STATE OF WISCONSIN

TAX APPEALS COMMISSION

PATRICK A. O'NEILL, **DOCKET NO. 10-V-021-SC**

Petitioner,

vs. **DECISION AND ORDER**

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

THOMAS J. MCADAMS, ACTING CHAIRPERSON:

This case comes before the Commission concerning the Department's imposition of a $1,000 penalty assessment against the Petitioner for using dyed diesel fuel in an improper manner in April of 2008. A trial was held in this small claims matter[1] on February 23, 2011 in Madison, Wisconsin. The Petitioner in this matter is represented by Attorney Peter J. Kind of the law firm of Knoke & Ingebritsen, of Monroe, Wisconsin. The Respondent, the Wisconsin Department of Revenue ("the Department"), is represented by Attorney Sheree Robertson, of Madison, Wisconsin. Both sides have filed post trial briefs.

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[1] The Commission decided to treat this case as a large claims case for two reasons. First, there appears to be no Wisconsin case law concerning Wis. Stat. § 78.155(2). Second, the fact pattern in this case may recur.

FACTS

Having heard the testimony of the witnesses and having reviewed the exhibits, the Commission makes the following findings of fact:[2]

Jurisdictional Facts

1. Respondent mailed to Petitioner, d/b/a Glenview Dairy, a Notice of Proposed Audit Report for Motor Vehicle Fuel Tax dated June 3, 2008, for the period May 1, 2002, through April 30, 2008, showing a dyed diesel fuel penalty due in the amount of $1,000 pursuant to Wis. Stat. § 78.155.

2. The Wisconsin Department of Revenue issued to Petitioner a Notice of Adjustment dated July 29, 2008, for a $1,000 penalty for the tax period April 1, 2008, through April 30, 2008, for using dyed diesel fuel in a taxable manner. (Exhibit 6.) By letter dated March 6, 2009, Petitioner's attorney informed Respondent of Petitioner's objection to the July 29, 2008, Notice of Adjustment, of his payment of the $1,000 penalty related to the Notice, and of the claim for refund of the $1,000. (A copy of the letter dated March 6, 2009 is attached to Exhibit 1.)

3. In its notice of denial letter dated April 14, 2009, Respondent notified Petitioner of the denial of his claim for refund of the Wisconsin dyed diesel fuel penalty in the amount of $1,000. (Exhibit 1.)

[2] The Department submitted proposed findings of fact with its post-trial brief. We have used many of the proposed paragraphs, making edits for form and clarity. We have also added additional findings of fact from the testimony. Neither party requested a transcript.

4. Petitioner filed a Petition for Redetermination dated June 12, 2009, objecting to the Wisconsin Department of Revenue's denial of his claim for refund of the Wisconsin dyed diesel fuel penalty of $1,000. (Exhibit 2.)

5. Per its Notice of Action letter addressed to Petitioner and dated December 11, 2009, the Wisconsin Department of Revenue denied his Petition for Redetermination dated June 12, 2009. (Exhibit 3.)

6. The Petitioner filed a timely petition with this Commission on January 29, 2010. (Commission File.)

Material Facts

Background Information on Petitioner and His Farming Operation

7. Until his retirement in 2001, Petitioner worked for the State of Wisconsin, Department of Agriculture, Trade and Consumer Protection for 33 years as a sanitation and field inspector. Petitioner testified at the hearing that he has also been a farmer for the past 45 years, and has been raising beef cattle since 2003.

8. In the years 2006, 2007 and 2008, Petitioner purchased dyed diesel fuel from the Blanchardville Co-op, a/k/a Co-Op Oil Association, to use in his tractors that are used in his farming operation. On the record at his hearing before the Wisconsin Tax Appeals Commission, Petitioner identified copies of 2007 and 2008 purchase invoices for the dyed diesel fuel that he had purchased. The invoices state that this product is dyed diesel fuel, that the diesel fuel is for non-taxable use only, and that there is a penalty for taxable use. As relevant to this case, the dyed diesel fuel is to be used in agriculture and in off-road vehicles and equipment.

9. Petitioner testified that in 1995, he first licensed his 1983 diesel Ford 250 pickup truck, which during the years at issue was a flatbed pickup truck that was licensed in 2007 and 2008 for road use. Petitioner drove the truck on the roads.

The Department of Revenue's Audit and Fuel Sample Taken

10. Mr. Kent Harris has been employed by the Wisconsin Department of Revenue since June 21, 2001, and since October 2006 he has been an Excise Tax Field Auditor. He contacted Petitioner by letter dated March 28, 2008, and made inquiries regarding his farm operations, including the equipment used, the kind of farming business, and the licensed vehicles because Petitioner had purchased a substantial quantity of untaxed fuel from a supplier.

11. After Petitioner responded to the March 28 letter, Mr. Harris telephoned Petitioner on April 15, 2008 and spoke with him about various aspects of his farming operation and fuel use. In that conversation, Mr. Harris made arrangements to meet with Petitioner on April 17, 2008, at his Glenview Dairy farm, which is located outside of Blanchardville, Wisconsin, for purposes of conducting a field audit.

12. On April 17, 2008, Mr. Harris arrived at Petitioner's Glenview Dairy farm for the audit and met with him. Mr. Harris reviewed Petitioner's gasoline invoices for 2007. Before the fuel sample was taken from the fuel supply tank of Petitioner's truck, Petitioner informed Mr. Harris that he had placed automatic transmission fluid ("ATF") in it to clean the injectors. Mr. Harris took the fuel sample from the fuel supply tank of Petitioner's truck to check to see if he was using dyed diesel fuel in a taxable manner.

13. After the sample was drawn, Mr. Harris saw that it had "traces of dye, . . . and was more orangeish." After the fuel sample was taken, the Petitioner told Mr. Harris that in either December of 2007 or in January of 2008, he had put 2 or 3 gallons of dyed diesel fuel in the fuel supply tank.

The Test Results of the Fuel Sample

14. Immediately after the fuel sample was taken from the fuel supply tank of Petitioner's truck, Mr. Harris placed it in a sample bottle as reference number 200000280656, labeled it, and assigned it Sample Reference Number 0026122. Mr. Harris took the fuel sample to his office where it was secured until a Field Compliance Officer for the Internal Revenue Service (IRS) came to pick it up for testing. The form accompanying the sample, however, did not include the reference number.

15. The IRS sent the fuel sample taken from the supply tank of Petitioner's truck to the Excise Forensics Laboratory - Pacific Northwest National Laboratory (Lab) for testing. The Lab received the fuel sample taken from Petitioner's truck on May 9, 2008, and analyzed it on May 13, 2008. (Exhibit 10.) The Lab prepared a written report dated May 14, 2008, on the fuel sample taken from Petitioner's pickup truck. The Lab's report shows that the fuel sample taken from Petitioner's truck contained a concentration of Solvent Red 164 Dye (mg/L) at 4.6 parts per million. Mr. Harris testified that the federal minimum standard of red 164 dye in diesel fuel is 11.1 parts per million.

16. Dr. Kenneth Washburn, a Product Specialist and Toxicologist for Citgo Petroleum, testified at Petitioner's hearing before the Wisconsin Tax Appeals

Commission that ATF also contains solvent red dye 164, the same dye used in dyed diesel fuel. Dr. Washburn testified that Citgo Petroleum has not done any testing on the effects of adding ATF to diesel fuel.

Assessed Penalty for Taxable Use of Dyed Diesel Fuel

17. Respondent assessed the $1,000 penalty for the period April 1, 2008, through April 30, 2008, because the audit was conducted in April of 2008 and Petitioner did not know exactly when he placed the dyed diesel fuel in the truck and the fuel sample was taken in April of 2008.

Statements Concerning Dyed Diesel Fuel Use

18. In a letter dated August 28, 2008, from Petitioner's attorney to Charles Zwettler, Chief of the Department of Revenue's Excise Section, it was stated that "Mr. O'Neill's use of the fuel in question resulted from an emergency situation." (A copy of the letter is attached to Exhibit 1.) The same statement was made in a letter dated June 12, 2009, to Mr. Zwettler. (Exhibit 2).

19. In Petitioner's Petition for Review, which is a pleading, on Page 2, Paragraph 1, it is stated in part:

> Mr. O'Neill informed the Wisconsin Department of Revenue agent that he put roughly two gallons of dyed diesel fuel into his truck in December of 2007. (Affidavit of Patrick O'Neill.) He was plowing out the driveway of a farm several hours from his dairy and realized he had forgotten to fill his truck's fuel tank. (Id.) Rather than risk running out of fuel and essentially stranding the elderly couple who lived on the farm, Mr. O'Neill used just enough dyed fuel to get to the closet fuel station in the nearby town. (Id.) . . .

Petitioner's Affidavit, a sworn statement, is attached to his Petition for Review and in Paragraph 5 of his Affidavit it is stated in part:

> Rather than risk running out of fuel and stranding the elderly couple who lived on the farm, I used two gallons of dyed diesel fuel, left over in a container in the back of my truck, to get to the closet fuel station in town.

Thus, on several occasions, Petitioner admitted that he had used dyed diesel fuel in his truck in an emergency situation. (Exhibit 4.)

ATF Use

20. ATF has a high concentration of red dye 164, about 20 times higher than that of dyed diesel fuel.

21. The Petitioner's mechanic testified at the hearing that years ago, he had recommended to the Petitioner that he add ATF to his vehicles, because it is inexpensive and acts as a lubricant and as a cleanser.

22. The Petitioner testified that prior to April of 2008, he would sometimes put half a quart of ATF in his truck when filling the tank with clear fuel.

23. The Petitioner testified that he had filled the truck's tank with clear diesel fuel a number of times after the incident on the other farm that happened in either December of 2007 or January of 2008.

OPINION

The DOR issued a $1000 penalty assessment against Mr. O'Neil on July 29, 2008. The basis of the $1000 penalty assessment was that a DOR auditor took a fuel sample from Mr. O'Neil's truck on April 17, 2008 and the sample had some red dye in

it, but at a level substantially below the level that is required to be added to diesel fuel. After exhausting his administrative appeals, Mr. O'Neil filed an appeal to this Commission on January 29, 2010. The Department moved for summary judgment on June 21, 2010 and the motion was denied on August 25, 2010. In brief, the Commission held that Wis. Stat. § 78.155 does not impose strict liability on the taxpayer for any positive test for red dye. The Commission conducted a trial in this matter on February 23, 2011 and the parties submitted post-trial briefs. The first part of this opinion will state the relevant law. The second part of this opinion will set forth the evidence. The third part of this opinion will state why we find that the Petitioner has met his burden of proof.

A. Applicable Law

1. Background

Federal law imposes a tax on fuel used for motor vehicle transportation, but not on fuel used for non-transportation purposes such as home heating. *See* 26 U.S.C. §§ 4081(a)(1)(A), 4082, and 4041(b). In order to differentiate between fuels used for taxable and tax-exempt purposes, oil companies are required to use a red dye to color tax-exempt oil. *See* 26 U.S.C. § 4082(a). This tax-exempt oil is commonly referred to as "red oil" or "2oil." Taxable oil used for transportation is not dyed, and is commonly referred to as "clear oil." *Consolidated Edison Co. of New York, Inc. v. U.S.*, 34 F. Supp. 2d 160 (S.D.N.Y. 1998). In brief, because taxed diesel fuel for highway use and untaxed diesel fuel for heating and off-highway use have largely similar chemical compositions and can be employed interchangeably, federal law mandates that the

untaxed fuel be identifiable by the addition of red dye. *Id.*; *See also* I.R.C. § 4082(a). Nontaxable fuel is commonly called "red-dyed fuel," while taxable fuel is called "clear fuel" or "low sulphur diesel fuel." This distinction is relevant for purposes of taxability, not combustibility; both types of fuel burn the same, but clear diesel is subject to federal excise taxes while dyed diesel is not. *See* 26 U.S.C.A. § 4082(a) (West Supp.1998). The dye enables the Government more easily to determine whether particular fuel has been taxed or not. Only businesses that use diesel for off-highway purposes, such as powering off-road equipment or generators, are permitted to hold or to use nontaxable, dyed diesel. *See* 26 U.S.C.A. §§ 4041(b), 6421(e) (West Supp.1998). Since January 1, 1994, it has been illegal at the federal level to be in possession of red-dyed fuel for taxable purposes.

The Wisconsin statutory provisions governing motor vehicle and general aviation fuel taxes can be found in Chapter 78 of the Wisconsin Statutes. Section 78.01(2p), Wis. Stats., defines dyed fuel to mean:

> If indelible dye has been added to diesel fuel before or upon withdrawal at a terminal or refinery rack, that fuel may be used only for an exempt purpose.

While Wisconsin does not have an emergency exception, if a taxpayer uses dyed diesel fuel in a taxable manner under Wis. Stat. § 78.12(3), he or she is required to file with the Department of Revenue a report of the taxable use and to pay the tax due. Under Wis. Stat. § 78.155(2), the Wisconsin Legislature authorized the Department of Revenue to assess a penalty for misuse of dyed diesel fuel. Wis. Stat. 78.155(2) provides the following:

> Any person who knows or has reason to know that he or she used **dyed diesel fuel** for a purpose that is taxable under this subchapter shall pay to the department a penalty of $1,000 or twice the amount of tax that should have been paid on the dyed diesel fuel, whichever is greater.

[emphasis added]. Wis. Stat. § 78.01(2m) lists seven diesel fuel exemptions.

2. Burden of Proof

As a general rule, the Department's assessment of a penalty is presumptively correct. *Edwin J. Puissant, Jr. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-401 (WTAC 1984); Wis. Stat. § 77.59(1). Therefore, a taxpayer who sues the Department for a refund bears the burden of proving the invalidity of the Department's determination. *MRC Industries, Inc. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 203-273 (WTAC 1991).

B. The Evidence

A narrative summary of the factual findings above is as follows: In April of 2008, the Department's auditor conducted a field audit of the Petitioner as the Petitioner had purchased a substantial quantity of dyed diesel fuel for use on his farm. The Department's auditor took a fuel sample from the Petitioner's truck and sent it to a laboratory for testing. The result revealed the presence of red dye 164, but at a level of 4.6 parts per million, whereas dyed diesel fuel usually has 11.1 parts per million. At the trial, the Department's auditor testified that the fuel in the tank was "orangeish" in color, not red. The Petitioner told the auditor that he had used about 2 gallons of the dyed fuel in an emergency situation sometime the previous December or January. The

Department issued the $1000 penalty assessment against Mr. O'Neil for the April 1 to April 30 tax period.

At the trial, the Petitioner testified concerning the circumstances surrounding his one time use of dyed diesel fuel the previous December or January. The Petitioner testified that he was snow plowing at one of his farms on a very cold day and was close to running out of fuel, so he put 2 or 3 gallons of dyed diesel fuel in his truck from a portable can to get to the nearest gas station. Subsequent to that day, the Petitioner filled his truck up with clear fuel on several occasions. On the advice of his mechanic, however, the Petitioner had also been putting ATF in the truck's fuel tank to make the truck run better. The mechanic also testified and confirmed that he had told the Petitioner to add the ATF to the tank. The Petitioner introduced testimony from a chemist that both dyed diesel fuel and ATF contain red dye 164.

C. Analysis of the Evidence

As mentioned above, a trial was conducted in this case on February 23, 2011. The Petitioner had the burden of proof at trial to show the Department's assessment was incorrect and the evidence that was put into the record showed that there were two issues in the case. First, the Petitioner challenged the chain of custody leading to the introduction of the test result of the fuel sample. Second, the Petitioner questioned whether or not the fuel in his tank was "dyed diesel fuel." We address each contention in turn.

1. Chain of Custody

An issue in this case is whether there was sufficient proof to establish a chain of custody for the test result on the fuel sample. The law with respect to chain of custody issues requires proof sufficient "to render it improbable that the original item has been exchanged, contaminated or tampered with." *B.A.C. v. T.L.G.,* 135 Wis. 2d 280, 290, 400 N.W.2d 48 (Ct. App. 1986). Wisconsin Stat. § 909.01 (2009-10) provides: "The requirements of authentication or identification as a condition precedent to admissibility are satisfied by evidence sufficient to support a finding that the matter in question is what its proponent claims." A perfect chain of custody is not required. *United States v. Moore,* 425 F.3d 1061, 1071 (7th Cir. 2005). Alleged gaps in a chain of custody "go to the weight of the evidence rather than its admissibility." *United States v. Lott,* 854 F.2d 244, 250 (7th Cir. 1988). The degree of proof necessary to establish a chain of custody is a matter within the trial court's discretion. *B.A.C.,* 135 Wis. 2d at 290.

The uncontroverted testimony was that the Department's auditor took a fuel sample from the Petitioner's truck on April 17, 2008. The sample was marked and taken to the auditor's office, where the auditor called a representative of the IRS to pick up the sample in order that it might be sent to a lab for testing. The representative came to get the sample, and then sent it to a forensic testing facility. A chemist there analyzed the sample, determining that it contained 4.6 parts per million of red dye 164. The chemist's report was received in evidence.

At the trial and in the post–trial briefs, the Petitioner raised the lack of an identifying number on one document as a basis for excluding the test result. We hold,

however, based on all of the evidence that the Commission received, that the lack of an identifying number in one place on a form does not prohibit the introduction here of the test result. Applying the legal standard, there was more than sufficient evidence received at the hearing to support a finding that the fuel sample test result was what it was claimed to be. Further, there was no evidence of exchange, tampering, or contamination. We are satisfied based on the testimony and the exhibits that the test result was in fact on the sample taken from the Petitioner's truck on April 17, 2008. On this issue, the Department prevails.

2. Dyed Diesel Fuel

The other issue in the case is whether the fuel the Petitioner used during the relevant period was "dyed diesel fuel" or whether the fuel was ordinary clear diesel fuel with ATF mixed into it. This issue arises because the test result was 4.6 parts per million and dyed diesel fuel ordinarily contains around 11.1 parts per million. The test result was thus well below that ordinarily found in dyed diesel fuel, just under half the required concentration. The first question we must answer is what Wisconsin law requires. Then, we must evaluate the evidence in this case and determine if the Petitioner has met his burden of proof.

This case requires us to interpret Ch. 78 of the Wisconsin Statutes. The ultimate goal of statutory interpretation is to ascertain the intent of the legislature. *See Rolo v. Goers*, 174 Wis. 2d 709, 715, 497 N.W.2d 724, 726 (1993). The first step is to look at the language of the statute. *See Id.* If the plain meaning of the statute is clear, the Commission need not look to the rules of statutory construction. *See In Interest of Jamie*

L., 172 Wis. 2d 218, 225, 493 N.W.2d 56, 59 (1992). We simply apply the clear meaning of the statute to the facts before us. *See Rolo*, 174 Wis. 2d at 715, 497 N.W.2d 724. The plain meaning of a statute takes precedence over all extrinsic sources and rules of construction, including agency interpretations. *UFE v. Labor and Industry Review Com'n.*, 201 Wis. 2d 274, 548 N.W.2d 57 (1996). When we look at Chapter 78, we see that Wis. Stat. § 78.155 plainly prohibits improper use of "dyed diesel fuel." Wis. Stat. § 78.01(2p) defines what "dyed diesel fuel" is. Two things come from this that are relevant to this case. First, the Wisconsin Statutes do not make red dye in diesel fuel illegal *per se*. Second, a trace of red dye in untaxed diesel fuel is evidence of improper use.

This analysis is consistent with that of the Second Circuit. For example, in *Apollo Fuel Oil v. U.S.,* 73 F. Supp. 2d 254 (E.D.N.Y. 1999),[3] a diesel fuel trucking company brought a refund action to recover a $1,000 penalty assessed by the IRS for misusing dyed diesel fuel. In brief, the fuel sample taken by the inspector was found to have a red dye concentration of 3.0 milligrams per liter. At trial, the taxpayer posited several possible sources of the red dye, including accidental contamination by hoses previously used with red fuel. After listening to the witnesses and evaluating their credibility, the magistrate judge determined that it strained credulity to believe that a few drops of fuel with a dye concentration of 11.2 milligrams per liter could dye the 15 to 20 gallons of fuel in the propulsion tank to a concentration of 3 milligrams per liter. Thus, based on the credible evidence received at trial, the magistrate judge determined that the taxpayer had not proved it was entitled to a refund of the $1,000 penalty. What

[3] The *Apollo* decision was affirmed in *Apollo Fuel Oil v. U.S.*, 195 F.3d 74 (2d Cir. 1999).

Apollo makes clear is that when a taxpayer contests this penalty assessment at a trial, all of the relevant and credible evidence properly received must be considered.

In this case, the Petitioner's mechanic told a coherent and facially plausible story that was not contradicted in any respect by extrinsic evidence that the Petitioner regularly put ATF in his truck to make the engine run better. That testimony, in our view, was credible and essentially uncontroverted. While there was also evidence received that at some point months earlier that the Petitioner had used about 2 gallons of dyed diesel fuel to avoid running out of fuel, we give that statement little weight.[4] We find, based on the credible evidence received at the hearing, that the Petitioner showed that the fuel in the tank during the relevant period was not "dyed diesel fuel."

CONCLUSION

There were two issues at this trial. First, the Department successfully laid a foundation for the test on the fuel sample and the challenge based on the chain of custody is denied. Second, the Petitioner proved that the fuel in his tank was not "dyed diesel fuel."

[4] The statement was largely uncorroborated and appeared to concern a different tax period.

ORDER

The Respondent's action on the Petition for Redetermination is hereby reversed.

Dated at Madison, Wisconsin, this 29th day of April, 2011.

WISCONSIN TAX APPEALS COMMISSION

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Thomas J. McAdams, Acting Chairperson

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Roger W. Le Grand, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**