced taxpayer's reported mpg from 6.16 mpg to 5.73 mpg. According to taxpayer, the lower mpg "drove up [taxpayer's] alleged tax liability very significantly." As a result, taxpayer "believe[s] significant changes to the audit adjustments are required."

Taxpayer challenges the 7.00 mpg cap as being arbitrary and unreasonable arguing that the mpg cap should be raised to 7.30 mpg. In support of that contention, taxpayer performed a statistical analysis of a single vehicle. Taxpayer argues that its statistical analysis leads to the conclusion that the 7.00 mpg cap should be raised to 7.30 mpg. Taxpayer points out that the sample vehicle, over the course of four years, operated with a fuel efficiency that resulted in an average mpg of 7.32. Taxpayer states that the 7.32 average is statistically reliable based on a statistical analysis of the verifiable data. However, it should be noted that taxpayer's analysis was based simply on a review of quarterly mpg averages and did not consider specific trips.

IFTA Articles of Agreement, R1210.300 (1998) provides the standard for determining whether a proposed assessment may successfully be challenged by the licensee. "The assessment made by a base jurisdiction pursuant to this procedure shall be presumed to be correct and, in any case where the validity of the assessment is questioned, the burden of proof shall be on the licensee to establish by a fair preponderance of the evidence that the assessment is erroneous or excessive." *Id*.

It is the taxpayer's responsibility to maintain specific, detailed, and accurate information concerning its fuel purchases. As set out in IC § 6-8.1-5-4(a):

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks. *See also* IFTA Procedures Manual, P540, 550 (1996).

The Department's proposed assessment of additional fuel tax, under IC § 6-8.1-5-1(b), is deemed to be "prima facie evidence that the department's claim for the unpaid tax is valid." That same section of the Indiana Code goes on to state that "the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." As noted above, IFTA Articles of Agreement, R1210.300 (1998), provides in part that, "[T]he burden of proof shall be on the licensee to establish by a fair preponderance of the evidence that the assessment is *erroneous or excessive*." (*Emphasis added*).

The issue is whether this Letter of Findings should discard the audit's methodology – capping a standard of 7.00 mpg for each vehicle – and adopt the taxpayer's standard of capping the mpg at 7.30. If the taxpayer's standard is adopted, then the amount of unaccounted for fuel is lowered and taxpayer is left owing a lesser amount of fuel tax.

In support of its contention that the mpg "cap" should be raised to 7.30, taxpayer conducted a statistical analysis of the quarterly mpg averages of one of its vehicles. According to taxpayer's analysis, over the course of 16 quarters (2004 through 2007) the consistent reported mean quarterly average mpg of its chosen vehicle was 7.32. According to taxpayer, a "standard deviation of only.17107 [demonstrated] an extremely high degree of reliability for the mpgs reported in each quarter."

In sum, taxpayer asks that the Legal Division make a statistical and arithmetic judgment and overrule the audit's decision to impose a 7.00 mpg "cap" and substitute a 7.30 mpg cap. Taxpayer asks that on review the Legal Division overturn the audit's conclusions based upon the taxpayer's limited sampling methodology. The Legal Division must decline the opportunity finding that a decision to do so would constitute an unwarranted and unjustified intrusion into the audit's conclusion. The taxpayer asks the Legal Division to substitute its own judgment for the judgment of the two experienced audit personnel who examined the taxpayer's records on a first-hand basis, who reviewed the detailed records of over 40 vehicles, who conducted an audit which extended over a period of one year, who considered individual trip records to evaluate the likelihood of potential "fuel gaps," and who prepared an audit report which consumed hundreds of hours of review and analysis. Taxpayer's substitute analysis may be well reasoned and thoughtful but there is nothing in that analysis which – on its face – leads to a conclusion that the audit's methodology is so inherently flawed that the Legal Division, by means of this Letter of Findings, should substitute its own judgment for that of the audit.

Taxpayer frames the issue specifically as follows; "In applying the mpg "capping" methodology, did the auditor employ arbitrary, unreasonable, and inaccurate assumptions that produced an unreasonable estimate of [taxpayer's] IFTA liability that cannot be fairly reflective of [taxpayer's] actual operations?" Taxpayer, for all intents and purposes, argues that the 7.00 mpg cap is "arbitrary and capricious." Taxpayer overreaches. There is absolutely nothing in the audit's conclusion that would recommend a conclusion that the report is "founded on prejudice or preference rather than on reason or fact" or that the report gives evidence of "[a]rbitrary or unfounded motivation." Black's Law Dictionary 100, 203 (7th ed. 1999).

FINDING

Taxpayer's protest is respectfully denied.

II. Annualized MPG.

DISCUSSION

Taxpayer makes a secondary, alternative argument somewhat related to the first. Taxpayer has identified certain vehicles for which the audit adjusted particular mpg records. According to taxpayer, "[W]e believe these vehicles also warrant an adjustment because viewing each operation within any given group does not allow for timing and operational issues that arise and we are convinced that using an annual mpg cap of 7.30 allows for those differences." Taxpayer believes that in circumstances in which the audit adjusted a particular vehicle's mpg based upon a quarterly basis, it "believe[s] 7.30 is more appropriate and supported by the evidence submitted." In other words, taxpayer maintains that if an individual vehicle's annual mpg figure is "reasonable" – at 7.30 mpg or less – that particular vehicle's quarterly mpg figures should be accepted even if one of the quarterly mpg's is greater than 7.30. As an example, if a given vehicle's first quarter's mpg is reported at 6.2, its second quarter's mpg is reported at 6.3, its third quarter's mpg is reported at 8.8, and its fourth quarter's mpg is reported at 7.8 – resulting in an average annual mpg of 7.275 – then both the third and fourth quarter's mpg should be accepted as initially reported because the average annual mpg falls below the taxpayer's proposed 7.30 ceiling.

Taxpayer argues that the Department should accept its proposed methodology because it does not believe that quarterly figures greater than 7.30 – as represented by the 8.8 and 7.8 in the example cited above – necessarily indicate unreported "fuel gaps." As explained by taxpayer, "We are not convinced all 'high' mpgs are proof of fuel record[] gaps having noticed that many instances of mpgs greater than 10.0 occur in low-mileage quarters when owner-operators either first began or were ending their working arrangement with [taxpayer] and thus likely came into or left the company with already-fueled trucks." Taxpayer maintains that a quarterly limit of 9.75 mpg would more accurately account for possible record-keeping difficulties.

Taxpayer's argument is neither illogical nor statistically unsound. However, as in Part I above, the Department is unwilling to intercede in instances in which there is no legal basis for the Legal Division to substitute its own judgment on that of the audit judgment. Reasonable, as the taxpayer's argument may be, there is no indication that the audit's decision to adjust individual quarterly mpg figures in the manner it did is either "erroneous or excessive." IFTA Articles of Agreement, R1210.300. Taxpayer asks the Legal Division to weigh the difference between two competing statistical methodologies of calculating the taxpayer's fuel tax liabilities and conclude that the taxpayer's methodology is preferred. The Legal Division finds nothing that would permit it to conclude that the audit's methodology was arbitrary, capricious, or unjustified. Taxpayer has failed to meet its "burden of proving that the proposed assessment is *wrong*...." IC § 6-8.1-5-1(b).

FINDING

Taxpayer's protest is respectfully denied.

III. Division 500 Deadhead Miles.

DISCUSSION

Taxpayer argues that all of its 32 "Division 500" vehicles can reasonably be expected to achieve greater than average mpg because these 32 vehicles operated at "50 [percent] dead mileage." According to taxpayer, these 32 vehicles "were devoted exclusively to a routine, repetitive service for Home Depot." Taxpayer explained that the transportation service for Home Depot "consisted exclusively of hauling loads one way for delivery to a Home Depot facility, after which the trucks always ran back to their point of origin with empty trailers...." Taxpayer concludes that "the lighter load associated with pulling empty trailers 50 [percent] of the time resulted in greater fuel efficiency and a higher mpg." Taxpayer proposes that the Division 500 vehicles be capped at 7.85 mpg instead of the 6.99 mpg cap as indicated in the audit report. Taxpayer states that the 7.85 mpg cap is sufficient to "identify a fuel accounting problem and that all Division 500 Units with any mpg of up to 7.85 should be moved into the Reasonable MPG Unit category... and should not have any additional fuel artificially attributed to their operations."

A review of the audit report is sufficient to warrant taxpayer's assertion that the Division 500 vehicles "reported very consistent and reasonable mpgs" during the audited period. Again, the Legal Division is in no position to make an absolute determination as to whether the 6.99 mpg cap is correct and the 7.85 mpg cap is incorrect; similarly, the Legal Division is in no position to conclude that the 6.99 mpg cap is incorrect and the taxpayer's preferred 7.85 mpg cap is correct. However, taxpayer has raised facts sufficient to warrant audit's reconsideration of the Division 500 vehicles based on the assumption that taxpayer can verify that these 32 vehicles operated in the manner described herein by taxpayer. IC § 6-8.1-5-1(b) requires that the taxpayer meets it burden of demonstrating that the proposed assessment is "wrong." Taxpayer has not done so, but it has raised an issue which warrants reconsideration by the Audit Division and, if justified, an adjustment in the amount of the fuel tax assessment.

FINDING

Taxpayer's protest is sustained subject to audit verification.

IV. Separate Company Vehicles.

DISCUSSION

Taxpayer maintains that certain vehicles should not have been included in the 2004 portion of the audit. Taxpayer states that these particular vehicles were acquired from a former competitor in June of 2004. Despite this acquisition, former competitor had already obtained its 2004 IFTA decals and the vehicles continued to

operate under former competitor's IFTA license until the beginning of 2005.

Current taxpayer employee, and former competitor's employee, submitted an affidavit indicating that she prepared separate IFTA returns on behalf of former competitor and that she submitted those returns to Florida which was former competitor's base state for IFTA purposes.

Taxpayer concludes that because the operation of these vehicles was reported by former competitor and IFTA taxes were already paid, the named vehicles should be removed from taxpayer's 2004 audit.

The Department accepts the affidavit as sufficient justification under the standard set out in IC § 6-8.1-5-1 for removing the named vehicles. To the extent that the affidavit adequately identifies the vehicles and that taxpayer can provide copies of the Florida returns verifying the affidavit's contention, the audit division is requested to remove the vehicles from taxpayer's 2004 audit.

FINDING

Subject to audit adjustment, taxpayer's protest is sustained.

SUMMARY

Taxpayer is denied as to issues I and II; no adjustment to the mpg "cap" will be made. Taxpayer is sustained as to issue III subject to audit verification of the use for which the "Division 500" vehicles were employed. Taxpayer is sustained as to issue IV subject to verification of the identity of the trucks acquired from "former competitor."

Posted: 10/29/2008 by Legislative Services Agency
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