

January 3, 2008

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Dear Jim:

You've asked for my thoughts on a practice the Pennsylvania Department of Revenue uses in motor carrier road tax audits under the International Fuel Tax Agreement. As I understand it, during an IFTA audit, Department auditors require an accounting of the IFTA licensee's IFTA decals, and if a decal issued to the licensee cannot be produced or otherwise accounted for, the auditor will assess the licensee as if the missing decal represented an IFTA vehicle operated by the licensee for 30,000 miles during the year for which the decal was issued, at a miles-per-gallon ratio of 4.0. (If these additional miles are assumed by the state to have been traveled in the same jurisdictions as the rest of the audited fleet, and in the same proportions, this assessment will represent a penalty of approximately \$1,725 per missing decal, that is, 7,500 gallons times \$0.23 cents per gallon, the average state diesel fuel tax rate. This does not include interest, which under IFTA is 12% per annum.)

As I understand the situation at hand, the decals concerned could not be accounted for by the licensee because they had been issued by it to independent contractors (owner-operators) who had broken their leases with the licensee during the year without returning their IFTA decals, and the licensee had not reported this to the Department. The decals had been issued by the Department to the licensee and had been provided by the licensee to the owner-operators, since, like many fleets using owner-operators, the licensee preferred to report the fuel use tax of the entire fleet itself.

It appears that Pennsylvania statute does not require the Department to make these large, arbitrary tax assessments against IFTA licensees that fail to account for all IFTA decals issued to them. (*See*, 75 Pa.Cons.Stat. §§2101, *ff.*, and §§9001, *ff.*) It is a Department regulation that makes a motor carrier licensed under IFTA liable for the tax on a vehicle which has left the carrier's control, if the carrier does not report this to the Department (61 Pa.Code §313.9). IFTA itself only requires a state to require its IFTA licensees to display IFTA decals on both sides of their IFTA vehicles. That's about all IFTA says about decals, and IFTA says nothing at all about decals in connection with an IFTA audit. I believe that most states, especially those states that charge a fee for issuing IFTA decals, require licensees to account for decals in some fashion, but I am aware of few if any states other than Pennsylvania that automatically and arbitrarily impose a large penalty for a licensee's failure to account for every decal issued it. Pennsylvania is definitely in the minority in this respect.

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An argument could be made that the regulation cited, 61 Pa. Code §313.9, conflicts with the motor carrier road tax statute. Section 2103(b) of Title 75, Pa.Cons.Stat., provides:

Other penalties.--Any person willfully violating any provision of this chapter or Chapter 96 (relating to motor carriers road tax) *not covered by any other penalty contained in this chapter* shall be guilty of a summary offense and, upon conviction thereof, for a first offense, shall be sentenced to pay a fine of not less than \$100 nor more than \$500; and, for each subsequent or additional offense, a fine of not less than \$200 nor more than \$500, or undergo imprisonment for a term not exceeding 90 days, or both. If the person convicted is a corporation, any imprisonment imposed shall be served by the responsible corporate employee. [italics added]

The assessments made under the regulation cited exceed the \$500 limit of the statute, and they do not represent any actual additional tax, but penalty, as will be discussed below.

There are good reasons why other states have not adopted a practice such as that described.

I. First, there are insurmountable practical difficulties for carriers that use owner-operators in fully accounting for the decals issued to them. The trucking industry has an acute shortage of drivers. There is intense competition among motor carriers for qualified drivers, whether employees or owner-operators. The competition is the greatest in the truckload segment of the industry, the one most likely to use owner-operators. The average turnover of drivers in this segment is consistently over 110% per year. Owner-operators are apt to leave a carrier suddenly and without notice. Since each owner-operator is a business independent of the licensee, the recourse of the licensee with respect to a decal taken by an owner-operator breaking a lease is effectively nil.

It is possible that an owner-operator that breaks a lease with a carrier continues to run on the former lessee's IFTA decal on his own account, but this is not typical. Far more commonly, the owner-operator immediately leases to another carrier, and then operates as a part of that carrier's IFTA fleet and with that carrier's decals on its vehicles. Typically, that is, the owner-operator's fuel use continues to be reported under IFTA by another licensee.

Even if a departing owner-operator were otherwise inclined to return IFTA decals to a former lessee, he may be deterred by the difficulty of getting the decals off his truck. An IFTA decal is specifically designed not to come off in one piece. If the adhesive works as intended, the owner-operator will have some trouble removing it, and will have only scraps, perhaps not even identifiable, to return to his former lessee (the IFTA licensee), if he is so inclined. The truck's finish may also be damaged in the process.

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There are many other reasons why an IFTA decal might be lost to a licensee during the year. The decal is, after all, a piece of paper, exposed on a vehicle to all kinds of rough weather and rough usage as well. Decals are sometimes stolen, they fall off in truck washes, or they may be lost in the licensee's inventory without ever being put on a truck.

Ironically, the Department's practice with respect to decals taken by departing owner-operators may prompt carriers to shift the burden of reporting and paying under IFTA to their lessor independent contractors, which they may do under IFTA. This would mean a greater number of IFTA accounts for the Department to administer, and, probably, a lower degree of compliance.

II. All this highlights the second reason that other states have not adopted Pennsylvania's practice: It is arbitrary and disproportionate. Certainly, the state has an interest in collecting its motor carrier road tax revenues, including the fees it charges for the issuance of IFTA decals to licensees. In this regard it is appropriate for the state to impose penalties for certain offenses that may impede or prevent that collection. And Pennsylvania law does so. For operating without an IFTA decal, which can indicate that an operation is not licensed under IFTA, a motor carrier may be fined \$25. For failure to file an IFTA return at all, a carrier can be fined up to \$500. But for failure to report the loss of a decal to the Department, a carrier may on audit be fined well over three times that sum. It alters nothing that the Department terms this fine "additional tax," since the state has no idea at all whether additional tax is in fact owed by virtue of the vehicle's travel since it left the carrier under audit, or whether a succeeding lessee carrier has properly reported and paid – which is like as not the case. Moreover, from what you tell me, even when a carrier reports that a vehicle has left its service with IFTA decals attached, the Department can take no practical action to ensure that any enforcement action might be taken against the vehicle if it still travels on those decals. The whole thing begins to look like a charade, although a very expensive one for the carrier.

III. The Department performs IFTA audits only on IFTA licensees based in Pennsylvania. The Department's practice therefore puts Pennsylvania carriers at a competitive disadvantage. They are heavily penalized for an "offense" that not only is no offense in other states, but one for which the underlying requirement – reporting a missing decal to the state – has, at least currently, no practical purpose. Other states seem in this respect more sensitive to the situation of their own motor carriers.

IV. Finally, the Department's practice at issue is completely foreign to the spirit of IFTA. IFTA audits, as laid out in the Agreement and the IFTA Audit Manual, have nothing to do with decals; the uniform rules the states and provinces have bound themselves to follow concern only fuel use tax liabilities and their proper apportionment among the jurisdictions. Moreover, IFTA audits are compliance rather than revenue audits; that is, since the fuel use tax is in essence a redistributive mechanism, an audit of

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the tax can most appropriately focus on the extent to which a licensee's record keeping and reporting systems enable it to render timely and accurate returns and payments. They do not focus, as pre-IFTA audits conducted by individual states too often did, on extracting the maximum amount of revenue from a licensee.

The use of 4.0 mpg to calculate the penalty due from a Pennsylvania carrier that fails to report the loss of a decal is interesting in this connection. Under IFTA, a carrier which, under audit, fails to produce any records to support its tax reports may, as a penalty, be assessed tax as if its fleet mpg ratio were 4.0 miles per gallon. The accompanying language of the Agreement seeks to make it plain that this ratio is only to be employed when records are simply unforthcoming, and no alternative method of assessment is available. Few carriers could continue in business, after all, if their fuel efficiency were not considerably better than 4.0. Yet the Department calculates its wholly fictitious assessment of "additional tax" using this ratio, which IFTA regards as a sort of penalty of last resort.

For all these reasons, then, the Department's practice of assessing Pennsylvania motor carriers for a failure to report the loss of a decal, even if it can be squared with statute, is completely inappropriate under IFTA.

Sincerely,

Robert C. Pitcher
Vice President, State Laws

cc: Richard D. Holcomb
John F. Lynch