MSSP

Market Segment Specialization Program

Gas Retailers

Department of the Treasury
Internal Revenue Service

Training 3149-114 (Rev. 07-
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Chapter 1

SETTING UP A GAS STATION PROJECT

INTRODUCTION

The gasoline service station has historically been the type of business where most of the income and many of the expenses are paid in cash. As such, the normal audit trail is easily thwarted and much more difficult to follow than other businesses with tighter internal controls. Often, no records are maintained or they are kept sporadically and in a disorganized manner. To counteract those circumstances, we have developed some alternative approaches to computing income for a service station under audit. We had a head start in the Los Angeles District by working through the Fed-State Joint Information Committee, a policy that is being adopted in any district with states that have sales taxes.

UNDERREPORTING OF INCOME

The Los Angeles District received over 170 reports from the California State Board of Equalization showing that service stations underreport their income by very large amounts. Because of potential fraud cases and tax deficiencies, we have developed procedures to audit those businesses. Here are some of the basic steps you might take to develop a gas station project and work the related cases in your district.

BASIC STEPS TO DEVELOPING A GAS STATION PROJECT

1. Select a manager to coordinate the project.

   a. Canvas Field and Office Exam groups for gas Station cases currently in-process.

   b. Check with PSP for any unassigned cases.

   c. Go to the Service Center and pull returns with a PIA/PBA business code of Form 3558 for Sch. C's and Form 5541 for corporations; returns with high potential for adjustment (returns that show less than $25,000 net income).

2. Gross Income Survey (s)

Go through your regional office to contact Lundberg Survey, Inc. in North Hollywood, CA Bob Sharp, Vice President; (818) 768-5111. The Lundberg Survey is a bimonthly index of retail gasoline prices, listed by type of oil and type of gas, and location of the particular gas stations.

a. Request a copy of the portion of the Lundberg Survey that covers the area in which your district lies. (Use Form 1334.) Requisition the hard copies and the computer tape.

b. Have a CAS use the Los Angeles prepared spreadsheet to tailor spreadsheets for your region or district using the specific and local Lundberg Survey information received.

c. Spreadsheet should include the following items:

   1) gas company name
   2) type of gas sold (regular, unleaded, premium)
   3) full or self service
   4) average price of gas per Lundberg Survey.

d. Other surveys available and reliable are:

   1) Department of Energy
   2) Bureau of Labor Statistics (Court case in Dallas allowed the IRS to use this method for calculation of gross income.)
   3) American Automobile Association.

   A realistic approach to using any other survey must include not only its viability as a gross sales analysis but also its defensibility in court.

3. District Counsel and Appeals

Work with District Counsel and Appeals to determine the level of support Exam can expect as to using **any survey** to established gross receipts.

4. Excise Tax Specialists

Contact your excise tax specialists to determine related issues and coordinate efforts. In many instances, the excise tax specialists have developed contacts with the state and can provide useful information. They also may have knowledge of distributors/jobbers in your area who sell to unbranded stations. Your Dye Fuel Inspectors will be another source of leads.

5. Collection

   Involve Collection upfront due to potential large adjustments, disappearing assets, heavy cash business, and potential for nonpayment of taxes.

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Chapter 2

BACKGROUND INFORMATION

FLOW OF PRODUCTS

To audit a service station or distributor, the examiner must understand the flow of products in the oil industry.

1. CRUDE OIL is pumped out of the ground.

2. The crude oil is transported to a REFINERY.

3. The refinery then make MARKETABLE PRODUCTS out of the crude.

4. The MARKETING department o fa MAJOR OIL COMPANY handles sales of those products to service stations.

This processing flow makes gathering information about a service station or distributors very simple with a MAJOR OIL COMPANY.

Service stations are more than dispensers of gasoline. The typical station has one or more of the following:

1. Gasoline
2. Diesel
3. Sale of vehicles
4. Car wash
5. Mini-markets
6. Lottery
7. Check cashing
8. Repair shops with or without
9. Towing

GAS SUPPLIERS

Virtually all gas stations fall into one of two broad categories: majors and independents. Gas stations which are majors (those who operate under the major band names, such as Mobile, Shell, etc.), usually have signed agreements which restrict them from buying from anyone other than the respective major oil company. However, experience shows that many majors do buy additional gas from independent distributors.

Independent are stations which go by name other than those listed below. Independents are also referred to as "unbranded" stations or open dealers. They purchase gasoline from anyone, including independent distributors as well as from major marketing dependents. Frequently, an independent oil company also owns several gas stations. In some cases, it is obvious these entities are related. In other cases, the relationship is not obvious.

MAJOR OIL COMPANIES

For our purposes, the Major Oil Companies sell gas under the following brand names:

Amoco	Esso	Phillips
Arco	Exxon	Shell
Atlantic	Fina	Sinclair
BP America	Getty	Stop & Go
Chevron	Gulf	Sun
Citgo	Hess	Sunoco
Conoco	Kerr McGee	Texaco
Diamond Shamrock	Mobile(& Petrol Canada)	Unocal

INDEPENDENT OIL COMPANIES

Gas stations supplied by independent oil companies are more difficult audits than those supplied by the majors. First, the suppliers of products must be identified. Some of these can be provided by purchase invoices during the audit. It is recommended that you work with the excise specialists to accumulate a list of suppliers in your district for future reference.

MINOR (UNBRANDED) STATIONS

The problem in investigating this section of the Oil Industry is with the marketing of products. The sales of products to a stationary through a middle man. This person is called by many names, including Jobber, Marketer, Distributor, Broker, etc. (referred to hereafter as "wholesale/distributor"). Most wholesale/distributors are well established and comply with all withholding and reporting requirements.

There are some wholesale/distributors who are not in full compliance with the withholding and reporting provisions. These individuals only need a telephone and a desk to arrange to buy from a refinery (usually a small independent) and sell to a station.

These distributors may furnish unreliable information, for instance:

1. Information given on sales to stations is inaccurate.

2. Information may be self-serving, especially if they own or have a close relationship with thee station.

3. The individuals (brokers, jobbers, etc.) go in and out of business frequently and thus, the information is often "unavailable."

The biggest problem in auditing an independent service station is finding the supplier(s) of the products.

OTHER PRODUCT SUPPLIERS

Food Wholesalers

Suppliers of cigarettes, sodas, and beers are limited. Soda and beer are franchises and these suppliers can be located through your local telephone directory. Cigarettes, especially in volume sales, also can be located through the local food wholesalers. Large mini-marts have only a few large wholesalers/warehouses to go to. These usually supply invoices with not only purchases but with suggested sale prices. Look for the total sales of these products. Then find out where purchases were made and how they were made (cash, credit, etc.).

Service Parts Suppliers

The typical service repair station purchases from a cash business. Following this trail is very difficult but not impossible. First, review the overall bay income. A median amount should be between $60,000 -

$150,000 each bay. See if even a mechanic is employed! Review the repair invoices. They should be sequential and reasonable. For example, there should be a labor charge, not just a charge for parts. Also, consider what to do with the invoices that are not there. The auditors should be able to interpolate from these available invoices the total income.

Remember, these are highly business-minded taxpayers. When they show you a business that earns less than hat they pay for mechanics wages, it does not make sense. Also, a reasonable business person will **NET** at least as much as an average person.

LUNDBREG SURVEY

The Lundberg Survey provides retail selling prices of gasoline and diesel. The prices are listed by type of oil company, full service. self service, credit, and cash.

The Lundberg Company surveys the sample stations biweekly. This information has been put into an Enable Spreadsheet for the examiner's convenience. An example of the spreadsheet will be shown later in this guideline but briefly, this is how it works. The number of gallons purchased by the station is listed monthly in the appropriate file and gross receipts are calculated automatically.

In Los Angeles an Enable spreadsheet was developed by a CAS using the Lundberg Survey. Since the average price per gallon varies from one area to the next, each district would need to purchase a separate Lundberg survey and have its own CAS unit develop the local information into a spreadsheet. Your regional office will provide additional information on purchasing Lundberg data.

Los Angeles District Counsel helped develop these audit techniques. One of the attorneys interviewed Bob Shart, Vice President of the Lundberg Corporation, to evaluate his potential as an expert witness. The attorney stated we can use the Lundberg Survey but we must first show that either the books and records are unavailable or that they are inadequate to determine the substantially correct tax.

OTHER SURVEYS

1. Bureau of Labor Statistics

   This is a Government issued survey covering approximately 82 markets throughout the United States. It does not vary by Oil Company but does vary by type of gasoline/diesel. This survey has been successfully used in court by the Southwest region.

2. American Automobile Association

   Similar to the Lundberg Survey, AAA canvases the United States. There has not been a court case using this survey. Like Lundberg, it is a survey that needs to be reviewed by District and National Counsel (to see if it will be supported).

3. Department of Energy

   Currently each state is required, under the old Windfall Profit Law, to survey their area for prices. Some states use outside surveys such as AAA while others do their own survey. Although limited to the are surveyed, this may be a useful method to discover your taxpayer's area pricing.

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Chapter 3

PRE-AUDIT TECHNIQUES

GROSS RECEIPTS/UNDERREPORTED INCOME

Since the most significant issue is unreported income, some work needs to be performed up-front by the examiner prior to actually opening the audit.

SUMMONS THE OIL COMPANY

If initial observations suggest that the taxpayer may not be reporting income, consider issuing a summons for the oil company records for its sales to your service station. The oil companies are not third-party record keepers, so no notice to the taxpayer is required. See Exhibits 3-1, 3-2, and 3-3.

IDENTIFY SOURCES OF INFORMATION

Identify sources of information on unreported income. Order CTR's, IRP's, for the SSN and EIN on the case. These third-party sources of information can be used to obtain information for unreported income. It should be stressed that all TIN's should be gathered and then all CTR's be ordered. Sometimes the TIN you have is not where all the money is being deposited!

1. CTR's of over 10,000 in cash (see Branch Coordinator)

2. IRP Transcripts (order in your group)

   IRP's may show sales of stations and other properties and may also reflect several stations or several oil companies used by the station(s). Additionally, the IRP often shows substantial income from AAA or other automobile service clubs. This income may not be reported and expenses may be overstated.

   Another item that may be indicated by the IRP transcript is a rebate. In many cases the major oil companies give rebates for sales volume. Sometimes these are given as a credit to rent when the oil company owns the property.

3. Motor Vehicle - determine local or state procedures for securing this information.

4. Real Estate Records -- for real estate sales and purchases. Contact your Collection employees for the best source of this information.

5. TECS -- (Treasury Enforcement Communication System) money declared with Customs when taken in or out of the country - selectively.

6. AAA and other towing companies -- stations often have their own trucks and they are used by AAA and other companies to tow in automobiles, for which they are subsequently paid by the towing company. Contact the auto club to determine their procedures for releasing this information.

7. State and Federal Agencies pertaining to:

    a. Sales Tax
    b. Weight & Measurements
    c. Environmental Concerns
    d. Measurement Standards; etc.

COMPUTE PURCHASES AND SALES AND COMPARE TO RETURN

When the summoned information comes in, run Lundberg (through the Enable Spreadsheet) for gasoline gross receipts. Use the gasoline gross receipts computed per the Lundberg Survey and the gasoline purchases per the summons, to compute the correct cost of goods sold. Then compare the amounts to those on the tax return and determine whether or not an adjustment is indicated.

DETERMINE OTHER GROSS INCOME ISSUES

The items listed above will provide lots of information. Here are some of the most significant gross income issues to look for during both the pre-audit and audit stages.

1. AUTO BODY REPAIRS

A unique method recently found is the use of the state smog certificate/inspection information available through the state. In California this would be the California Bureau of Automotive Repairs. This information not only gives us the actual smog certificates issued BUT also the repairs made to bring the car to certification level.

Notice that by comparing the records presented to the auditor and the records presented to the State the information should match. If not, there is underreporting.

2. CAPITAL GAINS

Sales of service stations go through escrow and are recorded at the Hall of Records. From our studies thus far in Los Angeles, the average sales price (for the business only) is $355,000, comprised approximately, as follows:

$ 50,000	Equipment
40,000	Inventory
199,000	Leasehold Improvement (usually goodwill)
16,000	Commission
50,000	Transfer fee
$355,000	Total
========	

The current trend regarding majors is for the major oil company to own all of their stations and lease them to the operators. The business itself may be bought and without the property.

3. INVENTORY

The service stations has a limited amount of storage capability. Generally, the storage container is kept full so inventory issues are usually de minimis.

4. MISSING STATIONS

There have been cases where taxpayers file a tax return, including a Schedule C, but omit one or more gas stations. When serving the summons, request "this station and any other stations, owned or run by (the taxpayer)." Watch statements showing deliveries to different addresses and other clues that the taxpayer owned more than one station. Provide both the Social Security Number and EIN's on the summons to assist the oil companies in this search.

Note: A significant variance between monthly volumes in purchases could indicate the sale or purchase of a station or multiple suppliers.

5. ENVIRONMENTAL CLEAN-UP ISSUE

Rev. Rul. 94-38 generally provides that costs incurred to clean up land and treat groundwater that a taxpayer contaminated with hazardous waste from its own business are deductible by a taxpayer as ordinary and necessary business expenses under IRC section 162. However such costs do not include costs attributable to construction of buildings, machinery, and equipment having a useful life substantially beyond the taxable year (as determined under IRC section 263A and the regulations thereunder). These costs are nondeductible capital expenditures under IRC section 263.

Rev. Rul. 94-38 does not apply in situation where a taxpayer cleans up land that was contaminated prior to its acquisition. In those situations, general principles of capitalization under IRC, section 263 are controlling.

Moreover, neither IRC sections 162 nor 263 apply when the costs incurred are reimbursable. Therefore, where there is a reasonable expectation of reimbursement, costs incurred for environmental cleanup may not be capitalized or deducted.

6. UNREPORTED INCOME

The information you received from your taxpayer must be accepted on the facts, not what the taxpayer claims to be reasonableness. If you find additional income or assets which are unreported, it is up to the taxpayer to prove that they are nontaxable. Please review the training materials economic reality and use the economic reality test.

However, note that a discrepancy between a taxpayer's explanation of additional income or assets and the economic reality test is not sufficient to sustain an audit adjustment. It is still necessary to use a direct or indirect method (such as a cash-T) to support an adjustment of additional taxable income.

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Exhibit 3-1

SUMMONS - MAJOR

All records for the periods ending December 31, 1991, December 31, 1992, and December 31, 1993, regarding the following items:

1. All purchases and reports for gasoline (that is, regular, unleaded and super unleaded), and diesel purchased, in gallons and dollars, by month and annual. Please indicate whether excise & sales taxes have been included.

2. All purchase reports for oil purchased in dollars and quantity.

3. All purchase reports for tires, batteries and accessories purchased in dollars and quantity.

4. A copy of the sales agreement(s) between "Mr. Taxpayer name and Mrs. Taxpayer name" (include any other business or station names) and the oil company, and a copy of any other contracts or agreements, including, but not limited to, for example, any contract that pays a premium or gives a discount for becoming a branded station.

5. Records for any other stations owned by the same taxpayer for the same periods.

6. The summary total of all credit card invoices submitted and processed.[1]

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[1] Do not ask for this unless the service station gives a discount for cash sales. It is very expensive for the oil company to provide this information.

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Exhibit 3-2

SUMMONS - INDEPENDENTS

All records for the periods ending December 31, 1991, December 31, 1992, and December 31, 1993, regarding the following items:

1. All purchase and reports for gasoline (for example, regular, unleaded, and super unleaded) and diesel purchased, in gallons and dollars, by month and annual. Please indicate whether excise and sales taxes have been included.

2. All purchase reports for alcohol, naptha, transmix, and other additives to gasoline or diesel, gallons and dollars, by month and annual.

3. All purchase reports for oil purchased in dollars and quantity.

4. All purchase reports for tires, batteries, and accessories purchased in dollars and quantity.

5. Sales agreement(s) between "Mr. Taxpayer name or Mrs. Taxpayer name" (include any other business or station names) and the oil company.

6. Records for any other stations owned by the same taxpayer for the same periods.

7. The summary total of all credit card invoices submitted and processed.[1]

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[1] Do not ask for this unless the service station gives a discount for cash sales. It is very expensive for the oil company to provide this information.

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Oil Company & Summons Information

The following information is needed to serve a summons to the major oil companies to obtain purchase information for the audits of specific service stations.

In most case you will mail the summons to the district large case manager identified on the list. In some cases, however, you will mail the summons directly to the oil company, per instructions from the district large case managers.

For the summonses being served by the district large case managers, please provide a self-addressed envelope for them to send the IRS parts of the summons back to you. Please note that some district large case managers prefer that the summons certification be signed by the agent serving the summons.

As per advice from Chief Counsel, and information summons to a third-party does not constitute an inspection of that third-party's books of accounts. Therefore, if the summons information does not reveal a discrepancy with the Lundberg data, the return can be surveyed. Reopening procedure would not have to be implemented at a later date if additional information relating to noncompliance by that taxpayer is received.

In addition, since the major oil companies are not "third-party recordkeepers," you do not have to notify the taxpayer that you are issuing a summons. However, since many of the oil companies are notifying the taxpayer, you may wish to consider issuance of Letter 1024 (DO) to those taxpayers whose returns are surveyed.

Exhibit 3-3 (2 of 2)

BRAND NAME	MAJOR OIL COMPANY
AMOCO	Amoco Oil Company
ARCO	Atlantic Richfield
ATLANTIC	Sun Company, Inc.
BP AMERICA	BP America
CHEVRON	Chevron USA, Inc.
CITGO	Citgo Petroleum Corporation
CONOCO	Conoco, Inc.
DIAMOND SHAMROCK	Diamond Shamrock
ESSO	Chevron USA, Inc.
EXXON	Exxon
FINA	American Petrofina (Fina, Inc.)
GETTY	Texaco or Star Enterprise or Other
GULF	Chevron Usa, Inc.
HESS	Amerada Hess Corporation
KERR MCGEE	Kerr McGee
MOBIL	Mobil Oil Corporation
PETROL CANADA	Mobil Oil Corporation
PHILLIPS	Phillips Petroleum Company
SHELL	Shell Petroleum, Inc.
SINCLAIR	Sinclair Oil Com-pay
STOP & GO	Sun Company, Inc. (up to 4/90)
SUN	Sun Company, Inc.
SUNOCO	Sun Company, Inc.
TEXACO	Texaco, Inc. Or Star Enterprise
UNOCAL	Union oil Company of California

Chapter 4

AUDIT TECHNIQUES

THE FIRST APPOINTMENT

Be prepared when scheduling the first appointment with the taxpayer. This appointment may be the most informative and important one you'll get, so prepare your questions in advance. see Exhibits 4-1 and 4-2 for appropriate interview questions to assist the examiner. Also, be sure to run the Lundberg Survey on the Enable Spreadsheet before meeting with the taxpayer. Take copies of the purchase invoices from the supplier companies to the interview. See Exhibit 4-3 for a sample of a document request.

SITE VISITATIONS

A visit to the station prior to the start of the audit will make the examiner's job a lot easier. Put a copy of the map showing the location of the station in the file. Compare the prices of **the taxpayer's** station to competitors' stations nearby. Do they now or did they used to offer discounts for cash? One very important thing to observe is how many are getting full service. See Exhibit 4-4 for a sample drive-by data collection.

POTENTIAL SOURCES OF ADDITIONAL INCOME

Items to look for as potential sources of additional receipts or business income:

1. Are other items sold or services rendered at the location(s)? For example: unbranded pumps, carwash, snow plows, cigarettes, beverages, vending machines, tires, repair bays, licensing for state inspections, mini-mart, lottery tickets, etc.

2. What type of location site? Location vs. Sales -- Expect a good location site to have a high volume of sales.

3. Do the sites have a beer and wine license? Sites that have a beer and win license will sell much more merchandise than stores without the license.

4. Are cars for sale at the location?

5. Are any other service station(s) owned in whole or in part as an individual, partner, or shareholder? Be alert.

6. What is the current selling prices and spread between pries of gasoline t the taxpayer's station and other stations in the area? be sure to check.

7. How many pumps, what is the grade of gas, what type of gas (diesel)?

8. Is the taxpayer's residence for sale? Visit taxpayer's residence.

9. Has internal controls been addressed? Are the internal controls currently in place the same as the year under audit?

   Note: Los Angeles District Counsel recommends that information about the area (good, bad, industrial, residential, etc.) be gathered for cases under their jurisdiction.

OTHER ISSUES

Capital Gains

Frequently, the taxpayer(s) has sold either the gasoline station or other properties and the capital gain has not been reported. Watch out f or this. Real estate records are helpful with real property.

Rent/Other Expenses

Another situation which appears in a number of cases is the doubling up on the expenses. For example, many oil companies bill the taxpayer through the purchase invoices, for items such as rent. The taxpayer takes the full amount of the purchase invoice as a purchase deduction and also takes the rent (again) as an "other expense" of the total ordinary business expenses. Check for this on rent statements or purchase statements. The agreement between the dealership and oil company is also a information.

Franchise Fees

This could be disguised goodwill. That is, taxpayers may characterize expenditures as payments for franchise fees when payments may be more properly characterized as nondepreciable goodwill. Don't forget to consider the whipsaw issue between what the taxpayer claims as a expense and the seller claims as a capital gain. However, for purchases of a franchise entered into after August 10, 1993, the taxpayer must amortize the intangible asset (even if part of the intangible is disguised goodwill) over 15 years using straight-line depreciation. IRC section 197 was added in the Revenue Reconciliation Act of 1993 and requires 15 years straight-line depreciation for IRC section 197 intangibles, which specifically include franchise fees and goodwill. A taxpayer may elect to apply the provisions of IRC section 197 retroactively to property acquired after July 25, 1991.

Prepayment Account

Sometimes the taxpayer has a 1 or 2-cent additional, per-gallon charge on the invoice. This money is placed in somewhat of a savings account. It is the taxpayer's money and he or she earns interest on the deposits (check Form 1040, Schedule B). Check to ensure that the taxpayer has not claimed this a cost of goods expense.

Rebates

Major oil companies give rebates for increased volume of gallonage. These are incentive programs. The most common one used is for a new owner of a station or an owner who has remodeled his or her station. This is frequently 2 to 5 cents per gallon, applied to the volume increase and can total up to $100,000 per station, per year. The oil company will generally apply this to the station rent or it can be found as a credit to the purchases account.

Check to ensure that the taxpayer does not deduct the full amount of the rent without reducing it by the rebates. Lately, the major oil companies will pay a rebate for the stations to be shut down for remodeling or replacement of the underground storage tanks.

Other Taxes

Watch out for taxes (sales and excise) collected by the oil companies but not shown in the purchased documents summoned. It is important to determine whether these taxes were included in the total dollars and per-gallon figures of the summoned documents. (Very important: The retail selling price in the Lundberg Survey includes all appropriate taxes. Make sure that any prepaid taxes are included in the gas station (and their suppliers) to collect sales tax or excise taxes form the consumer or gas station, respectively. See Exhibit 4-5. Watch out for taxes to be included in the cost of goods sold as well as a separate expense item. See Exhibits 4-6 and 4-7 for tax rate schedule.

Since January 1, 1988, the Federal gasoline tax under IRC section 4081 has been imposed no later than the removal of gasoline at the terminal rack. Thus a retail service station is not responsible for paying this tax to the Government.

Since April 1, 1988, the Federal diesel fuel tax under IRC section 4091 has been imposed on the sale by the registered producer (including a registered wholesale distributor). Thus a retail service station is not responsible for paying this tax to the Government unless it is also a registered producer.

Dye Fuel

Effective January 1, 1994, excise tax collected on diesel fuel changed to "TAX or DYE" at the rack (generally imposed in the same manner as the tax on gasoline). Notice of dyeing is required on paperwork by terminal operators and on retail pumps where dyed diesel fuel is old. A penalty of the greater of diesel fuel is sold. A penalty of the greater of $1,000 or $10 per gallon is imposed for selling or using dyed diesel fuel for a taxable use or for altering dyed diesel fuel. If this is noticed during your audit, contact your excise tax group immediately.

Blending

Many of the service stations are selling gasoline that has had other petroleum-based products added. Blending is legal if it is done in accordance with strict specifications. A number of cases were discovered, however, where the specifications were not followed.

While blending could occur at any station, it is common among unbranded (independent) stations to blend and generate more sales per gallon of actual gasoline purchased. These blending products did not include any pre-collected taxes. The most common products used in these cases were naphtha, alcohol, and transmix. This is done to reduce the costs of purchases and to avoid the payment of all taxes. The taxes are generally not collected on those products by the distributors because, the gas station usually purchases the blending ingredients from other places. Then, they're mixed at the gas station and, eventually, the customer is taxed as if the final product were all gasoline. If you find an invoice for one of these, serve a summons for all purchases and add this to the gasoline purchases, before applying the Lundberg pricing.

The service station is liable for the excise tax under IRC section 4081(b) and Treas. Reg. section 48.4081-3(g) on its sale or use of blended gasoline that it blended.

Examples of "Blending-Product Switching" Recipes for Higher Profits:

Example 1

In this example, 2,000 gallons of regular unleaded gasoline is sold as premium unleaded gasoline.

Product Purchases		Product Sales	
Product.....	Gallons	Product.....	Gallons
Reg. Lead	2,000	Reg. Lead	2,000
Reg. Unlead	5,000	Reg. Unlead *	3,000
Prem. Unlead	1,000	Prem. Unlead*	3,000
Gals. Taxed & Purchased	8,000	Gals. Taxed & Purchased	8,000

Example 2

In this example, 2,000 gallons of regular leaded and 3,000 gallons of regular unleaded gasoline becomes 5,000 gallons of premium.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Reg. Lead	3,000	Reg. Lead	* 1,000
Reg. Unlead	5,000	Reg. Unlead	* 2,000
Prem. Unlead	0	Prem. Unlead	* 5,000
Gals. Taxed & Purchased	8,000	Gals. Taxed & Purchased	8,000

Example 3

In this example, 1,000 gallons of regular leaded and 1,000 gallons of regular unleaded were mixed with 1,000 gallons of naphtha and sold as premium unleaded. Taxes from the additional premium sale is collected but not reported.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Reg. Lead	1,000	Reg. Lead	* 0
Reg. Unlead	5,000	Reg. Unlead	* 4,000
Prem. Unlead	1,000	Prem. Unlead	* 4,000
Naphtha	1,000	Gals. Taxed & Purchased	8,000
Gals. Purchased	8,000		
Gals. Taxed Paid On	7,000		

Example 4

In this example, 6,000 gallons of diesel is mixed with 1,500 gallons of transmix and sold as diesel. Taxes from the additional diesel sales is collected but not reported.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Diesel	6,000	Diesel	* 7,500
Transmix	1,500	Gals. Taxed & Purchased	7,500
Gals. Purchased	7,500		
Gals. Taxes Paid On	6,000		

Covenant Not to Compete

Issue is whether covenants not to compete entered into during acquisition are amortizable, or merely a protection device to ensure the conveyance of goodwill. That is, taxpayers may characterize the expenditures as a covenant not to compete when the expenditures may be more properly characterized as nondepreciable goodwill. Remember to consider the Whipsaw issue (where the taxpayer treats this as an expense while the seller treats this as a capital gain). However, for purchases of covenants not to compete entered into after August 10, 1993, the taxpayer must amortize the intangible asset purchased over 15 years using straight-line depreciation. IRC section 197 was added in the Revenue Reconciliation Act of 1993 and requires 15 year straight-line depreciation for IRC section 197 intangibles, which specifically include covenants not to compete and goodwill. A taxpayer may elect to apply the provisions of IRC section 197 retroactively to property acquired after July 25, 1991.

Imaging Reimbursement

Monies are given to the station owner to be used for signs, painting, and overall appearance improvement. This money is issued to either change brands (rebranding) or to improve the general conditions of the station. This can be a no-interest loan with no expectation of repayment or the contract may read that there is expectation of repayment but provisions are so vague that anyone can meet them. Payments usually exceed costs involved and the taxpayer may capitalize the improvements even though he or she is not the true owner of the property. Or, the taxpayer may deduct the expenses and not report the income.

Incentive Agreements

These agreements go by many names. Some of these have been noted above, such as imaging or rebates. Incentive "awards" or agreements may be paid in many fashions, usually as (1) a discount of certain cents per gallon or (2) a discount for purchases over a certain monthly volume. This money may also be given to the taxpayer as a lump sum. Some large oil companies pay this on total yearly sales. Notice that this could be quite a sum of money if the taxpayer sells millions of gallons of product. Competitive allowance, paybacks, advertising allowance or subsidies, and profit participation are just a few names given to these agreements.

Shrinkage, Leakage, Theft, and Personal Use

Although the taxpayer may claim these as reasons for substantial loss of gallonage or a discrepancy in the cost of goods sold, experience has shown that this is usually de minimis. If there has been substantial leakage, the local environmental agencies or fire department would have been involved in the cleanup.

Tank Replacements

This is a depreciation expense to the OWNER of the property. Generally the major oil company owns the property. Lately, the major oil companies will pay a rebate for the stations to be shut down for remodeling or replacement of the underground storage tanks. Recent revenue rulings reflect particular allowances for depreciation for owners. Contact your coordinator for further discussion.

Mark-Ups

This industry follows certain patterns that stay constant only to be changed by outside sources such as a new freeway exit, a new mini-mart or much cheaper products. Examples are:

1. One nozzle in a diesel location will (on the average) pump 100,000 gallons per month.

2. An average service station will have 80,000 gallons per month of products sold.

3. An average truck stop will pump 200,000 to 300,000 gallons of diesel per month.

Other Industry Percentages Based on Los Angeles Experience

Source of Income	Gross Profit Percentage
Mini Mart	20-30% gross profit
Parts	50% of labor charge
Labor	$35-50 per hour per person
Fuel	5% ARCO regular leaded to 12% Independent reg. leaded
Fuel Product Distribution	5-10% reg. leaded (loss leader)
	10-20% reg. unleaded, self
	10-20% premium unleaded, self

Note: Full service is as much as 50 cents more per gallon!

Net profit appears to be close to 10 percent of the total receipts, especially if there is more than gasoline involved at that location. As an example, a service station doing $2,500,000 in gross sales a year should have a NET profit of $200,000 to $250,000 or more.

To help break down the above figures even more, the following information about different types of sales may be helpful.

GASOLINE SALES

One of the problems is determining the percentage of full service. This is important since full service can be as much as 30-50 cents more per gallon. As a general rule, the following was found in Los Angeles:

Self Service	70-80% of business before 1990 80-90% of business after 1990
Full Service	20-30% of business before 1990 10-20% of business after 1990
Cash Sales	70-100%
Credit Sales	0-30%

Of course, these may vary considerably based on the station's location. Beverly Hills, for example, may be almost totally full service while other locations may be totally self service.

1. TIRES, BATTERIES, AND ACCESSORIES (TBA) AND OIL:

   Mark-up ranges:

Oil	80-120%, usually 100%
TBA	30-60%, usually 40-50%

2. MINI MARTS:

   Mark-up ranges:

Groceries	30-40%
Fast Food	40-60%
Beer & Wine	15-25%

3. MECHANIC/SERVICE BAYS:

   One bay, one mechanic will bring on the average $25,200 gross profit. An example will show you how this happens:

Hourly rate $40 for 6 hours work	$240.00
Per person wage of $20 for 8 hours	160.00
Profit per day	$ 80.00
	========

At $80 per day and 315 days worked, the total amount of gross profit is:	$25,200.00
	==========

   Note: This does not include parts, where there is normally a 50-percent or better mark-up. This $25,200 could double if the average part sold was, for example, $240 and the cost was $160. The service bay profit would be $50,400. Also, note this is for one bay, usually there is more than one bay per station.

INDUSTRY RATIOS FOR SERVICE STATIONS

	ROBERT MORRIS 1993	INDUSTRY NORMS & KEY BUSINESS RATIOS 1992	IRS CORPORATE INDUS. FIN. RATIOS 8TH EDITION 1994
Net Sales	100%	100%	100$
COGS	79.90%	81.70%	-
Cost of Operations	-	-	82.17%
Gross Profit	20.10%	18.30%	17.83%
All Other Expenses	1.60%	-	* 4.98%
Profit Before Taxes	1.30%	1.80%	1.75%

* Author's inserted calculations

INADEQUATE RECORDS NOTICE

The Lundberg Survey, as well as other surveys are being used because there are no records or the records are inadequate to determine the substantially correct tax. To be consistent, the revenue agent must request an inadequate records notice. This is noted on the Form 3198 and the T-Letter (F. 4665). The agent is required to state in the T-Letter how (in what way) the records are inadequate. The agent must also verbally inform the taxpayer that their records are inadequate. Refer to IRM 4271.22, for further explanation.

Some signs of inadequacy:

1. No daily record of sales

2. Missing purchase receipts

3. No recordkeeping for other services (auto repair, towing, etc.)

4. Illegible records

5. Records unable to be reconciled to the tax return

6. Records unavailable for inspection

7. No record of daily bank deposits that ties into sales

8. Meter readings not consistent from day to day

9. Only one 8-hour shift/tour-of-duty noted but station open 16 to 24 hours.

FRAUD

Fraud must be considered for all of these cases with large amounts of unreported income. For a criminal referral, other badges of fraud must be evident in the case beside that which resulted from the Lundberg Survey. In most instances, this is also necessary for District Counsel to sustain the fraud penalty.

Inadequate records is one badge of fraud. Altered documents, illegal activity, self-serving statements with no documentary proof, false or inconsistent statements, are just a few other common badges of fraud. Examples of specific gas station issues which would constitute a fraudulent scheme include:

1. Whole station activity omitted from the return

2. Unreported sale of a station

3. Mini market sales or repair and service operations not reported on the tax return.

The following are items to develop for a Fraud Referral. The examiner should do as much of this as necessary for the particular case under examination.

1. Personal living expense above income.

2. Gross profit percent low.

3. Were there merchandise sales reported?

4. Were there repairs/sales of cars reported?

5. What kind of cars does the taxpayer(s) drive?

6. What is the price of the home the taxpayer(s) own?

7. "C" Corps: Check facts and circumstances for the issue of constructive dividends.

Civil Fraud: "(Specific Intent) to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes" in Rowlee v. Commissioner 80 T.C. 1111, 1123 (1983).

NONFILER

1. MSSP gas retailer specialists should contact the district nonfiler coordinator for sources of nonfiler work.

2. Lundberg Survey data at retail is an excellent source of determining gross receipts for found nonfilers.

3. Following Gas Retailer procedures will help you to determine/discover cost-of-goods-sold, other sources of income and expenses (for example, determining that the station is open 24 hours is an indication of payroll expenses/other employees).

4. Computation to determine "Employees-Off-The Books." Number of employees times hours open times 365 days times minimum wage equals a rough estimate of minimum payroll.

PREPARER AND PREPARER PENALTIES

In the Tax Reform Act 1976, Congress created civil penalties designed to enable IRS to effectively deal with the problems of incompetent or unscrupulous preparers. If a willful attempt to understate tax liability occurs, the preparer will be subject to penalties. Recent study cases audited by Western Region found that returns prepared by unscrupulous preparers and presented to banks are very different from those filed with the IRS. When asked, the preparer said the taxpayer needed a different Form 1040 for obtaining a bank loan. When confronted, the taxpayer usually indicates that there was no bank fraud but erroneously filed tax returns. Agreements come quickly afterwards.

Don't forget that preparer penalties apply. Some penalties, such as for aiding and abetting, can apply whether or not the taxpayer has knowledge of or consents to the understatement.

COLLECTION

Procedures should be developed with collection. This cross functional project involves close coordination with the Examination Division and Collection Division. Revenue officers in the project network with revenue agents and revenue officers throughout the audit process. The sharing of information as well as attendance at closing conference is essential to success.

This early involvement with taxpayers and revenue agents serves a dual purpose. The officer is able to immediately initiate appropriate research/investigation. He or she could identify and track any disposition of assets during the process and encourage compliance or identify and reduce noncompliance.

Continuous involvement by revenue officers, especially when quick and jeopardy assessment procedures are utilized, has greatly enhanced our ability to collect.

BRIBERY AWARENESS

"Integrity is everyone's responsibility." The IRS has made an effort to make all employees aware of bribery attempts. Cash businesses have a high probability of bribery offers. To report these and any other integrity violations contact your local Internal Security Office.

BANKRUPTCY

True bankruptcy is a method to relieve a taxpayer of the burden of excess debt. Lately, however, bankruptcy laws have been used to circumvent the payment of taxes and other debts. If a taxpayer tells you that he or she filed bankruptcy, check this, he or she may not have filed. Then if taxpayer did file, check to see if it is valid. If the filing is not valid, the taxpayer has no relief from debts, including payment of taxes.

EMPLOYMENT TAX ISSUES

When it comes to cash businesses, this issue has been neglected by most auditors. Collection wants the employment issue immediately addressed. For Collection, these audits are fairly easy and assessments can be made quickly, which allows for freezing the taxpayers assets until the rest of the audit can be completed. In the Los Angeles District, Collection is willing to handle this part of the audit.

Simple audit techniques will give you quick results:

1. The stations are opened for so many hours a day times the number of days opened.

2. The number of employees increase by the number of businesses on the premises. For example, a single gas station with a kiosk, will have one individual at a time, while a convenience store could have as many as three employees. Service bays may have, in addition to the clerk handling the gasoline station, a mechanic per bay.

CASE DEVELOPMENT RECAP

1. Use summons power

2. Obtain taxpayer's books and records

3. Inspect the properties

4. Interview witnesses

5. Determine true taxpayer (person responsible for reporting).

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INITIAL INTERVIEW QUESTIONS FOR SERVICE STATIONS

Short Version

These questions were developed to provide enough information for the examiner to accurately estimate the income when the Lundberg Survey is not available or the audit is limited primarily to the income issue.

Common Service Station

1. Do you own any other stations?
2. What are your gas products' mark-ups per grade?
3. Was the mark-up the same in prior years?
4. What is your merchandise product mark-up?
5. Was the mark-up the same in prior years?
6. Do you have inventory on consignment (fuel, merchandise, etc.)?
7. What is your hourly rate for mechanics?
8. What is the daily gasoline sales volume? By type of gas? By season?
9. What is the daily merchandise sales volume? By season?
10. How often do you receive a fuel or merchandise load?
11. Do you accept credit card sales? What percentage is gas? Cash?
12. What are the names all the companies you get gas or other products from?
13. What was the beginning and ending inventory for the year(s) in question?

14. Has the station been remodeled? When? How long was the station closed for remodeling? Who paid for the remodeling? Did the taxpayer receive any reimbursement for the remodeling? Did he receive financial reimbursements such as business income replacement?

15. What are the names of all your suppliers of gasoline and other products you offer for sale?

16. What percentage of gas sales are full service?

17. Do you purchase blending products such as alcohol, naphtha, and transmix?

18. Do you own your delivery trucks? If yes, do you supply your own fuel? Who do you buy it from?

19. Do you distribute your product to anyone else?

20. Were you required to file a Form 720 (Excise Tax) or Form 2290 (Highway Use Tax)? Did you file it (them)?

21. What type of fuel sold: _ gasoline _ diesel propane? If selling diesel, was taxpayer in business prior to April l, 1988?

22. Is all fuel purchased with Federal Excise Tax included? (Obtain copies of sample invoices for all fuel types.)

23. What is the:

	gasoline	diesel fuel
- Number of bulk storage tanks:	________	___________
- Capacity of bulk storage tanks:	________	___________
- Number of gals. in inventory at January 1, 1994	________	___________

24. Is gasoline ever sold as diesel? ____ Yes ____ No
How do customers use propane?

25. Is taxpayer using correct tax rate? Be aware of taxpayer using the wrong tax rate. Be aware of taxpayer buying tax-free, and be aware of possible delinquent diesel fuel for Pre-April 1, 1988, activity.

Note: Items 3, 4, and 5 listed above are required by Los Angeles District Counsel for cases under their jurisdiction.

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INITIAL INTERVIEW QUESTIONS FOR SERVICE STATIONS

Long Version

These questions were developed to provide enough information for the examiner to accurately estimate the income when the Lundberg Survey is not available.

Gasoline Sales

1. How many gallons does the station pump per DAY? WEEK? MONTH? Provide monthly summaries for each type of gasoline or diesel and reflect seasonal changes.

2. What is the capacity of the fuel tanks?

3. How often do you order a fuel load?

4. How many pumps does the station have?

5. Are the pumps double-sided?

6. What is the percentage of full services business? Self serve?

7. What is the selling price for each type of gasoline or diesel?

8. What is your mark-up for each type of gasoline or diesel?

9. Did you have the same mark-up in the prior years? REGULAR/UNLEADED/SUPREME (LEADED OR UNLEADED)/DIESEL

10. Do you have a market analyst? If not, how do you determine your gas prices?

11. Do you offer a cash discount? If yes, how much? When did that policy start?

12. What is your percentage of credit card sales?

13. What percentage of your total sales are cash sales?

14. What are the names of all the gasoline companies you purchase gasoline or other products from?

15. What are your beginning and ending inventory amounts for the year(s)?

16. Do you purchase blending products such as alcohol, naphtha, and transmix?

17. Do you own your own delivery trucks? If yes, do you supply your own fuel? Who do you buy it from?

18. Do you distribute your product to anyone else?

19. Were you required to file a Form 720 (Excise Tax) or Form 2290 (Highway use Tax)? Did you file it (them)?

20. What type of fuel sold: gasoline _ diesel _ propane _. If selling diesel, was taxpayer in business prior to April 1, 1988?

21. Is all fuel purchased with Federal Excise Tax included? (Obtain copies of sample invoices for all fuel types.)

22. What is the:

	gasoline	diesel fuel
- Number of bulk storage tanks:	_________	_________
- Capacity of bulk storage tanks:	_________	_________
- Number of gallons in inventory at January 1, 1994:	_________	_________

23. Is gasoline ever sold as diesel? Yes___ No___
    How do customers use propane?

24. Is the taxpayer using correct tax rate? Be aware of taxpayer using the wrong tax rate. Be aware of taxpayer buying tax-free, and be aware of possible delinquent diesel fuel for pre-April 1, 1988, activity.

Note: Items 8 and 9 listed above are required by Los Angeles District Counsel for cases under their jurisdiction.

Conventional Service Stations with Mechanic Service

1. What type of training have the mechanics had? Experience requirements?

2. Are training classes offered by the oil companies?

3. Do the mechanics have a smog/emissions control license?

4. Do the mechanics have a brake and light inspection license?

5. What is your hourly labor rate?

6. What is the standard rate for a tune-up? 4-cylinder, 6-cylinder, 8-cylinder

7. What is the price of a smog/emissions control inspection? Do you have a "pass or don't pay" policy?

8. How are parts priced? List price or other? Provide mark-up schedules. Do you offer discounts?

9. Do you buy from a parts house? If yes, which one? Your account number? From what sources do you obtain parts, tires, and lubricants? (Oil companies, auto part stores, tire dealers, other stations, etc.?)

10. What type of equipment do you have at the station? (Computerized wheel alignments, electronic scopes)

11. With whom do you shop-out repairs that cannot be performed on-site (i.e. transmissions, radiators?)

Mini Mart Service Stations

1. What is the size of the store?
2. Does it have a walk-in cooler?
3. Does it have a beer and wine license?
4. What types of items do you sell?
5. How close is the nearest grocery/mini mart store?
6. How far away is the nearest recreation area?
7. How much storage area do you have?
8. How often do you order inventory for the store?
9. What is the daily sales volume of the store?
10. What is your mark-up?
11. Did you have the same mark-up in the prior years?
12. What is the largest selling item?
13. What percent is the largest selling item to the total?

Note: Items 10 and 11 listed above are required by Los Angeles District Counsel in cases under their jurisdiction.

Sample: INFORMATION DOCUMENT REQUEST

1. Copy of prior and subsequent year Federal Income Tax Returns

   - Any amendments to the original returns

2. Copy of prior revenue agent's reports, if any.

3. Copy of related tax returns:

   a. State Income Tax and State Sales Tax Returns

   b. Excise Tax Form(s) Number 720 and 2290.

   c. Officer/stockholders' or partners' Form 1040

   d. Related Corporate Returns (subsidiary, parent, brother/sister)

   e. Related partnership returns

4. Payroll tax returns:

   a. Forms 941 for all quarters encompassing the taxable year(s)

   b. State payroll tax records for all quarters encompassing the taxable year

   c. Form 940 for the two calendar years encompassing the taxable year

5. Forms W-2, W-4 and 1099's issued.

6. Form 2848 (Power of Attorney) or Form 2848-D (Authorization and Declaration), if necessary.

7. General Ledger and all subsidiary ledgers maintained

8. Journals:

   a. General - including payroll

   b. Cash Disbursements

c. Cash receipts

d. Voucher payables

e. Sales

f. Purchases

g. Any other special Journal maintained

9. Working trial balance with account numbers.

10. Chart of Accounts

11. Adjusting and closing journal entries

12. Pension/profit Sharing Plan

    a. IRS Determination Letter

    b. Copy of the plan and all amendments

    c. Annual information returns of the plan

13. Corporate minute book or partnership agreements

14. Agreements between you and the oil company(s)

15. Copy of certified audit report, if any

16. Bank Statements, checking (both personal and business), plus one month before and after the year(s) under audit.

17. Bank statements, savings passbooks (both personal and business) plus one month before and after the year(s) under audit

18. Brokers statements, margin accounts and any Forms 1099 received.

19. Control Documents: Council Tapes and "Z" tapes: Daily and Monthly

GAS RETAILERS DRIVE-BY REPORT

Date__________

Agent_______________

Return__________________ Year(s)_______ ________ _______

Station name per Return_____________________________________
Station name per site visit_________________________________
Owner ___________________________________
Address__________________________________
____

Location:
neighborhood_____ shopping center_____ freeway_____
Other______________________________________

Name(s) of other stations within immediate vicinity:
_______________________ _______________________
_______________________ _______________________

Operations:

Days open_______________ Hours________________

Traffic:
Day_____ Time_____ Light_____ Heavy_____

# of Employees:
Cashier(s)______ Service/repair______
Other_________________________________

Other Services:
Service Bays #_____ Emissions Testing #_____

Car wash _____ with fill up_____ extra cost_____
Vacuum _____

Towing_____ # of trucks_____ snow plows_____

U-Haul rentals_____

Mini Mart:_____
Full service____ Restricted____ Liquor Sales____

GAS RETAILERS DRIVE-BY REPORT

(page 2)

Other Services (continued):

Cigarette sales_____ Lottery ticket sales______
Vehicle accessories_____ Video rentals_________
Other___________________

Restaurant_______ Laundromat________

Coin operated machines: #________
Arcade games______ Cold drinks______
Candy, etc.______ Cigarettes______

Tanker present________ Identification______________
____
____

Pumps:

Self service #_________ Full service#______
Prepay________ all pumps_______
Cash only______ Credit card_______
Cash discount_______

Fuel offered:

Classification	Price/gallon
1. gasoline:	
leaded___	___________
regular unleaded___	___________
midgrade unleaded___	___________
super unleaded___	___________
other___	___________
2. diesel___	___________
3. propane___	___________
4. unbranded___	___________

Comments:____
____

EXCISE TAX LAW

OBJECTIVES:

-- determine what fuel is taxed
-- determine tax rate on different fuels
-- determine who is liable for filing tax on fuel
-- determine what tax return is filed

FUEL TAX:

Excise taxes are imposed on gasoline, diesel fuel, special motor fuels (including propane), aviation, alcohol and other specified fuels (see Pub.510). Fuel taxes are reported quarterly on Form 720.

FEDERAL EXCISE TAX RATES:

	Prior to 10-1-93	Effective 10-1-93	Effective 1-1-94
Gasoline	.141	.184	.184 * including LUST
Diesel	.201	.244	.244 * including LUST
Propane	.14	.183	.183

* L.U.S.T. Trust fund of .1 cent-per-gallon (for Leaking Underground Storage Tank fund).

Check your state and local agencies for their applicable taxes.

GASOLINE TAX

Since January 1, 1988, the Federal gasoline tax under IRC section 4081 has been imposed on removal of gasoline at the terminal rack. Thus the position holder is responsible for paying the excise tax to the Government.

PROPANE TAX

Tax on propane (Liquid Petroleum Gas), a special motor fuel, is imposed on retail sales if used in the propulsion of motor vehicle. (NO tax is imposed on propane used in BBB's, motor home stoves, or off-Highway business use such as power saws and forklifts.) Service stations who buy propane tax-free and make taxable sales must file Form 720 quarterly.

DIESEL #2 FUEL TAX

Prior law: From April 1, 1988, until January 1, 1994, the Federal diesel fuel tax law under IRC section 4091 was imposed on the sale by the registered producer (including a registered wholesale distributor). Thus retail service station was not responsible for paying this tax to the Government unless it was also a registered producer.

New law: Effective January 1, 1994, excise tax on diesel fuel changed to "TAX OR DYE" at the rack. (Generally imposed in the same manner as the tax on gasoline.) Tax of 24.4 cents (including LUST tax) per gallon of diesel fuel is paid by the seller on a quarterly excise tax return Form 720 unless the fuel is dyed red on removal from the terminal. In the case of taxed fuel used on a farm for farming purposes or by a state or local government, the registered ultimate vendor may make a claim for refund.

Diesel Fuel # 2: Any liquid sold as fuel suitable for use in a diesel-powered highway vehicle, diesel-powered boat, or diesel-powered train.

Rack: A mechanism for delivering fuel from a refinery or terminal into a truck, trailer, railroad car, or other means of nonbulk transfer.

Ultimate vendor: Seller of undyed diesel fuel to the user of the fuel (purchaser) for use on a farm for faring purposes or for the exclusive use of state or local government. Registration (Form 637) is required in order to qualify for refund or credit.

Taxable Event: Removal from terminal rack, entry into the United States, or removal or sale of blended diesel fuel.

Dyed diesel fuel: Regulations specify dye concentration. Notice of dyeing is required on paperwork by terminal operators, distributors, and on retail pumps where dyed diesel fuel is sold. A penalty of the greater of $1000 or $10 per gallon is imposed for selling or using dyed diesel fuel for a taxable use or for altering dyed diesel fuel.

Back-up tax: 24.4 cents per gallon tax is imposed on dyed diesel fuel that is sold or used for other than a nontaxable purpose. (In addition to penalty above.)

Non-taxable uses: 1) Use on a farm for farming purposes; 2) Exclusive use of state or government; 3) Use other than as fuel in the propulsion engine of a highway vehicle, boat, or train; and 4) Other limited uses.

Credit or refund: Allowed against income tax where tax was paid but fuel was used in a non-taxable use. Not allowable to farmers for farm use or to a state or local government.

Excise Tax Agent: Audits excise tax returns (Forms 720 and 2290) and imposes back-up tax. All potential excise tax issues should be referred to the excise Tax Group.

FLOOR STOCK TAX

Excise tax of 9 cents per gallon is imposed on any person holding untaxed diesel fuel on January 1, 1994. Also, 4.3 cents excise tax on any previously taxed gasoline or diesel is imposed on October 1, 1993, when the tax rate increased. This one time floor stock tax is reported and paid on Form 720. Service stations are usually subject to the floor stock tax when tax rates increase(lQ91, 3Q93 and 2Q94).

FORM 637

Diesel Fuel producers, refiners, importers, terminal operators, blenders, through putters, compounders, and others, such as those selling or buying taxable items tax-free, are registered on Form 637.

FORM 720

Form 720 is used to report and pay the excise taxes listed on the form. A return should be filed for each quarter.

FORM 2290

Form 2290 is used to compute and pay the tax due on heavy vehicles used on public highways. It is also used to claim exemption from the tax when such vehicles are expected to be used on public highways 5,000 miles or less (7,500 miles or less for agricultural vehicles). Proof of payment of this tax is required to register your vehicle in any state.

TAX RATE SCHEDULE - STATE OF CALIFORNIA

Product	Type of Tax	Collected at Whlsl or Retail	Rate	Dates
Gasoline	Excise	Refinery	.15 State .141 Federal ---- .291 Total	1/1/91-12/31/91
		Refinery	.16 State .141 Federal ---- .301 Total	1/1/92-12/31/92
		Refinery	.17 State .141 Federal ---- .311 Total	1/1/93-9/30/93
		Refinery	.17 State .184 Federal ---- .354 Total	10/1/93-12/31/93
		Refinery	.18 State .184 Federal ---- .364 Total	1/1/94-present

Product	Type of Tax	Collected at Whlsl or Retail	Rate	Dates
Gas	Sales	Wholesale*	.06	1/1/91 thru 6/30/91
		Wholesale*	.045	7/1/91 thru 3/31/92
		Wholesale*	.05	4/1/92 thru 9/30/92
		Wholesale*	.06	10/1/92 thru 3/31/93
		Wholesale*	.065	4/1/93 thru present

* Pre-collected amount only, in cents per gallon
** Whatever the applicable sales tax rate is (as a percentage of sales)

TAX RATE SCHEDULE - STATE OF CALIFORNIA

Product	Type of Tax	Collected at Whlsl or Retail	Rate	Dates
Diesel	Excise	Wholesale	.201 State	1/1/91-12/31/91
		Retail	.15 Federal	

			.291 Total	
		Wholesale	.16 State	1/1/92-12/31/92
		Retail	.141 Federal	

			.301 Total	
		Wholesale	.17 State	1/1/93-9/30/93
		Wholesale	.141 Federal	

			.311 Total	
		Wholesale	.17 State	10/1/93-12/31/93
		Wholesale	.184 Federal	

			.354 Total	
		Refinery	.18 State	1/1/94-present
		Wholesale	.184 Federal	

			.364 Total	
		Refinery	.244 Federal	as of 1/1/95
		Refinery	.18 State	

			.424 Total	

Product	Type of Tax	Collected at Whlsl or Retail	Rate	Dates
Diesel	Sales	Retail	until 1/1/92, the total sales tax collected was at the station.	
		Wholesale	.03	1/1/92-3/31/92
			.035	4/1/92-9/30/92
			.045	10/1/92-3/31/93
			.05	4/1/93-present

Exhibit 4-7

TAXES ON DIESEL FUEL AND GASOLINE

(all per gallon unless indicated otherwise)
(California Fuel Taxes and Fees also included)

I. Diesel Fuel Taxes and Fees:

Federal Excise Tax	$ .244
Federal Superfund	.0035
Federal Leaking Underground Storage Tank	.001
California Use Fuel Tax	.18
Sales and Use Tax	6-7% percent of sale
TOTAL taxes collected:	$ .4285 plus 6-7% sales taxes = .48-.50 per gallon

II. Gasoline Taxes and Fees:

Federal Excise Tax	$ .184
Federal Superfund	.0035
Federal Leaking Underground Storage Tank	.001
California Motor Vehicle Fuel Tax	.18
Sales and Use Tax	6-7% percent of sales
TOTAL taxes collected:	$ .3685 plus 6-7% sales taxes = .42-.45 per gallon!

The Federal superfund tax of $ .0035 is paid by the refiner or importer. By the time the service station gets the gasoline or diesel fuel, the amount of the tax is usually included in the station's cost of the product.

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Chapter 5

NATIONWIDE ISSUES

ISSUE 1

There is a concern over an event occurring in the industry, in particular the DETROIT/CANADIAN BORDERS. There appears to be a retail truck stop outlet directly adjacent to the CANADIAN border. The owner recently applied for a PERMIT TO BE A BONDED WAREHOUSE FOR FUEL (CUSTOMS). Accordingly, the owner of the truckstop has no other storage facility other than the underground storage tanks in his retail outlet. It is expected that the owner will sell the fuel to the trucks heading into CANADA and claim that it was sold for export, and, therefore, not a taxable event. The owner will then be able to circumvent payment of excise taxes (44 cents) and sales taxes (depends on state).

Government Position

The law itself is specific -- this is a taxable event. The Canadian Government is very willing to cooperate with our Federal Government in resolving these situations. Canada should be another source for research into this issue.

Rev. Rul. 69-150: Gasoline put into an auto and then driven into Canada is not exempt from excise taxes. NO CREDIT IS GIVEN AND TAX MUST BE PAID UP-FRONT.

Rev. Rul. 72-38: Aviation fuel instead of gasoline yields the same results as Rev. Rul. 69-150.

IRC Section 4081: Applies currently for all products including DIESEL. Bulk transfers such as those required in a BONDED warehouse can only be considered BULK if delivered by either a PIPELINE or MARINE BARGE. Otherwise, if delivered by TANKER TRUCK, it is not a BULK transfer and cannot be a tax-free event. Also, regardless of how it gets to the storage tanks, once it goes into the fuel tank (of a car or truck), it is a taxable event per revenue rulings.

A similar case was discovered between the Canadian border and Montana's border. Montana issued new regulations denying bonded warehousing in this particular scenario. Further, Montana would make the common carrier responsible for taxes (if there is no one else responsible for the taxes).

ISSUE 2

Indian Reservations

This issue first appeared in Montana and has potential for the nation. Native Americans selling state tax-free gasoline/diesel to non-native Americans. This issue is similar to the Canadian border problem but deals currently only with state excise taxes. The issue must be approached the same way as above if Federal excise taxes are evaded. Consideration of the state requirements for exemption must also be addressed since, as in the case of California, only a 100-percent Indian can sell tax-free.

Comments

Excise Taxes

Collected and unremitted excise taxes will be considered income until paid. The individuals responsible for the collection would be assessed the amount not paid as unreported income. If more than one person is directly or indirectly responsible, then the auditor should consider a whipsaw on all those responsible. See Exhibit 5-1 for schedule.

Tax Exemptions

Be aware that there are several developing cases, each focusing on an attempt to circumvent the requirement to either collect excise taxes or remit the taxes. These taxes could be either the Federal or the state taxes.

Receiving a PERMIT TO BE A BONDED WAREHOUSE FOR FUEL especially through CUSTOMS does not automatically exempt the holder from collecting or remitting excise taxes. For a taxpayer to be an exempt bonded warehouse, he or she must meet strict specific requirements. IRC section 4081 applies to all bonded warehouse and bulk sales. A gasoline or a truck stop could not be bonded (nor exempted). See Rev. Rul. 69-150 and Rev. Rul. 72-38.

Service stations or truck stops with INDIAN RESERVATIONS may be exempt from STATE taxes but NOT FEDERAL taxes. Strict regulations limit ownership to full Native Americans in some states. Be aware of your state requirement.

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GLOSSARY

A G O - Atmospheric Gas Oil: A volatile distillate.

Cetane Number - A measure of the ability of a fuel to ignite spontaneously, desirable in the operation of a diesel engine.

Cloud Point and Count Point - Describe the flow characteristics of fuel oil at low temperatures. These points are the temperatures at which wax crystals form and clog the fuel-injection system of a diesel engine.

Distillate - A refined petroleum product produced by the distillation of crude oil.

#1 Diesel Fuel - A volatile distillate fuel used in high speed diesel engines operated under wide variations of speed and load, such as city buses.

#2 Diesel Fuel - A lower volatility oil for use in high-speed diesel engines operated generally under uniform speed and load conditions, such as railroad engines and highway roads.

#4 Diesel Fuel - Used in low speed diesel engines.

#l Fuel Oil - A light distillate used in vaporizing-type burners.

#2 Fuel Oil - A distillate used in atomizing type burners for home and other moderate size heating applications.

#4 Fuel Oil - A blend of distillate and residual fuel oil used for commercial burners in larger size heating applications, such as industrial plants.

Kerosene - Similar to #l fuel oil with specifications that improve it for use in space heaters, cook stoves, and lamps.

M D O - Marine Diesel Oil: A volatile distillate used specifically for marine/ship purposes.

Naptha/Alcohol - Used to mix in diesel and gasoline. Naptha has no real purpose outside of blending with other products. While, alcohol can be legally blended up to 10 percent and sold as gasohol.

Residual Fuel Oil - A heavy oil that remains after distillation which is used for electric power generation, space heating, ship bunkering, and various industrial application. Includes #5 and #6 fuel oils.

Transmix - The portion of products accidentally blended in transport, that is: Diesel is mixed with Unleaded while in transit.