UPS FUEL SERVICES, INC. AND MORGAN STANLEY CAPITAL GROUP, INC.	§	STATE OF ALABAMA ALABAMA TAX TRIBUNAL
Petitioners,	§	DOCKET NO. MISC. 15-578
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Alabama Department of Revenue denied a joint petition for refund of motor fuel excise tax requested by UPS Fuel Services, Inc. and Morgan Stanley Capital Group, Inc. (together "Petitioners") for September, October, and November 2011. The Petitioners appealed to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on November 2, 2015. Sim Penton, Joe Carlisle, Jim Kelly, and Madison Barnett represented the Petitioners. Assistant Counsel Bo Stone and Ralph Clements represented the Department.

FACTS

UPS Fuel Services (individually "Petitioner") is a wholly owned subsidiary of United Parcel Service, Inc. ("UPS"), and is headquartered in Atlanta, Georgia. It purchases fuel for use by UPS's fleet of domestic ground vehicles. The Petitioner purchases some of the fuel from suppliers that transport the fuel through the Colonial Pipeline system that runs from Texas, through Alabama, to the Northeastern United States.

Fuel is injected into the Colonial Pipeline in Alabama at a single site in Moundville, Alabama. Fuel can be removed from the Pipeline in Alabama only at a terminal in Birmingham, Alabama. Fuel injected into the system in Moundville cannot be removed in Birmingham. Rather, it is transported out of Alabama and removed at terminals in Georgia

and beyond.

The Department issued the Petitioner an Alabama gasoline tax license in 2004. That license allowed the Petitioner to purchase diesel fuel tax-free from other licensed distributors in Alabama. See generally, *Motiva Enterprises, LLC v. State of Alabama*, Docket Misc. 08-410 (Admin. Law Div. 2/19/2009). As a prerequisite to obtaining the license, the Petitioner was required by Code of Ala. 1975, §40-12-194 to file a bond with the Department.[1] The Petitioner's original bond was in the amount of $40,000.

The Petitioner failed to report certain motor fuel it purchased from Morgan Stanley Capital Group, Inc. (individually "Morgan Stanley") in Alabama on its October and November 2010 Alabama motor fuel returns. The Department sent the Petitioner "Notice of Discrepancy" letters concerning the October and November returns on January 27 and January 28, 2011, respectively. The Petitioner failed to address the discrepancies, and the Department sent the Petitioner billing letters for October and November 2011 on March 23 and April 19, 2011, respectively.

The Department entered a preliminary assessment against the Petitioner for October 2010 on June 8, 2011, and a final assessment for that month on August 8, 2011. It notified the Petitioner by letter dated August 9, 2011 that if the Petitioner failed to pay the October 2010 final assessment by September 8, 2011, its gasoline tax license would be revoked, effective that date.

The Department also entered a preliminary assessment against the Petitioner for November 2010 on July 8, 2011, and a final assessment for that month on September 8, 2011. It notified the Petitioner by letter dated September 9, 2011 that if the Petitioner failed

to pay the November 2010 final assessment by October 9, 2011, its gasoline tax license would be revoked, effective that date.

By letter dated August 10, 2011, the Department notified the Petitioner that it was increasing the amount of the Petitioner's required bond from $40,000 to $86,000. The letter, Exhibit 10, reads in pertinent part:

> A review of your file has revealed that your average monthly fuel tax liability of $86,000.00 exceeds your current bond amount of $40,000.00. Therefore, in accordance with §40-12-194, Code of Alabama 1975, the Department requires an increase in your bond from $40,000.00 to $86,000.00.
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> * * *
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> The bond rider, new bond, or collateral bond must be submitted to our office by September 9, 2011. Failure to comply with this requirement will result in the revocation of your Alabama Gasoline License number G0002128 effective September 9, 2011.

The Petitioner failed to submit the new bond by the September 9, 2011 deadline. The Department consequently notified the Petitioner by letter dated September 13, 2011 that it was canceling the Petitioner's gasoline license, effective September 9, 2011. The cancelation letter, Exhibit 12, reads in pertinent part:

> On August 10, 2011 you were notified that it would be necessary for you to post a new or replacement bond, with the Department of Revenue increasing your current bond amount from $40,000 to $86,000. The deadline for this requirement was September 9, 2011.
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> Since you have failed to meet this bond requirement, we are revoking your Gasoline License G0002128 effective September 9, 2011.

The Department also notified the Petitioner's suppliers, including Morgan Stanley, by letters dated September 13, 2011 that the Petitioner's gasoline license had been revoked, and that the suppliers should collect the appropriate tax on any future fuel sales

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[1] Section 40-12-194 was repealed, effective October 1, 2012.

to the Petitioner.

In September, October, and November 2011, while the Petitioner's license was revoked, the Petitioner purchased four separate batches of diesel fuel from Morgan Stanley out of the Colonial Pipeline in Alabama. The fuel had been injected into the system at the Moundville facility, and title passed to the Petitioner at the time of purchase. The Petitioner did not, however, take possession of and use the fuel until it was transported outside of Alabama. As directed by the Department, Morgan Stanley collected Alabama fuel tax from the Petitioner on those sales and remitted it to the Department.

The Petitioner submitted a new bond for $86,000 to the Department on October 8, 2011. It also paid the October and November 2011 final assessments in full on November 17, 2011. It applied to the Department on November 23, 2011 to have its gasoline tax license reinstated. The Department subsequently reinstated the Petitioner's gasoline license, effective December 8, 2011. The Petitioner thereafter petitioned for a refund of the fuel tax it had paid to satisfy the October and November 2011 final assessments. The Department granted the petition and refunded that tax to the Petitioner.[2]

The Petitioner and Morgan Stanley filed the joint petition for refund in issue with the Department in October 2014 concerning the fuel tax the Petitioner had remitted to Morgan Stanley on the four batches of fuel the Petitioner had purchased from Morgan Stanley in September, October, and November 2011. The Department denied the refund by letter dated November 14, 2014. The Petitioner timely appealed to the Tax Tribunal.

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[2] Fuel tax was not due on the October and November 2010 fuel sales by Morgan Stanley to the Petitioner because the sales were from a licensed distributor in Alabama to another licensed distributor in Alabama. See again, *Motiva Enterprises, LLC*, supra.

Additional facts are set out in the below Analysis.

ARGUMENTS/ISSUES

The Petitioner raised the following arguments/issues in its Post-Hearing Brief:

(1) The Department failed to comply with Code of Ala. 1975, §40-12-194(b) when it increased the Petitioner's surety bond in August 2011;

(2) The Department failed to notify the Petitioner of its right to appeal the revocation of its gasoline license;

(3) The fuel in issue was not subject to the motor fuel tax because it was received by pipeline transfer;

(4) The imposition of the tax on the fuel in issue violated the Commerce Clause, U.S. Const., Art. 1, § 8, cl. 3, of the U.S. Constitution; and,

(5) The tax constituted a penalty that should be waived for reasonable cause pursuant to Code of Ala. 1975, §40-2A-11(h).

ANALYSIS

Concerning the Petitioner's first argument/issue, §40-12-194(a) required that to be issued a motor fuel distributor's license, the licensee must file a bond with the Commissioner of Revenue of not less than $1,000 or more than $25,000, "except as provided herein." Section 40-12-194(b) contained the exceptions to the $25,000 maximum bond limit, and read as follows:

> The commissioner may require a new or additional surety bond from a distributor if: (1) the commissioner determines that the surety on an existing bond is unsatisfactory; (2) a surety notifies the department that it intends to cancel a bond as provided in subsection (d); or (3) the commissioner, after reviewing the financial condition of the distributor, determines that the existing bond of the distributor is insufficient in amount to insure the prompt

> payment of all excise taxes that are due or may become due the state by the distributor upon the sale or withdrawal of gasoline. However, in no case shall a new or additional bond be more than the average monthly excise tax owed by the distributor.

The Department concedes that it did not determine that the surety on the Petitioner's existing bond was unsatisfactory, and that the surety did not notify the Department that it intended to cancel the Petitioner's bond. The issue thus turns on the third exception; that is, did the Department, "after reviewing the financial condition of the distributor," determine that the Petitioner's existing $40,000 bond was insufficient.

The evidence shows that in early August 2011, on or about the date that the Department entered the October 2010 final assessment against the Petitioner on August 8, 2011, the manager of the Department's Motor Fuels Section determined that the Petitioner's $40,000 bond was insufficient because the Petitioner's average monthly liability for the prior six months was approximately $86,000. That determination resulted in the August 10, 2011 letter discussed above in which the manager notified the Petitioner that the Department was increasing its bond amount. The above events are discussed in a March 18, 2014 email from a revenue examiner in the Motor Fuels Section to the current manager of that Section. The email, Exhibit 70, reads in part – "The October 2010 period made it to Final Assessment. At that point, (the Motor Fuels Section manager) reevaluated their activity and realized they were under bonded. Therefore, on August 10, 2011, (the manager) sent UPS Fuel Services a letter informing them that their average monthly fuel liability of $86,000 exceeded their current bond amount of $40,000. They were instructed to have their surety company forward us a bond rider increasing the bond amount to $86,000."

The Department argues that it was authorized to increase the Petitioner's bond pursuant to §40-12-194(b) because it knew that the Petitioner had failed to pay the October and November 2010 final assessments. The Department's Reply Brief reads in part, as follows:

> As stated in the Department's Post-Hearing Brief, the statement that "[t]he Commissioner did not review UPSFS's financial condition before ADOR required UPSFS to increase its Bond" is incorrect. It is true that the Department did not conduct a thorough, comprehensive review of UPSFS's financial condition, as would occur during an audit or a bankruptcy procedure. That type of review, however, is not required. The Taxpayers again ignore the one key fact, and the one data point which the Department did possess about UPSFS's financial condition, which was that it had failed or refused to pay several hundred thousand dollars' worth of motor fuel taxes, and was not responsive to the Department's correspondence concerning the same. In order to protect the state's revenues and efficiently administer the state's motor fuel excise tax regime, the Department must be permitted to alter bonding requirements to fit the circumstances according to the information that the Department has and can reasonably acquire, without requiring the Department to engage in a months or even years' long "review" process before making that determination. Otherwise, the ability of the Department to require reasonable bonds under § 40-12-194 would be, for practical purposes, a dead letter. The most important facet of the Taxpayer's financial condition, the one most pertinent to the Department's purpose, was UPSFS's willingness and ability to pay its motor fuel excise tax obligations. And, through its actions and failures to act, UPSFS proved itself either unwilling or unable to pay the taxes owed, precisely the situation the bonding requirement was intended to alleviate so as to protect the state's interests.

Department's Reply Brief at 3, 4.

I disagree with the Department's position for several reasons.

First, when the Alabama Legislature enacted the third exception to the maximum bond limit in §40-12-194(b), it clearly intended that the Department could increase a distributor's bond above the $25,000 maximum only after reviewing the financial condition of the distributor. The Department clearly failed to do so in this case, and even concedes that it "had no information about the financial condition of" the Petitioner. Department's

Brief at 3, 4. Without such information, the Department obviously could not have reviewed the Petitioner's financial condition, as plainly required by the statute.

The fact that the Petitioner did not pay the October and November 2010 final assessments within 30 days also could not and did not inform the Department of the Petitioner's financial condition. A solvent distributor may not timely pay a tax assessed by the Revenue Department for a variety of reasons, especially if the tax was erroneously assessed, as was the tax included in the October and November 2010 final assessments. In any case, §40-12-194(b) did not authorize the Department to increase a distributor's bond if the distributor failed to pay a final assessment. Rather, it authorized an increased bond only if the Department reviewed the distributor's financial condition and determined that because the distributor was not in satisfactory financial condition, the distributor's existing bond was insufficient and should be increased. Again, the Department failed to do so in this case.

I agree that "[t]he Department is not required to undertake a detailed or comprehensive audit of the distributor's financial condition." It is, however, under an affirmative statutory duty to at least review the distributor's financial condition. This could as a practical matter be done by the Department reviewing the distributor's most recent income tax returns filed with the Department, and/or obtaining and reviewing the distributor's most recent balance sheets, profit and loss statements, and other financial records.[3] Such a review could be promptly done in a short period, and thus allow the

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[3] Many distributors are publicly traded companies whose financial information is public and can be obtained over the internet. The Department is also authorized to examine a distributor's records, and may subpoena such records if necessary, see, Code of Ala. 1975, §§40-2A-7(a)(2) and (4), respectively.

Department to conduct the review, and, if necessary, request an increased bond, in an expedited manner.

The Department also did not revoke the Petitioner's license either because it determined that the Petitioner's financial condition was unsatisfactory or because the Petitioner did not promptly pay the October and November 2010 final assessments. Rather, as discussed, the Department's Motor Fuels Section manager requested the increased bond only because the Petitioner's average monthly motor fuel liability of approximately $86,000 exceeded the Petitioner's existing $40,000 bond.

I do not doubt that the manager acted in good faith and in what he thought was the Department's best interest when he directed the Petitioner to file the increased bond. He did so, however, without following the statutory mandate that the Department must first review the financial condition of the Petitioner. "Men must turn square corners when they deal with the government; it is hard to see why the government should not be held to a like standard of rectangular rectitude when dealing with its citizens." *Title Ins. Co. of Minn. v. SBE*, 4 Cal. 4th 715, 732 (Calif. Supreme Court, 1992).

Because the Department failed to follow the §40-12-194(b) procedures for increasing the Petitioner's motor fuel distributor's bond, it follows that the Department's demand for the Petitioner to submit an increased bond was invalid. It further follows that the Department's revocation of the Petitioner's license for not timely filing the increased bond was also improper as "fruit of the poisonous tree."[4] That is, but for the Department's

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[4] The fruit of the poisonous tree doctrine was developed in criminal cases involving the wrongful search and seizure of evidence. If evidence is wrongly or unconstitutionally obtained in a search and seizure, that evidence is the poisonous tree, and any additional evidence obtained as a result of the poisonous tree evidence is the fruit of the poisonous

improper request for the Petitioner to provide an increased bond, the Petitioner's license would not have been revoked, and the Petitioner could have purchased the four batches of diesel fuel in issue from Morgan Stanley tax-free at wholesale.

The Department cited Code of Ala. 1975, §40-12-195 in its August 9, 2011 letter notifying the Petitioner that its distributor's license would be revoked if it did not timely pay the October 2010 final assessment. That statute provided during the period in issue that the Department may revoke a distributor's license if "the the distributor shall fail . . . to pay within the time required by law all excise taxes . . . required to be paid by such distributor."[5]

To begin, §40-12-195 did not require the Department to revoke a distributor's license for failure to pay a tax due. By use of the word "may," the Legislature gave the Department discretion to revoke a license, depending on the circumstances. In any case, the Department could not have revoked the Petitioner's license in this case pursuant to §40-12-195 because the Petitioner did not fail to pay taxes that were "required to be paid. . . ." While the Department assessed the Petitioner for additional tax due for October and November 2010, and the Petitioner paid the amounts assessed as a prerequisite to having

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tree. All such evidence is inadmissible, and if used to convict, the conviction is due to be reversed. See generally, *Wong Sun v. U.S.*, 83 S. Ct. 407 (1963); *Floyd v. State*, 387 So.2d 291 (Ct. Crim. App. 1980).

The doctrine applies in principle in this case because the Department's improper request for the Petitioner to file an increased bond directly resulted in the Department's revocation of the Petitioner's license, which in turn directly resulted in the Petitioner having to pay tax on its fuel purchases from Morgan Stanley that but for the Department's improper actions would have been tax-free.

[5] Section 40-12-195 was repealed, effective October 1, 2012.

its license reinstated, the tax was not "required to be paid" because the underlying fuel sales were non-taxable licensed distributor to licensed distributor sales. This is confirmed by the fact that the Department later refunded the October and November 2010 final assessment amounts erroneously paid by the Petitioner. The §40-12-195 revocation provision was thus inapplicable in this case.

The remaining arguments/issues are pretermitted by the above holding. The joint petition for refund in issue is granted. The Department is directed to issue the refund of $818,677.56, plus applicable statutory interest, in due course. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-2(m).

Entered May 24, 2016.

Bill Thompson

BILL THOMPSON
Chief Tax Tribunal Judge

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