STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. ALABAMA OIL SUPPLY, INC. P. O. Box 336 Bessemer, AL 35021, Taxpayer.	§ § § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. MISC. 90-278

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed motor fuel tax against Alabama Oil Supply, Inc. ("Taxpayer") for the period November, 1986 through October, 1989. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on November 18, 1992. Herbert H. West, Jr. and Roy J. Crawford represented the Taxpayer. Assistant counsel John J. Breckenridge represented the Department.

The Taxpayer is a motor fuel distributor and sells diesel fuel, kerosene (together "motor fuel") and other petroleum products in Alabama. The motor fuel is subsequently used for both taxable on-road and exempt off-road purposes.

The Department audited the Taxpayer for motor fuel tax for the period November, 1986 through October, 1989. Unfortunately, the Taxpayer's records were inadvertently destroyed prior to the audit when an employee of the Taxpayer removed the records from a storage warehouse and took them to the City of Bessemer landfill. Consequently, the only records provided by the Taxpayer were for October, 1989.

The Department conducted the audit in two parts. First, the

Department reviewed the purchase invoices of six or eight of the Taxpayer's largest customers. Based thereon, the Department determined that the Taxpayer had underreported sales during the audit period.[1]

As discussed later, the customer invoice investigation was conducted "for information only" and was not used by the Department to determine the Taxpayer's liability. Rather, the Taxpayer's liability was computed as follows:

The Department determined the Taxpayer's total sales by adding beginning inventories and total purchases by the Taxpayer and then subtracting ending inventories. The beginning and ending inventory figures were obtained from the Taxpayer's returns. The purchase amounts were obtained from supplier records on file with the Department. The Department determined that the Taxpayer sold

[1] For example, the Taxpayer reported 621 taxable gallons sold in October, 1987, but the purchase invoices of Browning Ferris Industries alone showed 24,900 taxable gallons purchased from the Taxpayer during the same month. The investigation report is included in the audit report, Department Exhibit 3, as Schedules B through M.

12,219,873 gallons during the audit period, which is substantially the same as sales of 12,218,421 gallons actually reported by the Taxpayer during the period.

The Department then subtracted from total sales all documented off-road sales (3,489,469 gallons) and allowed a credit for all previously reported sales (2,068,028 gallons). The remaining gallons were determined to be taxable and are the basis for the assessment in issue. The Department's position is that if the Taxpayer cannot document that a sale was for exempt off-road use, then it must be taxed.

The parties executed a waiver on December 18, 1989 purportedly extending the three year statute of limitations for assessing tax until February 20, 1990. The Department subsequently entered a formal "Notice of Amount and Request for Payment (of) Motor Fuel Tax" (the "Notice") on February 15, 1990. The Notice informed the Taxpayer that additional motor fuel tax, penalty and interest was due totalling $1,434,759.43.

The Department reduced the amount claimed based on additional records provided at an informal conference, and thereafter entered a preliminary assessment on August 30, 1990 for tax, penalty and interest totalling $1,099,240.79.[1] The Taxpayer subsequently

[1]Based on more records provided by the Taxpayer after the preliminary assessment was entered, the Department now agrees that the tax due should be reduced by approximately $9,600.00 to $10,000.00. Penalty and interest should also be reduced accordingly.

appealed to the Administrative Law Division.

The Taxpayer disputes the audit and resulting assessment on three grounds, as follows:

(1) The Customer Invoice Investigation

The Taxpayer first argues that the audit is wrong because (1) the Department's review of the customer invoices accounted for only about one-half of the Taxpayer's total sales during the audit period, and (2) some invoices identified by the Department as sales by the Taxpayer were in fact sales by another distributor, Maxx Petroleum.[2] The Taxpayer's arguments on this point are found primarily on pages 5, 6 and 17 through 19 of its Brief, and pages 8 and 9 of its Reply Brief.

The above arguments are misleading because the customer invoices were not used to compute the Taxpayer's total sales or otherwise to compute the assessment in issue, except as documentation to allow credit for off-road sales. The Department reviewed only a portion of the invoices for the limited purpose of comparing actual sales with reported sales.[3] Consequently, it is

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[2] The disputed invoices are imprinted with the name "Maxx Petroleum/Mart, Inc.", but all have "Alabama Oil Supply" handwritten above the imprint. Maxx Petroleum and the Taxpayer have common ownership and the same mailing address.

[3] The audit report, at page 2, states as follows:

> "The attached investigation reports of various businesses/trucking companies were for the purpose of illustration only. A summary of the investigations offer a comparison of

irrelevant that the Department did not review all of the invoices, or that the disputed Maxx Petroleum invoices may have represented sales by Maxx and not the Taxpayer. Ironically, the customer invoice investigation was not necessary to the audit and the Department could have computed the Taxpayer's liability as it did even if the investigation had showed that the Taxpayer's returns appeared to be correct. The Taxpayer's argument is a "red herring"

> taxable sales to the taxable gallons reported by A.O.S. This comparative report indicated that a serious problem existed at A.O.S. (see Sch. "B")".

Page 2 of the audit report table of contents relates to the invoice investigation and is headed as follows:

> "INVESTIGATION REPORTS
> FOR ILLUSTRATION ONLY".

because total sales as computed by the audit of 12,219,87 gallons is almost exactly the same as total sales actually reported by the Taxpayer of 12,218,425 gallons.

(2) The Statute Of Limitations Issue

Code of Ala. 1975, §40-17-41 applied to all motor fuel excise taxes during the period in issue and read as follows:

> All actions by the state for the recovery of additional amounts claimed as excise tax due . . . shall be commenced within a period of three years from the date the return was filed.[4]

The Taxpayer argues that an "action" under §40-17-41 was a "civil proceeding instituted or commenced in court to enforce a tax liability". Taxpayer's Brief at page 9, citing Howell and Graves v. Curry, 5 So.2d 105, 109. Consequently, the Taxpayer contends that because the Department failed to file a civil proceeding in circuit court prior to November 21, 1992, (three years after the due date of the October, 1989 return), the entire period in issue is barred by the three-year statute of limitations and cannot be

[4] Section 40-17-41 was repealed by the Uniform Revenue Procedures Act (URPA) effective October 1, 1992. The statute of limitations for assessing all tax is now governed generally by that Act at Code of Ala. 1975, §40-2A-7(b)(2). However, §40-17-41 is applicable in this case because the period in issue was prior to the effective date of the Act.

assessed or otherwise collected. I disagree.

The intent of §40-17-41 was to require the Department to institute formal assessment procedures against a taxpayer within three years from when the return was filed. The Department commenced an action for the recovery of the tax in issue pursuant to §40-17-41 when the Notice was issued by the Department on February 15, 1990. That Notice informed the Taxpayer of the additional tax due and commenced a series of formal procedures by which the Taxpayer could dispute the amount claimed, and if not paid, the Department could assess and collect the amount due.

The Taxpayer argues that §40-17-41 cannot be referring to the assessment of tax because the Department was not authorized to assess motor fuel tax during the period in issue. Rather, the Taxpayer contends that the Department was required to proceed without assessment under §40-17-15. Section 40-17-15, also repealed by URPA, required the Department to give a distributor ten days notice of additional tax due, and if the distributor failed to respond or if the Department was not satisfied with the response, the Department was authorized to execute on all real and personal property of the distributor.

I am surprised by the Taxpayer's argument. Certainly the Taxpayer would have objected if, without an audit or other prior contact by the Department, the Department had mailed the Taxpayer notice of additional tax due, and "ten days after notice is

mailed", the Department had instituted execution procedures against all of the Taxpayer's property.[5]

[5] Under §40-17-15 the Department was apparently authorized to estimate additional tax due by a distributor and after ten days notice execute on the distributor's property, regardless of whether the notice was ever received by the distributor. To my knowledge the Department never used the procedures set out in §40-17-15, but instead, always followed normal assessment procedures concerning motor fuel tax. As stated, §40-17-15 was repealed effective October 1, 1992.

In any case, the Taxpayer's argument is wrong because the Department was clearly authorized during the audit period to assess motor fuel tax and all other taxes which it was authorized to enforce and collect. Code of Ala. 1975, §40-2-11(15) (§40-2-11(16) before October 1, 1992). That section authorizes the Department "to make all assessments of taxes or penalties which it is authorized to enforce or collect . . .".[6]

The Department is not a court within the judicial branch of government. However, the Legislature has conveyed on the Department quasi-judicial authority as "the state tribunal designated by the law with judicial functions to pass upon questions of fact or law which may arise in making assessments". Birmingham Vending Company v. State, 38 So.2d 876, at 879. "The Department of Revenue is a primary trial tribunal or court". State v. Pollock, 38 So.2d 870, at 873. "The final assessment not appealed from is as conclusive as the judgment of an ordinary court. It is the judgment of a tribunal constituted a court by the Legislature as authorized by §139 of the Constitution, and is as conclusion as such." Hamm v. Harrigan, 178 So.2d 529, at 538, quoting State v. Woodruff, 46 S.2d 553, at 563.[7]

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[6] The authority to assess all taxes and the procedures for entering assessments are now also set out in URPA, §40-2A-7, et seq.

[7] The Taxpayer correctly points out that §139 was repealed by passage of Amendment 328 in 1973. However, the Legislature is still authorized by Amendment 328 to confer on the Revenue

In summary, an action for recovery of additional tax was commenced under §40-17-41 when the Department in its quasi-judicial capacity issued the formal Notice to the Taxpayer on February 15, 1990. Consequently, the Department timely assessed all tax periods for which a return was filed within three years prior to that date, or after February 15, 1987.

The parties signed a waiver on December 18, 1989 purportedly keeping the entire audit period open to assessment until February 20, 1990. However, the waiver cites only §§40-2-11, 40-29-2, 40-29-51 and 40-29-52, and does not mention and therefore does not extend the statute of limitations set out in §40-17-41. The Department prepared the waiver and should be strictly held to its language. Accordingly, those months for which returns were filed before February 15, 1987 were not "acted on" by the Department within three years as required by §40-17-41, and consequently, should be removed from the assessment. Assuming that all returns were filed by the Taxpayer on or before the 20th of the next month,

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Department quasi-judicial authority the same as under §139. The function and authority of the Revenue Department is the same now under Amendment 328 as it was under §139.

the months of November and December, 1986 should be deleted from the assessment.

Two final points on this issue. First, the Department's normal, and to my knowledge exclusive, procedure for recovering additional tax is to assess the tax due and then execute on the final assessment, which if unappealed from is as conclusive as a circuit court judgment. Hamm v. Harrigan, supra. Consequently, if §40-17-41 refers to an action in circuit court, as argued by the Taxpayer, that section would only limit the Department's ability to proceed in court. The Department would still be authorized to audit and assess a taxpayer for additional tax due, as it has done in this case.

Also, a statute limiting the Department's ability to assess and collect tax must be strictly construed in favor of the Department and against the taxpayer. Lucia v. United States, 474 F.2d 565; Badaracco v. C.I.R., 104 S.Ct. 756. As between two possible interpretations, a statute of limitations provision must be given the construction most favorable to the Department.

(3) Construction of Section 40-17-11

The motor fuel taxes are levied on the sale, distribution, etc., of all motor fuel used on the highways of Alabama. However, Code of Ala. 1975, §40-17-11 provides that a distributor is not liable except under three circumstances:

> (1) Where the distributor or storer delivers such motor fuel into the fuel supply tank of a motor vehicle for the

propulsion thereof on the public highways of this state;

(2) Where the distributor or storer delivers motor fuel into dispensing equipment of a retail dealer designed and used to supply motor fuel into the fuel supply tank of a motor vehicle for the propulsion thereof on the public highways of this state; or

(3) Where the distributor or storer sells or distributes motor fuel, knowing or having good reason to know that the same is to be used for propelling motor vehicles on the public highways of this state.

The Taxpayer argues that all motor fuel is presumed non-taxable and the burden is on the Department to prove that the fuel is taxable under paragraphs (1), (2) or (3) above.[8] I disagree.

[8] The Taxpayer argues as follows: "The burden is on the Department to establish that motor fuel sold and distributed by Taxpayer fits within one of three categories; otherwise, §40-17-11 mandates that the sale of distribution is tax-free. The Department, having failed to establish the use of the vast bulk of the motor fuel sold or distributed by Taxpayer which forms the basis of the preliminary assessment, has failed to carry its bulk of proof." Taxpayer's Brief at page 20.

Code of Ala. 1975, §40-17-7 specifies that all motor fuel distributors shall keep adequate records showing their sales or distributions of motor fuel. Section 40-1-5(c) also generally requires all taxpayers subject to tax in Alabama to "at all times keep an accurate set of books in this state, showing the nature and details of the business . . . sufficient to fully disclose the information necessary to determine the correct amount of any tax levied by this title."

If a distributor fails to keep adequate records distinguishing taxable on-road and non-taxable off-road sales, as required by the above statutes, then "the taxpayer must suffer the penalty of non-compliance and pay on the sales not so accurately recorded as exempt." State v. T. R. Miller Mill Company, 130 So.2d 185, at 190, citing State v. Levey, 29 So.2d 129; see also State v. Ludlam, 384 So.2d 1089.

The Taxpayer contends that Ludlam and T. R. Miller are sales tax cases and therefore not applicable in this case because of the different statutes involved. However, the rule requiring adequate records is equally applicable concerning all taxes. As stated in Levey, supra, at page 131:

> The evident purpose of these and other provisions of the revenue law requiring the keeping of an accurate set of books and records by the taxpayer to disclose the details of his business is that, on an examination of them by the taxing authority, the amount of taxes for which the taxpayer should be liable may be properly determined. The State should not -- and the statute does not so contemplate -- be required to rely on the verbal

> assertions of the taxpayer or his witnesses in determining the correctness of the tax return, the amount of taxes due, what portion of the gross sales are exempt ones under the law. Records should be available disclosing the business transacted. (underline added)

If the Taxpayer is correct and the Department is required to prove that a sale or distribution of motor fuel is taxable, a distributor could fail or refuse to keep records and thereby escape liability unless the Department could obtain the necessary information from third-party sources. That would be impractical if not impossible in most cases, and certainly was not intended by the Legislature.

There is no presumption of non-taxability concerning the sale of motor fuel. Section 40-17-11 specifies that only certain sales or distributions by a distributor are taxable, but the distributor must keep adequate records by which the Department can determine which are taxable and which are not. Otherwise, the Department would have no practical way of enforcing the law.

The Taxpayer concedes that an assessment by the Department is prima facie correct, but argues that the presumption of correctness does not apply in this case because the Department was not authorized to assess motor fuel tax during the period in issue. That argument was answered earlier in the discussion concerning §40-17-41. The Department was clearly authorized to assess motor fuel tax against the Taxpayer, and the Taxpayer has failed to carry its burden of proving that the assessment is incorrect.

The Taxpayer contends that the audit liability is excessive when compared to two previous audits by the Department. The Department audited the Taxpayer's predecessor, V. J. Corporation, for motor fuel tax for June, 1982 through May, 1985. That audit resulted in only minor adjustments for additional tax due. A gasoline tax audit of the Taxpayer was also conducted for April, 1984 through March, 1988, which resulted in a small refund to the Taxpayer.

Unfortunately, the Taxpayer cannot be relieved of liability in this case based on a good reporting history. The Department's audit procedure was straightforward and based on the most reliable information available and must be upheld.

The Department is directed to recompute the Taxpayer's liability by allowing the additional documented off-road sales discussed in footnote 2. However, while not required to do so, I would also encourage the Department to review the case and consider if some reasonable compromise method for computing the Taxpayer's liability can be found. Although the Department is within its authority in taxing all undocumented sales, the Taxpayer has a good reporting history and a 1.1 million dollar assessment is a stiff penalty for the unintentional loss of records.

A Final Order will be entered upon receipt of the Department's recalculations setting out the Taxpayer's final liability. The Final Order when entered may be appealed to circuit court as

provided in Code of Ala. 1975, §40-2A-9(g).

Entered on May 4, 1993.

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BILL THOMPSON
Chief Administrative Law Judge