STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DANN OCEAN TOWING, INC.	:	DETERMINATION DTA NO. 822683
For Revision of Determinations or for Refund of Tax on Petroleum Businesses under Article 13-A of the Tax Law for the Period January 1, 2000 through December 31, 2004.	:	

Petitioner, Dann Ocean Towing, Inc., filed a petition for revision of determinations or for refund of tax on petroleum businesses under Article 13-A of the Tax Law for the period January 1, 2000 through December 31, 2004.

On October 29, 2009 and November 3, 2009, respectively, petitioner, appearing by Donna Marie Zerbo, Esq., and the Division of Taxation, appearing by Daniel Smirlock, Esq. (Michelle M. Helm, Esq., of counsel), waived a hearing and submitted the matter for determination based on documents and briefs to be submitted by May 24, 2010, which date began the six-month period for issuance of this determination. After due consideration of the documents and arguments submitted, Joseph W. Pinto, Jr., Administrative Law Judge, renders the following determination.

ISSUES

I. Whether petitioner, a foreign corporation, has contacts with New York State sufficient to justify the imposition of the petroleum business tax under Article 13-A of the Tax Law.

II. Whether imposition of the petroleum business tax on petitioner was arbitrary and capricious, thus violating the Due Process and Equal Protection clauses of the United States Constitution, because the assessment was based on time in New York waters without the benefit of published fixed coordinates and without the information necessary to verify the number of hours petitioner's vessels spent on each voyage.

III. Whether petitioner or its lessee was the petroleum business responsible for the filing of the petroleum business tax returns and paying the tax due as stated thereon, where the lessee had significant control over the vessels including the ability and obligation to purchase fuel.

IV. Whether the assessment was erroneous and arbitrary because it predated the establishment of clear criteria for defining New York waters and interpreting charter arrangements, which were later developed by the American Waterways Operators and New York State between 2005 and 2007.

FINDINGS OF FACT

1. During the period January 1, 2000 through December 31, 2004 (the audit period), petitioner was engaged in the business of providing tug boats for towing or other transportation services in all territorial waters of the United States between the east and west coasts, in waters from the Caribbean to South America and in waters from Europe to China.

2. Petitioner is family owned and has been in the maritime commerce business since the late 1800s. Petitioner was incorporated under the laws of the State of Florida and, during the audit period, did not have or do any of the following: own, rent or otherwise maintain real or personal property in New York State; maintain an office or place of business in New York; maintain a sales force, personnel, employees or agents in New York; execute contracts in New York; register to do business in New York; or register or store its vessels in New York.

3. During the audit period, petitioner maintained a fleet of 12 tug boats that were used to provide towing services to customers under charter agreements. Seven of these vessels were examined by the Division of Taxation (Division): the Ruby M; the Captain Dann; the Allie B; the Sarah Dann; the Shannon Dann; the Comet; and the Stephen Dann.

4. Two agreements between petitioner and St. Lawrence Cement Corporation (SLC), both dated March 1, 2001, indicated that petitioner would provide towage by the tugs Allie B[1] and Ruby M of cement barges; adequate personnel to load, discharge and maintain the barges; and sufficient crew members to perform these operations for a period of three years.

With respect to fuel, the contract for the Allie B, in Section IV, provided that SLC would pay the cost of the tug's fuel. Petitioner also agreed to provide fuel for the barge Midnight 1, which expense was to be invoiced to SLC with documentation that substantiated the cost of the fuel to petitioner. The Allie B contract called for petitioner to be compensated $3,600.00 per day plus fuel cost, with a minimum number of 330 work days per year.

The fuel provision of the Ruby M contract, Section IV, provided that the towage rates included the charge for fuel, calculated on a cost of $0.75 per gallon consumed by the tug. Any increases in the rate were to be passed along to SLC. Any fuel provided by petitioner for the barge was to be at the terminal price paid by petitioner plus a $0.05 per gallon service charge. As in the Allie B contract, the fuel expense for the barge was to be invoiced to SLC with documentation that substantiated the cost of the fuel to petitioner. In both contracts, fuel soundings were to be taken before and after filling the barge fuel tank and the difference between the soundings was the amount invoiced by petitioner to SLC.

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[1]The contract with regard to the Allie B appears to be missing pages, including all sections after that for "Default" and the signature pages. Since it is not complete, it cannot be discerned if there was a provision describing the parties' relationship like the one in the Ruby M contract.

Section XXI of the Ruby M contract stated that it was the intent of the parties to define their relationship as the sale of towing and operating services between a seller and buyer of said services.

A third contract between petitioner and LEEVAC Marine, Inc., signed by one of the parties to the contact on September 25, 2000, was for a term of four months, and was a time charter agreement between petitioner, owner of the tug Neptune, and LEEVAC, the charterer, for $3,100.00 per day. The services to be rendered were ship assist and towage of oil barges. The agreement specifically provided that LEEVAC would furnish all diesel motor fuel and lubricating oils for the tug's operation. Petitioner was responsible for providing four crew members and LEEVAC for two tankermen to load and discharge the tank barges. Although the tug was to be delivered at New York Kills, the towing was expected to occur on the Atlantic and Gulf coasts of the United States, Puerto Rico, Mexico and other Atlantic and Caribbean ports.[2]

5. Typically, a vessel had a crew of three to six individuals dictated by the vessel's specific engagement, with published rotations of crews calling for 40 days on board and 20 days off. However, travel arrangements were modified due to mechanical breakdowns, weather and customer requirements.

6. Crews consisted of a captain, mate, engineer and one to three deckhands. Crews were considered interchangeable although petitioner tried to associate the same captain and engineer with the same boat.

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[2]Although it appears this charter agreement would not be interpreted differently than those for the Allie B and the Ruby M, the agreement provided for LEEVAC to "furnish" the fuel and lubricating oils as required for the operation of the tug, which might or could have been explained by LEEVAC's status as a similar towing/marine company. Petitioner did not elaborate on LEEVAC and it is not known if it made any adjustment in its pro forma PT-350 returns based on the possibly unique status of LEEVAC.

7. Each vessel maintains a log book in which are recorded positions, arrivals, departures, significant events, embarking and disembarking crew members, and orders from customers and petitioner. Current position is called into the office dispatcher each morning and with it anticipated movements. This information is retained in position reports. The log book and position reports are used to produce billing reports, which are required by some customers when they are invoiced.

8. Log entries do not necessarily state the body of water the vessel is traversing, and the captain does not generally know which state jurisdiction the vessel is in at any given moment, since the captain navigates by the channel as defined by the navigational aids maintained by the United States Coast Guard. Location was determined by using nautical charts which illustrate channel navigational aids, water depths, significant landmarks, and wrecks' latitude and longitude, all tied to global positioning system (GPS) instruments.

9. After observing one of petitioner's vessels in New York waters, the Division contacted petitioner on November 14, 2004 and scheduled a field audit appointment at petitioner's office in Tampa, Florida, for January 24, 2005. The Division's auditor, Mr. Robert Bergeson, sent petitioner's controller, Mr. Rick Power, a letter (the appointment letter) on December 16, 2004, informing him that the Division's auditors would be at his office from January 24, 2005 through January 27, 2005 to perform an audit of petitioner's petroleum business tax for the period January 1, 2000 through December 31, 2004 on motor fuel and diesel motor fuel consumed during the propulsion of commercial vessels in New York State territorial waters.

10. The appointment letter requested very specific information, attached on a separate sheet, seeking all documentation for the audit period that was necessary to compute and verify

the tax due on the form PT-350, Petroleum Business Tax Return for Fuel Consumption - Commercial Vessels.

11. Upon audit, it was discovered that petitioner had not filed any petroleum business tax returns for the audit period despite the fact that it operated the seven above-mentioned tugs in New York State during the audit period and consumed diesel and motor fuel in New York. Petitioner's tugs were involved in towing cement between points in New York and dredging and ice-breaking in New York waters.

12. Petitioner produced its captains' logs and position reports for the seven vessels, an equipment list and a fuel vendor list. In addition, petitioner was requested to prepare forms PT-350 for each month of the audit period, which were completed and produced to the Division in or about January 2005. The Division recorded point-to-point movements from the captains' logs for each tug, determined fuel consumed on board from the position reports and tallied the New York hours from the summary sheets. The Division performed an in-depth analysis of two of the tugs' movements, mapping routes and tracking on a 24-hour cycle to ascertain proper time allocations.

13. After completing the analysis for two of the tugs, the results were compared with the forms PT-350 prepared by petitioner and demonstrated that the reported gallons were within a reasonable margin of the audited gallonage. Based on this information, the Division decided to accept petitioner's pro forma returns (they were never actually filed) and assess on that basis.

14. During the audit period, the methodology used to calculate the tax on fuel consisted of dividing New York working days by total working days everywhere and multiplying the

resulting ratio by total fuel which yielded fuel consumed in New York. Total gallons of fuel consumed in New York was then multiplied by the appropriate tax rate to determine tax due.[3]

15. By letter, dated September 8, 2005, the Division informed petitioner of the audit results, contained in two separate statements of proposed audit adjustment for petroleum business tax, which set forth additional tax due of $145,900.19, plus penalty and interest. Petitioner, through its representative, disagreed with the statements by signing the statement of proposed audit adjustment, dated October 6, 2005.

16. By letter, dated July 31, 2007, from James R. Breen, Director of the Division's Transaction and Transfer Tax Bureau, to Mr. Rick Power, petitioner's controller, Mr. Breen explained that the Division had been in negotiations with the American Waterways Operators Association (AWO) and had reached a conditional agreement regarding the petroleum business tax liability of the AWO members for prior years. The agreement had been reached on October 26, 2006. Essentially, the agreement provided that interest on liabilities for periods prior to May 2004 would be computed from June 8, 2004 forward and that penalties would be calculated at five percent of the total tax due. Mr. Breen noted the failure of petitioner to respond to the offer and extended the deadline to reach an agreement with the Division to September 14, 2007.[4] Mr. Breen stated that if petitioner was unable to come to an agreement with the Division on the tax due for the audit period by that date, it was to file returns or schedules broken down by month and vessel substantiating the tax due and pay the amount determined to be due.

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[3]Although the precise date the new methodology was instituted was not disclosed in the record, for periods after the audit period form PT-350 included a schedule A that provided a simplified method of computing tax for tugboat and towboat operators, assigning specific tax amounts to various delineated routes.

[4]Due to use of an incorrect address, the letter was remailed and the deadline was extended to October 5, 2007.

17. Since nothing was forthcoming from petitioner in response to this letter and no PBT returns were filed for the audit period, the Division issued two notices of determination to petitioner on August 6, 2007 that set forth the following:

Date	Assessment ID	Tax	Penalty	Interest	Total
8/6/2007	L-028989452-3	$83,575.17	$25,072.46	$48,308.29	$156,955.92
8/6/2007	L-028989453-2	$62,325.02	$18,694.61	$21,407.54	$102,427.17

18. Some background and operational facts with respect to petitioner were found in the affidavit of Mr. Rick Power, petitioner's controller, and the affidavit of Mr. Luther O. Waller, petitioner's general manager, both sworn to on February 19, 2010.

Some information about the conduct of the audit was found in the affidavit of Daniel Jervis, sworn to January 19, 2010, an excise tax auditor with the Division, who was assigned to the audit of petitioner that resulted in the deficiencies herein.

CONCLUSIONS OF LAW

A. Tax Law § 301-a(a) imposes a tax on every petroleum business for the privilege of engaging in business or doing business in New York State. Tax Law § 301-a(b)(2) provides that motor fuel brought into New York in the fuel tank connecting with the engine of a vessel propelled by the use of such fuel shall be deemed to be a taxable use of motor fuel for which the responsible party must file a return and pay the appropriate tax.

B. Petitioner argues that the PBT as applied to it as a foreign corporation is unconstitutional because its only connection to New York is the consumption of fuel in New York. It distinguishes ***Matter of Moran Towing Corp. v. Urbach*** (99 NY2d 443, 757 NYS2d 513 [2003]) on the basis that the tug companies there were New York corporations and that non-

New York corporations were beyond the scope of the Court's decision. This argument is without merit.

The Court in ***Moran Towing*** relied on ***Complete Auto Transit, Inc. v. Brady*** (430 US 274 [1977]) and its four-prong test to determine whether a state tax imposed on interstate commerce will survive a Commerce Clause challenge.[5] As in ***Moran Towing***, the only portion of the test applicable herein is whether substantial nexus existed between New York and the activity to which the PBT statutes apply.

Petitioner argues that it does not have sufficient nexus to be subject to the test in ***Complete Auto***. However, in ***Quill Corp. v. North Dakota*** (504 US 298 [1992]), the Supreme Court held that although a presence within the taxing state was necessary, it need not be substantial, only the slightest presence. As argued by the Division and concurred with herein, petitioner conducted business in New York when operating its vessels. This is clear from the contracts and vessel logs (which tracked the movements of some of petitioner's tugs) submitted in evidence, which indicate that petitioner's vessels and its personnel were involved in towing and discharging cement in New York at Catskill and College Point. Petitioner's vessels and employees also performed ice-breaking operations in the Hudson River and worked on dredging in New York waters. Said business operations created more than a slight presence in New York and satisfy the ***Quill*** requirement.

As stated in ***Moran*** and found equally applicable here:

> Further, consistent with our decision in ***Orvis*** [***Matter of Orvis Co. v. Tax Appeals Tribunal,*** 86 NY2d 165, 630 NYS2d 680 (1995)] they support the conclusion that physical presence of a business in this state is sufficient to constitute a "substantial

[5]The four-prong test says that the validity of the tax will be upheld (1) when the tax is applied to an activity with substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state.

> nexus" with the state under ***Complete Auto***. The fact that the tax is measured by the consumption of motor fuel within the state does not alter the State's authority to tax the privilege of doing business in New York.

It is concluded, therefore, that the application of the PBT to petitioner was constitutional.

C. Petitioner also raised a constitutional challenge to the assessments based on what it characterized as the arbitrary and capricious nature of the of the tax due to the requirement that petitioner calculate the time in New York waters without the benefit of published fixed coordinates and the information necessary to verify the number of hours petitioner's vessels spent on a voyage.

It must be noted that petitioner was requested to fill out PT-350 returns for each month of the audit period, which it did using all available information in its possession. Although it claims that the Division forced it to use Google maps to estimate its hours in New York, it also had at its disposal detailed captain's logs, position reports and maritime maps. In addition, the New York state borders with Connecticut and New Jersey, are set forth in specific metes and bounds descriptions at State Law §§ 2 and 7, which include latitudinal and longitudinal coordinates on land and water. Therefore, it is concluded that petitioner had at its disposal all the information it needed to accurately calculate its PBT due.

The Division's in-depth analysis of two tugs' movements, mapping routes and tracking on a 24-hour cycle to ascertain proper time allocations, resulted in a finding that petitioner's calculations represented on the pro forma forms PT-350 it prepared for each month of the audit period were within a reasonable margin of the audited gallonage. Therefore, the Division accepted petitioner's numbers and assessed tax based on petitioner's own calculations. The burden is on petitioner to show by clear and convincing evidence that the statutory notices issued

herein were erroneous and should be cancelled. (***Matter of Suburban Restoration Co., Inc. v. Tax Appeals Tribunal***, 299 AD2d 751, 750 NYS2d 359 [2002].)

It is concluded that petitioner had the information it needed to determine the hours it operated its vessels in New York and that its argument that the requirement was arbitrary and capricious is without merit. Petitioner did, in fact, utilize information at its disposal that was determined to be accurate by the Division, which undertook an exhaustive analysis of the movement of two of petitioner's vessels for a representative period.

D. Since it has been determined that there did exist tools and information adequate to determine the hours petitioner's vessels were in New York, petitioner's argument that the requirement must be found arbitrary because it predated the current criteria established through negotiations between New York State and the AWO is rejected. Although a new schedule was added that simplified filing for tug boat operators, its creation and use after the audit period herein was never intended to apply to the years 2000 through 2004. This is underscored by the agreement reached between the Division and the AWO (applicable to petitioner herein), which would have substantially reduced interest and penalty for certain prior periods, some of which are in issue. Petitioner chose not to take advantage of the agreement.

E. Petitioner also argues that it was not the proper party to file the PBT returns based upon the terms set forth in its charter agreements. Petitioner argues that it was the charterer, not petitioner, who had significant control over the tug and that the charter agreements placed the ability and obligation to purchase fuel for the tug's operation on the charterer. However, a careful reading of the charter agreements submitted in evidence does not support petitioner's assertion.

During the audit years, the instructions to form PT-350 made no mention of charter agreements. Sometime thereafter and at least by the year 2007, the instructions noted that where vessels were under a charter agreement, the terms of the agreement determined who was under an obligation to file a PT-350, i.e., the owner/lessor or the charterer/lessee. Therefore, an analysis of the charter agreement was not mandated during the audit period. Moreover, the salient language in the applicable instructions pertaining to who must file indicated operators of commercial vessels, like tugboats, which used motor fuel or diesel fuel in their vessels for consumption in New York State territorial waters, were responsible for filing the PT-350. Thus, petitioner was obligated to file the returns.

Assuming arguendo that the terms of the charter agreements were controlling during the audit period, it remains that petitioner was the party responsible for filing the PT-350. A candid and veritable indicator of the relationship between SLC and petitioner, and thus the essence of the agreement's intent, was found in Section XXI of the Ruby M contract, where it stated that the parties intended the agreement to be the sale of towing and operating services between a seller and buyer of said services. It is implicit in this statement of intent and in the terms and conditions of the charter agreements with SLC in evidence that petitioner was responsible for the provision of towing and operating services, i.e., providing all that was necessary to accomplish the tasks assigned. Petitioner provided adequate personnel to load, discharge and maintain the barges, and sufficient crew members to perform these operations for a period of three years. The highly trained crews, consisting of a captain, engineer, mate and deck hands, were responsible for the safe and efficient operation of the vessels, including the proper maintenance and fueling of the vessels. Although the charter agreements with SLC provided that SLC was responsible for the cost of the fuel, it was clear that the parties understood that petitioner was the

only party capable of operating the vessels, with the necessary authority and control to have them fueled. Further, the language regarding fuel in the charter agreements implied that the cost, which was subject to market fluctuations, was borne by SLC as part of the contract price.

The Allie B contract provided that the cost of fuel would be paid by SLC. This provision must be read with the next provision, which called for petitioner to provide fuel to the barge M1 on a demand basis and for a cost equal to the price paid by petitioner at the terminal. Hence, the parties understood that petitioner would be fueling and paying for such fuel at a terminal and that petitioner would charge no more for barge fuel than it paid for the tug's fuel. To monitor this provision, petitioner was required to submit an invoice substantiating the price of the fuel.

In the Ruby M contract, the towage rates included the price of fuel at a cost of $0.75 a gallon. If petitioner paid more it was to be passed along to SLC as part of the towage rate. As in the Allie B contract, petitioner was to provide fuel for the barge on a demand basis, at the price petitioner paid for it at the terminal plus a $0.05 per gallon service fee. Again, the barge fuel was subject to strict substantiation requirements.

The conclusion drawn from the language in the SLC contracts is that petitioner was the party responsible for purchasing the fuel for the vessels and that the cost of the fuel was part of the cost of the charter passed along to the charterer. The terms of the charter agreements did not confer a significant degree of control over the tugs to the charterers, apart from assigning the tasks to be completed by petitioner's tugs and crews. Hence, even if the instructions for form PT-350 had addressed charter agreements for the years in issue, the agreements with SLC

submitted in evidence do not support the contention that the charterers were the proper parties to file the PBT returns.[6]

F. The petition of Dann Ocean Towing is denied and the two notices of determination, dated August 6, 2007, are sustained.

DATED: Troy, New York
November 18, 2010

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE

[6]It is noted that the LEEVAC charter agreement does not appear to follow the relationship with SLC. However, without more information on LEEVAC, which provided crew members for its operations, petitioner has not demonstrated that its arrangement with LEEVAC was the norm and not an anomaly.