

PERFORMANCE AUDIT  
OF THE  
MOTOR FUEL, IFTA/MOTOR CARRIER, TOBACCO TAXES  
AND REGISTRATION DIVISION

DEPARTMENT OF TREASURY

October 2001

## EXECUTIVE DIGEST

# **MOTOR FUEL, IFTA/MOTOR CARRIER, TOBACCO TAXES AND REGISTRATION DIVISION**

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<b>INTRODUCTION</b>	This report, issued in October 2001, contains the results of our performance audit* of the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division, Department of Treasury.
<b>AUDIT PURPOSE</b>	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.
<b>BACKGROUND</b>	The Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division administered the motor fuel, motor carrier* fuel, tobacco products, public utility property, and severance tax laws. For fiscal year 1998-99, collections of these taxes totaled approximately \$1.9 billion. The Division was also responsible for maintaining the Department's registration records for business taxpayers. As of October 31, 2000, the Division had 35 employees assigned to tax administration activities and 19 employees assigned to registration activities.

\* See glossary at end of report for definition.

In November 2000, a major reorganization of the Department was implemented. Under the new organization, the Division is no longer a separate organizational unit. The staff formerly assigned to the Division will continue to perform their same administrative functions in two new organizational units, the Customer Contact Division and the Technical Services Division.

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AUDIT OBJECTIVES,  
CONCLUSIONS, AND  
NOTEWORTHY  
ACCOMPLISHMENTS

**Audit Objective:** To assess the Division's effectiveness and efficiency in collecting motor fuel, motor carrier fuel, tobacco products, public utility property, and severance taxes due the State.

**Conclusion:** We concluded that the Division was generally effective and efficient in collecting taxes due the State. However, we noted reportable conditions\* related to delinquent motor carrier tax returns, supplemental motor carrier tax returns, controls over delinquent severance tax returns, and tax return receipts reconciliations (Findings 1 through 4).

**Noteworthy Accomplishments:** In April 1998, the Department implemented a stamp program for cigarettes sold in the State. The Division issued stamps to licensed wholesalers and other organizations that import cigarettes. The stamps are affixed to packs of cigarettes to document that the proper tobacco products tax has been paid. The Department also established an enforcement team that works in conjunction with staff of the Michigan Department of State Police to investigate cases of cigarettes sold without tax stamps. Tobacco products tax collections significantly increased after the stamp program was implemented. For fiscal year 1998-99, tobacco products tax collections increased by approximately \$48 million (8.5%) from the prior fiscal year. The Department's Office

\* See glossary at end of report for definition.

of Revenue and Tax Analysis (ORTA) has concluded that these tax collections would have decreased significantly if the cigarette tax stamp program had not been implemented. Considering the effects of the national tobacco industry settlements on cigarette prices and other economic factors, ORTA has estimated that the stamp program resulted in additional annual tax collections of over \$120 million in fiscal years 1998-99 and 1999-2000.

**Audit Objective:** To assess the effectiveness of the Division's procedures for and controls over auditing tax returns, resolving problems related to tax return errors and omissions, and issuing taxpayer refunds.

**Conclusion:** We concluded that the Division's procedures for and controls over auditing tax returns, resolving problems related to tax return errors and omissions, and issuing taxpayer refunds were reasonably effective. However, we noted reportable conditions related to follow-up of motor fuel tax return errors and discrepancies and fuel hauler reports (Findings 5 and 6).

**Audit Objective:** To assess the Division's effectiveness and efficiency in performing its licensing function related to the taxes it administered.

**Conclusion:** We concluded that the Division was effective and efficient in performing its licensing function related to the taxes it administered.

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AUDIT SCOPE AND  
METHODOLOGY

Our audit scope was to examine the program and other records of the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such

other auditing procedures as we considered necessary in the circumstances.

Our audit procedures included examinations of program records and activities for the period October 1, 1998 through October 31, 2000.

We analyzed the program activities for each of the various taxes administered by the Division. This analysis included review of internal control and management practices for licensing activities, receipting and recording of tax returns, auditing of tax returns, assessment of tax deficiencies, and overpayment refunding.

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**AGENCY RESPONSES  
AND PRIOR AUDIT  
FOLLOW-UP**

Our audit report contains 6 findings and 7 corresponding recommendations. The preliminary response prepared by the Department indicated that it agrees with all the recommendations and that it has compiled or will comply with them.

The Division complied with 3 of the 4 prior audit recommendations. One of the prior audit recommendations was rewritten for inclusion in this report.

October 8, 2001

Dr. Douglas B. Roberts  
State Treasurer  
Treasury Building  
Lansing, Michigan

Dear Dr. Roberts:

This is our report on the performance audit of the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division, Department of Treasury.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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## Description of Agency

The Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division, Department of Treasury, administered the motor fuel, motor carrier fuel, tobacco products, public utility property, and severance tax laws. For fiscal year 1998-99, collections of these taxes totaled approximately \$1.9 billion. The Division was also responsible for maintaining the Department's registration records for business taxpayers. As of October 31, 2000, the Division had 35 employees assigned to tax administration activities and 19 employees assigned to registration activities.

In November 2000, a major reorganization of the Department was implemented. Under the new organization, the Division is no longer a separate organizational unit. The staff formerly assigned to the Division will continue to perform their same administrative functions in two new organizational units, the Customer Contact Division and the Technical Services Division.

Because the Division will no longer be a separate organizational unit, all recommendations in the audit report are directed to the Department. The various taxes that were administered by the Division are described as follows:

a. Motor Fuel Tax

The Division licensed motor fuel suppliers, wholesalers, exporters, retail diesel dealers, liquefied petroleum gas distributors, and liquid fuel haulers. It also collected gasoline, diesel motor fuel, aviation fuel, and liquefied petroleum gas taxes. These tax revenues are accumulated in the Michigan Transportation Fund, with certain revenues being periodically transferred to the Michigan State Waterways Fund and the State Aeronautics Fund. Also, the Division processed refunds to taxpayers for nonhighway usage. For fiscal year 1998-99, motor fuel tax collections totaled approximately \$1.0 billion.

b. Motor Carrier Fuel Tax

Sections 207.211 - 207.234 of the *Michigan Compiled Laws* prescribe a privilege tax for the use of public roads and highways. The Division collected the tax from motor carriers who drove on roads and highways within the State. Under the International Fuel Tax Agreement (IFTA), the Division was also responsible for collection of fuel taxes for other states and Canadian provinces for interstate motor carriers based in Michigan. The revenues collected for use of roads and highways

within the State are recorded in the Michigan Transportation Fund. For fiscal year 1998-99, motor carrier fuel tax collections totaled approximately \$48.4 million.

c. Tobacco Products Tax

The Division licensed wholesalers, secondary wholesalers, manufacturers, transporters, transportation companies, vending machine operators, and unclassified acquirers who distributed and sold tobacco products. The Division collected the cigarette tax of 75 cents per pack and the other tobacco products tax of 16.0% of the wholesale price. The cigarette tax revenue is distributed to the School Aid Fund (63.4%), General Fund (25.3%), Health and Safety Fund (5.3%), and Healthy Michigan Fund (6.0%). The other tobacco products tax revenue is distributed to the School Aid Fund (94.0%) and Healthy Michigan Fund (6.0%). For fiscal year 1998-99, tobacco products tax collections totaled approximately \$612.0 million.

d. Public Utility Property Tax

The Division collected taxes, in lieu of local property taxes, from communication, utility, and railroad companies. Each year, the State Board of Assessors appraises the Michigan property of these companies, prepares a tax roll, and submits it to the Department. The Division was responsible for ensuring that each company paid the amount of tax indicated on the tax roll. The revenues collected for public utility property taxes are recorded in the General Fund. For fiscal year 1998-99, public utility property tax collections totaled approximately \$156.0 million.

e. Severance Tax

The Division collected severance taxes based on a percentage applied to the gross cash value of oil or gas extracted in Michigan. The percentages are 6.6% for oil, 5.0% for gas, and 4.0% for the products from marginal and stripper wells. The tax is imposed on each corporation, association, or individual engaged in the business of severing these products from Michigan soil. The revenues collected for severance taxes are recorded as general purpose revenue in the General Fund, except that a portion of the revenues are recorded in the Orphan Well Fund (a subfund of the General Fund). The Division also levied and collected a fee, not in excess of 1.0% of the gross cash market value of all oil and gas produced in the State. These fee collections are recorded as restricted revenue to cover the Department of Environmental Quality's costs of monitoring and surveillance of wells. For fiscal year 1998-99, severance tax and oil and gas fee collections totaled approximately \$30.6 million.

## Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

### Audit Objectives

Our performance audit of the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division, Department of Treasury, had the following objectives:

1. To assess the Division's effectiveness and efficiency in collecting motor fuel, motor carrier fuel, tobacco products, public utility property, and severance taxes due the State.
2. To assess the effectiveness of the Division's procedures for and controls over auditing tax returns, resolving problems related to tax return errors and omissions, and issuing taxpayer refunds.
3. To assess the Division's effectiveness and efficiency in performing its licensing function related to the taxes it administered.

### Audit Scope

Our audit scope was to examine the program and other records of the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

### Audit Methodology

Our audit procedures, performed from July through December 2000, included examinations of program records and activities for the period October 1, 1998 through October 31, 2000.

We analyzed the program activities for each of the various taxes administered by the Division. This analysis included review of internal control and management practices for licensing activities, receipting and recording of tax returns, auditing of tax returns, assessment of tax deficiencies, and overpayment refunding.

### Agency Responses and Prior Audit Follow-up

Our audit report contains 6 findings and 7 corresponding recommendations. The preliminary response prepared by the Department indicated that it agrees with all the recommendations and that it has complied or will comply with them.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Treasury to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Division complied with 3 of the 4 prior audit recommendations. One of the prior audit recommendations was rewritten for inclusion in this report.

# COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

## EFFECTIVENESS AND EFFICIENCY IN COLLECTING TAXES

### COMMENT

**Audit Objective:** To assess the Motor Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division's effectiveness and efficiency in collecting motor fuel, motor carrier fuel, tobacco products, public utility property, and severance taxes due the State.

**Conclusion:** We concluded that the Division was generally effective and efficient in collecting taxes due the State. However, we noted reportable conditions related to delinquent motor carrier tax returns, supplemental motor carrier tax returns, controls over delinquent severance tax returns, and tax return receipts reconciliations.

**Noteworthy Accomplishments:** In April 1998, the Department of Treasury implemented a stamp program for cigarettes sold in the State. The Division issued stamps to licensed wholesalers and other organizations that import cigarettes. The stamps are affixed to packs of cigarettes to document that the proper tobacco products tax has been paid. The Department also established an enforcement team that works in conjunction with staff of the Michigan Department of State Police to investigate cases of cigarettes sold without tax stamps. Tobacco products tax collections significantly increased after the stamp program was implemented. For fiscal year 1998-99, tobacco products tax collections increased by approximately \$48 million (8.5%) from the prior fiscal year. The Department's Office of Revenue and Tax Analysis (ORTA) has concluded that these tax collections would have decreased significantly if the cigarette tax stamp program had not been implemented. Considering the effects of the national tobacco industry settlements on cigarette prices and other economic factors, ORTA has estimated that the stamp program resulted in additional annual tax collections of over \$120 million in fiscal years 1998-99 and 1999-2000.

## **FINDING**

### **1. Delinquent Motor Carrier Tax Returns**

The Division did not ensure that timely follow-up was made for delinquent motor carrier tax returns. In addition, the Division did not ensure that the automated delinquent tax control system for motor carrier tax returns accurately identified delinquent tax returns.

The Motor Carrier Fuel Tax Act was enacted to prescribe a privilege tax for the use of public roads and highways by motor carriers and to impose a specific tax on the use of motor fuel within the State. Motor carriers are required to file quarterly tax returns to report the miles driven on State roads and highways and pay a corresponding tax for such use. Adequate procedures for following up on tax delinquent carriers on a timely basis help the Department ensure that all carriers are paying the required tax.

Section 205.21 of the *Michigan Compiled Laws* provides that the Department shall send a delinquent taxpayer a letter stating that a tax return has not been filed and, if the taxpayer does not respond within 30 days, shall notify the taxpayer of its intent to assess the tax due. Section 205.21 of the *Michigan Compiled Laws* also provides that, if the taxpayer does not protest within 30 days the notice of intent to assess the tax, the Department may assess the tax, interest, and penalty it believes to be due.

In 1996, Michigan joined the International Fuel Tax Agreement (IFTA), a federally mandated fuel tax reporting system. Under IFTA, interstate motor carriers file a single quarterly fuel tax report in their home base state for fuel taxes owed to states and Canadian provinces belonging to IFTA. Each IFTA motor carrier must pay to its home state all motor carrier fuel taxes owed to all IFTA jurisdictions and then the home state disburses the taxes owed to each jurisdiction. As of March 31, 2000, there were 5,618 IFTA motor carriers in the State licensed by the Division. For fiscal year 1998-99, motor carrier fuel tax collections for IFTA motor carriers' mileage driven in Michigan totaled approximately \$42.2 million.

The Department separately licenses intrastate motor carriers who drive only on roads and highways within the State. The intrastate motor carriers must file a different quarterly tax return from the return filed by the IFTA motor carriers. As of March 31, 2000, there were 9,043 intrastate motor carriers in the State licensed by

the Division. For fiscal year 1998-99, motor carrier fuel tax collections for intrastate motor carriers totaled approximately \$6.2 million.

Our review of the Division's procedures and records related to tax delinquent motor carriers disclosed:

- a. The IFTA regional processing center sent delinquent tax notice letters quarterly to licensed IFTA motor carriers in the State who had not filed tax returns. However, the Division had not issued assessments for taxes, interest, and penalties to IFTA carriers who did not submit tax returns or respond to the delinquent tax notice letters.

The IFTA regional processing center sent 1,635 delinquent tax notice letters for the quarter ended December 31, 1999 and 1,332 delinquent tax notice letters for the quarter ended March 31, 2000. As of August 2000, the Division's records indicated that there were 617 carriers still tax delinquent for the quarter ended December 31, 1999 and 820 carriers still tax delinquent for the quarter ended March 31, 2000. Our review of a sample of 25 carriers on these tax delinquency lists disclosed that 7 carriers were inactive and had not been licensed by the Division in over 18 months. For the other 18 carriers in our sample, 17 carriers had not submitted tax returns or responded to their delinquent tax notice letters and the Division had not issued tax assessments.

Division staff informed us that the automated delinquent tax control system was not updated when carriers became inactive and delinquent tax notice letters continued to be sent to these carriers.

- b. In August 2000, the Division sent delinquent tax notice letters to licensed intrastate motor carriers who had not filed tax returns due for the quarterly periods ended June 30, 1997 through March 31, 2000. Prior to this, the Division had not sent any delinquent tax notice letters to licensed intrastate carriers who had not filed tax returns. As of August 2000, the Division's records indicated there were 2,497 tax delinquent intrastate carriers for the quarter ended December 31, 1999 and 2,867 tax delinquent intrastate carriers for the quarter ended March 31, 2000.

## **RECOMMENDATIONS**

We recommend that the Department ensure that timely follow-up is made for delinquent motor carrier tax returns.

We also recommend that the Department ensure that the automated delinquent tax control system for motor carrier tax returns accurately identifies delinquent tax returns.

## **AGENCY PRELIMINARY RESPONSE**

The Department agrees with the recommendations. The Department informed us that restricted resources for the development of computer delinquent control systems and other higher priority computer development needs in the Department delayed addressing the cited problems. A computer program to assess IFTA is now 90% complete. Program clean-up work, after the initial delinquent run, addressed inaccurate computed assessments. The program was changed to allow the transactions to be deleted. A request has also been submitted to remove the transactions when an account is discontinued.

## **FINDING**

### **2. Supplemental Motor Carrier Tax Returns**

The Department needs to take further action to ensure that all IFTA motor carriers are aware of the credits that may be claimed on the supplemental motor carrier tax return.

Section 207.214 of the *Michigan Compiled Laws* provides that motor carriers may credit against their motor carrier fuel tax each quarter an amount equal to 6 cents per gallon of the sales tax paid on diesel fuel purchased in the State during the preceding quarter. The carriers can also claim a credit for diesel fuel taxes paid for fuel used for nonhighway purposes.

IFTA motor carriers must submit a supplemental tax return to receive the sales tax credit. The carriers can also claim a credit on this return for diesel fuel taxes paid for fuel used for nonhighway purposes. For fiscal year 1998-99, refunds totaling approximately \$21.1 million were issued for credits claimed on supplemental returns.

In April 1997, when amendatory legislation providing for the sales tax credit became effective, the Department sent an information booklet to all licensed IFTA motor carriers on a one-time basis. Since then, the Department has sent this information booklet to all newly licensed IFTA motor carriers.

However, we do not believe that this one-time notification creates sufficient and continued awareness of the availability of the tax credits. Each quarter, the Department sends the supplemental tax return only to IFTA motor carriers who have previously filed this return. IFTA motor carriers who have never filed a supplemental tax return receive no additional notification regarding the availability of the tax credits beyond the Department's one-time mailing of the information booklet.

Our review of records related to IFTA motor carrier tax returns disclosed:

- a. An average of 1,669 (38.0%) of the licensed IFTA motor carriers filing regular tax returns with tax due did not file a supplemental motor carrier tax return each quarter for 1999. On average, in each quarter of 1999, licensed IFTA motor carriers filed 4,392 regular IFTA motor carrier tax returns with tax due and 2,723 supplemental motor carrier tax returns.
- b. Of the IFTA motor carrier tax returns filed by a sample of 49 licensed IFTA motor carriers for the quarters ended either December 31, 1999 or March 31, 2000, 17 (34.7%) carriers had filed a regular quarterly IFTA tax return reporting fuel purchases in the State, but they had not filed a supplemental tax return for the quarter. Based on the fuel purchases reported, the 17 carriers could have received refunds totaling \$2,363 if they had filed a supplemental tax return for the quarter.
- c. For 67 audits of licensed IFTA motor carriers completed by Department field audit staff in the period January through September 1999, the field audit staff had determined that 38 (56.7%) of the IFTA motor carriers should receive credits totaling \$89,820 for supplemental tax returns. We were informed by IFTA motor carrier field audit staff that the carriers receiving these credits had not filed supplemental tax returns because they were not aware of the credits available on the return.

It is not known whether eligible IFTA carriers not filing supplemental returns were unaware of the option or chose not to file. Because the diesel fuel and motor carrier fuel tax laws are complex, many IFTA motor carriers may not be aware of the credits that they may claim. Based on the high percentage of IFTA motor carriers not filing supplemental tax returns, we concluded that the Department should take further action to ensure that all IFTA motor carriers are aware of the credits that may be claimed on the supplemental tax return.

### **RECOMMENDATION**

We recommend that the Department take further action to ensure that all IFTA motor carriers are aware of the credits that may be claimed on the supplemental motor carrier tax return.

### **AGENCY PRELIMINARY RESPONSE**

The Department agrees with the recommendation. The Department informed us that it is now mailing a supplemental return to all Michigan licensed IFTA carriers every quarter. Also, the rate chart that is mailed to all IFTA carriers by all states and provinces includes a footnote for Michigan explaining that carriers will need to file a supplemental return with Michigan for the nonhighway use of taxed diesel fuel.

### **FINDING**

#### **3. Controls Over Delinquent Severance Tax Returns**

The Division had not formalized a methodology to identify and follow up on delinquent severance tax taxpayers.

The Department collects taxes on oil and gas extracted in Michigan, based on a percentage applied to the gross market value of the oil or gas extracted. Producers are required to file monthly tax returns reporting total oil and gas produced and the actual market value. For fiscal year 1998-99, the Division collected severance taxes and oil and gas fees totaling \$30.6 million from 115 taxpayers.

The Division relied on the knowledge and experience of one of its staff members to informally identify severance tax taxpayers who had not submitted monthly returns.

However, this staff member's process did not involve a recordkeeping methodology.

The Division had an automated database for recording returns filed by severance tax taxpayers that could be used to identify and follow up on delinquent severance tax taxpayers. Based on the limited number of taxpayers, the Division could also establish a manual control record for this purpose.

### **RECOMMENDATION**

We recommend that the Department formalize a methodology to identify and follow up on delinquent severance tax taxpayers.

### **AGENCY PRELIMINARY RESPONSE**

The Department agrees with the recommendation. The Department informed us that it is implementing a monthly process to verify the timely filing of all known filers. The Severance Tax Act does not require producers to register with the Department. Further, the Act does not require registration or reporting by pipeline owners of shipments from wells, collection points, or producing facilities; the quantities shipped; or the identity of the first purchaser. Most returns are filed by first purchasers. In fall 2000, Department of Environmental Quality personnel compared a list of known producers and first purchasers to severance tax returns and did not identify any nonfilers. The small amount of revenue per year as compared to other taxes limits the resources that are devoted to severance tax activities.

### **FINDING**

#### **4. Tax Return Receipts Reconciliations**

The Division did not reconcile with the State accounting records the tax return receipts for all the taxes it administered.

The Division reconciled with revenue recorded in the State accounting records the receipts received with tobacco products tax, severance tax, and IFTA motor carrier tax returns. However, the Division did not reconcile with the State accounting records the receipts received with motor fuel, intrastate motor carrier, and public utility tax returns.

Section 18.1485(2) of the *Michigan Compiled Laws* provides that each internal accounting and administrative control system shall include a system of authorization and recordkeeping procedures to control assets, liabilities, revenues, and expenditures.

To ensure that tax revenue has been properly recorded, the tax return receipts for all taxes should be reconciled with the State accounting records.

### **RECOMMENDATION**

We recommend that the Department reconcile with the State accounting records the tax return receipts for all the taxes that were administered by the Division.

### **AGENCY PRELIMINARY RESPONSE**

The Department agrees with the recommendation. The Department informed us that the Finance and Accounting Division assisted in developing procedures to reconcile receipts of all taxes administered by the Division with the State accounting records. The reconciliation was implemented in May 2001.

## **PROCEDURES AND CONTROLS FOR TAX RETURNS AND REFUNDS**

### **COMMENT**

**Background:** The Department collects motor fuel taxes mainly from the licensed suppliers who import fuel into the State or produce fuel at a refinery in the State. For fiscal year 1998-99, there were 72 licensed suppliers.

Most of the fuel received in the State is imported through large pipelines by suppliers who maintain pipeline terminals. The suppliers must remit the fuel taxes for fuel removed from their pipelines at these terminals, fuel produced at a refinery, and fuel imported by other means from another state. The suppliers are allowed certain deductions on their monthly tax returns in determining the taxes for fuel. The allowable deductions include fuel removed from space leased to other suppliers at a supplier's terminal, fuel sold to wholesalers who have tax-free exemption certificates or exporter licenses, and fuel exported to other states by the supplier.

For fiscal year 1998-99, there were 377 wholesalers with tax-free exemption certificates and 108 wholesalers with exporter licenses. Wholesalers with tax-free exemption certificates or exporter licenses may make tax-free purchases of motor fuel from suppliers. These wholesalers must remit motor fuel taxes for fuel purchased tax-free that is not sold to government agencies, exported to another state or country, or used for nontaxable purposes.

**Audit Objective:** To assess the effectiveness of the Division's procedures for and controls over auditing tax returns, resolving problems related to tax return errors and omissions, and issuing taxpayer refunds.

**Conclusion:** We concluded that the Division's procedures for and controls over auditing tax returns, resolving problems related to tax return errors and omissions, and issuing taxpayer refunds were reasonably effective. However, we noted reportable conditions related to follow-up of motor fuel tax return errors and discrepancies and fuel hauler reports.

## **FINDING**

### **5. Follow-Up of Motor Fuel Tax Return Errors and Discrepancies**

The Division did not ensure that timely follow-up was made of errors and discrepancies discovered in audits of motor fuel tax returns filed by suppliers.

The Division audits the suppliers' monthly tax returns to verify that fuel that has been removed from pipeline terminals or imported into the State by other means has been properly reported on the returns. When reporting errors or discrepancies are discovered in these audits, the Division sends a letter to the supplier explaining that the fuel in question may not have been properly reported and that an amount of additional tax and interest may be due. The letter states that, within 30 days, the supplier must either remit the additional tax and interest due or submit documentation that the Division's adjustments are incorrect. The letter also states that the Division will issue an assessment for the tax, interest, and penalty due if a response is not received from the supplier within 30 days.

As of October 31, 2000, the Division records indicated that 158 letters regarding fuel in question sent to 10 large suppliers had not been resolved. The Division records indicated that it had not resolved the discrepancies or issued an assessment for 86 letters with potential deficiencies totaling \$14.2 million over six

months after the letters had been issued. Of these 86 letters, 44 (51.2%) had not been resolved over one year after the letters had been sent to the suppliers.

To help ensure that the proper disposition is made, errors and discrepancies discovered in audits of supplier tax returns should be followed up on and resolved on a timely basis.

### **RECOMMENDATION**

We recommend that the Department ensure that timely follow-up is made of errors and discrepancies discovered in audits of motor fuel tax returns filed by suppliers.

### **AGENCY PRELIMINARY RESPONSE**

The Department agrees that timely follow-up is important. The Department informed us that it makes every effort to ensure that timely follow-up is made for information discovered through audits of motor fuel tax returns. Staff resource limitations, the large volume of data submitted with each return, nonelectronic reporting methods, and current computer system resources significantly affect the timing of the review of amended returns filed as a result of Division inquiries made upon review of returns. Additionally, mergers of large suppliers have occurred during the last several years, which resulted in a higher percentage of returns with numerous errors and omissions. Also, the merged companies frequently struggle to assimilate the accounting record functions and the response times have dramatically lengthened for the merged suppliers.

The Department estimates that 80% of the letters referenced in the finding have been resolved, with approximately 20% of the \$14.2 million cited assessed and/or collected. The remaining dollar amount has been canceled due to amended information or is awaiting final review of multiple amended returns from two remaining accounts.

### **FINDING**

#### **6. Fuel Hauler Reports**

The Division had not compared fuel import and export transactions reported on fuel hauler reports with fuel imports and exports reported on motor fuel supplier and wholesaler tax returns.

Section 207.110 of the *Michigan Compiled Laws* provides that fuel haulers transporting gasoline or diesel fuel in trucks with a capacity over 4,200 gallons shall file a report with the Department of all imports and exports of gasoline and diesel fuel. The Department requires fuel haulers to file quarterly reports of fuel imports and exports.

In fiscal year 1999-2000, 23 motor fuel suppliers and 61 motor fuel wholesalers were also licensed as fuel haulers (i.e., they transported their own fuel). In addition, there were 64 independent motor carriers who were licensed as fuel haulers. The 64 independent motor carriers import or export fuel for suppliers or wholesalers.

The Division received reports from four adjoining states of fuel exports to Michigan reported on supplier tax returns filed in these states. The Division used these reports to verify that fuel exports to Michigan reported to these states agreed with fuel imports reported by suppliers or wholesalers on Michigan tax returns.

The Division had not performed any comparisons of data reported on quarterly reports filed by fuel haulers with fuel imports and exports reported on motor fuel supplier and wholesaler tax returns.

Comparing data reported on fuel hauler reports filed by the independent motor carriers with fuel imports and exports reported on motor fuel tax returns filed by suppliers or wholesalers would add assurance that suppliers and wholesalers have properly included import and export transactions in the calculation of taxable fuel on their tax returns.

### **RECOMMENDATION**

We recommend that the Department compare fuel import and export transactions reported on fuel hauler reports with fuel imports and exports reported on motor fuel supplier and wholesaler tax returns.

### **AGENCY PRELIMINARY RESPONSE**

The Department agrees with the recommendation. However, the Department informed us that the lack of electronic reporting, limitations in the computer system, and staff resource limitations preclude implementing the recommendation at this time. The Department plans improvements to the motor fuel computer system that

will include e-filing and data matching capabilities and intake data from the new federal fuel tracking systems. This will significantly increase capacity to match return data, including imports and exports, to independent third party sources, such as fuel hauler reports filed electronically.

The Department commented that the finding notes the import/export data exchange program Michigan has with four surrounding states. The Department informed us that it does match these reports to motor fuel supplier and wholesaler reports, and the program is being expanded. The Department is in the process of entering into an exchange program with the Province of Ontario as authorized by Act 403, P.A. 2000, effective April 1, 2001.

The Department believes that the import/export data exchange program partially mitigates the effects of not matching the fuel hauler reports. The data from the two independent sources is largely, if not totally, duplicative.

## **EFFECTIVENESS AND EFFICIENCY IN PERFORMING LICENSING FUNCTION**

### **COMMENT**

**Audit Objective:** To assess the Division's effectiveness and efficiency in performing its licensing function related to the taxes it administered.

**Conclusion:** We concluded that the Division was effective and efficient in performing its licensing function related to the taxes it administered.

## Glossary of Acronyms and Terms

<b>effectiveness</b>	Program success in achieving mission and goals.
<b>efficiency</b>	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
<b>IFTA</b>	International Fuel Tax Agreement.
<b>motor carrier</b>	Person, partnership, corporation, firm, or other organization operating a commercial motor vehicle having 3 or more axles, regardless of weight, or having 2 axles and a gross vehicle weight exceeding 26,000 pounds.
<b>ORTA</b>	Office of Revenue and Tax Analysis.
<b>performance audit</b>	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
<b>reportable condition</b>	A matter coming to the auditor's attention that, in the auditor's judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.