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IFTA Audit Roadmap: What to Expect From Base State Tax Departments

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The International Fuel Tax Agreement (IFTA) system is an important clearinghouse mechanism for for-hire motor carriers and private carriers with interstate operations. The IFTA plan benefits participating carriers by offering a consolidated fuel tax system where payments are remitted to a single Base State rather than through each state in which commercial motor vehicles happen to operate. Despite its convenience, this agreement between the states can spell trouble for those motor carriers without strong documentation and recordkeeping practices.

IFTA audits can and do occur, resulting in administrative and financial burdens on motor carriers. The degree of granularity required for meaningful IFTA audit information disclosures may be surprising to many, as may the tenacity of auditors. This article provides a basic "roadmap" for steering through the course of events that follows a knock on the door by a Base State's tax authority. Preventing disappointing outcomes from IFTA audits begins in large part with diligent and thoughtful recordkeeping-which is an achievable best practice for motor carriers.

What Is IFTA, Really?

IFTA is an agreement made among 48 states and 10 Canadian provinces that streamlines the fuel tax reporting process for interstate carriers. The main purpose behind IFTA is to "promote and encourage the fullest and most efficient possible use of the highway system by making uniform the administration of motor fuels use taxation laws with respect to motor vehicles operated in multiple member jurisdictions."[i]Among its core principles, IFTA implements the concept of a "base jurisdiction." This allows a licensee to report and pay to its base jurisdiction all the fuel taxes it owes, which are then distributed to each member jurisdiction in which it traveled during the reporting period.[ii]

You may qualify for IFTA if you use commercial motor vehicles (CMVs) in the interstate transportation of either persons or property and those CMVs: (i) have two axles and a gross vehicle weight (GVW) or registered GVW exceeding 26,000 pounds; (ii) have three or more axles, regardless of their weight; or (iii) are used in combination with a trailer, for a combined GVW or registered GVW in excess of 26,000 pounds. You may register by completing the IFTA License Application and submitting it to the proper authority within the Base State[iii]-for example, the Bureau of Commercial Vehicle and Driver Services in Florida. You must agree to be "bound by the duties and obligations of licensees" as most currently amended, and it is the Base State which "must enforce those duties and obligations within its jurisdiction."[iv] With minor exceptions, an IFTA license is considered mandatory for any person or entity "based in a member jurisdiction operating a qualified motor vehicle(s) in two or more member jurisdictions."[v]

In many ways IFTA is similar to the International Registration Plan (IRP) for equipment, with which you may also be familiar. However, an IFTA license is regularly a prerequisite for applying to the IRP. Participating carriers are issued an IFTA license and a set of IFTA decals for each vehicle, which allow the carriers to operate in all IFTA jurisdictions without buying additional decals from those jurisdictions, also similar to the IRP's distribution of plates.

You will need to pay quarterly tax returns upon successful registration with IFTA-even if you do not operate or purchase fuel in any IFTA jurisdiction in any given quarter. In some jurisdictions, like Florida, the quarterly tax return due dates are the last day of the month following the quarter then-ended. For example, the tax return for the period of January through March is due on April 30. Yearly license renewal is available as long as the license is not revoked, suspended or canceled, all tax returns for the year were filed, and all motor fuel use taxes and related expenses have been paid in compliance with IFTA and the laws of the licensee's base jurisdiction.[vi]

How Will I Know My Company Is Being Audited?

The notification of an audit may come in the mail, or your company may first discover it is being audited by a phone call from your company's Base State's Department of Taxation (the Department). If your company has received notification that it has been selected for an audit, this is not necessarily an indication that wrongdoing or underpayment is suspected. Every year, each Base State's Department is obliged to audit an average of 3% of IFTA accounts required to be reported in the jurisdiction.[vii] At least 15% of the audited IFTA accounts must be those who are reporting the lowest miles/kilometers in member jurisdictions, and at least 25% audited must include those IFTA accounts reporting the highest miles/kilometers reported in member jurisdictions.[viii] However, it is also possible that the Department *has* noted reporting discrepancies, such as wildly different reporting in similar quarters, triggering an audit.

In most instances, your company will be given notice of an audit via correspondence from your Base State's Department of Taxation at least 30 days prior to the audit, and in that notification (or subsequent correspondence) you should receive direction as to the period of time the audit will cover, the types of records that will be audited, and the proposed audit start date.[ix] The auditor assigned to your company's case will also contact your company's representative for an opening conference to discuss the company's operations, distance and fuel accounting system, and audit procedures, and the scope of the audit.

What Does My Company Need to Provide to the IFTA Auditor?

IFTA recommends using a document such as the "Individual Vehicle Mileage Record"[x] reporting form to verify the registrant's application or fuel report for a date; however, many, if not most, Electronic Logging Devices (ELDs) have the capacity to record the required information as well. The types of records that must be retained for IFTA purposes include:

- Beginning and ending dates of the trip to which the records pertain
- Trip origin and destination
- Routes of travel
- Beginning and ending reading from the odometer, ECM or similar device

- Total trip distance
- Distance traveled in each jurisdiction
- Vehicle identification number or vehicle unit number

If utilizing ELD records, the records must include:

- The original GPS[xi] or location data to which the records pertain
- The date and time of each GPS reading, at intervals to validate the total distance traveled in each jurisdiction
- The location of each GPS reading
- Beginning and ending reading from the odometer, ECM or similar device, corresponding to the record date
- The calculated distance between each GPS reading
- The route of travelThe total distance traveled
- The distance traveled in each jurisdiction
- Vehicle identification number or vehicle unit number

Your company must also retain fuel receipts for all fuel purchases for IFTA-qualified vehicles. For IFTA purposes, all of these records must be maintained for **four years**.

The toughest part for most motor carriers to keep track of is the route data because a high degree of specificity is required (the auditor wants to know exactly which route you used, because it invariably impacts the distance traveled). If a motor carrier is unable to produce route records to confirm reported distance totals, the auditor can and will make his or her own calculations, which could result in the finding of an underpayment.

How Is the IFTA Audit Performed?

Most often, the auditor will request a list of and data from your entire IFTA-qualified fleet. Once that list is obtained, the auditor will select a number of vehicle records to audit with specificity. Generally, auditors will request the records be produced to them so that they may conduct the audit from their office (not your location).

It sometimes happens that the records for a certain vehicle are lost, or have been corrupted. In these instances, it helps if your company's representative has developed a congenial relationship with the auditor, because the auditor is more likely to be willing to negotiate the substitution of records from another vehicle to complete the audit. Also, if your company does not have the exact records requested by the auditor, but did maintain documents that are sufficient to show the requested information, the auditor may accept alternative documentation of the reported numbers for the motor carrier.

What Happens If the Auditor Determines My Company Has Underpaid?

The auditor will notify your company of an assessed underpayment in writing and will demand payment within a short period of time. Your company will have the option to appeal the decision of the auditor if you believe there is a material misunderstanding of fact or law, but this decision will have to be made relatively quickly after the decision or late payment penalties will likely be assessed. Like other forms of tax disputes, your company may choose to pay the assessment and then challenge the decision after payment, avoiding any late payment penalty.

The decision to fight or pay an assessed underpayment will hinge on many factors, such as the amount of the assessment, but will also rest upon the grounds for your company's challenge. For instance, if your company provided records sufficient to show the distances traveled, but the auditor refused to review the records (a material factual dispute), that would be a good reason to appeal the decision. Or, perhaps the auditor selected a vehicle in your company's fleet that was not required to retain IFTA records (a material legal dispute) and refused to select a qualifying vehicle.

These are issues that may or may not be able to be addressed by your company's employees, and as a result, additional professionals may need to retained to address any disputes with the Department. Your accounting and legal advisors will be helpful in navigating through underpayment allegations.

What If My Company Does Not Feel Comfortable Working With the Auditor?

If your company would prefer to be represented by an attorney or other tax representative in your audit process, it is permitted to do so. These audits may have serious financial and other civil penalties, and it may make sense to have an intermediary to negotiate on your company's behalf. If your company chooses to hire someone to assist with the audit, the company will likely need to authorize that person to act on the company's behalf by providing the Department with a Declaration of Tax Representative, or other proof of authorization documentation.

How Should My Company Prepare?

Participation in IFTA is a virtual inevitability for most interstate motor carriers and, while any type of audit is unpleasant, preparation for IFTA compliance can greatly ease that process. The key to minimizing the time and expense associated with an IFTA audit is to develop strong recordkeeping practices. The goal of every IFTA licensee should be to develop recordkeeping and compliance processes that maintain an accurate picture of the operation. The documents and data identified above must be reliably collected and maintained in order to evidence your actual fuel spend, mileage and routes. This is your responsibility-not the Base State's-and it will quickly become your problem during an audit.

It is helpful to bear in mind that the IFTA audit process is intended to arrive at the truth of your operation's fuel consumption and traffic. Once the audit begins, prepare to present this information and for you and your staff to answer the auditor's interview questions. In the best-case scenario, just as with income taxes, you have correctly paid or overpaid to IFTA. In the worst-case scenario, determinations will be made based upon the facts and circumstances of your operation (where quality recordkeeping does not exist) and the amount paid or demanded may not in fact align with the amount due. Viewed this way, IFTA compliance is more an exercise in accuracy than of

gamesmanship. Failure to maintain accurate records and to respond to audits professionally and with candor can only hurt yourself.

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[i] IFTA, *Articles of Agreement* § R130 (last updated Dec. 1, 2018)(available online at: https://iftach.org/manuals/2018/AA/Articles%20of%20Agreement%20December%202018.pdf).

[ii] *Id.* at § R130.100 (part of an interstate compact approved by Congress in the Intermodal Surface Transportation Efficiency Act of 1991, providing retention for each jurisdiction's sovereign authority to determine tax rates, exemptions, etc., and a uniform definition of the vehicles subject to IFTA).

[iii] *Id.* at § 315.

[iv] *Id.* at § R140.

[v] *Id.* at § 305.

[vi] *Id.* at § 345.100.

[vii] Audit Manual *A250.

[viii] Audit Manual *A260.

[ix] Audit Manual *A420.100.

[x] These source documents are developed by the Base State and generally available online.

[xi] GPS or similar electronic system.