



Compliance Tools (2013)

- **Audits**

The Webster dictionary defines audit as ‘a formal or official examination and verification of an account book’.

There are many points in the motor fuel distribution chain between refinery and the retail pump at your local station or truck stop in which audits are performed. Even if your state’s point of taxation is at the rack you may not want to rule out auditing other points in the distribution chain. At all points of the distribution chain the objective of an audit is to verify that all gallons are accurately reported and tax paid to the proper taxing authority.

- | | |
|---------------------|---------------------------|
| ❖ Refiner | ❖ Producer/Manufacturer |
| ❖ Terminal Operator | ❖ Alternative Fuel Dealer |
| ❖ Supplier | ❖ User |
| ❖ Distributor | ❖ Liquid Fuel Carrier |
| ❖ Retailer | ❖ IFTA Licensee |
| ❖ Blender | |

Audits are performed at customer sites or through virtual means (see Virtual Audits white paper document in the FTA Motor Fuel Tax Section Uniformity Book), but with either method a good audit plan is necessary to result in a good audit, however an audit does not always result in an assessment of tax.

A good audit plan includes;

- ✓ Pre-Planning
- ✓ Understanding the Industry
- ✓ Understanding Accounting System
- ✓ Interviewing individual(s) responsible for accounting for and filing motor fuel reports
- ✓ Determining type of system in use
- ✓ Assessing internal controls
- ✓ Knowing your source documents
- ✓ Determining what the system captures, records and reports
- ✓ Understanding transaction flow
- ✓ Verifying how system handles each type of transaction
- ✓ Keeping an open mind, eyes and always alert, looking for areas that carry the highest risk for error or fraud
- ✓ Tracking transactions and payments
- ✓ Validating third party records
- ✓ Maintaining detailed notes and documentation

You may also find it beneficial to perform a joint audit with the IRS or other states.

- **Fuel Tracking**

Fuel Tracking is the process of reconciling data elements reported on a source return to the information reported by a third party. A source return or third party data is defined as receipt, disbursement, or delivery schedules that are filed with a taxing jurisdiction. These schedules are found on terminal operator, terminal supplier, distributor, and petroleum carrier reports, among others. The reconciliation process typically links the source record to third party data by means of a license and document (bill of lading) number. If the transaction is found on one report, but not on the other, it is identified as an exception. Exceptions identify



recording errors (i.e. source document had the wrong purchaser or seller Federal Employer Identification Number (FEIN)) or transactions that were never reported. Exceptions may be a sign of lost revenue and should be reviewed by a taxing jurisdiction.

Fuel Tracking can also be used to find discrepancies in source or third party data. This is accomplished by comparing the data elements reported on a schedule of receipts (customer) to the data elements reported on a schedule of disbursements (seller). Taxing jurisdictions can also reconcile data elements on an information report (petroleum carrier, terminal operator, etc.) to source returns to identify discrepancies. Data elements include product type, point of destination and origin, mode of transportation, date shipped/received, carrier FEIN, and gallons. If the tracking system is able to link a transaction by document number, product type, and FEIN, all other data elements should match. Discrepancies in data elements, such as gallons, point of origin, or point of destination, may identify lost revenue and should be reviewed by a taxing jurisdiction.

Note - Due to the volume of data that is matched, fuel tracking is typically an automated process that relies on internal or external software.

Example 1: The following is an example of an exception. In this case, the distributor failed to report the correct seller FEIN. Instead of listing 104523504 as the seller FEIN, the purchaser listed 104523506. Therefore, the receipt and disbursement schedules could not be linked and an exception was generated.

Terminal Supplier (Disbursement) Seller FEIN – 104523504 ***** Error	Wholesaler (Receipt) Purchaser FEIN - 161353957
Document Number – 123AAC	Document Number – 123AAC
Purchaser FEIN - 161353957	Seller FEIN – 104523506 ***** Error
Carrier FEIN - 581456987	Carrier FEIN – 581456987
Product Type - 124	Product Type - 124
Point of Destination - 18500001	Point of Destination - 18500001
Point of Origin - 138734427	Point of Origin - 138734427
Mode of Transport - J	Mode of Transport - J
Date Shipped – 01/01/2013	Date Received – 01/01/2013
Gallons – 4,000	Gallons - 4,000

Example 2: The following is an example of a detailed exception. In this case, the terminal supplier reported 4,000 gallons instead of 400. Therefore, additional tax is due on 3,600 gallons of gasohol.

Terminal Supplier (Disbursement) FEIN - 104523504	Wholesaler (Schedule 1A) FEIN - 161353957
Document Number – 123AAC	Document Number – 123AAC
Purchaser FEIN - 161353957	Seller FEIN - 104523504
Carrier FEIN - 581456987	Carrier FEIN - 581456987
Product Type - 124	Product Type - 124
Point of Destination - 18500001	Point of Destination - 18500001
Point of Origin - 138734427	Point of Origin - 138734427
Mode of Transport - J	Mode of Transport - J
Date Shipped – 01/01/2013	Date Received – 01/01/2013
Gallons – 4,000 ***** Error	Gallons - 400 **** *Error

- Diversion Review**

Diversion is defined as product shipped from a terminal to a state or jurisdiction other than the destination state or jurisdiction indicated on the original bill of lading issued at the terminal.



Diversion reporting may or may not be required in your state but reviewing diversion information even when not required by state law can be a deterrent to motor fuel tax evasion.

If your state subscribes to the National Fuel Diversion Registry Program you will receive notification whenever your state is impacted due to a diversion being filed with the registry, when your state is the origin or destination. This will allow you to review the affected customer's filing(s) to ensure the proper gallons and tax are reported.

There is an annual fee to subscribe to the National Fuel Diversion Registry Program. Contact the FTA.

Diversion review is a good compliance tool even if your state does not statutorily require diversion reporting.

- **Import/Export Information Exchange Between States**

Exchanging import/export information between states is an important part of monitoring compliance. Cross-border evasion has been an issue for many years. It is especially true when a state is surrounded by state(s) with lower fuel tax rate(s). Many states exchange export information with destination states today. There are a few different options available for the exchange of information. EDI files can be transmitted safely and translated by the receiving state for review. Other states not using EDI have found exchanging information through e-mail in flat file format to work for them. However, since the discontinuation of ExTOLE, states have found it to be more cumbersome due to the need for multiple passwords for various states secure e-mail systems. There are some states that still wish to receive export information through the postal service either by printed reports or the export schedules submitted with the monthly return by the customer.

You should contact those states that you need to exchange information with to determine what method works best for both states.

- **Dyed Fuel Enforcement Programs**

Effective January 1, 1994, in an effort to reduce fraudulent use of untaxed diesel fuel, the federal government required diesel fuel sold for off-road use to be dyed red. Penalties were imposed for the use of dyed fuel in highway vehicles of \$1,000 or \$10 per gallon, whichever is greater. In addition to the penalty, the road tax would also be assessed. The penalty is for each occurrence and is increased for subsequent violations. The federal government's statute also allows for a penalty of \$1,000 if an individual refuses to allow an inspection. If a fuel sample is tested and contains any trace of red dye, the IRS considers this to be a violation. The federal government fuel inspectors are Fuel Compliance Officers (FCO) and Fuel Compliance Agents (FCA) and are employed by the IRS.

Many states have developed their own dyed fuel programs. In some states the diesel fuel compliance programs often involve participation of multiple state agencies. It is preferable for fuel inspectors to have the authority to stop vehicles traveling on the highway in order to check for the use of dyed fuel. Law enforcement personnel such as State Highway Patrol officers or Motor Vehicle Inspectors who routinely inspect vehicles for safety violations may be the best choice to perform inspections for use of dyed diesel. States must determine the penalty amounts that will be assessed at the state level for violations. Some state programs have adopted the federal penalties.

Testing of samples to determine presence of dye may be performed in a petroleum laboratory. These labs are often operated by the state's Department of Agriculture. States also have the option of contracting with the Internal Revenue Service to do the testing at their labs.

If your state is considering developing a dyed fuel program there are several things that should be considered. Some examples are;



- ✓ Do your statutes support the taking of fuel samples?
- ✓ Do you have an MOU (Memorandum of Understanding) signed with the IRS to partner with them in dyed fuel enforcement?
- ✓ Who has the authority to stop a vehicle?
- ✓ Where will the laboratory testing take place?
- ✓ Have penalties been determined?
- ✓ Who will train your fuel inspectors or enforcement personnel?
- ✓ Talk to states that have an existing dyed fuel program

If your state does not have a dyed fuel enforcement program today, chances are there is dyed fuel being used on your state highways and roads. When dyed fuel programs are first developed you may see a high percentage of violations; but as time goes on, percentages should diminish due to the presence of fuel inspectors in the field.

- **Publicity of Prosecuted Fuel Tax Cases**

States have found that publicizing prosecuted fuel tax cases can be a deterrent to evading motor fuel tax. Publicity has ranged from local to national news media and even state websites. When cases are made public, both states and industry can benefit from the information provided. The more known about current trends, evasion schemes and individuals involved, the more diligent we can all be in the fight against motor fuel tax evasion. State confidentiality statutes should always be considered before releasing any information regarding tax evasion.

- **ExSTARS**

Excise Summary Terminal and Reporting System (ExSTARS) is a federal Internal Revenue Service (IRS) system. ExSTARS requires monthly reporting and focuses on the terminal distribution level and processes data reported by terminal operators and bulk carriers. Each taxable fuel facilities is issued a facility control number (FCN). Fuel terminals are issued a terminal control number (TCN), and refineries are issued a refinery control number (RCN) by the IRS. Each terminal (TCN), and vessel or pipeline operator is required to electronically file a monthly report in ExSTARS which includes inventory balances and detailed product distribution information.

To participate and review ExSTARS data, each state will need to sign an MOU with the IRS. Each state wishing to receive ExSTARS data will first have to pass the IRS security review. Once approved, individuals will receive a User ID and Password to be used to access the ExSTARS system on the internet to download the data specific to your state. It is important to remember that ExSTARS is an IRS system and IRS confidentiality rules apply; therefore, there are special handling guidelines depending on whether the data the state received according to IRC 6103(d), or IRC 6103 (c). If the data is subject to IRC 6103(d) provisions, it must be secured to a higher level. Refer to IRS Publication 1075 Tax Information Security Guidelines for Federal, State and Local Agencies and Entities or contact your IRS security liaisons. For IRC 6103(c) data also referred to as 813 data, it is treated as state data and can be handled with state confidentiality rules.

As a state, if you are relying on terminal reports, manifest and import information from other states, you may not be getting a complete picture of fuel movement in your state. ExSTARS is a national accounting system of all products entering and leaving terminals throughout the United States. ExSTARS allows you the opportunity to view information regarding loads of fuel leaving an out of state terminal destined for your state to verify proper reporting and tax calculations.