STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2011-16

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF REVENUE
DIVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908

In the Matter of:	:	
	:	**Motor Fuel Tax**
Taxpayer.	:	

DECISION

I. INTRODUCTION

This matter came for hearing pursuant to a Notice of Hearing and an Appointment of Hearing Officer ("Notice") both issued on January 26, 2006 by the Division of Taxation ("Division") to the above-captioned taxpayer ("Taxpayer") in response to its request for hearing. The undersigned was appointed substitute hearing officer by order dated July 25, 2007. This matter came for hearing on September 11 and October 12, 2007. Both parties were represented by counsel. The matter was kept open for the filing of briefs, revisions to the audit,[1] and for the parties to discuss a resolution. The Taxpayer filed a brief and the Division rested on the record. The matter closed on June 3, 2011.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 31-36-1 *et seq.*, the *Division of Legal Services Regulation 1 Rules Procedures for Administrative Hearings.*, and the *Division of Taxation Administrative Hearing Procedures Regulation AHP 97-01.*

[1] A revision of the Notice of Deficiency was submitted on April 22, 2008 and is hereby marked and admitted as Division's Exhibit Q.

III. ISSUE

Whether the Taxpayer owes the additional motor fuel tax, interest, and penalties assessed pursuant to R.I. Gen. Laws § 31-36-1 *et seq.*

IV. MATERIAL FACTS AND TESTIMONY

The parties did not dispute the following facts. The same fuel that is used to heat homes and businesses can also be used to power eighteen wheelers, off-road vehicles, and heavy machinery. When the fuel is intended for vehicles or commercial heating, it is taxed at the point of sale. If the fuel is intended for home heating purposes, it is dyed and left untaxed.[2] Dyed diesel may be resold for vehicle or commercial use, but if it is resold, the motor fuel tax must be added to the sales price and remitted to the State.

Senior Revenue Agent, testified on behalf of the Division. He testified that he performed an audit for the period of January 1997 through December, 2002 for motor fuel tax. He testified that initially he began with a test period but changed to an actual audit because of missing records. He testified that he reviewed the Taxpayer's records, Federal and State corporate returns, purchase invoices, sales history reports, delivery tickets, and sales tax returns. He testified that he based his audit estimates on these records.

testified that the fuel tax is charged to the customer at the point of sale. He testified that a dealer can buy untaxed number two (2) heating oil and re-sell it to power construction equipment but the dealer would have to file a T-12 report and the Taxpayer did not file those returns during the audit period. testified that a delivery ticket is comparable to a sales invoice and indicates how many gallons were sold

[2] See R.I. Gen. Laws § 44-18-30(20) for exemption from sales and use tax for home and residential heating fuel. See also the Division's *Sales and Use Taxation Regulation* SU 95-89 regarding said exemption.

to a particular customer. He testified that the Taxpayer's records were fair to poor, and some were unavailable. When sections of the records were unavailable, he testified that he used distributor reports and other sources provided by the Taxpayer to spot check the vendor's or purchaser's records. He further testified that a statute of limitations waiver was not required since the Taxpayer did not initially file motor fuel returns.

testified that there were two (2) areas of liability: Schedule 9A and 9B.[3] He testified that Schedule 9B – additional motor fuel sales - represented a discrepancy between how much diesel fuel the Taxpayer sold and how much the Taxpayer purchased so that the Taxpayer sold more gallons of diesel than tax paid in purchase of diesel fuel.

testified that the Taxpayer most likely sold what had been purchased as heating fuel as diesel fuel. He testified that he took the total sales for each month, gave credit for purchases in the same month, and assessed the difference in gallons. See Division's Exhibit G-2 (audit work papers for Schedule 9B).

testified that he used a variety of the Taxpayer's documents in his assessment. For example, he testified that the Division's Exhibit I summarized the monthly totals of the different diesel products sold by the Taxpayer and he used a combination of the Taxpayer's records and distributors' reports to create it. He testified that when the Taxpayer's owner disputed the amounts in Exhibit I, he reviewed the original delivery tickets and cross-referenced them with the accompanying product history report but not all tickets were available. See also Division's Exhibits H, I, K and L (corporate return analysis, fuel purchase analysis, sales return analysis, and fuel sales analysis). He testified that the records went back to July, 1999 so for January, 1997

[3] After hearing, the Division revised the deficiency and withdrew the assessment based on Schedule 9A. See Division's Exhibit Q and Division's email of April 1, 2011.

through July, 1999, he projected an estimate based on a six (6) month period in 1999 which was close to the missing period. He testified that the Division issued a Notice of Deficiency (See Division's Exhibit O) with a penalty and statutory interest. See Division's Exhibit N (interest calculation worksheet).

On cross-examination, testified that it is normal for an audit to go back six (6) years for a non-filer and that the Taxpayer was classified as a non-filer because it did not file the T-12 forms that were required since it sold untaxed diesel for off-road purposes. He testified that since the Taxpayer did not have records available indicating his inventory, Schedule 9B did not account for inventory. He testified there were no records of the fuel stored in an off-site storage facility. He testified that initially he was going to perform the audit using a test period but because not all the invoices were available, he went to an actual basis focusing on motor fuel tax. He testified that he did not have all the diesel purchases but he received those invoices from the Taxpayer and if he didn't have all the invoices, then he would be short on purchases. He testified that he gave the Taxpayer's owner a copy of the purchase list and the owner did not dispute the purchases. He testified he did not take into consideration any of the borrowed fuel from the off-site storage facility as that fuel would be sold and then replaced by the Taxpayer so there was a sale involved. See Division's Exhibit J (initial test period for purchase analysis for January through June, 2002).

("Owner"), Taxpayer's president, testified on the Taxpayer's behalf. He testified that the Division based its gallons sold on the computer records which only tracked gallons so were not accurate. He testified that the sales history report does not contain only sales but also the transfer of oil and storage so that the sales in the

report used by the Division do not match the Taxpayer's actual sales and are inflated. He testified that he gave the purchase records to the Division. He testified that he might borrow fuel – e.g. 30,000 gallons - from the off-site storage facility and later have to replace it. He testified that he billed based on delivery tickets but those tickets could also be used to track pumping out a truck or delivering oil to the storage facility. He testified that those would not be sales but would go into the computer as sales. He testified that the delivery slips track the transfer of fuel and the storage of fuel so to count those as a sale would be counting a sale twice. The Owner testified that he never filed a T-12 form and didn't know what one was. He provided a letter and inventory listing from the off-site storage tank. See Taxpayer's Exhibit Five (5). The Owner testified that delivery slips were also generated for a customer that kept bouncing checks so each bounced check would post as a new delivery. See Taxpayer's Exhibit Two (2).[4]

On cross-examination, the Owner testified that Division's Exhibit P were the records he used during the audit period and on which based his audit. He testified that his records were his computerized records and delivery tickets. He testified that a delivery ticket is generated when the fuel is moved and there is no subset of records indicating whether it is an actual sale or transfer. He testified that his business is a cash business so he bases his income tax return on whatever is deposited in the bank. He testified he gave the Division the system he uses. He testified that the computer records and the delivery tickets do not reflect his sales so his accountant uses bank deposits which are what the Division's auditor should use. He testified that he might overdraw at the storage facility but then be expected to make it up. When asked about to account for

[4] The revised assessment incorporated these bounced checks. See Division's Exhibit Q (includes the Division's letter of April 22, 2008) and the Division's email of April 1, 2011.

the 250,000 gallon discrepancy even after taking the Schedule 9A customer and bounced checks into consideration, the Owner testified that it could be inventory and timing differences. The Owner testified that Division's Exhibit P lists his customers by name and by gallons. He testified that those records could be used to compute tax and those records were given to but inventory was not taken into account.

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.,* 637 A.2d 1047 (R.I. 1994). See *Parkway Towers Associates v. Godfrey*, 688 A.2d 1289 (R.I. 1997). If a statute is clear and unambiguous, "the Court must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Oliveira v. Lombardi*, 794 A.2d 453, 457 (R.I. 2002) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. Dept. of Environmental Management,* 553 A.2d 541 (R.I. 1989) (internal citation omitted). In cases where a statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998). The statutory provisions must be examined in their entirety and the meaning most consistent with the policies and purposes of the legislature must be effectuated. *Id.*

B. Relevant Statutes and Regulation

R.I. Gen. Laws § 31-36-7[5] sets a current tax rate of 32¢ per gallon (but the rate was 28¢ and 30¢ per gallon during this audit)[6] on all taxable gallons of fuel sold or used in Rhode Island, to be paid every month by every distributor. R.I. Gen. Laws § 31-36-6[7] requires every distributor to keep a complete and accurate record of the number of gallons of fuel sold and used by the distributor and that these records shall be in a form and include any information prescribed by the Tax Administrator. Additionally, R.I. Gen. Laws § 31-36-16[8] states that any person who receives untaxed fuel and then sells it

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[5] R.I. Gen. Laws § 31-36-7 states in part as follows:

> Monthly report of distributors – Payment of tax. – *(a) State requirements.* Every distributor shall, on or before the twentieth (20th) day of each month, render a report to the tax administrator, upon forms to be obtained from the tax administrator, of the amount (number of gallons) of fuels purchased, sold, or used by the distributor within this state and the amount of fuels sold by the distributor without this state from fuels within this state during the preceding calendar month, and, if required by the tax administrator as to purchases, the name or names of the person or persons from whom purchased and the date and amount of each purchase, and as to sales, the name or names of the person or persons to whom sold and the amount of each sale, and shall pay at the same time to the administrator tax at the rate of thirty-two cents ($0.32) per gallon on all taxable gallons of fuel sold or used in this state.

[6] See PL 1998 ch. 31 Art. 6 § 2; PL 2002 ch. 65 Art 29 §1.

[7] R.I. Gen. Laws § 31-36-6 states the following:

> Every distributor shall keep a complete and accurate record of the number of gallons of fuels sold by the distributor and of the number of gallons of fuels used by the distributor, the date of the sales and of any use and, except in the case of retail sales through filling stations operated by the distributor, the names and addresses of the purchasers. The record shall be in a form and contain any information that the administrator may prescribe. Every distributor shall make for every sale of fuels, except retail sales through filling stations operated by the distributor, a written statement in duplicate containing the names and addresses of the distributor and the purchaser, the number of gallons sold and the dates of sale and delivery, one of which shall be delivered to the purchaser and the other retained by the distributor. Each record and statement shall be preserved by the distributor and purchaser for a period of three (3) years, and shall be open to inspection upon demand of the tax administrator or his or her authorized agents.

[8] R.I. Gen. Laws § 31-36-16 states as follows:

> Payment of tax by persons other than distributors. – Any person who shall receive fuels in any form and under any circumstances that shall preclude the collection of the tax provided for in this chapter, from the distributors, and shall then sell or use the fuels in any manner and under any circumstances that shall render the sale or use subject to the tax, shall be considered as a distributor, and shall make the same report, pay the same taxes, and be subject to all other provisions of this chapter relating to a distributor of the fuels; excepting, that the requirements under this chapter for the filing of a bond shall be discretionary with the tax administrator, and if the bond is required to be filed it shall be in an amount not to exceed seventy-five thousand dollars ($75,000).

for a taxable purpose shall be considered a distributor. Thus, pursuant to said statute, the Taxpayer is a distributor. In addition, the Division's *Motor Fuel Tax Regulation* MF 89-02[9] requires that anyone acquiring fuel without paying tax and then sells the fuel for use for an internal combustion engine is liable for tax.

C. Arguments

The Division argued that the assessment was made on discrepancies between the sales and tax paid on fuel purchases and sales based on the Taxpayer's own records and distributors' reports. The Division argued that the Taxpayer was given credit for any taxes paid to distributors or erroneously paid sales and use tax.

The Taxpayer argued that the discrepancy between diesel gallons sold and purchased was due to stored inventory. The Taxpayer argued that since the test period showed the Taxpayer did not have excess dyed fuel, the Division changed its audit method and that it was unfair to perform a six (6) year audit since the Taxpayer is not required to file T-12 forms and only needs to maintain records for three (3) years under R.I. Gen. Laws § 31-36-6. The Taxpayer argues that the Division only believes its records are inadequate since they do not support the Division's assumptions. The

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[9] Said Regulation states as follows:

> Regulation MF 89-02 Taxability of Special Fuels
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> The definition of fuel includes all volatile and inflammable liquids (other than lubricating oils, diesel fuel for the propulsion of marine craft, and oils used for heating purposes) used or suitable for use for operating or propelling motor vehicles using internal combustion type engines.
>
> The tax applies to all liquid fuels sold for use or used in motor vehicles (except as provided in the definition relating to diesel marine craft) and it is not confined to sales for use or used on the highways of this state.
>
> Filling stations, peddlers or other vendors acquiring fuels such as No. 2 fuel, LPG and other gasoline substitutes without having paid the tax to their supplier must include the tax at the time of sale or delivery for use in internal combustion engines and must report the sales and pay the tax to the tax administrator.
>
> Any person, firm or corporation acquiring fuel upon which the tax has not been paid and who subsequently sells or uses such fuel for propelling an internal combustion engine immediately becomes liable for the tax and must arrange with the tax administrator to report sales or use and pay the tax due.

Taxpayer argued that the history posting journal summary is a summary of all products from the tank trucks and not a source of entry of sales to third parties.

D. Whether the Taxpayer Owes Motor Fuel Tax

At hearing, the Owner testified that the neither the Taxpayer's computer system nor its delivery tickets accurately reflect the Taxpayer's sales and the auditor should use his (Owner's) "bank deposits" for his audit.[10] The Owner's testimony flies in the face of the requirement in R.I. Gen. Laws § 31-36-6 that "[e]very distributor shall keep a complete and accurate record of the number of gallons of fuels sold by the distributor and of the number of gallons of fuels used by the distributor, the date of the sales and of any use and, except in the case of retail sales through filling stations operated by the distributor, the names and addresses of the purchasers."

The Owner testified that the Taxpayer's records did not contain the proper breakdown of its sales. However, it is the Taxpayer's statutory obligation to maintain its records regarding the number of gallons sold and used. The Owner cannot use his failure to maintain accurate records regarding the sale of number of gallons sold to argue that the Taxpayer does not owe tax. The Taxpayer gave the Division all of its records but the Owner's testimony was that those records were inaccurate as to number of gallons sold.

The Owner testified that the discrepancies in the gallons purchased and sold was because of transfer of fuel between the trucks and the off-site storage and the borrowing of fuel. He also testified as to several bounced checks for purchasing fuel but those were considered when the Division made adjustments to the initial assessment. The Owner admitted that the delivery slips did not differentiate between the transfer, storage, and purchase of fuel and argued that the auditor should rely on bank deposits. The Owner's

[10] Pages 9-10 of the transcript of October 12, 2007 hearing.

explanation of discrepancies in the purchases and sales was not supported by his records even though such records are statutorily required to track the number of gallons sold.

When there are no returns filed by a taxpayer, or if the Tax Administrator is not satisfied with the records provided, the Division shall make an estimate of gross receipts based on any information that comes into the possession of the Division. See R.I. Gen. Laws § 31-36-9(4).[11] In this matter, the Division conducted an audit based on the Taxpayer's available records.

The Taxpayer argued that it kept its records for three (3) years as required by statute so the audit cannot cover six (6) years. However, the Taxpayer did not file the required T-12 reports for the sale of dyed diesel fuel. Based on the Taxpayer's records for 1999 to 2002, the Taxpayer should have filed T-12 forms. As a consequence, the audit may cover a period longer than three (3) years. Thus, pursuant to R.I. Gen. Laws § 31-6-9(4) (see footnote eleven (11)), the Division estimated the number of gallons purchased, sold, and used for the months in 1997 to 1999.

The Division relied on the records provided by the Taxpayer. The Taxpayer could not produce any records – despite such records being statutorily required - to

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[11] R.I. Gen. Laws § 31-36-9(4) states as follows:

> *(4) Determination without report; interest and penalties.* If any person fails to file a report, the tax administrator shall make an estimate of the amount (number of gallons) of fuels purchased, sold or used which is subject to tax. The estimate shall be made for the month or months in respect to which the person failed to file a report and shall be based upon any information which is in the tax administrator's possession or may come into the tax administrator's possession. Upon the basis of this estimate, the tax administrator shall compute and determine the amount required to be paid to the state, adding to the sum thus arrived at a penalty equal to ten percent (10%) of it. One or more determinations may be made for one or for more than one month. The amount of the determination, exclusive of penalties, shall bear interest at the annual rate provided by § 44-1-7, as amended, from the twenty-fifth day after the close of the month for which the amount or any portion of it should have been paid until the date of payment. If the failure of any person to file a report is due to fraud or an intent to evade the provisions of this chapter, a penalty of fifty percent (50%) of the amount required to be paid by the person, exclusive of penalties, shall be added to it in addition to the ten percent (10%) penalty provided in this section. After making his or her determination the tax administrator shall mail a written notice of the estimate, determination, and penalty.

support its contention that the discrepancies were because of storage or transfer of fuel. The Division relied on the Taxpayer's own records. Thus, there has been no showing by the Taxpayer that the methodology used by the Division was improper or incorrect. See *Tax Division Decision* 2000-17 (March 29, 2000) and *Tax Division Decision* 2000-9 (February 15, 2000) (tax assessments rely on taxpayers' records and not oral testimony).

E. Penalties

Pursuant to R.I. Gen. Laws § 31-36-9(4) (see footnote eleven (11)), the Division imposed a 10% penalty on the assessment as well as interest. The penalty is not discretionary. See *Brier Mfg. Co. v. Norberg*, 377 A.2d 345 (R.I. 1977).

VI. FINDINGS OF FACT

1. The Notice of Hearing and an Appointment of Hearing Officer were both issued on January 26, 2006 by the Division to the Taxpayer in response to its request for a hearing.

2. A hearing was held on September 11 and October 13, 2007 with this matter closing June 3, 2011.

3. A field audit was conducted by the Division on the Taxpayer for the period of January 1, 1997 through December 31, 2002.

4. The Division audited the Taxpayer using the Taxpayer's available records.

5. The Taxpayer's records showed that it sold more number two (2) fuel (heating fuel) than it purchased.

6. Based on the records available, the Division determined that the Taxpayer improperly sold untaxed number two (2) fuel for motor fuel taxable purposes.

7. The Taxpayer was unable to produce records to support its contention that its own records used by the Division overestimated the amount of untaxed fuel sold because of the storage and transfer of fuel.

8. The facts contained in Sections IV and V are reincorporated by reference herein.

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.* and R.I. Gen. Laws § 31-36-1 *et seq.*

2. Pursuant to R.I. Gen. Laws § 44-1-1 *et seq.* and R.I. Gen. Laws § 31-36-1 *et seq.*, the Taxpayer owes the motor fuel tax deficiency as assessed by the Division in its initial Notice of Deficiency (Division Exhibit O) and revised by Division's Exhibit Q. Pursuant to R.I. Gen. Laws § 31-36-9, the Taxpayer owes the interest and penalty assessed on said deficiency.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows:

Based on R.I. Gen. Laws § 44-1-1 *et seq.* and R.I. Gen. Laws § 31-36-1 *et seq.*, the Taxpayer owes the motor fuel tax assessment and penalty and interest as set forth in Division's Exhibit O but further revised by Division's Exhibit Q.

Date: July 12, 2011

Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

____X____ ADOPT
_____ REJECT
_____ MODIFY

Dated: August 3, 2011

David Sullivan
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 31-6-9 states in part as follows:
(8) Petition for judicial review; citation and hearing. After a hearing, and provided all taxes, interest, and penalties as determined by the tax administrator have been paid, any person aggrieved by the determination may, within fifteen (15) days from the date of mailing by the tax administrator of the determination, petition the sixth division of the district court, setting forth the reasons why the assessment is alleged to be erroneous and praying relief from it. The clerk of the court shall then issue a citation, substantially in the form provided in § 44-5-26, to summon the tax administrator to answer the petition, and the court shall proceed to hear the petition and to determine the correct amount of the tax, interest, and penalties.

CERTIFICATION

I hereby certify that on the 3rd day of August, 2011 a copy of the above Decision and Notice of Appellate Rights were sent by first class mail, postage prepaid and return receipt requested to the Taxpayer's attorney at the address on file with the Division of Taxation and by hand delivery to Bernard Lemos, Esquire, Department of Revenue, One Capitol Hill, Providence, RI 02908.

Gail Bilasco