STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
EVANS DELIVERY COMPANY, INC.	:	DETERMINATION DTA NO. 820401
for Revision of a Determination or for Refund of Highway Use Tax under Article 21 of the Tax Law for the Period April 1, 1998 through March 31, 2002.	:	

Petitioner, Evans Delivery Company, Inc., P.O. Box 268, Pottsville, Pennsylvania 17901, filed a petition for revision of a determination or for refund of highway use tax under Article 21 of the Tax Law for the period April 1, 1998 through March 31, 2002.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 340 East Main Street, Rochester, New York, on December 5, 2005 at 12:00 P.M., with all briefs to be submitted by June 19, 2006, which date began the six-month period for issuance of this determination. Petitioner appeared by Gary D. Borek, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether the Division of Taxation conducted a proper test period audit of petitioner's business operations.

FINDINGS OF FACT

Petitioner submitted 34 Proposed Findings of Fact. Proposed Findings of Fact "1", "2", "4", "6" through "10", "12" and "13" have been accepted and incorporated into the Findings of Fact herein. Proposed Findings of Fact "3", "5", "11", "14" through "26" and "31" through "34"

have been rejected as not relevant to the issues herein. Proposed Findings of Fact "27" through "30" have been rejected as inaccurate or not supported by the record in this matter.

1. On December 26, 2003, the Division of Taxation ("Division") issued to petitioner, Evans Delivery Company, Inc., a Notice of Determination assessing highway use tax due in the amount of $127,046.46, plus penalty and interest, for the period April 1, 1998 through March 31, 2002.

2. Prior to the issuance of the Notice of Determination, petitioner, by Elizabeth F. Murphy, as corporate secretary, and Kevin M. Karr, petitioner's representative, executed four consents extending period of limitation for assessment of highway use tax under Article 21 of the Tax Law which collectively extended the statute of limitations for assessment for the audit period to January 31, 2004.

3. Petitioner, a Pennsylvania corporation, is a common carrier operating out of Pottsville, Pennsylvania, using owner operators for the transportation of all its loads. The corporation holds permits for all the owner operators. Deliveries are made in states along the Atlantic seaboard, the New England states, as well as in New York and Ohio.

4. On January 11, 2002, the auditor telephoned Ms. Murphy to schedule an appointment to commence the audit. The auditor explained to Ms. Murphy that it was the Division's intention to conduct a detailed audit or, if petitioner preferred, a test period audit after reviewing the records available.

5. On the same date, the Division sent to Ms. Murphy an appointment letter advising that the audit would commence on March 18, 2002 for the purpose of performing a field audit of petitioner's New York State truck mileage taxes. The letter requested that all books, records, worksheets and other documents pertinent to the preparation of petitioner's tax returns, as well

as all information requested on the attached sheet, be made available for the entire audit period. Attached to the letter was a document entitled "Books and Records Needed at the Start of the Audit." The attachment stated that the audit would involve New York State truck mileage tax and the period of audit was February 1, 1998 through January 31, 2002. The attachment requested that tax returns (MT-903), mileage records (ICC logs, odometer readings and trip sheets), fueling records (bulk fueling and retail fuel receipts), records pertaining to laden and unladen weight of vehicles, New York State Thruway receipts and statements and a list of all equipment be made available.

6. Following discussions with the auditor, petitioner requested that a test period audit be conducted. Thereafter, petitioner executed, on February 4, 2002, a Test Period Audit Method Election Form for Highway Use Tax for the audit period of February 1, 1998 through January 31, 2002. The form describes a "Test Period Audit" as "[t]he use of a limited period within the audit period to determine the audit results for the entire audit period. Generally, applicable records within the selected test period are examined and the results, after appropriate adjustments, are projected over the remainder of the audit period." The form also states that the election does not preclude the taxpayer from protesting "the audit results on grounds such as the particular test period selected, the inclusion of certain transactions within the test, the taxability of certain transactions, or the method of projecting the results of the test period findings."

7. In May 2002, the auditor suggested that the month of November 2001 be selected as the test period. This period was chosen as it appeared to be representative of petitioner's activities, it was not affected by the commencement of the audit as the return had been filed prior to the audit, and as it was a recent month, the auditor was of the opinion that more records would be available. As petitioner maintained ICC logs for only six months, none were available for the

audit period prior to November 2001. Petitioner was in agreement with the selection of November 2001 as the test period.

8. Initially, petitioner provided the auditor with a mileage folder for each vehicle that had a highway use tax permit for the test month. The folders contained the mileage record for the vehicles such as trip reports and Interstate Commerce Commission ("ICC") logs. Trip reports are supposed to be maintained by the drivers and are to contain a record of the deliveries completed by the driver, the origin and destination of each trip, and the stops, routes and fuel purchased during the trip. ICC logs are required to be maintained by the drivers to indicate the amount of their driving and resting time.

The trip reports present in the folders often covered only a short period of each month, usually between four and ten days. Although some of the trip reports were complete, the majority were not. The reports were missing stop points, odometer readings and the routes taken by the drivers. Petitioner's representative stated that many trip reports were received late, often after the highway use tax returns had been filed. The returns were filed based upon the incomplete information contained in the vehicle folders at the time of preparation. The auditor therefore concluded that the returns did not report all New York State miles because not all trip reports with such miles were in the folder when the highway use tax returns were prepared. No amended returns were filed to account for the New York miles reported on the late received trips. The ICC logs were then reviewed to determine the New York routes taken by the drivers in the course of their deliveries, a review which revealed that numerous New York trips were not reported on the trip reports. Based on the final mapping of the routes taken as determined by the auditor, the audit revealed that approximately 80% of the trip reports were missing. In addition, the monthly folders provided did not indicate the amount of fuel purchased or New York State

Thruway or toll information which could have assisted the auditor in each vehicle's mileage determination.

9. Based on the inadequate and unreliable records provided in the folders, the auditor decided to randomly select 20 folders in an effort to obtain sufficient information in at least some of the folders to conduct an audit. The auditor initially selected a sample of folders using a random number generator contained in his computer. He commenced the audit by first reviewing petitioner's highway use tax returns for the month of November 2001 which revealed that petitioner had reported 62 trucks employed during this period. The auditor numbered these 62 trucks and, using the random number generator contained in his computer, requested that his computer produce 20 numbers. As there was one duplicate folder chosen, he reduced the number of folders examined to 19. He then examined the trip reports and ICC logs contained in these folders, and reduced the number of folders to be used in the audit to 13 due to the lack of information on either the trip reports or ICC logs. By reducing the number of folders to 13, the auditor reduced his sample to less than 25% of reported miles for the month, and he therefore chose 5 more numbers. As two of these were duplicates of the original folders chosen, he added the other three to his audit.

10. To compute the miles traveled by petitioner's vehicles during the test audit period, the auditor used as the starting point the first location on the ICC log where the vehicle entered the State of New York. The auditor listed any stops the driver made followed by the last point the driver recorded in the State. This information was entered into a computer software program offered by Rand McNally, which provided the most practical routes which trucks would use to travel based on the ICC log entries. The sample revealed that the trucks had traveled in New York State for 18,705 miles, while for the same period, petitioner had reported 4,799 miles, an

error rate of 289.77%. In addition, the auditor was not provided with any records relating to the number of New York State Thruway miles traveled, nor were toll receipts or billing statements provided. This error rate was projected over the entire audit period to determine the amount of additional tax due.

11. The auditor also conducted a review of the highway use tax returns filed by petitioner to check for correct rates used and the accuracy of the calculations on the returns. The review revealed that a large portion of the trips completed by the drivers with reported miles in New York were not posted to the returns, reported trips were often incomplete and short actual miles and incorrect tax rates were used to calculate the tax due.

CONCLUSIONS OF LAW

A. Article 21 of the Tax Law imposes two highway use taxes upon commercial carriers with respect to motor vehicles operated on New York State public highways. The first, commonly referred to as the truck mileage tax, is imposed pursuant to Tax Law § 503. This tax is based on the mileage of the vehicle on New York public highways and the weight of the vehicle (20 NYCRR 481.1[a]). The other tax authorized by Article 21 is known as the fuel use tax and is imposed pursuant to Tax Law § 503-a. The FUT is based upon the amount of motor fuel and diesel motor fuel used in New York. The statute provides for a credit on fuel purchased in New York State but used outside the State (Tax Law § 503-a[3]). In addition to the taxes imposed by Tax Law §§ 503 and 503-a, Tax Law § 503-b imposes a supplemental tax based upon the tax computed pursuant to section 503 of the Tax Law.

B. Tax Law § 507 imposes the following record keeping requirements upon carriers subject to tax under Article 21:

> Every carrier subject to this article and every carrier to whom a permit was issued shall keep a complete and accurate daily record which shall show the miles traveled in this state by each vehicular unit and such other information as the tax commission may require. Such records shall be kept in this state unless the tax commission consents to their removal and *shall be preserved for a period of four years* and be open for inspection at any reasonable time upon the demand of the tax commission (emphasis supplied).

Additionally, regulations promulgated pursuant to Tax Law § 507 further delineate records required under this section (***see***, 20 NYCRR parts 483, 493). In particular, 20 NYCRR 483.4 states in pertinent part:

> Every carrier reporting either under the gross weight or unloaded weight method shall keep available odometer, hubometer and any similar readings, fuel consumption records, map mileage from the point of origin to the point of destination, or tariff schedules or record of mileage used for billing purposes and used to compute the actual taxable mileage which is taxable under article 21 of the Tax Law. The mileage shown in the daily mileage, manifest or trip records, or any other more accurate record for each vehicle, must be the actual mileage traveled and shall be totaled at the end of each month.

C. The court in ***Lionel Leasing Industries Co., Inc. v. State Tax Commn.*** (105 AD2d 581, 481 NYS2d 520, 523) provided the following guidance concerning the audit standards that must be met:

> Where the taxpayer's records [as required under Article 21] contain substantial discrepancies and there are inadequate or no records, it is impossible to determine petitioner's tax liability without resort to outside indices. The department is required to then select a method of audit reasonably calculated to reflect the taxes due. Petitioner must by clear and convincing evidence demonstrate that the method or the tax was erroneous (***Matter of Urban Liquors v. State Tax Comm.***, 90 AD2d 576, 577, 456 NYS2d 138). Where the taxpayer's recordkeeping is faulty, exactness is not required of the audit, nor is an item by item analysis necessary (***Matter of Korba v. New York State Tax Comm.,*** 84 AD2d 655, 656, 444 NYS2d 312, [***lv denied*** 56 NY2d 502, 450 NYS2d 1023]). The legislative intent in imposing the highway use tax was to equitably spread the cost of highway maintenance in proportion to the wear and damage caused by the weighted vehicle (***Matter of Consolidated Freightways Corp. Of Del. V. Tully***, 89 AD2d 270, 272, 456 NYS2d 457, ***affd*** 59 NY2d 897, 466 NYS2d 317).

D. Pursuant to the court's decision in ***Lionel Leasing***, the Division is required to determine a taxpayer's highway use tax liability based upon the taxpayer's records unless those records are inadequate. The court thus applied sales tax audit principles to audits conducted under Article 21, as evidenced by the sales tax cases***, Korba*** and ***Urban Liquors***, cited by the court in ***Lionel Leasing***. It is appropriate, therefore, to apply the principles governing sales tax audit procedures to the instant matter.

In ***Matter of Chartair v. State Tax Commn.*** (65 AD2d 44, 411 NYS2d 41), the court stated:

> Although there is statutory authority for the use of a 'test period' to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law § 1138, subd. [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit (citations omitted). However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack a rational basis (citation omitted). (***Id.***, 411 NYS2d at 43).

Because the statutory authority to determine a taxpayer's (sales tax) liability by estimate procedures rests upon a finding that the taxpayer's books and records are inadequate to conduct a complete audit, the Division is required to first request (***Matter of Christ Cella v. State Tax Commn.***, 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (***Matter of King Crab Rest. v. State Tax Commn.***, 134 AD2d 51, 522 NYS2d 978, 979-980) the taxpayer's books and records for the entire period of the proposed assessment (***Matter of Adamides v. Chu***, 134 AD2d 776, 521 NYS2d 826, 828, ***lv denied*** 71 NY2d 806, 530 NYS2d 109), in order to determine from verification drawn independently from within these records whether they are sufficient to support a complete audit (***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, 76, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025). If the Division's examination establishes that

the taxpayer's records are adequate and complete, the taxpayer is entitled to have its assessment calculated based upon a detailed audit of those records (***Matter of James G. Kennedy & Co. v. Chu,*** 125 AD2D 773, 509 NYS2d 199; ***Matter of Allied New York Services v. Tully***, 83 AD2d 727, 442 NYS2d 624; ***Matter of Names in the News v. State Tax Commn.,*** 75 AD2d 145, 429 NYS2d 755, 756; ***Matter of Chartair v. State Tax Commn., supra***). When the taxpayer's records are incomplete and unreliable for determining accurate sales, the Division may resort to a test period audit using external indices (***Matter of Skiadas v. State Tax Commn.,*** 95 AD2d 971, 464 NYS2d 304, 305; ***Matter of Urban Liqs. v. State Tax Commn***., 90 AD2d 576, 456 NYS2d 138, 139; ***Matter of Hanratty's/732 Amsterdam Tavern v. New York State Tax Commn.***, 88 AD2d 1028, 451 NYS2d 900, 902, ***appeal dismissed*** 57 NY2d 954, 457 NYS2d 1028; ***Matter of Korba v. New York State Tax Commn.***, ***supra***).

E. A petitioner challenging a validly issued notice of determination bears the burden of demonstrating error in either the audit method or audit results (***Matter of A & J Gifts Shop v. Chu,*** 145 AD2d 877, 536 NYS2d 209, ***lv denied*** 74 NY2d 603, 542 NYS2d 518). Where the petitioner carries this burden by showing the audit method adopted by the Division lacks a rational basis, the petitioner need not prove the exact amount of the overassessment ***(e.g., Matter of Adamides v. Chu, supra*** [where a portion of the assessment was canceled because the Division did not request records for that period of the audit]; ***Matter of King Crab Rest. v. State Tax Commn., supra*** [where the court canceled an entire assessment on the ground that the auditor had not made a sufficient investigation of the records to justify his conclusion that the records were inadequate to support a complete audit]; ***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249, 429 NYS2d 759 [where the court held that in the face of complete and adequate records the use of estimating procedures to calculate the assessment is arbitrary and capricious];

see also, Matter of Spallina, Tax Appeals Tribunal, February 27, 1992 [where the Tribunal stated that a taxpayer who demonstrates a fundamental error in the audit methodology has carried her burden of proof and need not prove the exact amount of the overassessment]). Under the rule first enunciated in ***Chartair***, a taxpayer may prove that an audit method was not "reasonably calculated to reflect the tax due" (***Matter of W.T. Grant v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869) by showing that records were made available from which the exact amount of tax could have been determined and the Division nonetheless resorted to an indirect audit method (***Matter of Chartair v. State Tax Commn., supra***, 411 NYS2d at 43).

F. In this case, the audit was commenced by the mailing of an appointment letter which set forth specifically the records which petitioner needed to produce for review by the Division. In addition, petitioner executed a Test Period Audit Method Election Form which specifically stated that petitioner agreed that the Division could conduct a test period method audit. Petitioner also agreed to the test period month used.

One of the critical items needed in an audit of this type is daily records of mileage traveled within the State. This information was not contained in the daily trip reports which the auditor reviewed in the vehicle mileage folders in enough detail for the Division to calculate the highway use tax which petitioner was obligated to pay. In fact, many of the trip reports were either not in the folders or incomplete, missing stop points, odometer readings and the routes taken by drivers. New York State Thruway or toll information and the amount of fuel purchased by the drivers was not provided. A large portion of trips completed by drivers with New York State miles were not posted to the highway use tax returns, amended returns were not filed to correct these omissions and incorrect tax rates were used to calculate the amount of tax due. In addition, petitioner failed to maintain ICC logs for the period prior to November 2001. Thus, the

Division decided to employ the available ICC logs to reconstruct the amount of miles driven by petitioner's drivers in New York State during the test period. The month of November 2001 was chosen, in part, because the auditor was of the opinion that more records would be available, in light of the fact that petitioner did not maintain ICC logs for periods prior to November 2001. There is no statute or regulation of New York State that requires the ICC logs be kept by a taxpayer. However, Tax Law § 507 states specifically that records which show miles traveled by a motor carrier on a daily basis must be maintained by such company for four years. A taxpayer operating as a motor carrier must be prepared to calculate actual miles traveled. Where a taxpayer fails to maintain or make available records required under Article 21, the Division is authorized to estimate the taxpayer's highway use tax liability (***see, Lionel Leasing Industries Co., Inc. v. State Tax Commn., supra,*** 481 NYS2d at 523). Here, the records for the test month of November 2001 were incomplete and the filed highway use tax return incorrect as to the amount of miles driven by petitioner's drivers. Petitioner lacked complete books and records for even the test period month from which the auditor could determine the correct amount of highway use tax due. The Division correctly determined that without the trip records or complete ICC logs or other record of the mileage details that form the basis of the tax in this case, the Division could not have computed the tax due. Given such information, it was impossible for the Division to conduct a detailed audit of the test period month.

G. The Division cannot simply ignore a taxpayer's records and use an indirect method of estimating tax due if the taxpayer's records are readily available and provide an adequate basis on which to determine the amount of tax due (***Matter of Christ Cella, Inc. v. State Tax Commn., supra***; ***Matter of Chartair, Inc. v. State Tax Commn., supra***). However, in this case, the Division was justified in resorting to a test period audit, as petitioner had signed a consent to a

test period audit method, and had agreed to the month of November 2001. Despite its authority to resort to a test period audit method to compute the tax, the Division has a duty which requires it to select an audit method reasonably calculated to reflect tax due. There is no presumption of correctness that attaches to the audit unless there is an initial showing that the methodology selected was reasonably calculated to reflect the tax due (***Matter of Fashana,*** Tax Appeals Tribunal, September 21, 1989). "[C]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist" in each case; however, certain limitations have been placed on this principle (***Matter of Basileo,*** Tax Appeals Tribunal, May 9, 1991, ***quoting Matter of Grecian Sq. v. New York State Tax Commn***., 119 AD2d 948, 501 NYS2d 219, 221). Although exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn***., 54 AD2d 1023, 388 NYS2d 176, 177, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990; ***see, Matter of Pizza Works***, Tax Appeals Tribunal, March 21, 1991), the record nonetheless must contain sufficient evidence to allow the trier of fact to determine whether the audit had a rational basis (***Matter of Basileo, supra, citing, Matter of Grecian Sq. v. New York State Tax Commn., supra; see, Matter of Fokos Lounge***, Tax Appeals Tribunal, March 7, 1991; ***Matter of Fortunato***, Tax Appeals Tribunal, February 22, 1990). Once this threshold determination is made, the burden then rests upon petitioner to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (***Matter of Meskouris Bros. v. Chu,*** 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451, 452).

H. The Division chose a recent quarter within the audit period which appeared to be representative of petitioner's activities and appeared to have sufficient records, including some

of its ICC logs, so that the audit results would have as its basis petitioner's own records. Tax quarters further in the past did not have the same available information. Petitioner argues that the Division's methodology is unreliable and invalid because it was improperly based upon a sample of a test period rather than an audit of all the records of the test period. Petitioner also argues that a sample of a test period based on a non-statistical simple random selection process is invalid. The primary difference between a test period audit and a statistical sampling audit is that the test period audit generally involves the testing of all records within a portion of an abbreviated audit period, while the statistical method samples randomly-selected items from the entire audit period (***see, Matter of Marine Midland***, Tax Appeals Tribunal, May 13, 1993). Since there were critical records missing from the mileage folders of the test period itself pertaining to mileage calculations, such as trip reports, ICC logs, New York State Thruway miles and fuel purchases, a detailed audit of even the test period was not possible. Thus, it is concluded that the test period chosen, and the sample of the mileage folders within the test period, was the best available choice to project the tax liability over the audit period, absent proof by petitioner that it was not representative of a typical period.

I. Within the test period a random number of vehicles was chosen to be reviewed in detail. Petitioner maintains that the number of vehicles tested was too small, that the leases in the test sample are on average more recent than the leases for vehicles in the test month and therefore the drivers of the tested vehicles were more inexperienced than the drivers of the nontested vehicles thus leading to more mileage reporting errors in the vehicles tested, making the results of the audit invalid. However, petitioner failed to establish that a new lease meant an inexperienced driver, or that an inexperienced driver meant more mileage reporting errors. Where record keeping is inadequate, exactness is not required in the audit result. Petitioner has the difficult

burden of proving error in the assessment (***see, Lionel Leasing Industries v. State Tax Commission, supra***) and must advance more than mere criticism or conjecture relating to the Division's audit methodology to prevail on this point.

Finally, the analysis submitted by petitioner in support of its position that the error rate should be reduced contains incomplete or incorrect information and is therefore insufficient to establish that the method employed by the Division to compute the additional tax due was unreasonable or that the amount assessed was erroneous. As with the vehicle mileage folders, the analysis contains unaccounted for miles or gaps in the trip records where no mileage is reported. For instance, one vehicle (#8946) has 43,520 miles unaccounted for between November 2, 2001 through November 16, 2001. Several other vehicles have large portions of the month where no trip reports exist. One vehicle (#9079) has an entry for a trip to Springfield, Massachusetts on November 6, 2001, but no return trip. In addition, the analysis does not consider New York miles driven by vehicles for which no New York miles were reported by petitioner. The auditor reviewed the folders of five vehicles for which petitioner reported no New York miles but which the ICC logs indicated New York miles were driven in the test month. These New York miles were properly factored into the error rate computed by the auditor but were erroneously omitted in the analysis submitted by petitioner.

J. As previously noted, the statutory authority for the use of external indices must be based upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit (***Matter of Chartair, Inc. v. State Tax Commn.***, ***supra***). In order to determine whether a taxpayer's records are adequate for audit purposes, the Division must first request and then examine the taxpayer's records for the entire

audit period (***Matter of Christ Cella v. State Tax Commn***., ***supra***; ***Matter of Adamides v. Chu***, ***supra***; ***Matter of Ahme*** , Tax Appeals Tribunal, November 10, 1988).

There is nothing in the record which establishes that the Division made a request for the books and records of Evans Delivery Company, Inc. for the period February 1, 2002 through March 31, 2002 before issuing assessments against petitioner. The appointment letter originally sent to the corporation by the auditor listed the period at issue as February 1, 1998 through January 31, 2002. The Test Period Audit Method Election Form for Highway Use Tax indicates the same period. Accordingly, it must be found that the Division's failure to request books and records for the final two months of the audit precluded it from resorting to a test period audit to determine the tax due, and the highway use tax assessed for the months of February and March 2002 is canceled (***Matter of Adamides v. Chu***, ***supra***).

K. The petition of Evans Delivery Company, Inc. is granted to the extent indicated in Conclusion of Law "J"; but in all other respects the petition is denied. The Notice of Determination dated December 26, 2003, as modified, is sustained.

DATED: Troy, New York
December 19, 2006

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE