STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. MATHEWS AND MATHEWS, INC. P. O. Box 578 Jasper, AL 35501, Taxpayer.	§ § § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. MISC. 91-164

RECOMMENDED ORDER

The Revenue Department denied three petitions for refund of gasoline or motor fuel tax filed by Mathews and Mathews, Inc. (Taxpayer) for all or a part of the period September, 1986 through November, 1989. The three petitions involve (1) the 4¢ per gallon gasoline tax levied at §40-17-220, (2) the 8¢ per gallon motor fuels tax levied at §40-17-2, and (3) a combined petition involving both the 8¢ and the 4¢ per gallon motor fuel taxes levied at §§40-17-2 and 40-17-220, respectively.

The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on October 21, 1991. Roy Crawford appeared for the Taxpayer. Assistant counsel Beth Acker represented the Department. This Recommended Order is based on the evidence and arguments presented by the parties.

FINDINGS OF FACT

The Taxpayer is a motor fuels distributor based in Walker County, Alabama. The Department audited the Taxpayer and assessed additional motor fuel and gasoline tax against the Taxpayer for the period in issue. The Taxpayer paid the taxes to avoid additional

penalty and interest and then filed the petitions for refund in issue. The Department denied the refunds and the Taxpayer appealed to the Administrative Law Division. The relevant facts concerning each petition are set out below:

Petition (1) - The 4¢ per gallon gasoline tax levied at §40-17-220.

The Taxpayer contracted to sell gasoline to Walker County for use in County vehicles during the audit period. The Taxpayer was required by the contract to maintain at least two retail outlets in each of the four road districts in the County.

The issue in this case is whether the Taxpayer sold the gasoline directly to Walker County, in which case the sales were exempt from the 4¢ per gallon gasoline tax under §40-17-220(d)(4), or §40-17-220(d)(4), or whether the sales were to the independent station operators, in which case the county exemption would not apply. The 7¢ per gallon gasoline tax levied at §40-17-31 is not in issue because sales to counties (or cities) are not exempt from that tax.

The Taxpayer sold gasoline through three types of service stations during the audit period: (1) stations owned (or leased) and operated by the Taxpayer, (2) stations owned (or leased) by the Taxpayer and operated by an independent operator, but at which the Taxpayer retained ownership of the gasoline inventoried at the station and, (3) stations owned (or leased) by the Taxpayer and

operated by an independent operator, but at which the Taxpayer sold gasoline to the operator on consignment, except that gasoline delivered by the operator into Walker County vehicles.

The Department concedes that the sales at the category (1) stations were by the Taxpayer directly to the County and therefore exempt. Those sales are not included in this petition.

Concerning the category (2) stations, the Taxpayer retained title to the gasoline inventoried at the stations and also owned the tanks and pumps at the stations. The Taxpayer determined the price and amount of gasoline inventoried at each station.

All gasoline except the gasoline sold to Walker County was handled as follows: The independent operator sold the fuel, collected from the customer, and remitted the entire proceeds to the Taxpayer. The Taxpayer then paid 50% of the gross profit back to the operator as a pumpage fee.

Sales to Walker County at the category (2) stations were handled as follows: The County employee that bought the gasoline signed a receipt showing the amount purchased. The operator gave the receipts to the Taxpayer and the Taxpayer in turn billed the County. The County paid the Taxpayer and the Taxpayer then paid the operator an agreed upon 5¢ per gallon pumpage fee. Ninety percent of the gasoline involved in this petition for refund was sold through category (2) stations.

Only one station falls into category (3). In that case, the Taxpayer sold most of the gasoline to the independent operator on consignment. However, the operator also delivered gasoline into Walker County vehicles at the price set by the Taxpayer and for the same 5¢ per gallon pumpage fee received by the category (2) stations. The sales to Walker County at the category (3) station were handled the same as at the category (2) stations - the County employees signed a receipt for the gasoline, the operator gave the receipts to the Taxpayer, the Taxpayer billed the County, the County paid the Taxpayer, and in turn the Taxpayer paid a pumpage fee to the operator. The Taxpayer periodically replaced without charge the gasoline that was delivered into the Walker County vehicles.

The Department claims that the Taxpayer sold the gasoline to the independent operators at the category (2) and (3) stations. The Taxpayer argues that the sales were directly to the County, with the operators acting as agents, and therefore exempt.

Petition (2) - The 8¢ per gallon motor fuels tax levied at §40-17-2.

The issue here is whether diesel fuel sold by the Taxpayer to Walker County was for off-road use and therefore not subject to the 8¢ per gallon tax levied at §40-17-2. The additional 4¢ per gallon motor fuel tax levied at §40-17-220 is not in issue because all

sales (both on and of f road) to a county are exempt from that tax, see §40-17-220(d)(4).

The Taxpayer sold diesel fuel to Walker County during the audit period and delivered the fuel to a County bulk storage facility in each of the four County road districts. The County then pumped the fuel either directly into its vehicles or into portable tanks for delivery to vehicles throughout the County. The County failed to separately meter the fuel or keep records distinguishing on-road and off-road usage.

The County paid tax during the audit period on 20% of the fuel used in three of the four road districts and on 45% of the fuel used in the fourth district. The remaining fuel was purchased tax-free. The 20%/45% formula was based on a 1987 study conducted by the County indicating that approximately 80-90% of the fuel in three of the road districts and 55% of the fuel in the other district was used in off-road equipment. Thereafter, to avoid having to keep specific records of how the fuel was used, the County, allegedly with the approval of an unnamed Department employee, began paying tax using the 20%/45% formula.

The Department concedes that the County used part of the fuel off-road but claims that the Taxpayer is liable on all the fuel sold to the County because the County failed to either separately meter or keep records showing on-road versus off -road usage.

Petition (3) - The 8¢ and 4¢ per gallon motor fuel taxes levied at §§40-17-2 and 40-17-220, respectively.

The Taxpayer sold diesel fuel to various building contractors, strip miners, loggers, etc. during the audit period, but did not charge tax on the sales because the Taxpayer knew or had reason to believe that the fuel was to be used off-road.

The Department claims that the Taxpayer is liable for the same reason as in petition (2) above. That is, the purchasers failed to keep adequate records showing that the fuel was used off-road. The Taxpayer has proffered evidence showing that the fuel was used for off-road purposes.

CONCLUSIONS OF LAW

Petition (1) - Section 40-17-220(d)(4) exempts sales to counties and cities from the 4¢ gasoline tax. This petition turns on whether the Taxpayer sold the gasoline in issue directly to the County, in which case the §40-17-220(d)(4) exemption would apply. Otherwise the tax is due.

A sale occurs when and where the seller transfers title, i.e. delivers the goods to the purchaser. See §§7-2-106(l), 7-2-401(2), and also 40-23-1(a)(5). In this case the Taxpayer retained title to the gasoline until the gasoline was delivered into the County vehicles by the station operators acting as agents f or the

Taxpayer. The sales were thus by the Taxpayer directly to the County and therefore exempt pursuant to §40-17-220(d)(4).

The same is true for the County sales at the category (3) station. While the majority of the gasoline was sold to the independent operator on consignment, the gasoline sold to Walker County was handled separately and in the same manner as at the category (2) stations. The Taxpayer retained title to the gasoline and the operator pumped the gasoline into the County vehicles for a set 5¢ per gallon pumpage fee. The Taxpayer replaced the gasoline sold to the County at no charge to the operator. Again the Taxpayer sold the gasoline directly to the County with the operator acting as agent.

Petition (2) - Section 40-17-2 levies a tax "upon the selling, using or consuming, distributing, storing or withdrawing from storage" of motor fuel used for on-road purposes. Motor fuel sold or used for off-road purposes is not taxable. If the tax has been paid once on the fuel, then the subsequent distribution, withdrawal, use, etc. of the same fuel
is not taxable, "the intent being that the tax shall be paid but once", see §40-17-2.

Section 40-17-3 provides that (1) distributors shall pay the tax based on sales, (2) storers shall pay based on withdrawals, and (3) users shall pay on the amount used or consumed. Again, §40-17-

3 emphasizes that the tax shall apply only if the fuel is used for on-road purposes.

In many cases a distributor may not know how the fuel is to be used when it is sold. Accordingly, §40-17-11 provides that a distributor is not liable for tax except (1) where the distributor pumps the fuel directly into an on-road vehicle, (2) where the distributor sells to a retail dealer that sells to on-road vehicles, and (3) where the distributor knows or has good reason to know that the fuel is to be used for on-road purposes. Even if (1), (2) or (3) above applies, the distributor can sell tax-free if the purchaser is licensed with the Department pursuant with §40-17-14. That last provision allowing tax-free sales to licensed purchasers should not be construed to mean that all sales to unlicensed purchasers are taxable. That is not the case. Rather, a sale by a distributor to an unlicensed purchaser is taxable only if (1) , (2) or (3) above applies.

Under §40-17-11(3), a distributor is liable only if the distributor knows or has reason to believe that the fuel is to be used for on-road purposes. If the distributor objectively determines after investigation that the fuel is to be used off-road, then the sale by the distributor is not taxable.[1] Liability for the tax then shifts to the purchaser/user.

[1]Department Reg. 810-8-1-.37 recognizes that a distributor having good reason to know that the fuel is to be used off-road is not liable for the tax. That Reg. lists reasonable guidelines by

A user (either licensed or unlicensed) is liable for the motor fuel tax on all previously untaxed fuel that is used or consumed for on-road purposes. See §40-17-3. Section 40-17-11 provides that any user that purchases fuel from a distributor for on-road use without advising the distributor of his intent is not only liable for the tax but is also subject to a 100% penalty and is guilty of a misdemeanor. A dual user (someone that uses fuel in both on-road and off-road vehicles) is also required to obtain a license from the Department pursuant to §40-17-14.

---

which a distributor can determine if the fuel is to be used off-road, i.e., talking to user's employees, common usage, of fuel in industry, etc.

The Department correctly recognizes that when a distributor sells to an unlicensed dual user the fuel sold for off-road use can be sold tax-free. See Department's brief at page 10.[2]

However, the Department also argues that the distributor bears the risk of selling tax free to an unlicensed user. The Department contends that the dual user must keep specific records distinguishing the fuel used for off-road and on-road purposes, and that the distributor is liable if the user fails to keep adequate records.

[2]Department Reg. 810-8-1-.41(2) incorrectly states that sales by a distributor to an unlicensed dual user are taxable whether the fuel is used on-road or off-road.

The Department's position is incorrect. A distributor cannot be held liable because a subsequent user fails to keep adequate records. Rather, a distributor is liable under §40-17-11(3) only if he knows or has good reason to know at the time of sale that the fuel is being purchased for on-road use. As previously stated, if the distributor has reasonable information that the fuel will be used off-road, the sale is tax free and the responsibility for the tax thereafter shifts to the user.[3] A user can be required to keep adequate records of off-road versus on-road usage, see Reg. 810-8-1-.58(2), but if the user fails to keep adequate records, the user and not the distributor is responsible for the tax.

In this case the Taxpayer sold the diesel fuel to Walker County with good reason to believe that only 20% of the fuel used

[3]A distributor is required to keep adequate records from which the Department can verify that untaxed fuel was sold for off-road use, or at least that the distributor had good reason to believe that the fuel was to be used off-road. Reg. 810-8-1-.56.

in three road districts and 45% of the fuel used in the fourth road district was to be used on-road. The Taxpayer was thus liable for and properly paid the tax on those sales. The Taxpayer had good reason to believe that the balance of the fuel was to be used in off-road equipment and therefore cannot be held liable on those sales.

However, Department Reg. 810-8-1-.58 requiring the user to keep adequate records showing on-road and off-road usage is reasonable. A dual user cannot be allowed to purchase fuel tax free and then fail to keep records showing how much fuel was used for nontaxable purposes. Estimates and unverified assertions by the user are not sufficient. Consequently, the County in this case, as a dual user, is liable for tax on all previously untaxed fuel for which no records were kept from which the Department can verify off-road use.

The fact that the County was not properly licensed as a dual user under §40-17-14 does not relieve the County from liability. Any user, whether licensed or unlicensed, is liable for tax on any previously untaxed fuel used on-road, or for which inadequate records are kept.

Petition (3) - Section 40-17-11 also applies to the additional 4¢ motor fuel tax levied at §40-17-220, see § 40-17-221(b). Consequently, the principles applicable to petition (2) above are also applicable here. That is, the Taxpayer is not liable for

either the 8¢ or the 4¢ motor fuel tax unless it knew or had good reason to know that the fuel sold to the contractors, strip miners, etc. was being purchased for on-road use.

Whether the Taxpayer knew or had good reason to know that the fuel was to be used off-road is a question of fact that must be decided on a case-by-case basis. The Taxpayer has offered to present additional evidence at a subsequent hearing. However, to possibly avoid another hearing, the Taxpayer is directed to present affidavits and/or any other evidence on point to the Department. The Department should review the evidence and thereafter notify the Administrative Law Division as to whether the evidence is acceptable. A second hearing will be scheduled only if the Department does not accept the evidence as sufficient.

The above considered, the tax involved in petitions (1) and (2) should be refunded by the Department. However, this Recommended Order along with the administrative record will not be formally submitted to the Commissioner for entry of a Final Order until the Taxpayer's liability for the tax involved in petition (3) is finally resolved.

Entered on March 11, 1992.

_____

BILL THOMPSON
Chief Administrative Law Judge