STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
K-SEA TRANSPORTATION, INC. **AND** **K-SEA OPERATING PARTNERSHIP, LP**	:	DETERMINATION DTA NOS. 822862 AND 822863
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, 2005 through December 31, 2006.	:	

Petitioners, K-Sea Transportation, Inc., and K-Sea Operating Partnership, LP, filed petitions 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, 2005 through December 31, 2006.

On September 16, 2009, the Division of Taxation, appearing by Daniel Smirlock, Esq. (Michelle M. Helm, Esq., of counsel), and petitioners, appearing by Terence P. Gill, Chief Financial Officer, waived a hearing and submitted these matters for determination based on documents and briefs to be submitted by January 29, 2010, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]). After due consideration of the documents and arguments submitted, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioners have established any basis warranting reduction or elimination of the penalties imposed.

FINDINGS OF FACT

1. Petitioners, K-Sea Transportation, Inc., and K-Sea Operating Partnership, LP, operate tugboats and barges transporting cargo throughout the waters of the east coast, including the waters of New York. They maintain offices in East Brunswick, New Jersey, and Staten Island, New York. As operators of commercial vessels doing business in New York waters, petitioners were subject to tax on petroleum businesses based upon the motor fuel and diesel motor fuel consumed in their vessels while in New York, and were required to file petroleum business tax returns for fuel consumption - commercial vessels, form PT-350. Petitioners did not file the required tax returns for the period April 1, 1998 through December 31, 2006 until January 2007.

2. On December 9, 2003, the Division of Taxation (Division) sent a letter to petitioners indicating that a field audit was to be performed of the businesses' petroleum business taxes, as it pertained to fuel use consumption for commercial vessels. The letter stated that as petitioners had failed to file the required petroleum business tax returns, the statute of limitations for the audit would be six years.

3. On September 20, 2007, the Division issued to petitioners a letter with attached statements of proposed audit adjustments for petroleum business tax, which indicated an additional tax liability in the amount of $1,603,303.60 for the period April 1, 1998 through December 31, 2004. Petitioners disagreed with the Division's computation of the time that its commercial vessels spent in New York waters, and recomputed the petroleum business tax due based on a percentage of 10%, rather than the 25% used by the Division. On September 26, 2007, petitioners submitted a check in the amount of $1,070,000.00 based upon its computation of the tax due for the period April 1, 1998 through December 31, 2004. On November 12, 2007, the auditor returned to petitioners' offices in an attempt to substantiate the claim that petitioners'

vessels were in New York waters 10% of the time. The additional review confirmed the Division's original determination of 25%, but the overall fuel consumption was reduced due to the discovery of vessels that did not enter New York waters.

As a result of the Division's review, revised statements of proposed audit adjustments for petroleum business tax were issued to petitioners on December 7, 2007. In a letter dated December 19, 2007, with the revised statements of proposed audit adjustments attached, the Division explained that the $1,070,000.00 would be applied to the tax, penalty and interest due for the period April 1, 1998 through February 23, 2003. For the remainder of the audit period, February 24, 2003 through December 31, 2004, the Division determined additional tax due in the amount of $379,219.41, plus penalty and interest. Penalty was reduced from 30% to 5%. By letter dated January 17, 2008, and by signing the statements of proposed audit adjustments agreeing to the petroleum business taxes asserted to be due, petitioners agreed to the application of the $1,070,000.00 to the period April 1, 1998 through February 23, 2003 and to the additional tax due, plus penalty and interest. Petitioners remitted full payment of the remainder of the tax, penalty and interest due.

4. As part of the review, the Division updated the audit period, with petitioners' consent, to include the years 2005 and 2006. On December 7, 2007, revised statements of proposed audit adjustments for petroleum business tax were issued to petitioners indicating additional tax due for the period January 1, 2005 through December 31, 2006 of $440,255.97, plus penalty computed at 30% of the tax due, and interest. By the same January 17, 2008 letter, petitioners agreed to the amount of the additional tax due, plus interest, determined for the period January 1, 2005 through December 31, 2006. Petitioners did not agree to the imposition of penalty at 30%, and remitted payment of the tax, interest and penalty computed at 5%.

5. On March 24, 2008, the Division issued to petitioner, K-Sea Transportation, Inc., a Notice of Determination assessing additional tax on petroleum businesses for the period January 1, 2005 through December 31, 2006 in the amount of $52,279.83, plus penalty and interest. On the same date, the Division issued to petitioner, K-Sea Operating Partnership, LP, a Notice of Determination assessing additional tax on petroleum businesses for the period January 1, 2005 through December 31, 2006 in the amount of $387,976.14, plus penalty and interest.

6. Beginning in 1994, the tax on petroleum businesses, Article 13-A of the Tax Law, and specifically sections 301 and 301-a, was the subject of various challenges to its constitutionality (***see Matter of Tug Buster Bouchard Corp. v. Wetzler***, 217 AD2d 192, 635 NYS2d 803 [1996], ***affd*** 89 NY2d 830, 653 NYS2d 271 [1996], ***rearg denied***, 89 NY2d 918, 653 NYS2d 921 [1996]; ***Matter of Moran Towing Corp. v. Urbach***, 182 Misc.2d 756, 699 NYS2d 252 [1999], ***reversed***, 283 AD2d 78, 726 NYS2d 748 [2001], ***lv dismissed***, 96 NY2d 937, 733 NYS2d 376[2001], ***reversed***, 99 NY2d 443, 757 NYS2d 513 [2003], ***on remand***, 1 AD3d 722, 768 NYS2d 33 [2003], ***appeal withdrawn***, 3 NY3d 635, 782 NYS2d 406 [2004]). The litigation came to a conclusion on June 8, 2004.

7. On October 17, 2006, the director of the Transaction and Transfer Tax Bureau of the Department of Taxation and Finance sent a letter to the American Waterways Operators Association (AWO) outlining an agreement reached between the Department and the AWO regarding the petroleum business tax liability of AWO's members, including petitioners, for prior years. The letter stated that the amount of tax due would be the lower of the tax calculated by using one of two methods, and that interest would be computed from June 8, 2004, the date the litigation matter was resolved, to the date of payment, and penalties were to be calculated at 5% of the total tax due.

8. On May 8, 2007, the director of the Transaction and Transfer Tax Bureau wrote a letter to individual members of the tugboat industry, including petitioners, in an attempt to clarify the methods of computation of the petroleum business tax liability as agreed upon by the Division and the AWO. The letter stated, in part, that "[t]he tax is due on the fuel consumed on the NYS waterways. Any method that accurately reflects this amount is acceptable."

9. On July 31, 2007, the Division wrote a letter to petitioners stating that nine months had passed since the agreement with the AWO had been reached and nearly three years had passed since the audits of petitioners had commenced but no agreement had been reached between petitioners and the Division. The letter went on to explain that the settlement offer outlined in the October 26, 2006 letter to the AWO would not be extended indefinitely, and to take advantage of the reduced interest rate and penalties, petitioners would have until September 14, 2007 to reach an agreement with the Division. The letter further provided that:

> If you do not believe that an agreement can be reached by that date, you must file with the auditor tax returns (PT-350) or file a schedule broken down by month and vessel of what you believe to be the tax liability for the audit period, and pay the amount of tax that you believe is due along with the penalty and interest. Any additional tax (beyond the amount that is voluntarily paid) determined to be due on audit after September 14, 2007, will be charged the full amount of statutory interest and will be subject to statutory penalty.

10. During the course of the audit, petitioners were advised by the auditor that they needed to comply with the September 14, 2007 deadline in order to take advantage of the reduced interest and penalty. In addition, the auditor told them they should remit whatever amount they reasonably calculated to be due based on their own records, despite the fact that the audit was still in progress.

CONCLUSIONS OF LAW

A. The legislative history of New York State's tax on petroleum businesses begins in 1980, three years prior to the enactment of Article 13-A.[1] In that year, the state enacted a new franchise tax on certain oil companies (L 1980, ch 271; Tax Law § 182). The legislation contained a "no pass-through" provision, which stated that "the tax . . . shall be a liability of the oil company . . . and shall not be included, directly or indirectly, in the sales price of its products sold in this state." Tax Law § 182 was followed by Tax Law § 182-a (L l981, ch 481) and Tax Law § 182-b (L 1983, ch 18), the latter in response to litigation contesting the constitutionality of Tax Law § 182, in particular its "no pass-through" provision.

In 1983, Tax Law §§ 182, 182-a and 182-b were replaced with Article 13-A of the Tax Law (L 1983, ch 400). The petroleum business tax imposes a tax on "every petroleum business, for the privilege of engaging in business, doing business, employing capital, owning or leasing property, or maintaining an office in this state . . . ." (Tax Law § 301[a][1]). A petroleum business was defined to include "every corporation and unincorporated business formed for, engaged in or conducting the business, trade or occupation of importing or causing to be imported (by a person other than one which is subject to tax under this article) into this state for sale in this state, or extracting, producing, refining, manufacturing, or compounding petroleum" (Tax Law § 300). In 1984, an amendment to the petroleum business tax (L 1984, ch 67) extended the tax to businesses importing petroleum for their own consumption. The definition of "petroleum business" in Tax Law § 300 was expanded to include every corporation and unincorporated business regularly engaged in importing or causing to be imported petroleum into

---

[1]The legislative history of New York State's tax on petroleum businesses is explained in ***Matter of Moran Towing Corporation v. Urbach*** (99 NY2d 443, 757 NYS2d 513). The history set forth above was obtained largely from that decision.

the state for its own consumption. In addition, the activities taxable under Tax Law § 301 were expanded to include the consideration given or contracted to be given for petroleum imported into the state by a business for its own consumption (Tax Law § 301[a][1][ii]).

From 1984 through August of 1990, an annual "privilege tax" was imposed on each petroleum business calculated as a percentage of "the consideration given or contracted to be given by it for petroleum . . . which it imported or caused to be imported . . . into this state for consumption by it in this state" (Tax Law § 301[a][1][ii]). The statute further provides that a "[a] petroleum business, which brings petroleum into this state in the fuel tank connecting with the engine of a vessel propelled by the use of such petroleum" shall receive a credit equal to the amount of gallons of fuel purchased in New York against the total gallons consumed by the business in New York (Tax Law § 301[c]).

Since September 1990, the "privilege tax" is a monthly tax calculated on a cents-per-gallon basis (***see*** Tax Law § 301-a). The statute provides that "fuel brought into this state in the fuel tank connecting with the engine of a vessel propelled by the use of such motor fuel shall be deemed to constitute a taxable use of motor fuel . . . to the extent that the fuel is consumed in the operation of the vessel in this state" (Tax Law § 301-a[b][2]; ***see*** Tax Law § 301-a[c][1][B]). Section 301-a also provides a credit for the fuel a petroleum business has purchased in New York (***see*** Tax Law § 301-a [b][2]; [c][1][B]).

These statutes reflect the amendments enacted in 1997 in response to ***Matter of Tug Buster Bouchard Corporation v. Wetzler*** (217 AD2d 192, 635 NYS2d 803, ***affd*** 89 NY2d 830, 653 NYS2d 271), which declared Tax Law § 301(a)(1)(ii) unconstitutional. The 1997 amendments added Tax Law § 301(c); § 301-a (b)(2) and § 301-a (c)(1)(B) (***see*** L 1997, ch 389, § 1, part A, §§ 153, 154). Section 301(c) was to apply retroactively to April 1, 1984, and the

amendments to section 301-a were to apply retroactively to September 1, 1990 (***see*** L 1997, ch 389, § 1, part A, § 219[24], [25]).

B. In June of 1998, Moran Towing Corp. filed a verified petition pursuant to Article 78 of the Civil Practice Laws and Rules (CPLR) in Albany Supreme Court seeking to overturn the Department of Taxation and Finance's decision denying its request for a refund of taxes paid under Article 13-A of the Tax Law for the period September 1, 1990 through February 28, 1997. Moran also challenged, as facially unconstitutional under the Commerce Clause (US Const, art I, § 8[3]), those portions of Tax Law §§ 301 and 301-a imposing a tax on fuel imported by a vessel for its consumption within the state while engaged in interstate commerce. Moran further contested the Legislature's retroactive application of the 1997 amendments to the petroleum business tax.

In May 1999, Supreme Court granted the Commissioner of Taxation and Finance's motion to dismiss the petition for failure to exhaust administrative remedies. The court also found that the 1997 amendments to the petroleum business tax creating a retroactive adjustment to the Tax Law did not contravene the Due Process Clause of the 14th Amendment to the United States Constitution. On appeal, the Appellate Division reversed and declared the tax on the consumption of fuel in section 301(a)(1)(ii) and section 301-a(b)(2) and (c)(1)(B) of the Tax Law facially unconstitutional under the Commerce Clause (***Matter of Moran Towing Corp. v. Urbach***, 283 AD2d 78, 726 NYS2d 748). The Appellate Division noted that the petitioner was being taxed on the consumption of fuel that had not "been removed from the stream of interstate commerce" and had not "come to rest" within New York. The Court found that the challenged statute was unconstitutional because it artificially imposed a substantial nexus with New York,

such "that an activity previously identified as simple interstate movement is now, without more, 'deemed to constitute a taxable use'." The Department of Taxation and Finance appealed.

Ultimately, the Court of Appeals reversed the Appellate Division's determination that the relevant sections of the petroleum business tax were facially unconstitutional (***Moran Towing Corporation v. Urbach***, 99 NY2d 443, 757 NYS2d 513 [2003]). The Court of Appeals remanded the matter to the Appellate Division, which affirmed the Albany Supreme Court's decision that the 1997 amendments to the petroleum business tax creating a retroactive adjustment to the Tax Law did not contravene the Due Process Clause of the 14th Amendment to the United States Constitution (***Moran Towing Corporation v. Urbach***, 1 AD3d 722, 768 NYS2d 33 [2003]). The appeal to the Court of Appeals was withdrawn on June 8, 2004 (***Moran Towing Corporation v. Urbach***, 3 NY3d 635, 782 NYS2d 406 [2004]).

C. Tax Law § 315 provides that the penalty and interest provisions of Article 12-A shall be applied to the administration of and procedure with respect to the petroleum business tax imposed pursuant to Article 13-A. Pursuant to Tax Law § 289-b(1)(a), a penalty not to exceed 30% of the tax determined to be due shall be charged for failure to file a return or failure to pay any tax due. If it is determined that the failure to file or pay was due to reasonable cause and not due to willful neglect, all or part of the penalty may be abated.

D. It is petitioners' position that the payment made in September 2007 in the amount of $1,070,000.00 was based on a good faith estimate of the petroleum taxes due using the percentage of New York State gallons to total fuel consumption that the companies were experiencing since January 2007 when they began filing petroleum business tax returns. Petitioners claim that they believed this payment would cover substantially all of the tax liability for the entire nine-year period. Petitioners point to the amount of time to complete the litigation

process, the confusion over the actual liability, which should have been computed earlier, and the confusion resulting from the communications with the Division as to how to take advantage of the reduced penalties as reasons to reduce the penalty percentage to 5%.

E. As the Division points out, petitioners' claim that the payment made in September 2007 was intended to cover the entire audit period, including the years 2005 and 2006, is not supported by the record. Petitioner was originally audited for the period April 1, 1998 through December 31, 2004, resulting in combined additional tax due of $1,603,303.60, plus penalty and interest. Petitioners were so advised by the Division's letter dated September 20, 2007, which included statements of proposed audit adjustments for the period April 1, 1998 through December 31, 2004. Petitioners disagreed with the Division's computation, recomputed the amount of petroleum business tax due and submitted to the Division on September 26, 2007 a check in the amount of $1,070,000.00. At the time of the payment, there was no assessment for the years 2005 and 2006, and these years were not added to the audit until the Division updated the audit period after the payment was made. The conclusion that petitioners intended the payment to cover the initial period of the audit is further bolstered by petitioners' letter of January 17, 2008 and their signing of the statements of proposed audit adjustments agreeing to the Division's application of the payment to the period April 1, 1998 through February 23, 2003.

F. It is not contested by petitioners that they were subject to the petroleum business tax imposed by Tax Law §§ 301 and 301-a, and that they were required to file returns (Tax Law § 308[a]) and pay the tax due (Tax Law § 308[b]). Certainly, confusion existed within the commercial vessel industry surrounding Tax Law §§ 301 and 301-a, as exhibited by the litigation concerning their constitutionality and application. However, such litigation ended in June 2004. Subsequently, the Division and the American Waterways Operators Association, which

represented commercial vessel operators in negotiations with the Division, reached an agreement outlined in a letter dated October 17, 2006 regarding the petroleum business tax liability of AWO's members, including petitioners, for prior years. The letter provided that the amount of tax due would be the lower of two methods, and that interest would be computed from the date the litigation ended to the date of payment, and penalties would be calculated at 5% of the total tax due. On May 8, 2007, the Division further advised petitioners as to the methods of computation of the petroleum business tax liability and stated that the tax was due on the fuel consumed in New York State waterways and that any method that accurately reflected this amount would be acceptable. Despite this guidance, petitioners failed to file tax returns and pay the tax due.

On July 31, 2007, the Division advised petitioners that the settlement outlined in its October 26, 2006 letter would not be extended indefinitely, and to take advantage of the reduced interest and penalties, petitioners would have until September 14, 2007 to reach agreement with the Division as to the results of the ongoing audit. More importantly, the letter clearly stated that if an agreement was not reached by such date, petitioners, in order to take advantage of the favorable terms of the settlement, would need to file tax returns and pay the tax determined to be due, along with the penalty and interest. The letter further stated that any additional tax determined to be due on audit after September 14, 2007 would be charged the full amount of statutory interest and be subject to statutory penalty. Petitioners were also advised by the auditor of the need to meet the September 14, 2007 deadline. Again, petitioners failed to file the required returns and pay the tax due despite the clear direction of the Division and the auditor advising petitioners that they needed to compute and pay the amount of tax due by the deadline to avoid the statutory penalties.

G. Petitioners have not provided evidence that would support reduction or abatement of the penalties imposed, and they are therefore sustained. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). The Tribunal explained that "[b]y first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citations omitted]" (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992, ***confirmed*** 193 AD2d 978, 598 NYS2d 360 [1993]). Here, petitioners failed to timely file tax returns and pay the tax due for the period January 1, 2005 through December 31, 2006. The payment of $1,070,000.00 was not intended to cover the tax liability for the years 2005 and 2006. In three letters dated October 16, 2006, May 8, 2007 and July 31, 2007, the Division notified petitioners as to the method to be used to compute the tax due, and the last two letters stated that any method which accurately reflected the tax due would be acceptable. The last letter specifically stated that the deadline for the reduced penalty was September 14, 2007, and should agreement not be reached with the auditor, petitioners were obligated to compute and pay the tax due to avoid additional penalties. Despite this guidance, petitioners ignored their responsibilities to file and pay the tax due. Their reliance on the Division to compute the tax due is contrary to the directions received from the Division, and contrary to the requirements contained in the Tax Law that it was their responsibility to file tax returns and pay the tax due. Under these circumstances, penalties were properly imposed.

H. The petitions of K-Sea Transportation, Inc. and K-Sea Operating Partnership, LP are denied, and the notices of determination dated March 24, 2008 are sustained.

DATED: Troy, New York
July 22, 2010

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE