Internal Revenue Service
Market Segment Specialization Program

Gas Retailers

Audit Technique Guide (ATG)

NOTE: This guide is current through the publication date. Since changes may have occurred after the publication date that would affect the accuracy of this document, no guarantees are made concerning the technical accuracy after the publication date.

This material was designed specifically for training purposes only. Under no circumstances should the contents be used or cited as sustaining a technical position.

The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in *Webster's Dictionary* or from a list of names of counties in the United States as listed in the *U.S. Government Printing Office Style Manual*.

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Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

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Chapter 1

BACKGROUND INFORMATION

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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 makes MARKETABLE PRODUCTS out of the crude
4. The MARKETING Department of OIL COMPANIES handles sales of these products to distributors, jobbers, wholesalers or brokers and 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 sources of revenue:

1. Gasoline
2. Diesel fuel
3. Sale of vehicles
4. Car wash
5. Mini-markets
6. Lottery
7. Check cashing
8. Propane
9. Scales
10. Repair shops with or without tow
11. Towing
12. Kerosene

GASOLINE SUPPLIERS

Virtually all gasoline stations fall into one of two broad categories: majors and independents. Gasoline stations that sell branded gasoline (those who operate under the major brand names, such as Mobil, Shell, etc.), usually have signed agreements which restrict them from buying from anyone other than their respective major Oil Company. However, experience shows that some major retailers do buy additional gasoline or diesel fuel from independent distributors. The major Oil Company(ies) can operate branded locations. The dealer may own the property ("open dealer") or may lease the station from the Oil Company(ies) ("dealer operated"). Sometimes diesel fuel can be purchased from independent suppliers; however, the pumps need to be clearly marked to indicate the diesel fuel product is not the major oil company's diesel fuel being sold.

Independents are stations that go by any name other than those listed below. Independents are also referred to as "unbranded" stations. They purchase gasoline from anyone, including independent distributors as well as from major marketing departments. Frequently, an independent Oil Company(ies) also owns several gasoline stations. In some cases, it is obvious these stations are related. In other cases, the relationship is not obvious.

MAJOR OIL COMPANIES

For our purposes, the Major Oil Companies sells gasoline under the following brand names:

Amoco [BP Amoco]	Exxon [Exxon Mobil]	Sinclair
ARCO [BP Amoco]	Fina	Sun
BP [BP Amoco]	Getty	Sunoco
Chevron	Hess [Amerada Hess]	Texaco
Citgo	Marathon Ashland	Tosco
Coastal	Mobil [Exxon Mobil]	
	Total [Ultramar, Diamond Shamrock	
Conoco	Philips	
Diamond Shamrock [Ultramar, Diamond Shamrock		
Shell	Union 76 [Tosco]	

INDEPENDENT OIL COMPANIES

Gasoline stations supplied by independent oil companies are more difficult audits than those supplied by a major oil company.

First, the suppliers of gasoline and diesel fuel products must be identified. Purchase invoices provided during the audit can determine some of these suppliers. It is recommended that you work with the excise tax specialists to accumulate a list of suppliers in your district for future reference.

MINOR (UNBRANDED) STATIONS

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

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

These distributors may furnish unreliable information, for instance:

1. Information given on sales to stations might be inaccurate.
2. Information may be self-serving, especially if the distributors own or have a close relationship with the station.
3. These individuals (brokers, jobbers, etc.) go in and out of business frequently and thus, the information is often "unavailable." [Possible burn-out company]

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

OTHER PRODUCT (NON-GASOLINE) SUPPLIERS

Food Wholesalers

Suppliers can be located through your local telephone directory. Cigarette distributors also can be located through the local food wholesalers. These suppliers 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 parts on a cash basis. Following this trail is very difficult but not impossible. First, review the overall income per service bay. A median amount should be between $60,000 - $150,000 per service bay. The mechanic is usually an employee.

Review the repair invoices, which should be sequentially numbered and reasonable in amount. For example, there should be a labor charge, not just a charge for parts. Also consider what to do about missing invoices. Look for the voided, and estimates of, service bay repair invoices. The auditors should be able to interpolate from these available invoices the total service bay repair income.

Remember, if a station owner shows you a repair bay operating at grossly less than the wages of its mechanic, there is further reason to investigate.

MARKETING STRUCTURES FOR OUTLETS

Gasoline retail outlets are frequently categorized as follows:

Service Stations

These are facilities with at least one mechanic's service bay in addition to gasoline pumps (typically with sales of at least 20,000 gallons/month).

Pumpers

This is a facility with at least six nozzles, selling in total on the average more than 50,000 gal./mos.; there may be supporting services such as a C-store, car wash or bays.

Convenience Marts

Small retail facilities with one or two pumps and fewer than six nozzles.

Other Small Gasoline Dispenser

Recap of **1988** Statistics

Type of Outlet	Percent of All Outlets	Avg. Monthly Galls Sold Per Respective Outlet In thousands	Percent of Volume of All Gasoline Sold*
Service Station	29	79	26
Pumpers	45	125	64
Convenience Marts	18	37	8
Other	8	20	2
Total	100	261	100

***1998** estimated sales of gasoline 2.9 billion gallons

SURVEYS

Surveys can be used but we must first show that either the books and records are unavailable or that they are inadequate to determine the substantially correct tax.

Bureau of Labor Statistics (BLS)

This is a Government Indexes and Databases survey covering approximately 82 markets throughout the United States. It does not compile data by Oil Company(ies) but instead does compile data by type of gasoline/diesel fuel. This survey has been successfully used in court. ***Stafford v. Commissioner*** T.C. Memo 1992-637.

While BLS statistics can be used to support an income adjustment, such statistics may not be used solely to determine income, IRC section 7491(b).

American Automobile Association (AAA)

AAA canvases the United States. There has not been a court case using this survey. District Counsel should review AAA survey before it can be used. Provides in its AAA Daily Fuel Gauge Report comprehensive retail gasoline surveys, based on daily data taking in over 60,000 self-server stations (access www.aaa.com).

U.S. Department of Energy

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

Lundberg Survey

The Lundberg Survey provides retail-selling prices for gasoline and diesel fuel. The prices are listed by: type of Oil Company, full service, self-service, credit, cash, and grade of gasoline. The use of this data source was upheld in ***Barragan v. Commissioner***, TC Memo 1993-92 ***aff'd*** 76 A.F.T.R.2d 95-5629, 95-2 U.S.T.C. 50,624 (9th Cir, 1995).

U.S. Department of Commerce

Economics and Statistics Administration, Bureau of the Census, provides a periodical Census of the Retail Trade, including Gasoline Retail Stations (www.census.gov/bus/retail).

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Chapter 2

PRE-AUDIT TECHNIQUES

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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.

The 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 more difficult to follow than other businesses with tighter internal controls. Sometimes no records are maintained or they are kept sporadically and in a disorganized manner. For these situations we have developed some alternative approaches to computing income for a service station under audit. In districts whose state(s) have sales tax you can work through your Fed-State contacts to get gross sales information. For example, the California State Board of Equalization provides information for California service stations.

IDENTIFY SOURCES OF INFORMATION

Order Cash Transaction Reports (CTRs), Information Returns Processing (IRPs), for the Social security Number (SSN) and Employer Identification Number (EIN) on the case. These sources of information can be used to obtain information for determining unreported income. It should be stressed that all TINs should be gathered and then all CTRs should be ordered. Sometimes the TIN you have is not where all the money is being deposited! Be sure to check spouses and children (shown as dependents) SSNs also.

1. CTRs of over $10,000 in cash (see CTR Coordinator)

2. IRP Transcripts (order in your group)

IRPs 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. Other types of rebates are also given for certain mini-mart items from the manufacturers.

Chapter 3

AUDIT TECHNIQUES

CONTENTS

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 have, so prepare your questions in advance. See Exhibit 2 for pages of text for appropriate interview questions to assist the examiner. See Exhibit 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 nearby. Do they now or did they use to offer cash discounts? One very important thing to observe is how many customers are pumping their own gasoline and how many are getting full service. Also observe the types of non-gasoline activities. See Exhibit 4 for a sample drive-by data collection sheet.

SUMMONS THE OIL COMPANY

If initial observations suggest that the taxpayer may be underreporting income, consider issuing a summons to the Oil Company(ies) for records for its sales to the service station. As added by the Taxpayer Bill of Rights, IRC section 7602(c) requires that we give taxpayers reasonable notice in advance of all contacts with third parties made regarding the determination or collection of their tax liabilities. That Section also requires that we provide the taxpayer with record of all such third-party contacts. A summons served on a third party is a third-party contact under IRC section 7602(C). The advance notice of the third-party contacts required by IRC section 7602(C) must be given in addition to the notice of a third-party summons required by IRC section 7609(a). Therefore, provide the taxpayer with a Letter 3164 before issuing a third-party summons and complete a Form 12175 for each summons issued.

See Exhibit 1. Give notice of this third-party summons as required by IRC section 7609(a) to the taxpayer and all other persons identified in the summons. Contact the appropriate Counsel office if you have questions about third-party summonses.

POTENTIAL SOURCES OF ADDITIONAL INCOME

After opening the audit if the observations suggest that the taxpayer may be underreporting his or her income, you should consider issuing a third party contact either through a summons or letter. Don't forego the new third party contact requirements of TBOR II and under IRC section 7602 and 7609 along with the Acts 3415 and 3417. Again any questions should be directed to your local District Counsel Office.

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)?
   That is, unbranded pumps, car wash, snow plows, cigarettes, beverages, vending machines, tires, repair bays, licensing for state inspections, mini-mart, lottery tickets, etc.

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

2. Location and Sales ─ Expect a good location site to have a high volume of sales.

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

4. Are cars for sale at the location?

   Motor Vehicle Records ─ determine local or state procedures for securing this information.

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

   Real Estate Records ─ for real estate sales and purchases. Contact your Collections employees for the best source of this information.

6. Check the current selling prices and note variances between prices of gasoline at the taxpayer's station and other stations in the area.

7. How many pumps; what are the grades of product being sold and are there any other types of products such as diesel fuel, propane, or blending products?

8. Have internal controls been addressed? Are the internal controls currently in place the same as during 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.

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

10. State and Federal Agencies responsible for:

    - Sales Tax
    - Weights & Measurements
    - Environmental Concerns
    - Measurement Standards; etc.

11. Bank Deposit Analysis

    A bank deposit analysis may not work for all cash businesses. Many businesses that deal heavily in cash do not deposit all cash received.

    Recently, more people are using debit cards and credit cards to pay for gasoline and diesel fuel purchases. Also service bay repairs are normally paid by check or credit card. Therefore, it is now easier to use a bank deposit analysis as an indirect method to support our BLS adjustment.

    The key to doing a bank deposit analysis for a service station business is to remember to add to bank deposits the amount of credit card sales and cash payouts. When a person buys gasoline at a gasoline station by using an Oil Company(ies) credit card, the Oil Company(ies) receives the credit card sales money directly. The Oil Company(ies) then gives the service station owner credit for his or her daily credit card sales against the fuel purchases.

OTHER GROSS INCOME ISSUES

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 when comparing the records presented to the auditor during the audit and the records presented from the State the information should match. If not, there is underreporting.

Sale of Business Assets or Franchise

Sales of service stations go through escrow and are recorded in document repositories such as the county court houses (for example, in Los Angeles 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 (and/or goodwill)
$289,000	Total
======	

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

The Oil Company(ies) has agreements that allow new owners to purchase the assets of the business and pay off the liability by being charged an extra few cents a gallon for purchases.

Since this should not be charged to cost of goods sold, but rather should be charged against a payable, agents should obtain copies of the purchase agreement and discuss this at the opening conference. The extra charge is a combination of interest and principal and must be distinguished.

Agents should consider the impact of the sale of franchise rights and franchise agreements/lease versus sales.

Inventory

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

Missing Stations

There have been cases where taxpayers file a tax return, including a Schedule C, but omit one or more of their other gasoline stations. When serving the summons, request "this station and any other stations, owned or operated by (the taxpayer)." Watch for statements showing deliveries to different addresses and other clues that the taxpayer owned more than one station.

Provide both the Social Security Number and Employer Identification Number on the summons to assist the oil companies in this search.

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

Unreported Income

The information you received from your taxpayer must be accepted on the facts, not what the taxpayer claims to be reasonable. If you find additional income or assets which are unreported, it is up to the taxpayer to prove that they are nontaxable.

However, note that a discrepancy between a taxpayer's explanation of additional income or assets and the financial status 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

Mechanic/Service Bays

One bay, one mechanic will bring on the average $25,200 gross profit. In this example the hourly rate charged is $40 for 6 hours work for a total of $240 in income.

Daily income	$240
Per person wage of $20 for 8 hours	160
Profit per day	$ 80
	====

At $80 per day and 315 days worked, the total amount of gross profit is: **$25,200**

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.

Useful 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	79.9%	81.7%	
Cost of Operations			82.17%
Gross Profit	20.1%	18.3%	17.83%
All Other Expenses	1.6%		*1.98%
Profit Before Taxes	1.3%	1.8%	1.75%

*Author's inserted calculations

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. A diesel fuel pump in an average service station location will (on the average) pump 10,000 to 20,000 gallons per month.

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

3. An average truck stop will sell from 200,000 to 1,000,000 gallons of diesel fuel 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	$45-60 per hour per person
Fuel	7% ARCO regular unleaded to 15% Independent regular unleaded

Fuel Product Distribution:

- 10% regular unleaded (loss leader)
- 10-20% mid. 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 $125,000 to $250,000 or more. To help break down the above figures even more, the following information about different types of sales maybe 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. One thing to consider is what percentage of their total pumps is full serve versus the percentage of self-serve pumps.

TBA (Tires, Batteries and Accessories) and Oil:

Mark-up ranges:

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

MINI MARTS:

Mark-up ranges:

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

COMPUTE PURCHASES AND SALES AND COMPARE TO TAX RETURN

After opening the audit if the observations suggest that the taxpayer may be underreporting their income, do not forego the new summons requirements of TBOR II and IRC sections 7602 and 7609 along with the Acts 3415 and 3417. Again any questions should be directed to your local District Counsel Office.

- Go through your Internet access for your Bureau of Labor Statistics survey of periodic index of retail gasoline prices, listed by type of gasoline or diesel fuel and the service station regional location.

- Print a copy of the portion of the BLS Survey that covers the area in which your district lies.

- Prepared spreadsheet to tailor spreadsheets for your region and/or district using the BLS Survey information received.

- Spreadsheet should include the following items:
  1. company name
  2. type of gasoline sold (unleaded, and premium)
  3. full or self service
  4. average price of gasoline per BLS Survey

- When the summoned information comes in, run the Bureau of Labor Statistics Survey (BLS) analysis for determine gasoline and diesel fuel gross receipts. Calculate the gasoline gross receipts by multiplying the BLS price and the gasoline gallons purchased (per the summons) to compute the potential gross gasoline sales. Then compare this calculated amount to the amount on the tax return and determine whether an adjustment is indicated. Do not forget to consider non-gasoline sales when comparing your BLS computed gasoline and diesel fuel sales to the tax return.

- Compare the dollars and gallons purchased information received from the Oil Company(ies) to the tax return. Remember, this is only the gasoline/diesel fuel sales and there are probably other items being sold at the station. See below for other items.

Surveys can be relied upon:

1. Lundberg Survey

   - Related case laws ─ ***Barragan v. Commissioner***, TC Memo 1993-92 ***aff'd*** in unpublished opinion1995 U.S. Lexis, 76 A.F.T.R.2d 95-5629, 95-2 U.S.T.C. 50,624 (9th Cir, 1995)

2. Department of Energy

3. Bureau of Labor Statistics

   - Related case laws ─ ***Stafford v. Commissioner***, TC Memo 1992 (court case in Dallas allowed the IRS to use this method for calculation of gross income).

4. American Automobile Association

A realistic approach to using any other survey is to consider its reliability as a gross sales analysis tool and its defensibility in court.

Any reference to surveys should include the new statutory provision and examination restrictions. In the case of an individual taxpayer, IRC section 7491(b) places the burden of proof on the Service with respect to any item of income which was reconstructed solely through the use of statistical information (for example, BLS statistics is "solely" used to reconstruct Income). Further such "sole" use of statistics is contrary to Service guidance which limits it usage to non-filing and uncooperative taxpayers. IRM 4(12) 64.3.

While we believe that a proper examination as described in this ATG would not run afoul of IRC section 7491(b) and that these surveys can continue to be used to determine income. We emphasize again that they may only be used in conjunction with other information, which would support a conclusion of unreported income.

OTHER ISSUES

Rent/Other Expenses

Another situation, which appears in a number of cases, is the double deducting of 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 purchases statements. The agreement between the dealership and Oil Company(ies) is also a good source of information.

Another problem with rent occurs when the taxpayer takes the full amount shown for rent per the purchase invoices. However, most of the major oil companies charge rent based on gallons purchased, but then the Oil Company(ies) gives the taxpayer a rent rebate.

Franchise Fees and Covenants Not to Compete

This could be disguised goodwill. Goodwill is an intangible asset as defined in IRC section 197. For pre-August 11, 1993, acquisitions, goodwill (for example; acquired in connection with a franchise) cannot be written off, but remains on the books as a capitalized item. 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 the straight-line depreciation method. IRC section 197 was added in the Revenue Reconciliation Act of 1993 and permits 15 years straight-line depreciation for IRC section 197 intangibles, which specifically include franchise fees, 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. Don’t forget to consider the whipsaw issue between what the taxpayer claims as an expense and what the seller claims as a capital gain.

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 as a cost of goods expense. The reserve account is included on the gasoline purchase invoices. Make sure that if you see gasoline reserve on a purchase invoice that the bottom amount of the purchase invoice is not purchases per return. Additionally, ensure that the taxpayer has included as income any interest credited to this account for benefit of the taxpayers.

Rebates

Major oil companies give rebates for increased purchases. These are incentive programs. Generally, rebates are required to be offset against the purchase price of the merchandise on which rebates are computed. 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(ies) will generally apply this to the station rent or as a credit to the taxpayer’s account.

Check to insure that the taxpayer does not deduct the full amount of the purchase through cost of goods sold without reducing it by the rebates. See Treas. Reg. section 1.471-3(b). Lately, the major oil companies will pay a rebate for the stations to be shut down for remodeling or replacement of the under ground storage tanks. Some oil companies give rebate incentives for stations being open 24 hours.

A change to correct the timing of when a taxpayer accounts for purchase rebates (for example, income versus reduction of the price of purchased merchandise) is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply. See Rev. Proc. 97-27, 1997-1 C.B. 680.

Other Taxes

Watch out for amounts equal to taxes (sales and excise) collected by the oil companies but not shown in the purchase documents summoned. It is important to determine whether these amounts were included in the total dollars and per-gallon figures of the summoned documents. (Very important: The retail-selling price in the BLS Survey includes all appropriate taxes. Make sure that any prepaid taxes are included in the purchases.) It is a common practice for the gasoline station (and their suppliers) to collect the amount of sales tax or excise taxes from the consumer. Watch out for double deductions, that is, taxes to be included in the cost of goods sold as well as a separate expense item.

The federal taxes on gasoline, diesel fuel, and, beginning July 1, 1998, kerosene, are imposed on the products before the products are delivered to the service station. Thus, the Retailers are not responsible for paying these taxes to the government; rather, the amount of the taxes is usually included in the station's purchase price of the products. This is common in many states. See Exhibits 6 and 7 for more information.

However, see the discussion of "Blending," below.

The operator generally is liable for the tax on propane and other liquefied petroleum gasoline (LPG) that it sells for use in vehicles.

See a further discussion of federal excise taxes on fuels in Exhibit 5.

Netting Taxes

The oil companies collect the pre-collected sales tax. The taxpayer receives credit for this pre-collected sales tax on their state sales tax returns. One common problem found during audits is where the taxpayer deducts the full amount of the gasoline and diesel fuel purchase invoiced as purchases per return. However, many taxpayers report their gross receipts net of sales taxes. Therefore, if a taxpayer reports their gross receipts net of sales taxes, then make sure their purchases are reported net of the pre-collected sales tax.

Dyed Fuel

Diesel fuels and kerosene that has been dyed red according to Treasury Regulations has not been taxed when the fuel is delivered to the service station. A legible and conspicuous Notice stating either: DYED DIESEL FUEL, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE, or DYED KEROSENE, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE must be posted by the seller on any retail pump where it sells dyed diesel fuel or dyed kerosene for use by its buyer. A substantial penalty (and tax) may be imposed on a person that sells dyed fuel for a taxable purpose, such as for use in a registered highway vehicle. If you suspect that these rules are being violated, contact your excise tax group immediately.

Blending

Some service stations sell gasoline and diesel fuel into which the operator has added previously untaxed liquid. Stations may blend to generate more sales per gallon of gasoline or diesel fuel purchased. The most common products used for blending include naphtha, alcohol, transmix, waste oil, and (before July 1, 1998) kerosene. Generally, the blender owes excise tax on this increased volume of fuel. If you suspect that a blender is not paying the tax to the government, contact your excise tax group immediately. If you find an invoice for one of these blending products, serve a summons for all purchases and add this to the original gasoline or diesel fuel purchases before applying the BLS pricing.

Note that the taxes (both excise and sales) could be over 40 cents per gallon.

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

Example 1

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

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Reg. Unlead	5,000	Reg. Unlead	3,000
Prem. Unlead	1,000	Prem. Unlead	3,000
Gals. Taxed & Purchases	-----	Gals. Taxed &Purchases	-----
	6,000		6,000

Example 2

In this example, 5,000 gallons of regular unleaded gasoline become 5,000 gallons of premium.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Reg. Unlead	5,000	Reg. Unlead	-0-
Prem. Unlead	-0-	Prem. Unlead	5,000
Gals. Taxed & Purchases	-----	Gals Taxed & Purchases	-----
	5,000		5,000

Example 3

In this example, 6,000 gallons of regular unleaded were mixed with 1,000 gallons of previously untaxed naphtha and premium unleaded. It is sold as premium unleaded. The amount of the tax from the sale is collected but not reported.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Reg. Unlead	6,000	Reg. Unlead	* 4,000
Prem. Unlead	1,000	Prem. Unlead	* 4,000
Naphtha	1,000		-----
	-----	Gals. Taxed on Sale	8,000
Gals. Purchased	8,000		

*Gals. Tax Paid On 7,000

Example 4

In this example, 6,000 gallons of diesel fuel is mixed with 1,500 gallons of previously untaxed transmix and sold as diesel fuel. The amount of the tax from the sale is collected but not reported.

Product Purchases		Product Sales	
Product	Gallons	Product	Gallons
Diesel fuel	6,000	Diesel fuel	* 7,500
Transmix	1,500		-------
	-----	Gals. Taxed on Sale	7,500
Gals. Purchased	7,500		

*Gals. Taxes Paid On 6,000

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 (re-branding) and/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 is not the true owner of the property. Or, the taxpayer may deduct the expenses and not report the income.

An Oil Company(ies) makes cash payments to a Gasoline Station Owner for the purpose of improving the image of the Owner's station. The Station Owner maintains title to the improvements.

Improvement of the station may be contingent upon the Station Owner purchasing a specified volume of petroleum products.

Types of Reimbursements

The Oil Company(ies) may disburse the cash payments in a lump sum or in a series of payments upon the purchase or petroleum products. The Oil Company(ies) might also require the Station Owner to pay for the improvements before disbursing the cash payments.

How Should It Be Reported?

The facts and circumstances of your specific image upgrade program may vary from the typical program and produce different tax results. For example, the tax results may vary depending on the relationship of the cash payments to the purchases of petroleum products, the nature and ownership of the image upgrades, or the contractual relationship between the Gasoline Station Owner and the Oil Company(ies). We recommend that a Gasoline Station Owner consult with a tax advisor to determine the proper tax treatment.

Typical Treatment by Recipient

- Cash Payments

  Generally, a gasoline station owner should include the cash payment fully in gross income in the taxable year that is proper under the station owner's method of accounting.

  In an overwhelming majority of cases, station owners must use an accrual method of accounting. If the purchase, production or sale of merchandise is an income-producing factor in the taxpayer's business, then the taxpayer generally must maintain inventories. But see Rev. Proc. 2001-10, 2001-2 I.R.B. (Jan. 8, 2001). (Providing a "small taxpayer exception" from the requirements to use an accrual method under IRC section 446 and to account for inventories under IRC section 471 for taxpayers with average annual gross receipts of $1,000,000 or less.)

  Taxpayers who maintain inventories are required to use an accrual method of accounting unless the Commissioner authorizes the taxpayer to continue to use its present method of accounting. The courts have developed a test to determine whether the Commissioner has abused his discretion in not permitting a taxpayer to continue to use its present method. That test is the substantial identity of results test (SIRT). If a taxpayer meets the SIRT then it will be permitted to continue to use its present method.

  Under the SIRT, the taxpayer must establish that its present (generally cash) method of accounting produces substantially identical results to the accrual method proposed by the Service. The courts have held that where the difference is as little as 1.32 percent or 1.6 percent the methods do not produce substantially identical results. ***Wilkinson-Beane v. Commissioner***, 420 F.2d 352 (1st Cir, 1970); ***Surtronics, Inc. v. Commissioner***, T.C. Memo 1985-277.

- Expenditures

  A Gasoline Station Owner may deduct certain costs paid with monies received under an Image Upgrade Program. To be deductible, these costs must be for ordinary and necessary expenses paid or incurred in the taxable year for carrying on a trade or business. Deductible cost may include incidental repairs and advertising.

  A Gasoline Station Owner is not permitted to deduct any costs paid or incurred for new buildings or permanent improvements or betterments that increase the value or prolong the useful life of property. These costs must be treated as capital expenditures. For example, expenditures for new signage and new gasoline pump. Generally, such costs may be recovered through depreciation or amortization. Any remaining basis is taken into account in determining gain or loss when the property is sold or otherwise disposed of.

In the first year in which a taxpayer begins to capitalize costs required to be capitalized, which the taxpayer has consistently deducted in the past, there is a change in the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

- Other compliance issues:

  1. The money received may not be used for business purposes.
  2. The taxpayer may treat the payment as a loan, then capitalize the improvements.
  3. The taxpayer deducts the expenses and does not report the income, or
  4. Attempts to defer the inclusion of income over time.

Questions to Answer

Several questions arise in deciding whether or not an amount received should be considered a loan or income to the recipient:

1. Was there a debtor-creditor relationship created at the time the proceeds in question were received by a party to the transaction?
2. Was there an intent to repay the other party?
3. Did the creditor intend to enforce the "obligation"?
4. Was the transfer documented and evidenced by written agreements? (For example, is there a note?)
5. Was interest paid?
6. Was there regular repayment of principal or interest by the debtor?
7. Was there a specific date for repayment of a sum certain by the debtor? Alternatively, was the repayment predictable and realistic?

Most loans usually have a date certain for repayment and a defined periodic payment amount (for example, bank home loans). In some situations there may not be a definite periodic payment amount being repaid, such as payment per gallons purchased. It is not necessary to have a definite fixed monthly amount to have a valid loan as long as the taxpayer’s loan meets the court's definition of a bona fide loan (as discussed below).

What is a Loan?

"The Tax Court considered certain objective facts to determine the taxpayer's intent and whether a bona fide loan occurred. The factors derived from case law and applied by the Tax Court included:

1. The existence or non-existence of a debt instrument;
2. Provisions for security; interest payments and fixed payment date;
3. Whether or not repayments of a loan were made;

4. The taxpayer's ability to repay the loan; the borrower's receipt of compensation; and the testimony of the taxpayer.the repayment of loan must be unconditional and not contingent upon some future event. ***Frierdich v. Commissioner***, T. C. Memo, 1989-103 ***aff'd***. 925 F.2d 180 (7th Cir 1991). See also ***Columbo v. Commissioner***, T.C. Memo 1975-162.

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 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.

Accommodations

Payments between the major oil companies and service station dealers may involve the refund to dealers of gasoline purchase charges in excess of the customary charge for gasoline. The excess charge is retained in a separate account to be used for the discretionary benefit of the dealer. This could be called a number of things, such as liquidation/accommodation agreement, or security agreement.

Disbursement of the funds could go directly to the dealer or payments are made on behalf of the dealer to a third party.

This type of agreement allows the dealer to take the full amount of the invoice when only the actual business expense should be deducted.

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 amount should be de minims. Any large amount claimed should be substantiated. For example 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(ies) 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.

Depreciation Period for Service Station Canopies and Service Station Buildings

Summary of Issues Encountered in Gasoline Retailing

	DEPRECIATION PERIOD AND METHOD		
ASSET	5-YEARS (CLASS 57.0) DDB TO S/L	15-YEARS (CLASS 57.1) 150%DB TO S/L	39 YEARS [1](NONRESIDENTIAL REAL PROPERTY) S/L
Canopy, signs	if personal property	if land improvement (for example, cemented in)	N/A
Service Station Building	if modular unit (that is, movable)	building (permanent structure)	
		primarily used for gasoline retailing, measured by floor space <u>or</u> gross receipts	Primary gasoline retailing test not met
Car Wash Building	if modular unit (that is, movable)	if building	N/A
Underground storage tanks, pumps, other mechanical equipment, piping, shelves, counters, refrigerators, vending machines	personal property (even if affixed or installed)	N/A	N/A
Parking Lot	N/A	part of Service Station	N/A

[1] 31.5 years for buildings placed in service before May 13, 1993.

Summary of Discussion of Depreciation Period for Service Station Canopies and Service Station Buildings

The following list contains the topics that are discussed.

- Depreciation Period Determined in the Code and by Asset Classes in Revenue Procedure
- Asset Classes for Gasoline Retail
- The Salient Distinction: Personal Property vs. Land Improvement or Building
- Gasoline Retail Station Building vs. Other Nonresidential Building (5 years, 15 years, 39 years)

  Modular Structures

  Fixed Station Buildings
    - ♦ Text Non-petroleum Sales, if any
    - ♦ Change in Classification Is Change in Accounting Method

  Other Assets Associated with Service Station
    - ♦ Car-wash Buildings, Associated Land Improvements
    - ♦ Canopies, Gasoline Brand Signs
    - ♦ The Tanks, Pipelines, And Pumps

Depreciation Periods Determined in the Code and by Asset Classes in Revenue Procedure

IRC section 168(c) provides the depreciation periods for various classes of property, including depreciation periods of 5 years, 15 years, and 39 years, for "5 year property", "15 year property", and "nonresidential real property", respectively.

IRC section 168(e)(3)(E) includes in "15 year property" certain retail motor fuel outlets (including C-Stores), see discussion below. According to IRC section 168(e)(2)(B) other buildings used in marketing (for example, not qualifying as retail motor fuel outlets) are considered "nonresidential real property."

Under the general rules of IRC section 168(e) the majority of assets are in property categories as defined by reference to class lives. For this discussion of interest: if property has a class life of more than 4 but less than 10 years it is "5 year property", and a class life of at least 20 but less than 25 years confers 15 year property classification.

Next, the term "class life" is defined by IRC section 168(i)(1). That definition incorporates former IRC section 167(m), which specifically authorized the Commissioner to promulgate regulations regarding class lives of depreciable assets.

The implementing regulations, Treas. Reg. section 1.167(a)-11(b)(ii), left the installation of the class life system to revenue procedures, currently applicable Rev. Proc. 87-56, 1987-2 CB 674.

It divides assets into two broad categories: (1) Asset guideline classes 00.11 through 00.4, consisting of specific depreciable assets used in all business activities (the asset category); and (2) asset guideline classes 01.1 through 80.0, consisting of depreciable assets used in specific business activities (the activity category). The same item of depreciable property could be described in both an asset category and an activity category. In doubt assets should be included in the asset category. (This is by analogy to the priority rule in Question 50 of Rev. Proc. 62-21, 1962-2 C.B. 418 ***et seq.***) Note this default rule does not apply if the asset is specially designed or dedicated to the activity. See ***JFM, Inc. v. CIR***, 67 TCM 239 (1994) [Service's argument that canopy is land improvement, includible in Class OO.3, rejected because asset clearly related to the gasoline marketing]; ***Norwest Corp. v. CIR.*** 111 T.C. 105 (1998) [court assigned to asset category furniture and fixtures that are not specially designed for taxpayer's activity].

Asset Classes for Gasoline Retail

Asset classes of interest for the Gasoline Retail Stations would be Classes 57.0 and 57.1 (activity classes includes gasoline retailing assets). It is generally not worthwhile to separate out general asset class property where it will attract the same depreciation as under the competing activity class; as you can see below, there would be only a difference for furniture and fixtures, etc., Class OO.11, with a depreciation life of 7 instead of 5 year as other personal property used in marketing).

Class	Description	Class Life	Depreciation Life
Asset Category			
00.11	OFFICE FURNITURE, FIXTURES AND EQUIPMENT: Includes furniture and fixtures that are not a structural component of a building. Includes such assets as desks, files, safes, and communications equipment.	10	7
00.13	DATA HANDLING EQUIPMENT, EXCEPT COMPUTERS: Includes only typewriters, calculators, adding and accounting machines, copiers, and duplicating equipment	6	5
00.3	LAND IMPROVEMENTS: Includes improvements directly to or added to land, whether such improvements are IRC section 1245 property or IRC section 1250 property, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers in Class 51), wharves and docks, bridges, fences, landscaping, shrubbery, or radio and television transmitting towers. Does not include land improvements that are explicitly included in any other class, and buildings and structural components as defined in section 1.48-1(e) of the regulations.	20	15
Activity Category			
57.0	DISTRIBUTIVE TRADES AND SERVICES: Includes assets used in wholesale and retail trade, and personal and professional services. Includes IRC section 1245 assets used in marketing petroleum and petroleum	9	5
57.1	DISTRIBUTIVE TRADES AND SERVICES- BILLBOARD, ERVICE STATION BUILDINGS AND PETROLEUM MARKETING LAND IMPROVEMENTS: Includes IRC section 1250 assets, including service station buildings and depreciable land improvements, whether IRC section 1245 property or IRC section 1250 property, used in the marketing of petroleum and petroleum products, but not including any of these facilities related to petroleum and natural gasoline trunk pipelines. Includes car wash buildings and related land improvements. Includes billboards, whether such assets are IRC section 1245 property or IRC section 1250 property. Excludes all other land improvements, buildings and structural components as defined in section 1.48-1(e) of the regulations.	20 yrs	15

Moreover, IRC section 168(e)(3)(E) specifically includes as 15-year property “any IRC section 1250 property which is a retail motor fuels outlet (whether or not food or other convenience items are sold at the outlet).”

For purposes of applying these class demarcations to service station building and canopies, IRC section 1245 property is personal property, while immovable property or land improvement have to be considered IRC section 1250 property.

Thus, the qualification for the shorter 5-year life depends on whether the particular asset can qualify as personal property. If so, the asset may be depreciated over 5-years (in Class 57.0 the asset has a class life of 9 years which, under IRC section 168(e), renders it 5-year property). Note that this could apply not only to canopies but also to modular service station buildings. Conversely, if the asset cannot be considered personal property but must be considered a building, a structural component of a building, or land improvement, in other words something which would be considered immovable property, the asset falls into Class 57.1 with a Class life of 20 years, rendering it 15 year property under IRC section 168(e).

<u>The Salient Distinction: Personal Property vs. Land Improvement or Building</u>

For the demarcation of tangible personal property under IRC section 1245 property, Treas. Reg. section 1.1245-3(b)(1) arrogates the helpful guidelines of Treas. Reg. section 1.48-1 (c). “Tangible personal property" means any tangible property

- EXCEPT land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures).
- Thus, buildings, paved parking areas, and fences are not tangible personal property.
- Tangible personal property includes all property (other than structural components) which is contained in or attached to a building.
- Property such as office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs, which is contained in or attached to a building constitutes tangible personal property.
- Further, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even under fixed installation.
- Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property. Local law shall not be controlling for purposes of determining whether property is "tangible" or "personal".

If the examining agent wishes to pursue this issue, further factual development is essential. The court in ***Whiteco Industries, Inc. v. Commissioner***, 65 T.C. 664 (1975) cited various factors to consider in analyzing whether particular property is a structural component of a building or depreciable personal property. They include:

- Whether the property is capable of being moved, and has it in fact been moved?
- Whether the property is designed or constructed to remain permanently in place?
- Whether there are circumstances which tend to show the expected or intended length of affixation, that is, are there circumstances which show that the property may or will have to be moved?

- How substantial a job is removal of the property and how time-consuming is it? Is it readily movable?
- How much damage will the property sustain upon its removal? and
- What is the manner of affixation of the property to the land? (Bolted down vs. cemented in.)

<u>Gasoline Retail Station Building vs. Other Nonresidential Building (5 years, 15 years, 39 years)</u>

1. Modular Structures

   If the Service Station building is a modular structure and would have to be considered movable personal property, it would fall into Class 57.0 with a 5-year depreciation period. Typically, only smaller modular structures (for example, kiosks) will qualify. In Rev. Rul. 75-18, 1975-1 CB 9, abandoned the functional use test. Thus, the mere fact that a modular structure is used like a building does not require its characterization as a building. The critical indicia are, as later highlighted in ***Whiteco***, whether the permanence of the structure is evident from the installation and the design. ***Fox Photo Inc. v. CIR***, TC Memo 1990-348, emphasized again the criteria of whether the structure is easily movable and whether constructed in a manner that reflects anticipation of the structure having to be moved. The absence of a plan to move a modular structure is not critical, that is, indefinite installation does not taint the personal property characterization.

2. Fixed Station Buildings

   a. Test non-petroleum sales, if any

      If there are significant sales other than traditional gasoline station products (motor fuel, lubricants, tires, batteries, other auto accessories, soft drinks and cigarettes), that is, in the case of a convenience store that is combined with gasoline sales, test the facility to determine whether it is used primarily in petroleum marketing. For Service Station Buildings (other than modular buildings, which would qualify as personal property), the Coordinated Issue Paper of April 2, 1997, provides further guidance. It discusses IRC section 168(e)(3)(E) as added by section 1120 of the Small Business Job Protection Act of 1996 (the Act). This section now provides that the term "15-year property" includes

      > "any section 1250 property which is <u>a retail motor fuels outlet</u> (<u>whether or not food or other convenience items are sold at the outlet</u>)." [Emphasis added]

      The legislative history (S.Rep. No. 281, 104th Cong., 2nd Sess. 15 (1996)) envisions for a gasoline retail outlet that at least 50 percent or more of the

      1) gross revenues are generated by traditional gasoline station retail, <u>or</u>
      2) floor space in the building (including restrooms, counters, and other areas allocable to traditional service station "services") are devoted to the petroleum marketing activity.

"Gross revenue" is defined as the revenue generated by the sale of the product to the consumer. For purposes of determining whether a C-store building qualifies as a retail motor fuels outlet, gross revenue includes all excise and sales taxes.

The gross revenue attributable to petroleum sales (motor fuel, lube oil, battery, tires, auto accessories and other traditional motor fuel retail outlet sales) should be compared to gross revenue from all other sources (for example, food items, beverages, lottery, video rentals, etc.). If the petroleum sales as reflected in (a) receipts or (b) floor space utilization, are greater than the non-petroleum sales receipts or floor use, the building qualifies as 15-year property. The gross revenue should be analyzed for a full tax period. Temporary fluctuations in the results of the revenue analysis should not be used to determine whether the building qualifies or fails the gross revenue test. For example, if a special promotion is run for a 6-month period and the gross revenue ratio is temporarily affected, the primary use of the building should not be changed. If the building initially meets (or fails to meet) the disjunctive 50-percent test, but subsequently fails to meet (or meets) such test for more than a temporary period, such failure or qualification is a change in the use of the property.

If either the petroleum sales or floor space use tests is satisfied, the building is treated as 15-year property; otherwise, the building should be treated as an ordinary retail building and, as a nonresidential real property attract a 39 year life (31.5 years for buildings placed in service May 13, 1993). However, small structures of 1400 square feet used in the context of gasoline retailing need not to be tested and should be accepted as qualifying under IRC section 168(e)(3)(E) as gasoline retail outlets. See Sec. 2, Rev. Proc. 97-10, 1997-1 CB 628.

b. Change in classification is change in accounting method

IRC section 168(e)(3)(E) is effective for structures placed in service after August 19, 1996. Taxpayers may elect to apply the provision to property that was placed in service before August 20, 1996. According to the legislative history, if a taxpayer has already treated the property as 15-year property the taxpayer is deemed to have made the election. If a taxpayer has not treated the property as 15-year property the Service treats the election as an accounting method change, with automatic consent granted as provided in Rev. Proc. 97-10, 1997-1 CB 628, ***supra***.

3. Other Assets Associated With Service Station

a. Car-wash buildings, associated land improvements

Car Wash Buildings are enumerated in Asset Class 57.1 property with 15-year depreciation, as are associated land improvements, such as pump islands.

b. Canopies, Gasoline Brand Signs

Canopies are in Class 57.1 with a 15-year life, unless they qualify under the ***Whiteco*** test, see above as personal property for Asset Class 57.0 and 5-year depreciation. In ***JFM, Inc. v. CIR***, T.C. Memo 1994-239, the court held canopies to be personal property in Class 57.0, with a 5-year life. The canopies in that case were bolted down onto four to six special concrete footings. Of the 14 canopies at issue, the taxpayer had sold 2 to third parties for reuse, and at least 3 had been taken down and ether moved to another location or had been rebuilt and reinstalled at the same location. Thus, some of these canopies had in fact been moved.

c. The tanks, pipelines, and pumps

Underground storage tanks, fuel dispensing pumps, and other automobile service equipment are under the ***Whiteco*** test typically considered personal property and to be subsumed to Class 57.0 with a 5-year life.

ENVIRONMENTAL CLEAN-UP ISSUE

Rev. Rul. 94-38, 1994-1 C.B. 35, 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 263 and the regulations thereunder). These costs are nondeductible capital expenditures under IRC section 263.

Rev. Rul. 94-38 does not apply in situations 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.

A change to require the taxpayer to begin capitalizing costs required to be capitalized, which the taxpayer has currently deducted, is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

Moreover, neither IRC section 162 nor section 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.

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SUMMONS

MAJOR OR MINOR

All records for the periods ending December 31, 19xx, December 31, 19xx, and December 31, 19xx, of transactions with [name(s) of taxpayer(s) and/or the specific service station(s)] regarding the following items:

1. All purchase reports for gasoline (that is, regular, unleaded and super unleaded) and diesel fuel purchased, in gallons and dollars, by month and annual, and records showing whether excise and sales taxes have been included.

2. All purchase reports for lube 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 of transactions and agreements described above in the four preceding document requests for any other stations owned by the same taxpayer for the same periods.

6. Records, such as the summary, showing the total of all credit card invoices submitted and processed.*

   *Do not ask number 6 unless the service station gives a discount for cash sales. It is very expensive for the Oil Company(ies)to provide this information.

Furthermore, do not summon these records if the summary does not already exist because a summons cannot compel the creation of records not in existence. Instead, the revenue agent should interview the summoned party to acquire the information needed to create the summary.

7. Records listing all distributors of [name of oil company] products, including but not limited to gasoline and diesel fuel, who would supply [name of taxpayer(s)] and any of his or her locations.

8. A copy of the sales agreement(s) between [name of taxpayer(s)- include any business or station names] and your distributors of [name of oil company] products 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 stations.

   A distributor by definition should include anyone who sells [Oil Company(ies)name] product directly or indirectly to [taxpayer(s) name and any related entities]. Distributors would also include but not limited to jobbers, wholesalers and brokers.

SUMMONS – INDEPENDENTS

All records for the periods ending December 31, 19xx, December 31, 19xx and December 31, 19xx, of transactions with [name(s) of taxpayer(s) and/or the specific service station(s)] regarding the following items:

1. All purchase reports for gasoline (that is, regular, unleaded and super unleaded) and diesel fuel purchased, in gallons and dollars, by month and annual, and records showing whether excise and sales taxes have been included.

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

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

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

5. 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.

6. Records of transactions and agreements described above in the four preceding document requests for any other stations owned by the same taxpayer for the same periods.

7. Records, such as the summary, showing the total of all credit card invoices submitted and processed.*

   *Do not ask number 7 unless the service station gives a discount for cash sales. It is very expensive for the Oil Company(ies)to provide this information.

Furthermore, do not summon these records if the summary does not already exist because a summons cannot compel the creation of records not in existence. Instead, the revenue agent should interview the summoned party to acquire the information needed to create the summary.

Summons Information

In most cases you will mail the summons to the large case manager identified on the list available through your Area ES&P Coordinator. In some cases; however, you will mail the summons directly to the Oil Company, per instructions.

For the summonses being served by the 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 large case managers prefer that the agent serving the summons sign the summons certification.

You do have to notify the taxpayer that you are issuing a summons under TBOR II and related current law. Please follow the appropriate procedures.

Contact your district ES&P coordinator for the addresses and telephone number needed.

BRAND NAME	MAJOR OIL COMPANY(IES)
AMOCO	BP Amoco
ARCO	BP Amoco
ATLANTIC	Sun Company, Inc.
BP AMERICA	BP America
CHEVRON	Chevron USA, Inc.
CITGO	Citgo Petroleum Corporation
CONOCO	Conoco, Inc.
DIAMOND SHAMROCK	Ultramar 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
MOBIL	Exxon Mobil Oil Corporation
PHILLIPS	Phillips Oil Company(ies)
SHELL	Shell Petroleum, Inc.
SINCLAIR	Sinclair Oil Company(ies)
STOP & GO	Sun Company, Inc. (up to 4/90)
SUN	Sun Company, Inc.
SUNOCO	Sun Company, Inc.
TEXACO	Texaco Marketing and Refining Inc. or Star Enterprise
TOSCO	Circle K, "76", Exxon, Mobil, BP
	Tosco Refining and Marketing Company
UNOCAL	Union Oil Company(ies) of California

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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 a Survey is not available and/or the audit is limited primarily to the income issue.

1. Do you own any other stations?
2. What are your gasoline 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 gasoline ? 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 gasoline ? Cash?
12. Name all the companies you get gasoline 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 remodel? Did the taxpayer receive any reimbursement for the remodel? Did he or she receive financial reimbursements such as business income replacement?
15. Name all of your suppliers of gasoline and other products you offer for sale.
16. What percentage of gasoline sales is 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. Is all fuel purchased with Federal Excise Tax included? (Obtain copies of sample invoices for all fuel types.)

		Gasoline	Diesel fuel
22.	Number of bulk storage tanks:	________	_________
	Capacity of bulk storage tanks:	________	_________
	Number of gals. in inventory at year-end	________	_________

23. Is gasoline ever sold as diesel fuel? ____ Yes ____ No
    How do customers use propane?
24. Be aware of taxpayer using the wrong tax rate. Be aware of taxpayer buying tax-free.

Note: Los Angeles Counsel for cases under their jurisdiction requires Items 3, 4, and 5 listed above.

INITIAL INTERVIEW QUESTIONS (cont.)

FOR SERVICE STATIONS - Long Version

These questions were developed to provide enough information for the examiner to accurately estimate the income when a 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 fuel and reflect seasonal changes.
2. What is the capacity of the fuel tanks?
3. How often does the station 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 fuel, with period specification as these data changes during audit periods?
8. What is your mark-up for each type of gasoline or diesel fuel with period specification as these data changes during audit periods?
9. Did you have the same mark-up in the prior years? REGULAR/UNLEADED/SUPREME / DIESEL FUEL
10. Do you have a market analyst? If not, how do you determine your gasoline 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. Name all the gasoline companies you purchase gasoline line 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. Is all fuel purchased with Federal Excise Tax included? (Obtain copies of sample invoices for all fuel types.)
21.

	Gasoline	Diesel fuel
Number of bulk storage tanks:	_______	_______
Capacity of bulk storage tanks:	_______	_______
Number of gallons in inventory a year-end	_______	_______

22. Is gasoline ever sold as diesel fuel? __ Yes ___ No How do customers use propane?
23. What are your sales tax rates and excise tax rates?
24. Be aware of taxpayer using the wrong tax rate. Be aware of taxpayer buying tax-free.

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

INITIAL INTERVIEW QUESTIONS (cont.)

Conventional Service Stations with Mechanic Service

1. What type of training have the mechanics had? Experience requirements?
2. Do the oil companies offer training classes?
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? This may be moot where emissions control is handled by State directly.
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 (that is transmissions, radiators?)

INITIAL INTERVIEW QUESTIONS (cont.)

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 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 Form 1099 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 1099's received.
19. Control Documents: Concil Tapes and "Z" tapes: Daily & Monthly
20. Consolidated Monthly Statements from the Oil Company

Sample
INFORMATION DOCUMENT REQUEST (cont.)

Note:
The sample IDR above includes documents that should be in the Service's possession (for example, Forms 940, 941, W-2, W-4 and 1099). It is acceptable to request these documents informally (that is, via an IDR), but ordinarily they cannot be summoned. See ***Powell v. United States***, 379 U.S. 48 (1964). Furthermore, the Service should not summon documents that are in its possession and capable of being retrieved readily. See ***United States v. Davis***, 636 F.2d 1028 (5^{th} Cir.), ***cert. denied***, 454 U.S. 862 (1981).

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_____

RETAILERS DRIVE-BY REPORT (cont.)

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:

<u>Classification</u> <u>Price/gallon</u>

(Do not forget cash vs. credit, and full vs. self services.)

a. gasoline:
   regular unleaded___ ________
   midgrade unleaded___ ________
   super unleaded___ ________
   other___ ________

b. diesel fuel____ ________

c. propane____ ________

d. unbranded_____ ________

Comments:____

FUEL TAX LAW FOR RETAILERS

Fuel Distribution System

Gasoline, diesel fuel, and kerosene ("fuel") generally are distributed from refineries and points of entry into the United States through the "bulk transfer/terminal system" to wholesale distributors and then to retailers.

The bulk transfer/terminal system consists of refineries, pipelines, waterborne fuel transporting vessels, and terminals. Fuel may be bought and sold many times while it is in this system. Terminals are large facilities that store and distribute fuel and other liquid products. Some terminal operators own the fuel stored in their terminals. Other terminal operators do not own the fuel but rather lease the storage space to others. Still other terminal operators both own fuel and lease space to others. Terminals where space is leased to others are for-hire terminals and persons that store fuel in such terminals are throughputters.

Fuel leaves the bulk transfer/terminal system at the terminal rack. At the rack, fuel is usually loaded into tank trailers that are operated by, or on behalf of, wholesale distributors. A wholesaler may buy fuel at the rack from a throughputter or terminal operator, or the wholesaler may itself be a throughputter or terminal operator.

After fuel is loaded into the trailers, it is usually transported to retail stations where the fuel is sold to consumers. A wholesaler often will operate the retail service station. In some cases, fuel may be bought and sold one or more times by other wholesalers before it is finally sold at the retail pump.

Imposition of Tax

The tax on gasoline, diesel fuel and, (since July 1, 1998) kerosene is imposed when the fuel is removed from a terminal at a terminal rack. The terminal operator or a throughputter at the terminal is responsible for paying the tax to the government. As of October 1,1997, the rate of tax is $0.184 per gallon on gasoline and $0.244 on diesel fuel. As of July 1, 1998 the Federal tax is $0.244 per gallon on kerosene.

Note that although the amount of the tax is usually included in the price of the fuel both sold to, and sold by, a service station operator, price is irrelevant in determining federal tax liability. Nothing in federal tax law requires a seller of fuel to include the amount of tax in its selling price or to separately state the amount on an invoice. However, also note that IRC section 7211 imposes a criminal penalty on whoever in connection with the sale of fuel makes any statement intended to lead any person to believe that any part of the price at which the fuel is sold consists of a federal tax knowing that such statement is false.

FUEL TAX LAWS FOR RETAILERS (cont.)

A Retailer generally is liable for the federal tax on gasoline, diesel fuel, or kerosene only when the operator blends taxed fuel with previously untaxed fuel or when the operator delivers dyed diesel fuel or dyed kerosene into the fuel supply tank of a registered diesel fuel powered highway vehicle. See previous discussion on blending.

A Retailer generally is liable for tax when it delivers propane and other liquefied petroleum gasoline (LPG) into the fuel supply tank of a registered highway vehicle. As of October 1, 1997, the tax rate on propane is $0.136 per gallon.

All fuel taxes are paid on Form 720, Quarterly Federal Excise Tax Return, which is usually due by end of the month following the end of the quarter. Most taxpayers have to make semimonthly deposits of tax during a quarter.

Exemptions from Tax

There are no limited exemptions from the gasoline tax.

Diesel fuel and kerosene are exempt from tax if the fuels are dyed red in accordance with Treasury Regulations. This fuel may be used for nontaxable uses such as for heating, on a farm, and uses other than as a fuel in a registered diesel fuel-powered highway vehicle.

Retail pumps from which dyed diesel fuel or dyed kerosene is sold must display the legend: DYED DIESEL FUEL [KEROSENE], NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE. Any person that sells dyed diesel fuel or dyed kerosene for a taxable use (such as use in a registered highway vehicle) may be liable for a substantial penalty imposed by IRC section 6715. The penalty also applies to any person that willfully alters the strength or composition of the dye in dyed fuel.

The retailer that delivers dyed fuel into the fuel supply tank of a registered highway vehicle is also liable for a back-up tax of $0.244 per gallon.

The tax on LPG does not apply to LPG that is sold for heating, cooking or other off-highway uses.

Credits and Refunds

NOTE: Specific procedural rules apply to fuel tax credits and refunds. See Publication 378 and the applicable form.

A gasoline wholesale distributor may be eligible for a credit or refund of the gasoline tax if it sells gasoline at a tax-excluded price to a state or local government or a nonprofit educational

FUEL TAX LAWS FOR RETAILERS (cont.)

organization. The term wholesale distributor includes a person that makes retail sales of gasoline at 10 or more retail motor fuel outlets. The refund claim may be made on Form 8849 and the credit may be taken against any excise tax liability that the claimant reports on Form 720. This credit may not be taken as a credit against the claimant's income tax liability.

A credit or refund of the gasoline tax is allowable to the ultimate purchaser of gasoline if the gasoline is used in an off-highway business use. This claim may be made as a credit on the claimant's income tax return or on Form 8849. A credit or refund is not allowed for fuel that is lost or destroyed by fire or other casualty.

A person that has been registered by the IRS as an ultimate vendor of diesel fuel may claim a credit or refund on its sales of taxed (undyed) diesel fuel to state and local governments and for farming use. The ultimate purchaser of the fuel makes all other claims relating to taxed (undyed) diesel fuel that is used in a nontaxable use.

A person that has been registered by the IRS as an ultimate vendor of kerosene may claim a credit or refund on its sales of taxed (undyed) kerosene to state and local governments, for farm use, and for sales from a blocked pump. A blocked pump is a retail fuel pump that cannot fuel a highway vehicle and which displays the following legend: UNDYED UNTAXED KEROSENE, NONTAXABLE USE ONLY. The ultimate purchaser of the fuel makes all other claims relating to taxed (undyed) diesel fuel that is used in a nontaxable use.

Floor Stocks Tax on Kerosene

Some gasoline stations may be liable for the floor stocks tax on kerosene. This tax of $0.244 per gallon applies to any person holding kerosene at the start of July 1, 1998. A person is holding the fuel if the person has title to it (whether or not delivery to that person has been made). However, the tax does not apply to kerosene held by a person if the aggregate amount held by that person is not more than 2,000 gallons. The tax was due August 31, 1998 and was to be reported on Form 720 on a return for the third quarter.

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TAX RATE SCHEDULE ─ STATE OF CALIFORNIA

Product	Type of Tax	Collected at	Rate	Dates
Gasoline	Excise	Terminal	.18 State .184 Federal ----- .364 Total	1/1/94-12/31/95
Gasoline	Excise	Terminal	.18 State .183 Federal ----- .363 Total	1/1/96-9/30/97
Gasoline	Excise	Terminal	.18 State .184 Federal ----- .364 Total	10/1/97-Present
Diesel fuel	Excise	Terminal	.18 State .244 Federal ------ .424 Total	1/1/94-12/31/95
Diesel fuel	Excise	Terminal	.18 State .243 Federal ----- .423 Total	1/1/96-9/30/97
Diesel fuel	Excise	Terminal	.18 State .244 Federal ----- .424 Total	10/1/97-Present

SALES TAX:

Product	Type of Tax	Collected at	Rate**	Dates
Gasoline	Sales	Wholesale*	.065	4/1/93 thru present
Diesel fuel	Sales	Wholesale	.05	4/1/93-present

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

OTHER STATE TAXES

At a weighted average other States' gasoline taxes are currently 23.8 cent per gallon and estimated 2 cent in local taxes. Together with the Federal motor fuel tax, this amounts to an average of 44.2 cents per gallon.

Seven States (California, Georgia, Hawaii, Indiana, Illinois, Michigan, and New York) apply sales taxes to the sale of gasoline. Moreover, there may be additional local taxes. See for example Long Island, NY, where these additional levy results in a total tax burden of 51 cents per gallon.

Exhibit 3-7

FEDERAL TAXES ON DIESEL FUEL AND GASOLINE

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

1. Diesel fuel Taxes and Fees:

Federal Excise Tax	$.244
California Use Fuel Tax	.18
Sales and Use Tax	6-7% percent of sale

TOTAL taxes included in price: $.424 plus Sales taxes (6-9%) =.48-.50 per gallon

2. Gasoline Taxes and Fees:

Federal Excise Tax	$.184
California Motor Vehicle Fuel Tax	.18
Sales and Use Tax	6-7% percent of sales

TOTAL taxes included in price: $ .3685 plus sales taxes (6-9%) = .42-.45 per gallon

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.

The Federal Highway Administration maintains a schedule of State Taxes.

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Chapter 4

Other Considerations

CONTENTS

INADEQUATE RECORDS NOTICE

When a survey is being used because there are no records or the records are inadequate to determine the substantially correct tax. In order 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:
- No daily record of sales
- Missing purchase receipts
- No recordkeeping for other services (auto repair, towing, etc.)
- Illegible records
- Records unable to be reconciled to the tax return records unavailable for inspection
- No record of daily bank deposits that ties into sales
- Meter readings not consistent from day to day
- Only one 8-hour shift/tour-of-duty noted but station is open 16 to 24 hours.

FRAUD

Potential liability for civil and/or criminal fraud should be considered when unreported income is significant. For a criminal referral, the Government, beyond a reasonable doubt must prove fraud. The evidence should be substantial. There must be sufficient “badges of fraud” beyond those which are apparent by application of a Survey.

In order to establish liability for the 75-percent civil fraud penalty of IRC section 6663, the Government also must meet a high standard of proof. The Government must show fraud by clear and convincing evidence. Although this standard is lower than the criminal standard mentioned above, various badges of fraud should be present.

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 gasoline station issues, which could constitute a fraudulent scheme, include:

1. Whole station activity omitted from the return
2. Unreported sale of a station
3. Mini market sales and/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: to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes." ***Rowlee v. Commissioner*,** 80 T.C. 1111, 1123 (1983). See also IRC section 6663.

NON-FILER

1. ES&P Retailers specialists should contact the Area non-filer coordinator for sources of non-filer work.
2. The BLS survey data at retail is a source of determining gross receipts for found non-filers who have been located.
3. Following Retailers 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" # of employees X hours open X 365 days X min. wage equals a rough estimate of minimum payroll.

PREPARER AND PREPARER PENALTIES

In the Tax Reform Act of 1976, Congress created civil penalties designed to enable the 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.

Study cases found that certain preparers are giving banks very different copies of their customer-taxpayers returns than those filed with the IRS. When asked, the preparer said that the taxpayer needed a different Form 1040 for obtaining a bank loan. When asked the taxpayer usually indicates that there was no intended bank fraud. According to the taxpayer there were errors in the filed tax returns. Any adjustments to correct these errors are usually agreed.

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

In addition, the government may bring a civil action under IRC section 7407 to seek an injunction to stop an income tax preparer from engaging in any conduct subject to civil penalties, under IRC section 6694 or 6695 (for negligently or willfully understating a tax liability on a return or claim for refund).

COLLECTION

Procedures should be developed with collection. This cross-functional project involves close coordination with the Examination and Collection Areas. Revenue Officers in the project network with revenue agents by post-of-duty visitations and written communications.

There is also contact between revenue agents and revenue officers throughout the audit process. The sharing of information as well as attendance at closing conferences is essential to success.

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

Continuous involvement by Revenue Officers, especially when quick and/or 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. To report these and any other integrity violations contact your local Internal Security office.

BANKRUPTCY

In general, bankruptcy is a method to relieve a taxpayer of the burden of excess debt. If a taxpayer tells you that he or she filed bankruptcy, check this - he or she may not have filed. If he or she did file, check to see if the bankruptcy proceeding is ongoing and if a discharge was granted. Consult with the appropriate Counsel office about any question regarding the effect of a discharge on the tax liabilities under investigation. Some tax debts are non-dischargeable even though the taxpayer may have received a discharge of other debts in the bankruptcy proceeding. An example of non-dischargeable taxes is trust fund taxes incurred post confirmation by a debtor in a Chapter 11 reorganization.

In addition, before pursuing any collection activity against a taxpayer in bankruptcy, determine whether the automatic stay is in effect. For further reference, see IRM 5.9, Bankruptcy Handbook.

EMPLOYMENT TAX ISSUES

This is one of the big issues of noncompliance found with service station audits. A common problem found on most service station returns is no deduction at all for wages. If the taxpayer does take a deduction for wages, it is a very minimal amount.

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 increases by the number of businesses on the premise. For example, a single gasoline station with a kiosk, will have one individual at a time, while a convenience store could have as many as three employees per shift.

Service bays may have, in addition to the clerk handling the gasoline station, a mechanic per bay.

DIVISION COUNSEL AND APPEALS

Work with Division Counsel and Appeals to determine the level of support Exam can expect when using any survey to establish gross receipts.

EXCISE TAX SPECIALISTS

Contact your excise tax specialists to determine related issues and to 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 sells to unbranded stations. Your Fuel Compliance Officers will be another source of leads.

Glossary

A G O (Atmospheric Gasoline Oil) ─ a volatile distillate.

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)

CETANE NUMBER ─ a measure of the ability of a fuel to ignite spontaneously, desirable in the operation of a diesel fuel 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 fuel engine.

DISTILLATE ─ a refined petroleum product produced by the distillation of crude oil.

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.

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.

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

FORM 2290 ─ 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 (7500 miles or less for agricultural vehicles). Proof of payment of this tax is required to register your vehicle in any state.

#1 DIESEL FUEL ─ a volatile distillate fuel used in high speed diesel fuel engines operated under wide variations of speed and load, such as city buses.

#1 FUEL OIL ─ a light distillate used in vaporizing-type burners.

#2 DIESEL FUEL ─ a lower volatility oil for use in high-speed diesel fuel engines operated generally under uniform speed and load conditions, such as railroad engines and highway roads.

#2 FUEL OIL ─ a distillate used in atomizing type burners for home and other moderate size heating applications.

#4 DIESEL FUEL ─ used in low speed diesel fuel engines.

#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 #1 fuel oil with specifications that improve it for use in space heaters, cook stoves and lamps.

M D O (Marine Diesel fuel Oil) ─ a volatile distillate used specifically for marine/ship purposes.

NAPTHA/ALCOHOL ─ used to mix with diesel fuel and gasoline. Naphtha has no real purpose outside of blending with other products. While, alcohol can be legally blended up to 10% and sold as gasoline.

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

RACK ─ a mechanism for delivering fuel from a refinery or terminal into a truck, trailer, railroad car, or other means of non-bulk transfer.

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.

TAXABLE EVENT ─ removal from terminal rack, entry into the United States, or removal or sale of blended diesel fuel.

TRANSMIX ─ the portion of products mixed in transport, that is, diesel fuel is mixed with gasoline while in transit.

ULTIMATE VENDOR ─ seller of undyed diesel fuel to the user of the fuel (purchaser) for use on a farm for farming purposes or for the exclusive use of state or local government. Registration (Form 637) is required in order to qualify for refund or credit.

Note: For a more list of definitions relating to excise tax, refer to Publications 378 (Fuel Tax Credits and Refunds) and 510 (Excise Taxes for 2001).