

# I

## THE PROBLEM

The problem of motor fuel tax evasion is one of enormous fiscal implications for the State government. But it is also a serious matter in the marketplace, where legitimate fuel merchants have lately found themselves unable to compete against those who undercut them on price. The price cutters, after all, do not pay taxes and can therefore afford to undersell the legitimate market.

### **Tax Evasion in New Jersey: \$40 Million**

The first witness at the hearing was Harvey Borak, Chief of the Office of Criminal Investigations in the New Jersey Division of Taxation. Borak described two distinct types of schemes to evade payment of motor fuel taxes:

1. There are the traditional schemes, the mislabeling of diesel fuel as No. 2 fuel oil to avoid the tax, the underreporting of gallons sold; and there are also those who simply collect tax and fail to remit payment.
2. During the last two years, the State has seen the arrival of the 'daisy chain' method which was revealed in New York State in the early 1980's. This method, which is designed to evade taxes through the formation of nominee companies, is used mostly within New Jersey by an organized group of Russian immigrants.

According to Borak, the operation of the daisy chains has resulted in "substantial tax loss to both the state and federal governments." He estimated that "somewhere around 40 million dollars" in tax revenues are lost to the state as a result of motor fuel

tax evasion. And he said the problem is getting worse.

BY COUNSEL CAROL L. HOEKJE:

*Q. What is the principal area of motor fuel tax evasion?*

*A. As we see it now, it's the substitution between diesel fuel and No. 2 fuel oil.*

*Q. What creates the problem?*

*A. It's simply that diesel is subject to tax and home heating oil is not. When you come down to it, they are basically the same product.*

*Q. In addition to hurting the state in terms of lost tax revenues, does motor fuel tax evasion also hurt the legitimate business owner?*

*A. Absolutely. We see that time and again. The legitimate dealer finds it almost impossible to compete in the marketplace because after paying the taxes and [considering] his overhead, the amount that he could mark up the fuel, his selling price can't possibly compete with the dealer not paying the tax, and he stands the risk of losing his business.*

*Q. Does motor fuel tax evasion also hurt the state indirectly in terms of lost federal highway funds?*

*A. Yes, it does, because less money is going into the federal highway trust funds for distribution to the states... in matching programs and other highway and transportation funded projects.*

BY CHAIRMAN JAMES R. ZAZZALI:

*Q. So that unless corrected, whether by regulatory or law enforcement means, I take it you're*

*suggesting that the revenue loss will be greater as the years go on?*

*A. Yes, it would be greater. Let me just say one thing. You referred to law enforcement means and legislative means. One by itself is not enough... it doesn't really pay to put a tremendous amount of law enforcement resources... if you don't have the legislation and the reporting requirements to go with it. It goes hand in hand.*

Borak explained that home heating oil is not subject to the motor fuels tax “basically because the original thought” was that the monies from the tax on fuel that is used on the road would be used for the purpose of raising funds for highway maintenance and construction. Diesel fuel is generally taxable because it is sold for use on the highways. In instances where it is not used for on-highway vehicles, however, such as in construction equipment and farm equipment, diesel fuel is not taxable.

BY COMMISSIONER WILLIAM T. CAHILL, JR.:

*Q. When does this fuel begin to get designated as diesel as opposed to No. 2?*

*A. ...[I]t could be used for anything up until the point in time it's going to that so-called retailer for ultimate use.*

Borak attributed an increase in fuel tax problems in New Jersey to the entry of “new players” from New York State in the 1980's.

*New York had a problem mainly in gasoline at that time. They did some initiatives.... They changed their law, they had more aggressive enforcement activities... and as a result of these, tax evaders spread out around the country and New Jersey was one of their places.*

### **A National Problem: \$1 Billion Lost**

James H. Rodio, a trial attorney in the Tax Division of the U.S. Department of Justice, testified that evasion of gasoline and diesel taxes is also a national problem. He estimated that losses on a

national level exceed \$1 billion.

*That's always thought to be conservative. At a meeting of the federal highway administration task force, an IRS (Internal Revenue Service) representative from the national office estimated the tax evasion at anywhere from half a billion to five billion dollars a year.*

In the New York metropolitan area, Rodio estimated, the federal loss is about \$200 million dollars a year. He testified, “Many, many barges enter New York each day where the taxes are not paid. We are aware of companies that do business from between 20 to 30 million gallons a month where no excise tax is paid.” With an increase in the federal excise tax on gasoline from nine to 14 cents a gallon, “of course the evasion is much higher.”

*Q. Is it a problem not only for the federal government but also for the individual states?*

*A. That's correct. And most of the states where a federal investigation begins, there is normally a state problem. Not exclusively, it doesn't always happen, but most of the places where we see evasion on the federal side, we also see it on the state side.*

*Q. Where do the federal tax dollars go and are they allotted back to the states in any way?*

*A. Yes, they are. The motor fuel excise tax revenues are placed in the highway trust fund. The majority of that money goes back to the states.*

Rodio testified that the Justice Department continues to prosecute cases in New York even though the state law has changed.

*The federal law has stayed the same. There have been several changes, most recently this past July, but the ability to evade through the daisy chains... still exists on the federal side.*

Rodio continued:

*What we're seeing is that they are fully integrated. By that, I mean that they control the terminals, they control the wholesale companies and they also control the retailers. They also have the financial wherewithal to bring in cargo loads of gasoline from Europe or wherever.*

*Q. Is the use of a conspiracy charge an important aspect of the law?*

*A. [E]very indictment that we've had, we begin with a conspiracy count. I think it's the backbone of any prosecutions I have because you can lay out the entire scheme in your conspiracy count. The conspiracy count also helps you because a defendant does not have to commit every act that is part of the conspiracy. In a substantive offense, such as tax evasion, they may have to commit many of the elements of the offense by themselves. So conspiracy is a very important tool that we use.*

Rodio explained that the federal license or registration for tax-free transactions is IRS Form 637. He testified that counterfeiting of "637's" is one of the methods used in a daisy chain.

*A counterfeit 637 is one that belongs to a legitimate company. The IRS has issued it to a company that operates legitimately. The bad guys secure the information on the license....The most important thing they secure is the correct name of the company and the federal license number....they will put in the address they want to use.... You will call the Internal Revenue Service and ask if the company and the license are correct, and in a case of counterfeit license, they will be, because the license has been issued to a legitimate company.*

*Q. Does requiring total accountability for both taxable and nontaxable transactions assist in fighting motor fuel tax evasion?*

*A. Total accountability is very important... I*

*think it's very important in the diesel context, because diesel is home heating oil. I mean they're the same product. You need an audit trail, you need to identify from a company what it's selling as diesel and what it's selling as home heating oil and who they're selling to. You need the large quantities so you can go to these quantities and determine whether these sales actually took place.*

Rodio noted however:

*Total accountability only works where you have sufficient manpower to do the audits, to do the compliance checks.*

*Q. Is it important for states and the federal government to work together in the sharing of reporting?*

*A. Sharing of reporting is very important....The local, state and federal taxing authorities have to work together, they have to share information. The dollars lost are tremendous. Without helping one another, we're not going to be able to solve the problem.*

*Q. In your opinion, where is the best place in the distribution chain to place the tax in order to minimize evasion?*

*A. One of the basic things you want to do in any tax law is limit the number of taxpayers. You don't have to do as many audits, you don't have to do as many compliance checks, there are fewer importers and refiners, at least on the federal side, than there are wholesalers... So I think it has to go to the top of the distribution chain, at least on gasoline. Diesel poses another problem because it's also home heating oil, but my recommendation would be at the top.*

*...I think the industry would have some problems with that if they have to pay the tax before they receive the payment for the petroleum. So if the tax does go at the top, you have to be very careful who you make your taxpayers and then you have to permit the industry a period of time to receive*

*the money and then remit it to the government. If you limit your number of taxpayers and you have a number of competent auditors who can investigate, I think you can keep a good eye on things.*

BY COMMISSIONER KENNETH D. MERIN:

*Q. Mr. Rodio, you indicated before this is a national problem. Is it truly a national problem or is it a problem that is primarily geographically proximate to these areas where organized crime or the crime groups or the new groups are located?*

*A. It is a national problem. It's not limited to areas where organized crime operates. There are very serious problems from the State of Texas and I'm not aware of organized crime being there. On the national level, more evasion involves non-immigrants and non-traditional organized crime. At least that's what we are seeing.*

BY COMMISSIONER CAHILL:

*Q. You know, it would appear to me that someone could do this with almost any product, this kind of a scheme and is there something peculiar to motor fuels as opposed to olive oil or a number of products...? What's peculiar about fuel as opposed to other products that you could do this with?*

*A. If there is an excise tax on olive oil or olives and there are multiple tax-free transactions permitted, then, yes, you're going to have a daisy chain system.*

*The reason it occurs in motor fuel is because the excise tax is there, it's a large tax on a percentage of the product....It's the money.*

### **Money: The Great Incentive to Tax Evasion**

Total motor fuels tax on every gallon of diesel fuel sold in the State of New Jersey is 37.6 cents: 13.5 cents state tax plus 20.1 cents federal tax plus 4 cents

state petroleum gross receipts tax. Obviously, a significant amount of money can be made by evading even part of that amount. Exhibit 1 depicts the current tax rates for both gasoline and diesel.

State Taxation Investigations Chief Harvey Borak was asked what the incentive was to evade fuel taxes. He responded:

*[B]asically to make a lot of money... when you take into consideration that these violators deal with... millions of gallons... of product, you can readily see what the incentive is. It's quite a lot of money.*

Federal attorney James Rodio testified similarly:

*The only incentive is money, pure and simple. The dollars add up faster in motor fuel tax evasion than in almost any other type of evasion.*

Thomas Boney, Deputy Chief Investigator of the Fraud Bureau of the State Division of Criminal Justice, illustrated the amount of money that is involved. For example, "compact little tank trucks" that service home heating customers usually have a 2,500-gallon capacity. One such load dropped off at a diesel fuel stop instead of at a home heating oil customer results in a windfall of over 800 fuel tax dollars (excluding petroleum gross receipts tax). "[A driver] might do three or four of those a night, so the potential is very high." With the longer tankers with capacities from 8,500 to 10,000 gallons, "you are talking about \$3,300 dollars for one drop one night, which will be emptied out in a period of four to eight hours."

The state tax rate on diesel fuel in New Jersey increased in Fiscal Year 1988 from 11 cents to 13.5 cents a gallon. Around the same time, tax collection figures began to decrease. Figures compiled by the Division of Taxation show that reported gallonage in the "Special Fuels" category (taxable fuels other than gasoline) showed a marked decrease beginning in Fiscal Year 1989 and continuing through Fiscal Year

1991. Criminal Investigations Chief Borak testified to a “steady decline” from a figure of approximately \$511 million in 1988 to approximately \$458 million in 1989, to approximately \$386 million in 1990.

Exhibit 2 depicts the total motor fuel tax collection figures for the past six fiscal years. Diesel fuel tax collections comprise around six percent of the total.

Gasoline Tax Evasion. While diesel fuel tax evasion is the principal problem for the State of New Jersey, state investigators are beginning to see a problem with gasoline tax evasion. Borak testified, “We’re beginning to see that now. Quite frankly, we didn’t see much of a problem up until very recently.” And SCI Special Agent Robert Diszler testified, “We have had witnesses tell us that gasoline scams are occurring and we have begun to notice that some of these diesel fuel companies are branching out now into gasoline as well.”

### **The Legitimate Merchant**

A panel of four New Jersey fuel business owners testified about changes they have seen in the fuel business and how these changes have affected them. This panel consisted of Timothy Doherty, president of J.J. Doherty Fuel Company in Trenton; Edward Miller, general manager of Tozzi Fuel Company in Raritan; R. Paul Riggins, president of Riggins Oil Company in Vineland; and Joseph Russo, president of Well Oil Company in Perth Amboy.

Mr. Doherty testified that his father started their family-owned company in 1932. His company delivers heating oil to residences and commercial accounts, and also sells diesel fuel and gasoline to service stations.

*Q. Mr. Doherty, have you seen recent changes in your business?*

*A. I certainly have. The topic today has changed our business drastically as far as our abilities to compete in the marketplace in selling fuel and*

*gasoline.*

*Q. Has your business been affected by these changes?*

*A. Yes, I would say. Our company is a small company and our volume is not that great but we have lost business and have been unable to compete in selling of diesel fuel especially as well as gasoline.*

Doherty said his diesel fuel sales have declined from between 65,000 and 85,000 gallons a month to less than 20,000 gallons. “When I quote the legitimate price [to a prospective customer], I’m laughed out of the office because the man can buy 8 to 10 to 15 cents a gallon cheaper than what I’m selling.”

*Q. In your opinion, how is it possible for these suppliers to offer some of these low prices?*

*A. Well, in my opinion, there has to be only one way and that is that they are not remitting the taxes to the state and federal government, probably more so to the federal government rather than to the state.*

Doherty recalled an experience with one customer. When he quoted a price around 65 or 70 cents a gallon without taxes,

*[The customer] informed me that he could buy for around 43 cents a gallon plus his taxes so, obviously, there was a large... difference in price, and this purchaser would be a fool to buy from me and not from the other person for the much lower price.*

*This occurred over and over again, no matter who you walk into, no matter who you get to solicit....we have company-operated stations and dealers as well and I know when their volume drops from 40 or 50,000 gallons down to two loads a month, something is wrong. Something is happening.*

*Q. Have you yourself felt pressured to buy at the lower prices from certain suppliers?*

*A. Well, you do have the temptation to do that if*

*you can't meet competition. Certainly, you want to try to make the sale and do what you can to survive, but I have been in the business myself for 25 years and remember when the auditor used to come around and do the books and we'd all be sweating bullets because 200 gallons was here and we couldn't find this, that or the other thing so I think some of that has not occurred in the past ten years.*

*I haven't seen an investigator or an auditor from the State to audit any of those things, and I'm not looking forward to the pleasant aspect of having people coming in and investigate but it is a deterrent, and legitimate business people always have records to show and to resolve the problems that might occur, and that sort of thing has not been done in the past ten years.*

*Q. Where do you see the economic future if no changes are made in the regulatory system?*

*A. Well, I don't see how we can forecast any profitability in wholesaling or retailing of fuel oil [or] gasoline in light of the fact that the environmental controls are now causing us to invest thousands of dollars in tank upgrades and what not. We cannot, with the volumes that we're selling now, exist...*

*Q. Have you experienced a certain sense of frustration in what you have been seeing in the past several years in the market?*

*A. Most certainly.... You know, you try to do the right thing as a legitimate business person and when you're on level ground we can compete. It's hard enough for us to compete against major oil companies and direct-operated service stations as well as one another but if we're on a level playing ground we can do that. But when you're talking about 33 or 37 cents a gallon in taxes and 28, 29 cents a gallon on motor fuels or gasoline, that's an awful lot of profit... so it has been a very, very frustrating past couple of years and many of us, like I said before, with the environmental concerns that we have to adhere to now and the likelihood of dismal profitability,.... many*

*of us are saying it's not going to be worth it if this situation... isn't corrected.*

Fuel merchant Edward Miller operates a company in Raritan, New Jersey, almost exclusively in the home heating oil and burner service installation business. He testified that he has not been in the commercial end to any large degree and has had only a "small handful of commercial diesel accounts" in the last two years.

*Q. Have you experienced any loss of business?*

*A. Yes, all of them....in every instance it was strictly a case of the price for which I could deliver the product becoming substantially non-competitive with other prices that the customer could buy for.*

*Q. How much lower were these prices?*

*A. At times as much as 16 to 20 cents.*

Miller testified that he could understand why a business owner would give in to the pressure to buy from those who offer the lowest prices:

*Oh, I couldn't blame in my heart and even in my competitive nature blame anyone who did. I mean, if you're fortunate enough in today's time to own your own company for a long period of time and it's not leveraged and it's not borrowed against and you're not paying a large debt to the bank from having acquired it recently you may be able to withstand this, but anyone who is leveraged to any degree or has any large bank debt and you're sitting and looking at a lifetime of work dissipated in front of your eyes for something that is not a competitive problem and it's nothing you've done wrong. You haven't aligned yourselves with the wrong suppliers or made the wrong deals or operated your business poorly. It's -- I could blame no one under those circumstances.*

Miller testified, "I have had prices quoted to me as recently as two weeks ago of delivered product at 91 cents, all taxes included, and... there is no product,

legitimate product, in that price out there.” He knows of other companies which have lost business. “In some cases millions of gallons of annual business,” he told the Commission. “It’s getting worse, not better.”

*Q. Do you share Mr. Doherty’s sense of frustration?*

*A. Very much so. I’m very glad everyday that I’m in the home heating oil business predominantly... If I were in the motor fuels business, if that was a predominant portion or even a substantial portion of my sales, my frustration would probably have long since turned to anger.*

R. Paul Riggins’ business was started by his grandfather in 1926. He is a diesel wholesaler and has a home heating oil business. Riggins testified about how his company experienced a significant financial strain starting in the beginning of 1990. “We had the largest loss in the history of our company in 1990.... We were getting undercut by other distributors... anywhere from 8 to 16 cents a gallon, and the customer list just started to vanish.”

Riggins testified that his father had retired from the business but had come back to work “because we were under significant financial strain. We had to lay off a good portion of our work force and he’s volunteered to come back and help us out without pay.” Riggins told how his business made an economic decision to buy at low prices quoted by “new players in the market.”

*We had to either start buying to generate sales or we had to dismantle the infrastructure of our company, which would mean laying off a whole sector of our work force, selling off a significant amount of assets that had been built up by my family over the past number of years. It was that significant.*

*Q. It was an economic decision?*

*A. Absolutely.*

Riggins testified that after he started buying

some of the lower cost fuel, his company was able to recover some of its lost business. He said he buys the product “tax-included” from the new players; in the past “we would buy tax-free from major oil companies and sell it with the taxes included and remit the taxes ourselves.” The price differential has gone as low as 20 cents.

*Q. Do you have any idea how these companies are able to offer such low prices?*

*A. We have suspicions which we are trying to track down and get resolved.*

*Q. What are your suspicions?*

*A. That they may not be submitting the taxes.*

*Q. Have you tried to ascertain from the Division of Taxation whether your suppliers are paying their taxes?*

*A. Yes we have... There isn’t any mechanism for the state to come back and say “Yes, this company’s paying taxes.” That’s the problem and we asked, “Are they paying their taxes,” and they cannot answer.*

Riggins noted, “I’ve been pressing people for an answer for two years now.”

*Q. What kind of answer would you like to get?*

*A. That they’re going to move on a change of the legislation insofar as how diesel taxes are collected because that is the only way we’re going to solve the problem. It’s not going to be done through enforcement.*

*Q. Do you share the frustration that has been voiced by Mr. Doherty and Mr. Miller?*

*A. Absolutely.*

BY CHAIRMAN ZAZZALI:

*Q. Mr. Riggins, in your testimony you indicated that in order to remain competitive you have bought now from these individuals “tax included,” right?*

*A. That’s correct.*

*Q. And what do you do? Do you assume that the taxes have been paid or do they represent to you that the taxes have been paid?*

*A. They represent the taxes have been paid on the invoices.*

*Q. So understandably you wash your hands and assume it's their problem?*

*A. Yes.*

Joseph Russo testified that his business sells gasoline, diesel fuel, home heating oil and lubricants. He also owns a fuel transportation company.

*Q. Have you experienced loss of business and in what product?*

*A. Yes, I have, mainly in gasoline, probably a million gallons.*

*Q. Have you seen certain changes in the business since you've been operating?*

*A. Yes. It's very difficult, almost impossible, to put any new business on whether it be gasoline or diesel fuel. You can't quote someone a legitimate price when they're buying 20 cents, 15 cents under what you're quoting them and expect to put new business on.*

....

*I had someone come to me... wanted a price with diesel fuel. I wouldn't even quote him. The reason we didn't quote him, I knew he wouldn't buy and I flat out refused. He is open today and selling products for nine cents a gallon less than I can buy it for so there was no point in quoting him.*

Russo also testified about the importance of access through a trucking company to move a product.

*The terms are flexible. They'll give you anything you want to move the product.... They have to either have their own truck or they have to have someone who has an access agreement with the terminal or you cannot get in. You cannot load...*

*Someone is moving it. It is moving so there are carriers that are moving it....*

Russo observed,

*The names of the companies change regularly. They're here today, they're gone tomorrow.*

....

*The people that solicited me dropped their price the first time ten cents a gallon in a matter of a half hour just because I told him his price was too high. He was driving a brown Mercedes, had a New Jersey license plate in the front and a New York plate in the back. The one in the front was expired and registered to a pocketbook company... and he started with cash payment and ended with accepting my check. I didn't buy the product. I won't buy the product.*

*Q. Do you share the sense of frustration that has been voiced here this morning?*

*A. Yes, I do. I used to enjoy going to work. I don't anymore. I get calls all day long from my accounts about the price and there's nothing I can do about it and it's very frustrating.*



## II

# MODUS OPERANDI

The perpetrators of the tax evasion schemes are brazen, creative and, in some cases, dangerous. Testimony at the public hearing as well as findings during the investigation revealed the presence of a loosely knit group of immigrants from the Soviet Union and other eastern European countries. And, as so often happens when there is easy money to be made, the old-time La Cosa Nostra also surfaced. The investigation also revealed similarities in the schemes employed to evade taxes.

### The Daisy Chain

There was frequent reference during the hearing to the “daisy chain,” which Investigations Chief Borak defined:

*[B]asically it's the use of a nominee bogus company, often referred to as paper companies or burn companies.... The names change often, there's an awful lot of paper flow, and the paper flow is for a purpose, it's to hide the original source...*

Borak testified that his staff has identified “over 50 individuals involved in over 80 business enterprises in the past two years involving the purchase and sale of gasoline and diesel fuel. The average active life of the majority of these companies is a mere three months.”

*Our investigation has identified one purchaser who has always dealt with the same individual but who has seen the corporate name and address change six times over the past 18 months. This makes the investigation even more difficult.*

Borak described how the daisy chain scams operate:

*[A] licensed company will purchase a barge load of No. 2 fuel oil, then form a nominee company with a mail drop for an office. Their tax will be “burned” within the nominee company, then the product will be sold as “tax paid.”*

*Another scam involves the use of the Federal Form 637, which is a federal exemption form that allows gasoline and diesel to be sold tax free. This provides the violators with the initiative to set up bogus companies, an example of which is the daisy chain method, which then causes us the problems with the state taxes.*

Using a chart, Exhibit 28, Borak described how paper, product and money move in different paths on a daisy chain:

*What you have is you have a trail that is established for your paper. It could go from licensed dealer A and it will be indicated at that time that it is “tax free” fuel. And it will go to B, also “tax free” fuel, eventually to C, then all of a sudden the paper changes. When it comes down to this point [indicating] we now have paper that indicates that it's product with “tax included.”*

*It will go through a number of other companies, so-called paper companies, showing tax included, and what ends up is the dealer now has paper in his hand that he purchased product, “tax paid,” when that, of course, never happened.*

*Q. And, in fact, is tax ever paid in these situations?*

*A. No, there is not.*

BY COMMISSIONER BARRY H. EVENCHICK:

*Q. Referring again to your chart which depicts a simple daisy chain, the tax-free fuel that's referred to, is that home heating fuel, is that what you mean by the term "tax-free fuel?"*

*A. That's right.*

*Q. So that what this chart is depicting is the purchase in the first instance of what is home heating fuel and the eventual sale of that product as diesel fuel.*

*A. That's right.*

*Q. Plus the bypassing of the taxation process?*

*A. You see, it's hard to say... one is home heating fuel and one is diesel -- when you are dealing with the same product. It can be used for two purposes.*

*Q. Although they are the same product, is there any way in this age of sophisticated technology to change the appearance, characteristics of one, so that it can readily be distinguished from another?*

*A. [T]here are some countries, particularly over in Europe, that do use a dye to denote one from the other. That has been talked about in this country. But just to give you an idea of what we're dealing with...we were given access to the office [of a burn company] and we found some vials of different colored liquid. We sent it off to the state police lab and we found out it was dye. In other words, they're waiting to hear what color we're going to use.*

Borak noted that his staff has identified daisy chains that have gone as far as the West Coast.

*Q. What are the complications of auditing a daisy chain?*

*A. ...For one thing ...the paper, trying to follow*

*the paper trail, who are the people that are involved in the operation...trying to identify the people. They don't stay around, the bank accounts don't stay open. Trying to identify who is in back of it is a very, very difficult and time-consuming endeavor.*

*Q. Is it difficult to determine where to put the assessment?*

*A. Very difficult. You can't tell where it exactly falls and more important... if you do determine that it falls on one of these burn companies, who are you going to collect from?*

BY COMMISSIONER CAHILL:

*Q. Do these invoices with notations that all tax was included set out the amount of the tax?*

*A. Not generally. What they will usually do is there will be total figures and it will say that tax is included.*

*Q. It is not required to show the amount of the tax?*

*A. No, it is not.*

Justice Department attorney Rodio testified:

*The major element or the most common element of any motor fuel tax evasion scheme is the attempt to disguise the true taxholder, the true taxpayer.... The sole purpose of the paper is to mislead investigators and auditors to set up a phony trail.*

Rodio testified that the purpose of a daisy chain or a false invoice scheme is "to move the point of taxation, at least on paper, away from the real seller."

### **Common Characteristics**

Borak described some common characteristics of companies engaged in daisy chain scenarios.

*[T]hey are companies with a very short life span. They use a lot of fictitious identification. They don't stay at a listed address for any prolonged period of time. They use heavy use of telephones, answering services, speakers and so forth.*

*They use couriers to pick up the collections, sometimes it's in cash. They use wire transfers.... They open bank accounts for very short periods of time. There's a very, very heavy fall of money through these accounts, but they stay for a very short period of time.*

*Q. Are there any common characteristics to the people who are involved?*

*A. What we see is that many are Soviet immigrants and many of them come from certain areas in Brooklyn, New York.*

**BY COMMISSIONER EVENCHICK:**

*Q. How is it that this situation seems tied to Russian immigrants? Anything in particular that makes this attractive to them?*

*A. The only thing I can say of those that we've looked into, what we find is that many of them back in their home country had been involved in black market and white-collar crimes.... We are a very open society and for people who were able to survive doing these type of things in their very closed and very closely monitored society, it's kind of easy for them to do it.*

**BY COMMISSIONER MERIN:**

*Q. Is there any way under consideration by [the U.S. Immigration and Naturalization Service] to attempt to screen these people, figure out some way to check their background?*

*A. Not that I know of.*

**BY COMMISSIONER CAHILL:**

*Q. These bogus companies that you referred to,*

*are they normally corporations?*

*A. Yes, many of them are incorporated.*

*Q. They're New Jersey corporations?*

*A. Yes, they are.*

*Q. So I assume they're all registered with the Secretary of State?*

*A. Most of them are.... I'll tell you, it's just amazing the amount of times that they change corporate names, the amount of times that they change offices and change business cards and invoices. It's often been said that some would like just to have their printing contract, just to keep up with them with the cost of changing their names and titles and business cards. It's a good business, whoever's doing it.*

### **New York Daisy Chains**

Raymond Jermyn, Chief of the Rackets Bureau for the Suffolk County (New York) District Attorney, told the hearing that the "the people who ultimately became defendants on criminal prosecutions were the ones who originated [the] term [daisy chain]."

Testifying with Jermyn was Assistant State Attorney General Vincent O'Reilly of New York, who described an investigation called Greenstar of a tax evasion scheme - in two versions. Greenstar Petroleum was a fictitious company established in New Jersey. "Between July of 1984 and the end of May 1985 the total number, amount of taxes, excise tax and sales tax, evaded... was 39 million dollars, and then there's an additional 14 million in federal excise tax," O'Reilly said.

Using Exhibits 29 and 30 as guides, O'Reilly explained to SCI Counsel Charlotte K. Gaal how the paper trail, the product trail and the payment trail all took different routes.

*[I]n the course of the investigation we executed a search warrant on the business records of No*

*Brand Petroleum, which was located out in Suffolk County, and we found a computer, and in the tray of the computer, these invoices ... still attached, not even distributed.*

*Q. In both instances, the company left with the responsibility of the tax was the fictitious company?*

*A. Right.*

BY COMMISSIONER CAHILL:

*Q. I gather that once you do an investigation or an audit, you're able to follow the paper trail. It's just that too often it leads to a bogus company whose principals have simply fled.*

*A. That's correct.*

*Q. I mean, you can follow it?*

*A. It's difficult, but due to a lot of hard work by a lot of state tax auditors, they can follow the paper trail, the gas trail and the money trail. But once you get back down to who's responsible for the tax, those people are gone and there's no company left to obtain tax dollars from.*

O'Reilly said that the New York authorities concentrated primarily on sales tax evasion and excise tax evasion on gasoline.

BY COUNSEL GAAL:

*Q. Why did they concentrate on gasoline?*

*A. The volume was just tremendous....They had a much greater volume in gasoline and, therefore, noticed the evasion of taxes on gasoline to a greater extent than they did on the diesel fuel.*

*Q. Is it fair to say that the problems were the same with respect to diesel fuel?*

*A. Yes.*

Rackets Chief Jermyn testified about a related scheme involving one of the entities that was on both of those charts, the No Brand Petroleum scheme (Exhibit 31), a "relatively small case" involving eva-

sion of only a million dollars in federal excise tax.

*In this case the burn company was initially Cabot Petroleum and later on it was Houston Holdings. In this case Houston Holdings was a Panamanian corporation. The 'president' of Houston Holdings was a janitor in the law office of the attorney who incorporated Houston Holdings down in Panama City. In the case of Cabot Petroleum, the 'president' of Cabot maintained offices in Suffolk County which were about the size of a broom closet. They had a post office box for mail and the president was a sign painter who was invited by his uncle to become an oil baron.*

Jermyn described how invoices generated during this scam would show the transfer of gasoline with "all taxes paid" when, in fact, none had been paid. Jermyn noted that over \$100 million worth of gasoline was sold through one company, Houston Holdings, for which the state and federal and local authorities "did not receive one cent in tax revenues."

*Q. Again, is this also another daisy chain?*

*A. Same, and the beauty of this is another company could be instituted at the end of a given time period. At the end of a tax quarter, the bad guys would usually switch companies.*

The Grandfather of the Daisy Chain. Jermyn testified about Larry Iorizzo of Long Island, a man he characterized as the "grandfather of the daisy chain," who "started out as a legitimate retailer of gasoline but who later became enamored by the good life and the ability to make a quick dollar. Ultimately, he became one of the biggest bootleggers on Long Island." In the five years that "he operated on a grand scale after he brought in the Colombo family as his partners, you're talking about over 100 gas stations on Long Island and millions and millions of dollars in sales."

After Iorizzo was prosecuted, he fled to Panama, "because he knew he was facing a heavy jail sentence," but later became a cooperating witness.

*Q. Was there any involvement with New Jersey in respect to his matters?*

*A. Yes. He operated some truck stop gas stations in the early bootlegging days which sold a lot of diesel fuel. And he also, towards the end, when he busted out his retail company, Advantage Petroleum, he, in the process, over one weekend, defrauded two of the larger distributors of gasoline on the East Coast of approximately 15 million dollars in revenues... they were both New Jersey companies.*

Jermyn also testified that fuel licenses received in New Jersey were “brokered” in the marketplace for as much as \$100,000.

*In many cases, most of the time the source of the fuel, the legitimate source... were New Jersey’s refineries. Many times New Jersey licenses, legitimate New Jersey companies, were used in daisy chains to effectuate a particular evasion scheme.*

. . . .

*Q. Mr. Jermyn, where are the people now who were involved in the motor fuel tax evasion cases you worked on?*

*A. Fortunately for us, a number of them are in jail. Some are fugitives, having fled the country to avoid prosecutions. A number of them are dead, either by natural means or otherwise, and many of them are out of business, at least in New York.*

O’Reilly explained how home heating oil is generally treated in New York.

*Home heating oil in New York is diesel fuel. As Mr. Borak explained, it’s diesel fuel and under the definition of motor fuel, diesel fuel is motor fuel, so it’s treated basically the same, except home heating oil is taxed a little bit differently. ...Due to the volume, the state never really concentrated or saw a problem in home heating oil. What they saw was the tax-free transfer problem and that’s what I think they tried to*

*eliminate.*

*Q. Is the buyer accountable in New York if the seller cannot be located?*

*A. Yes, yes, there is a provision in the state tax law for that also.*

O’Reilly recommended that states “try and develop a system that allows the state to get its money up front. That’s where you want to collect your tax dollars. You don’t want to wait until it goes all the way down the hoop.”

BY COMMISSIONER MERIN:

*Q. Mr. O’Reilly, you indicated in your opinion you thought that the easiest way for the state to collect the tax would be to collect it at the first source of supply in the state, but you also said there were reasons why that might not be easy to accomplish. I think I understood what you meant, but could you please just state those reasons?*

*A. ...[T]he state may like it, but there may be a number of competing industries out in the oil and gas industry that may not think that that’s such a great idea. You might be eliminating a lot of jobs, you might be eliminating a lot of businesses. You might be doing a lot of things to legitimate interests in the oil and gasoline industry that they may not be interested in having that kind of system....*

*...As far as a prosecutor’s viewpoint, I think it’s the best system you could come up with. Your state gets its money right away and then the free enterprise system takes over after that.*

The New York witnesses made the following observations:

*[O’Reilly]: But I think what the Commission ought to take away from these hearings is that trying to eliminate the tax-free transfers, I think that’s the problem that New York had and eliminated it and they did see an increase in the tax*

revenues. I don't know if it eliminated tax evasion completely, but I think it will go a long way towards solving the problem.

*Q. Mr. Jermyn, would you agree with those comments?*

*A. [Jermyn]: Absolutely. If a government is going to levy a tax, why not collect it. If their intention is to levy it, they should collect it.*

*Q. And the public is paying it?*

*A. [Jermyn]: Absolutely.*

*[O'Reilly]: The public is paying it right at the pump every day.*

### **Immigrant Presence and The "Mob Tax"**

Jermyn described a significant presence of immigrants involved in the motor fuel tax evasion cases:

*There was a large number of Turkish immigrants at the retail levels and there were eastern bloc immigrants who became involved all the way up the chain of distribution to the point where they were actually acquiring gasoline terminals as a result of bootlegging activities.*

....

*There was a language barrier to begin with. Conspiratorial conversations were often in a foreign language. There weren't many agents that could speak Rumanian, unfortunately, or Russian. There was inability to infiltrate the closely-knit groups by way of informants or police agents and, in addition to that, these individuals were well-educated and oftentimes smarter than law enforcement agencies.*

*Q. Did you also find the presence or involvement of traditional organized crime groups in the motor fuel tax evasion cases?*

*A. Yes. Just as with any other industry, where there is an opportunity to make money, illegitimate traditional organized crime groups infil-*

*trate that industry. In this case, that occurred very early on...*

*...the immigrants who became involved in businesses were bright enough to realize that they had to pay tribute to traditional organized crime families in order to operate in certain areas, and there was usually a one or two cents per gallon levy by the mob families imposed upon the sale of bootlegged gasoline.*

*Q. Is that called the "mob tax"?*

*A. Yes... amounted to millions and millions of dollars.*

Jermyn said the investigation revealed the involvement of three traditional organized crime families in the early period of bootlegging between 1981 and 1988 - the Lucchese, Genovese and the Colombo organized crime families. "And later on in the schemes the Gambino family also became involved," he said.

Jermyn characterized the relationship between traditional organized crime and the eastern bloc immigrants as "very cooperative."

*[O]ne of the abilities of the organizational skills of the principals involved in these schemes was that they were able to forge a very close working relationship. It became almost like a cartel between the traditional organized crime families and the eastern bloc people, and they were able to monopolize and control the price of unbranded gasoline in the Long Island area for many, many years.*

He recalled a surveillance that revealed a "summit meeting" between the bootleggers, the organized crime figures and the eastern bloc people, "sitting at a large conference table in a meeting room in Long Island."

*Q. Who was the most significant organized crime figure you prosecuted?*

*A. [O]ne of the defendants in the racketeering*

*case, which was prosecuted federally, was a captain in the Colombo organized crime family by the name of Michael Franzese. There were also many organized crime associates who were prosecuted and convicted and were serving lengthy jail terms.*

Jermyn described one motor fuels case in which Franzese was involved:

*The amount that was actually evaded was in excess of \$30 million dollars and it involved a company where a bond was actually obtained for the payment of the taxes and Mr. Franzese bribed the official in the bonding company to issue the bond. The bonding company actually ended up losing additional moneys, so that there were many victims other than just the state and the federal government.*

### **The Violent Side of Fuel Tax Evasion**

Testimony was heard from various witnesses about a darker side of fuel tax evasion and an underlying fear among those in the business.

Rackets Chief Jermyn testified:

*Where necessary, violent means have been used to expand a particular bootlegger's sphere of influence. We've estimated as many as a dozen murders have taken place in the last seven years as a result of the bad guys infiltrating the marketplace.*

Jermyn described the murders of Michael Markowitz and Phillip Moskowitz. Markowitz, he said, was "one of the bigger bootleggers in the New York area." He was an eastern bloc immigrant who came to this country with virtually no money in 1979 but at the time of his death had "upwards of 30 million dollars just in assets... not even counting various bank accounts over in Austria and Lichtenstein." Markowitz was shot in the head while sitting in his Rolls Royce in Brooklyn in 1989.

Phillip Moskowitz was murdered after he was indicted and "certain tapes were released in which he compromised the positions of various organized crime families and identified them as being active in the bootlegging business. His body was found in New Jersey," Jermyn said.

SCI Special Agent Diszler gave testimony based on the Commission's own investigation.

BY COUNSEL HOEKJE:

*Q. Agent Diszler, have you sensed a fear among the witnesses to whom you have spoken?*

*A. In most instances we have. Most of them are aware, through the media, of course, that there have been violent homicides which have occurred in New York and New Jersey concerning this industry.*

*Witnesses have told me that they can discern certain accents over the telephone quite easily and many times have felt intimidated and threatened by the sales pitch which they get. Even bank officers have expressed an underlying fear to me.*

*Many times these individuals attempt to open bank accounts in New Jersey at local banks and when they fill out the bank applications it is learned that they have no roots to the community whatsoever. If the accounts are opened, within days and sometimes within hours there are wire transfers moving through their accounts which number in the thousands of dollars. These banking people who are not familiar with the businesses involved often become highly suspicious and concerned enough to usually contact the local police departments.*

BY CHAIRMAN ZAZZALI:

*Q. Are you comfortable identifying the type of accents that you referred to before when people got those anonymous calls?*

*A. Yes, I would be comfortable in saying that it*

*was definitely a Soviet, Eastern European accent.*

### **Substitution: A Traditional Scam**

Although daisy chains and false paper trails were the subjects dealt with most at the hearing, the more traditional method of tax evasion-- substitution of home heating oil for diesel-- was also discussed.

Investigator Michael Buchinski of the Middlesex County Prosecutor's Task Force testified about an investigation he conducted after learning that large amounts of cash in sums of approximately \$10,000 were being deposited frequently in a bank by a Middlesex County heating oil company. Investigator Buchinski began the investigation suspecting that narcotics might be involved, but subsequently learned that it involved motor fuel tax evasion.

In response to questioning from SCI Counsel James F. Villere Jr., Buchinski testified about his observations of the oil business:

*I placed a call to the business to find out about the purchase of diesel fuel. I was told that the fuel oil company does not engage in diesel sales, did not have a sufficient customer base... and referred to the need to clean out their oil tanks before putting in diesel fuel.*

*I knew that No. 2 heating oil and diesel fuel were virtually identical. The tanks need not be cleaned out.*

Buchinski testified that he learned that the cash deposits stopped in November, 1990, then resumed and increased in frequency beginning in July of 1991.

*Q. Did you think it odd that home heating oil sales would increase in the summer months and decline in the winter months?*

*A. Yes, and I learned more.*

Buchinski reported observing activity at the company by a single truck driver whose company owned tankers which moved in and out on an irregular basis and loaded up No. 2 fuel oil.

*I now believed that the cash deposits were connected to the important single truck driver.*

*The deposits always followed by a day the taking on of oil by the same truck driver.*

Buchinski followed these truck drivers several times and on one occasion turned back at the Delaware Memorial Bridge. On one occasion he asked for assistance from the New Jersey State Police in stopping the driver's truck. "An hour later, the troopers pulled over the trailer being operated by that truck driver. There were numerous motor vehicle violations for which summonses were issued." The truck carried fictitious plates. In the cab was a letterhead from that truck driver's company showing sales of diesel fuel and gas, but no heating oil.

*Also in the cab was an invoice showing a sale to a Virginia truck stop. In addition, the driver told the troopers that he had made sales in the State of Maryland.*

*Q. Were you still monitoring the cash deposits?*  
*A. Yes, the cash deposits continued through this week [of the public hearing].*

Investigator Buchinski determined that more than \$430,000 in cash was deposited by the heating oil company from July 16, 1991 to late October.

*I believe that all or the bulk of the cash sales deposited by the oil company were from that particular truck driver.*

Once, Buchinski and SCISpecial Agent Diszler followed the truck from this company, pulled it over and were told by the driver (a different driver this time) that he was carrying diesel and his destination was a truck stop in North Jersey.



In subsequent testimony at the hearing, Diszler gave further testimony about the Middlesex County scenario. He testified about following the same truck driver “well into the State of Maryland” on one occasion and later learning that a dated invoice found in the truck during the subsequent New Jersey State Police stop indicated that the driver had taken the load of fuel to a truck stop in Carmel Church, Virginia. Noting that the average tax on 7,000 gallons of diesel fuel would be around \$2,600, Diszler testified, “In one month of only 20 loads of taxable fuel the taxes [evaded] would be in excess of \$50,000.”

Subsequent to the public hearing, the truck driver/company owner testified in executive session before the SCI. He admitted that he had paid no motor fuel taxes to either the State of New Jersey or Virginia, but denied that he had ever brought fuel directly to a truck stop. The SCI has referred this matter to both state and federal authorities for further review.

More Fake Identification. Middlesex County Investigator Buchinski told the SCI about another banking scenario involving the fuel business in which fake identification was used to open accounts at two banks in Middlesex County. Four persons who subsequently attempted to withdraw large amounts of cash from these accounts were all from New York State and all were involved in the fuel oil business at addresses in New Jersey. Yet, when Investigator Buchinski checked their business addresses he determined that both businesses were “nothing more than answering machines... [and] that the companies had only been opened a short time before leaving without any forwarding information, addresses or names.”

## **SCI Investigation**

Special Agents Marilyn D. Cichowski and Robert Diszler and Investigative Accountant Arthur A. Cimino testified as a panel on the second day of the hearing. They described certain patterns observed during the investigation. Diszler described the offices typically seen:

*They were usually small rooms in old office buildings throughout the state. Some were located in converted homes on second floors consisting of usually desks, chairs and telephones.*

*Most of the locations which were obtained from the corporate record checks and from the Division of Motor Vehicles were vacant when we checked them. Some of the addresses were simply mail drops and others were simply answering machines. We found that those that were vacant had not left any forwarding addresses.*

Diszler added, “In all of the companies that we looked at, we never saw a single truck, a truck yard or a storage facility. I did see many luxury automobiles.”

He noted that “many of these companies were found to be relatively new and they operated for extremely short periods of time, usually less than a year, sometimes less than six months.” Checks with landlords revealed that “many of these companies would leave in the middle of the night,” paying for rent with checks that later bounced.

Many of the companies were “usually very close to New York City and primarily located in Middlesex County, Union, Hudson, Bergen and Essex Counties. There was particularly heavy concentration of these companies in Linden, New Jersey, Woodbridge, New Jersey and the surrounding towns.”

Salesmen for these companies used pagers or had mobile telephones. “These salesman usually would simply present business cards at the various diesel truck stops throughout the state.” Diszler recalled “one instance where one individual was working for five different companies at the same time... He had Americanized his first name and was using other American names as well.”

Special Agent Marilyn Cichowski testified about the officers of these companies. She told of the use of “multiple identification cards” and the common

use of business locations as home addresses in order to establish bogus New Jersey residency.

*They also often have multiple driver licenses. When we did out-of-state driver look-ups, they often had New York licenses, either valid or expired, and there were a lot of chauffeur licenses in New York.*

. . . .

*Q. Do many of these corporate officers appear to have ties to New Jersey in any way?*

*A. Solely by purchasing P.O. boxes or using recurring addresses where they do not live.*

*Q. Were we often unable to locate the officers of companies?*

*A. Yes.*

Agent Cichowski testified about other commonalities:

*In New Jersey and right now in California as well, there's some real common threads amongst many of the nefarious fuel companies we've reviewed. Among the commonalities are those officers of those companies are emigres from Eastern European countries which are the former republics [of the Soviet Union], but they're all individual republics now. Of course, not every Soviet emigre in the fuel business is a tax evader and we don't want to malign a whole nationality. Conversely, not every tax evader is a Soviet emigre.*

Exhibit 35 shows the location of major terminals in New Jersey. Agent Cichowski testified about indications that "vertical integration" is increasingly occurring:

*...What this means is that the products are being controlled from the terminal through transportation, distribution and ultimate dispensing from rack to service station. Such situations will add to the frustration of the investigations.*

Agent Cichowski testified about a vehicle stop made by a State Trooper in northern New Jersey. The car, in which there were three individuals, was exceeding the speed limit.

*Each of the individuals could not recall the other person's name for more than ... one sentence. One was Igor, one was Bob and then everybody's names kept changing [and] they couldn't agree to who they were.*

The car itself was a stolen vehicle with an altered VIN number.

*...The individuals had drivers' licenses from Florida, New Jersey, New York. Two of the individuals had six aliases. The driver had no driver's license... contained within the two briefcases were portable phones, beepers, blank invoices for fuel companies, filled-in invoices for fuel companies and a fictitious 637 federal certificate....*

The Records. Investigative Accountant Arthur Cimino testified about records subpoenaed from fuel companies:

*Q. Accountant Cimino, were we able to subpoena records from all fuel companies that we identified as doing business in New Jersey in the last two years?*

*A. No. We found that a lot of these companies were no longer in existence. We couldn't locate them.*

Cimino recalled that there were at least 20 companies that the Commission was unable to locate. Often the officers of these companies lived out-of-state, primarily in Brooklyn and Long Island, beyond the Commission's jurisdiction.

Cimino testified about invoices examined during the SCI investigation. All indicated that "federal tax and New Jersey taxes were included." He also noted that typically the invoices list the tax rates but do not break out the total dollar amount due for each tax.

*Q. When we spoke to company owners, the buyers in these instances, did they seem to feel that the phrase "all state and federal taxes included" relieved them of any liability for payment of those taxes?*

*A. Absolutely. They felt as long as they had an invoice that had that phrase on it they were absolved of any tax liability whatsoever. And that was true even though they had no idea whether their supplier or the supplier's supplier actually paid any taxes.*

*Q. Now, I note on this chart (Exhibit - 36) that the invoice does have a number but did we also receive invoices without numbers?*

*A. Yes, we did. It's an auditor's nightmare.*

Accountant Cimino also testified about his attempts to follow a chain of companies that avoided motor fuel taxes. He noted that the SCI went through four levels in the supply chain "and we wound up out-of-state." A number of suppliers were companies that had disappeared.

*Q. Were these suppliers in general licensed with the State of New Jersey?*

*A. We found no licensed supplier whatsoever.*

*Q. Would the fact that there are so many companies in this chain of distribution make it possible for tax authorities easily to identify tax liability?*

*A. No. At present it's very difficult.*

*In less than a year-and-a-half, from January 1990 to at latest June 1991, we're talking about approximately 37.4 million gallons of diesel fuel and we found no one who actually paid a tax. Everyone had their "tax-included" invoices, and we're talking about over 5 million dollars in taxes to the State of New Jersey and something over 7.5 million dollars to the federal government.*

*Q. Can we say conclusively that none of these taxes were paid?*

*A. No -- first of all, it's very difficult even if we had access to tax information.*

*I should add that the taxes filed are privileged information. We requested and couldn't get that but even if we had it, it would be very difficult to tell because when you have the companies, not only burn companies, some of these other companies disappear and move. It's very difficult to follow that chain. And so, no, we can't say that, but based upon the chain, based upon the type of companies that we're talking about, I'd be very surprised if any significant amount of those taxes were paid.*

Cimino also testified about curious coincidences regarding the dates of operation of some fuel companies:

*It was funny. We looked at companies and we'd see where their suppliers were significant suppliers and would exist for a three-, four-month period and as soon as they would disappear from the records, simultaneously another company would be there and would be a significant supplier for three or four months and as they disappear from the records simultaneously another company would appear.*

Cimino described further characteristics of typical invoices:

*I place very little credence on the invoices that I find in this chain. They are so easily fraudulently prepared. When you're dealing with a company that has no planned existence, does not worry about being audited for income tax or anything else down the road because they're not going to be here down the road, they can prepare an invoice that says absolutely anything. It doesn't have to tie into their records at all so, you know, the fact that we'll say "all taxes included" for a company who maybe is supposed to collect the tax makes no difference because no one is going to look in the records to find that they paid the tax.*

*In terms of the price, they can put any price they want there. We have heard and I believe that often that price is inflated, that it behooves the company that's going to continually exist to have a higher price, to have a higher deduction for tax returns. Makes no difference that the company's not going to be there for tax returns so they may remit that price to someone else and back under the table because we've heard that this is a very cash-intense business. They use check-cashing. That cash is being passed under the table so, in effect, the invoices we looked at, you just take it with a grain of salt, really.*

BY COMMISSIONER EVENCHICK:

*I have to say, Mr. Chairman, that as I have sat here now for a day and some part of a second day and as I looked at the headline in this morning's Ledger that says "Slick Schemes" and went on to suggest that the people involved in this criminality are engaged in sophisticated fraud, I began to wonder if it isn't more attributable to our lack -- when I say "our," I mean the State -- our lack of action. It seems to me that this is more a situation of "fool me once, shame on you. Fool me twice, shame on me." I don't understand based on what I've heard so far why some rather simple steps legislatively could not be taken that in my view would put an end to much of what we have heard.*

Commissioner Evenchick asked Accountant Cimino about a licensing recommendation:

*Q. [P]art of the licensing process I would presume would be a requirement that these people show evidence of tax responsibility either through the identification of their taxpayer numbers or the certification that requisite taxes have been paid.*

*Is that the kind of thing that would be included in the licensing process?*

*A. Yes, and with the individuals we're talking about, you know, you can take it another step.*

*...You know, just go and see that they exist. Maybe some bonding involved, you know, and make sure we're talking about... real individuals, people... that can be identified.*

Cimino added, "They're stealing the taxes. It's not that they're making a normal profit. They're stealing our taxes. The consumer is paying that darn thing. It's just not getting back to New Jersey, to the State, for its use."

### **Organized Crime in New Jersey Motor Fuel Tax Evasion?**

Because the New York State law enforcement officials had testified about organized crime involvement in their cases and the "mob tax," questions naturally arose about possible organized crime presence in New Jersey motor fuel tax evasion schemes.

Deputy Chief Investigator Boney was asked:

*Q. From your experience in these cases, do you believe organized crime is involved?*

*A. Yes, it's been shown that organized crime has been involved. ...It's been documented in different fashions. John Gotti himself, personally, has expressed interest in this area as a reputed head of the Gambino LCN. Basically... we see the traditional La Cosa Nostra groups and families involved and we see the non-traditional groups. Mr. Borak mentioned the immigrant groups. We're also finding groups from India that are involved in this type of industry, Pakistanis. So there are both forms of organized crime.*

Special Agent Diszler of the SCI concluded:

*Q. Is there a connection to traditional organized crime?*

*A. We believe there are such indications but we have to withhold comment at this time. Naturally, concerning the SCI mandate to investigate*

*and report on organized crime involvement in New Jersey, it is an area which we are actively and closely monitoring.*

### **Where did the Taxes Go?**

Testimony from individual witnesses at the hearing illustrated vividly the lack of accountability for fuel taxes under the present system. For instance, Gurmit Singh, partner in Singh Sandman Corporation, owner of the Sandman Truck Plaza in Bordentown, testified that he buys diesel for the truck stop "all taxes included." The SCI investigation revealed that the amount of state motor fuel tax due from Singh Sandman's purchases in 1990 was \$473,125.54. Asked if any part of that was ever actually remitted to the state, Singh said he did not know.

Gideon Misulovin is the owner of National Energy Petroleum (NEP) in Woodbridge, which has been in business since 1989. NEP buys and sells diesel fuel but does not have any storage tanks itself. Misulovin testified that NEP does not hold any motor fuel licenses from the State of New Jersey. As with Singh, Misulovin testified that NEP has never remitted motor fuel tax directly to the State of New Jersey. Asked why not, he replied, "Because we pay to our suppliers 'all tax included.' He said he did not know whether his suppliers pay motor fuel tax to the State of New Jersey or even where they buy their fuel. NEP records supplied under subpoena to the SCI for NEP show that in the calendar year 1990, NEP purchased a total of over \$20 million in diesel fuel, "all tax included." State tax on that figure was over \$2.9 million. Misulovin said he did not know whether any part of that amount was ever remitted to the State of New Jersey.

Ilia Shmukler, who said that he was once a salesman for NEP, said he did not know where that firm bought its fuel.

Shmukler testified that he subsequently opened his own company, ICT Distributors. He testified

that he bought all his diesel fuel "tax included" at a "good price" from a company called Cash Oil Company located in New York. He sold everything he bought to NEP.

*Q. Do you know if your supplier ever remitted state motor fuel taxes?*

*A. I don't know.*

*Q. Did you ever ask your supplier whether it paid fuel taxes?*

*A. I ask him when I start working. He tell "I will pay it, don't worry about this," and that's it, no more questions... He tell me "this not your problem, I will pay it, everything will be all right."*

SCI Agent Diszler testified that in a time period of four months Shmukler's company, ICT Distributors, "brokered an invoiced amount of \$6.9 million in diesel fuel to NEP, his old company." ICT Distributors held no New Jersey fuel license.

*Cash Oil Company, which was the New York company that Mr. Shmukler was buying from in New York, was located in Fort Lee, New Jersey, for three weeks, and simply used the address to open a New Jersey bank account.*

### **The Springfield Investigation**

While Shmukler professed ignorance concerning many facets of the industry in which he was a player, he and his associates normally conducted themselves in a furtive manner -- as if they had something to hide.

Detective Judd Levenson of the Springfield Township Police Department in Union County testified about an investigation he conducted for two months in 1989 at a business in Springfield. Although his original suspicion was that narcotics were involved, Levenson was eventually able to determine that the activity involved fuel. Two vehicles registered to Shmukler were observed at the site of the surveillance.

Levenson detailed information he received from a suspicious landlord:

*Individuals showed up one day in the beginning part of March, inquired about renting our office space. They paid cash for the monthly rental of the office. That night they moved into the office with some furniture. They also were all driving vehicles that had out-of-state plates, mainly from the State of New York. They all spoke with foreign accents and they conversed with one another in a foreign language.*

*Q. Did the tenants make any changes or alterations to the premises?*

*A. Yes, they did. Immediately upon moving into the office area, they removed the wooden door, the main door for the office, and they replaced it with a steel door that had a peephole. The steel door also had four separate different types of locks that were added to the steel door.*

Inside the steel door, a hidden camera was hooked up to the peephole and connected to a tape recorder and video monitor, which was constantly recording activity in the outside hallway of this area.

*They also partitioned off their office area so that it was not accessible to other tenants.*

. . . .

*The individuals would all park in an isolated section of the parking lot, as far away as possible from the front or back door entrance into their location. They would all park together in one group....*

*They seemed to be very cautious. When they exited their vehicle, they would look around the entire parking lot.... The one thing they all had in common was everybody had some type of an attache case when they went in or when they went out.*

Detective Levenson recalled instances involving

the exchange of items from briefcases taken out of the trunks of cars. He also described his attempts to follow vehicles from the premises: "There were usually two vehicles that would run in tandem, with one vehicle following another one." He followed the vehicles to the Goethals Bridge into Staten Island. The majority of the individuals were operating vehicles that had New York plates. One of Shmukler's vehicles was followed to New York in one such surveillance.

Inquiries to Interpol resulted in a report that two of the persons Levenson was watching were natives of the Soviet Union who had emigrated to Israel and from Israel to the United States. Levenson also said he had been told that two of the men he had under surveillance had been seen carrying weapons.

*Q. Why was your investigation terminated?*

*A. In the beginning part of May, they gave notification to the landlord that they would be leaving and that same night they gave notification, they packed up and moved out approximately between 10:00 and 11:00 o'clock at night.*

Mikhail Pasinkovsky and Igor Zak, owners of fuel oil companies in New Jersey, were called as witnesses after Shmukler. Both had invoked their Fifth Amendment privilege against self-incrimination in executive session and Counsel represented that they would continue to do so if called to testify at the public hearing.

# III

## STATUTORY WEAKNESSES

### New Jersey Motor Fuel Tax Laws

The New Jersey motor fuel tax statute, N.J.S.A. 54:39-1 et seq., was enacted in 1935 and has remained substantially unchanged. The statute defines as taxable only that product which is “used, offered for sale or sold for use... for the purpose of generating power for the propulsion of motor vehicles upon the public highways.” N.J.S.A. 54:39-2. This very strict definition is in contrast to broader definitions found in statutes of other states which define as potentially taxable any fuel “suitable” or “capable” for use in the propulsion of a motor vehicle.

The narrow New Jersey definition of a taxable fuel limits accountability for *potentially taxable* transactions in the fuel distribution chain. Thus any transaction along the distribution chain in “No. 2 fuel oil” is not taxable and therefore not reportable until it is first identified as “diesel” to be sold for on-highway use.

The need to raise funds for the construction of roads and highways was, of course, the logical reason for taxing diesel fuel but not home heating oil. Unfortunately, as the witnesses in the SCI public hearing demonstrated repeatedly, unscrupulous tax evaders have learned well how to take advantage of the statute’s original intent to exempt home heating oil from taxation.

Lack of Accountability. Testimony from Investigations Chief Borak underscored some basic loopholes in the current motor fuels tax statute.

*Q. Does the motor fuel tax law require that the product be identified to the taxable use before*

*reporting and remitting of tax?*

*A. Yes, that’s correct.*

*Q. Does the motor fuels statute require any reporting of nontaxable transactions?*

*A. No, it does not.*

*Q. Are all players in the distribution chain licensed and registered by the state?*

*A. No, no, they are not.*

*Q. Are all players who engage in taxable fuel transactions bonded by the state?*

*A. Currently they are not.*

*Q. In summary, does the motor fuels tax statute require total accountability for all fuel transactions, whether taxable or nontaxable?*

*A. [It does not].*

Borak testified that the statute needs to be modernized to reflect the incentive to evade taxes at the current high rates. For instance, he said that requiring total accountability for both taxable and nontaxable transactions would allow the state to track the product, which would help in enforcement and collection. Borak also favored licensing all the participants in the distribution chain.

*Q. Is it better to collect your money up front, rather than to chase after tax evaders?*

*A. Well, from a tax administrator’s point of view, absolutely so.*

*Q. Are we really talking about imposing a new tax to help out the state?*

*A. Absolutely not. We’re not talking about or considering any new tax. What we are talking about here is really a better way to collect the tax*

*that is already out there. You've got to keep in mind something... the public is paying the tax when they are buying the product, in essence, but the evaders are keeping the money. The government is not getting it.*

**Special License B Inadequate.** The fuel tax statute creates a "Special License B" category for buyers of non-taxable No. 2 fuel oil who sell it as taxable diesel. This license category is ineffective for two main reasons. First, these "Special License B" holders are supposed to report and remit tax on taxable transactions only. They are not required under the statute to report non-taxable transactions. Without accountability for both taxable and non-taxable transactions, however, the state's auditors cannot effectively determine whether in fact all taxes due to the state are being paid. Sellers are, in effect, on the honor system.

Second, this category does not affect the situation commonly found in tax evasion scams in which the buyer of fuel receives an invoice which declares that the fuel is diesel and that it is sold "all taxes included." In this case no tax or reporting obligation falls on the ultimate retail buyer because the taxes have allegedly been paid. Yet, typically, at least several traceable layers of sellers up the ladder from that retailer - the intermediary wholesalers or brokers - have no license and no reporting obligation. Without licensing and reporting by *all* players along the distribution chain, tax evasion thus becomes a lucrative game for the entrepreneur, and auditors and enforcement agents find themselves constantly several steps behind these companies.

Enforcement is as difficult as collection. A buyer with a "tax-included" invoice is not liable for that tax under state law even if the seller cannot be located. False and misleading paper trails and "burn" companies which stay in existence for only a few months create stumbling blocks for investigators. Ironically, it is the long-established dealer with a permanent address who instead becomes a target of collection and enforcement efforts.

Borak discussed the Special License B category.

*Q. Does this licensing system prevent tax evasion at the current time?*

*A. No, it's not doing its job.*

*Q. Is a Special License B holder required to report nontaxable sales?*

*A. No, it is not.*

*Q. Is a Special License B holder bonded?*

*A. No, it is not.*

*Q. Is there any requirement that a Special License B holder buy from a licensed seller?*

*A. No.*

*Q. This category applies when the dealer buys a product tax-free or without tax paid on the product?*

*A. Yes.*

*Q. Does it apply to the situation, as in the daisy chains, where a dealer buys diesel fuel "tax included"?*

*A. No, it does not.*

## **Difficulties in Criminal Investigations**

Several witnesses testified to the difficulty in developing motor fuel tax evasion cases.

Division of Criminal Justice Investigator Boney called motor fuel tax fraud cases "very labor intensive." He described investigative efforts that were necessary in one case to follow trucks from refineries back and forth across the state, especially since tax evaders "work under cover of darkness, they are ambitious, it's their livelihood, they have been doing it their whole lives, they're bent on breaking the law, they're inclined to conceal what they're doing, and it's very manpower intensive."

*Q. Would greater accountability in the statute assist in criminal investigative efforts?*

*A. It would definitely assist.*



SCI Special Agent Marilyn D. Cichowski was asked:

*Q. Is it possible to stop this type of fraud by traditional law enforcement methods?*

*A. No... Criminal investigators are really having a very difficult time chasing the trail. Most of the investigations to date are reactive and because of the method of reporting and accompanying delay, the investigators are always chasing after the individuals and the corporations, and the smoke's gone from the burn companies.*

*Unlike companies that have physical presence and tangibility...these businesses exist with little more than answering phones and beepers. Traditional methods of investigations just don't work.*

SCI Investigative Accountant Arthur A. Cimino testified:

*[I]t's a time-consuming, difficult process and eventually you'll come to find... the burn company. But before you find that burn company you have to understand ... the phone calls are going to go out so the burn company is going to be long notified by the time you get to the first or second level ....*

Justice Department attorney Rodio testified:

*[M]ost of these cases take about two years to investigate.... It takes a long time, these cases are manpower intensive, you have to look at a lot of documents and they're very difficult to prosecute. That's why good law enforcement mechanisms on the civil side are very important.*

### **Difficulties in Civil Enforcement Cases**

Deputy Attorney General Mary R. Hamill, Chief of the Financial Section in the State Division of Law, testified:

*[T]he people who deal in this area are real*

*manipulators... these people have dissolved their corporation by the time I'm filing answers in the tax court; there are no assets.*

Hamill and Deputy Attorney General Martin Wheelwright testified about their experiences in Tax Court representing the Division of Taxation in connection with motor fuel tax civil assessments. Two of these cases involved unsuccessful attempts to defend regulations, promulgated by the Division of Taxation, that would better track fuel in its movement through the state. The third case illustrated the difficulty in collecting judgments against either the seller or buyer of taxable fuel where one company had already dissolved, one truck was the only apparent asset, and no personal liability existed for corporate officers.

Hamill concluded:

*And so we need to have something that will put some teeth into enforcement.... We just can't do it in the typical audit situation, civil litigation context. It's too slow and it just isn't working.*

Hamill and Wheelwright both made recommendations for change, pointing to problems with the current Special License B category.

*Q. In describing to us some of your experiences, what is the most important message that you would like to share?*

*A. [By Ms. Hamill]: It seems to us that the more exemptions there are in the statute, the more problems you have, because as soon as you begin to have legitimate... tax-free sales, you have the possibility of starting the daisy chain as shown on Exhibit 28.*

One recommendation that Hamill made, based on a particular case about which she had testified, was to eliminate the export exemption entirely or at least eliminate the sale for exportation exemption.

Hamill also recommended that the problem with the Special License B category be addressed:

*And then this problem with the Special License B's, which entitle people legitimately to buy this fuel that can be used either on the highway or as heating oil tax-free, and then... they're able to finagle and it adds enormous complexity to the statute.*

Hamill further recommended possibly changing the law to provide that the tax on special fuels would fall on the final sale, "where you know whether it's going to be used as heating oil or used on the highway."

Wheelwright noted in conclusion, "I just wanted to say that it seems to me that the simpler the structure of the tax collection system, the better off everybody will be." Commissioner Evenchick responded, "That's a message, Mr. Chairman, that seems to be coming through all of the witnesses, coming through loud and clear."

## IV

# POSSIBLE SOLUTIONS

The problem of fuel tax evasion is not a difficult one to comprehend. Developing solutions is more complicated.

### **The Maryland System: Total Accountability**

William Turner, Chief Auditor of the Motor Fuel Tax Division in the State of Maryland, testified that sound laws, an adequate staff, proper resources and a total accountability system are important features of the Maryland motor fuel tax system.

*Q. What does “total accountability” mean?*

*A. Total accountability means accounting for all fuels that could be used as a motor vehicle fuel on receipts, disbursements and inventories.*

Turner testified, “You follow the fuel to its ultimate use. If it’s a nontaxable use, you follow that fuel to that use. If it’s taxable, you follow it to that use.”

*Q. Why is total accountability so important?*

*A. [I]f you don’t track the movement of fuel, you won’t be able to ensure that the taxes are paid on the fuel that is sold for taxable use.*

Turner told the SCI that all the players in the Maryland system are registered and licensed. “You must register the sellers of the fuel and you also must register the users of fuel to see that that fuel is used for a taxable or nontaxable purpose.”

Turner testified, “We don’t recognize the word ‘heating oil.’ Heating oil is only heating oil when it goes to a heating plant.”

*You don’t know what they’re going to do with it until it’s actually used or sold or actually delivered to the end user. Many of our assessments, as high as 100,000 dollars, are coming from the small heating oil (so-called) distributors who have tank wagons of 3,500 gallon capacity who buy under the table with terminals and then they sell to truckers ...so until it’s actually delivered, you don’t know what the fuel is going to be used for.*

Turner explained that Maryland uses the term “Special Fuel” to mean “any type of product other than gasoline that could be used for motor fuel.”

*Q. Does this include both diesel and No. 2 fuel oil?*

*A. Yes... Any type of fuel that can be used for motor fuel.*

*Q. Is there total accountability for all fuels?*

*A. Yes, there is. Special fuels are handled no differently than gasoline.*

*Q. Does total accountability apply regardless of whether the use is taxable or nontaxable?*

*A. Yes, it does. It applies whether it’s taxable or nontaxable. Until the fuel is actually put into a non-highway mode, no one knows what the fuel is going to be used for.*

Turner explained that Maryland has an exemption procedure for the tax-free purchase of special fuel: “All users and sellers must be bonded to buy tax free and they must file an annual bond and annual application.” Those who buy tax free must have an exemption number and they must also keep accountability on the use of their fuel.

*Q. What, in your opinion, minimizes or eliminates daisy chains?*

*A. Total accountability from the top down, the reporting of taxable and nontaxable transactions and the limited availability of tax-free purchases.*

*Q. Mr. Turner, is it possible to totally eliminate fuel tax evasion?*

*A. No, I don't think you will ever eliminate fuel tax evasion... The only way I feel that tax evasion can be kept at a minimum is with the total accountability system, registering all the players.*

### **New York State's Experience**

Assistant Attorney General Vincent O'Reilly of New York detailed several changes in the New York law. The first took place in 1982 and moved collection responsibilities from the retailer up to the distributor. "That's when the daisy chains really started to take hold and take flight in New York," he said. Ironically, the overall effect of this change was to cause increased evasion. Lost tax revenues were estimated at \$90 million annually at that time.

*The way the law existed in the early 80's and up to 1985 was that there was a high return to the criminal, the probability of getting caught was very low, and the way the law was structured prior to 1985... allowed a number of tax-free transfers between different entities. And so that gave rise to the bad guys being able to substitute burn companies and illegitimate companies and nonexistent companies into the paper chain to avoid taxation.*

*Q. When you say the "high return," you're talking about millions of dollars, is that right?*

*A. Millions of dollars.*

In June of 1985, "recognizing that they were still having a major problem in tax evasion on oil and gas," O'Reilly said, New York changed to a First

Importer Rule, which meant that "the person that brought the gasoline into the state ... was responsible for paying the sales and excise taxes, and then they'd have to recoup them down the line as the gasoline got transferred." That change increased collections by \$123 million.

Rackets Chief Jermyn testified that in 1982 local, state and federal law enforcement agencies formed a task force concentrating primarily on Long Island and some New York City boroughs. Both he and O'Reilly were on the task force. "The task force was created primarily so that there was not a duplication of effort in terms of the limited resources we had available. We found in some cases that when surveillances were being conducted, we found on license plate checks that some of the vehicles we were checking we thought were bad guys were actually good guys from other sister agencies."

*Q. How successful was the task force?*

*A. Under the circumstances, considering the difficulty of these prosecutions, we believe that we have been successful. We have obtained and secured convictions in over a hundred cases, obtained significant jail sentences ranging up to 66 years in prison, and we've also been able to obtain some restitution for the government.*

....

*Law enforcement agencies assigned to this case had to learn a whole new jargon in order to know what was being discussed in the meetings. One of the terms that was used was called "burning the numbers," the "number" being a reference to the license number that was assigned to a particular tax exempt distributor .... "Burning the number" means to report the sales, attribute them to that particular tax-exempt company, which would be the last licensed distributor on a particular daisy chain, so that would be the tax-responsible company. By the time the tax authorities identified that company, the president was back in Rumania or in Panama or wherever and there were no taxes to be had for the state.*

## Fuel Merchants Panel

Timothy Doherty suggested “an ongoing auditing process” by the Division of Taxation, with follow-up and cross-checking at the terminals to make certain that dishonest brokers or dealers do not keep two sets of books.

Edward Miller recommended that the fuel taxes be collected either at the terminal or at the retail level -- “It has to go to one of those two places.” Taxing at the terminal would allow heating oil dealers to be licensed and to buy the fuel tax-free, reducing the number of companies that would have to be audited and monitored, Miller said.

R. Paul Riggins said the matter could not be solved simply through better enforcement. He said the industry should try to reach a consensus on where the tax should be collected.

Joseph Russo, who is also a fuel transporter, recommended taxing gasoline at the refinery only after an agreement between the state and legitimate jobbers that would alleviate the cash flow problem such a system would cause in the beginning. But Russo said the problem with No. 2 oil is more difficult.

*If you tax the product [No. 2 fuel oil] at the terminal and you tax the heating oil, you're going to kill the industry. They can't absorb that kind of money. It's just too much cash to lay out.*

He expressed the opinion that honest merchants should not have to pay taxes up front for all No. 2 oil, and then wait even a short period for the state to rebate the tax on that portion of the product actually sold as home heating oil. Taxes on diesel fuel should be collected by the retailer, Russo said.

Russo also recommended licensing “every legitimate distributor, both diesel and heating oil,” with the state reviewing reports from terminals and carriers, and auditing the sales of non-taxable product to

make sure there is no hidden substitution of taxable diesel for non-taxable heating oil.

A veteran oil industry employee and a salesman for the past 13 years, Francis W. Chewey recommended making “the retailer and the commercial user responsible for the payment of motor fuel taxes... just like the collection of sales taxes. All the mechanisms are basically in place now. The functions which must be performed can be done with people from Weights and Measures and the Division of Taxation.”

Chewey suggested a model program for the collection of both state and federal taxes as well as a funding mechanism for enforcement.

*The results could be very dramatic.... Money now going to lawbreakers could be used to reduce our tax burden... we're talking about \$376,000 for every million gallons of unreported [diesel fuel sales]....*

## The Fuel Merchants Association

FMA Executive Vice President Fred Sacco also supported a system whereby the state would collect all motor fuel taxes including federal taxes. But he was adamantly opposed to a system that would result in taxes being collected on all No. 2 fuel and then returned to merchants through a rebate system on sales of non-taxable heating oil.

*On the diesel side you heard me indicate that the majority of my members are really in the fuel oil or the home heating oil business; only very little diesel. They are frightened to death with the aspect of moving the tax collection on diesel ... to the refinery gate. ...[W]e sell in New Jersey almost a billion gallons of home heating oil through our members.*

*By doing the tax collection at the refinery gate you are saying to us that we've got to put up, over about a three- or four-month cycle, 370 million dollars, which would be the equivalent in terms*

*of diesel taxes for home heating oil. We are frightened to death with that prospect.*

*It is conceivable in my mind that you might move the collection process to the refinery gate but do not impose the tax liability on the home heating oil people until it's clearly sold as a diesel fuel so what you've done is you've moved it one step from the refinery gate, providing there is a registration mechanism that establishes an audit trail.*

Sacco recommended instead that the collection point be moved to the "next to the last step" in the distribution process, that is, to those merchants who sell to retailers.

BY COMMISSIONER EVENCHICK:

*Q. Rather than the last [step]?*

*A. Rather than the last, because what you've done, sir, is by moving it to the last step you've moved to a cash economy. Number one, you've moved to a market that contains probably 10,000 users of motor fuels because you have to include all the trucking companies, all the transportation companies as well over 4,000 service stations. That could be an administrative nightmare for the Division [of Taxation].*

Instead, Sacco proposed:

*There aren't many more, beyond our 400 members, who are in the distribution system excepting these names that you've heard.*

*Q. Like the "No Name" company?*

*A. Yes, sir. So it's very plausible in my mind to set up a registration and an audit trail that next to the last point where that company -- my members have the tax collection responsibility that they have had to date, sir. We pay to the State of New Jersey almost 90 million dollars a year in motor fuels taxes.*

## **New Jersey Petroleum Council**

James E. Benton, executive director of the New Jersey Petroleum Council, appeared along with Gerald Scheffler of the Sun Oil Company in Philadelphia, who serves as the chairman of the Council's Excise Tax Committee. The Petroleum Council is a trade association representing the major oil companies in New Jersey.

Benton said his members would support the creation of a tighter system for reporting sales of No. 2 fuel oil into the state.

*We believe a modest registration or licensing program would assist the state to develop an administrative system that would assure more effective enforcement.*

Scheffler said:

*I believe that certainly with the minimal or no control on number two fuel oil that leaves the terminal creates obviously a major opportunity to have that fuel fall into the diesel fuel racks. It is the same fuel and we certainly, I think, all agree with that.*

*Right now, to my knowledge, there is absolutely no reporting of that type of fuel. There is no licensing required for handling, distributing, selling that type of fuel...*

He added:

*A license to deal in diesel fuel only seems to fall on the honest businessman. The dishonest businessman doesn't even seek one and therein lies the problem.*

*What we're suggesting I believe is that even though it would be a little painful to everybody in the industry including the majors, including the distributors and down to the retail level, a licensing procedure.*

*...As far as licensing and tracking that fuel, that number two fuel, the majors wouldn't have a problem doing that as far as reporting it to the state... if it was a licensed procedure and that would be considered the pain we would be willing to share if it helped solve this problem.*

Benton also recommended that the Division of Taxation consider the establishment of a toll-free hotline for businesses to report those appearing to operate outside the law.

### **State Treasurer**

Douglas C. Berman appeared at the end of the hearing “to call for tough legislation that would help curtail this problem.”

Treasurer Berman testified:

*What is happening with this motor fuels scam is particularly troublesome.... This is a calculated effort by groups with apparent ties to organized crime to systematically defraud the taxpayers of the State of New Jersey and other states of our nation and the federal government. This is a*

*conspiracy that must be broken.*

Calling for “laws and regulations to enable us to prosecute these fraud cases and to discourage the system that makes the rip-offs possible,” Berman concluded:

*...[W]e strongly believe the remedial legislation should tighten reporting and licensing provisions, revise the point of taxation for these petroleum products, require letters of credit when necessary to protect the revenue and provide for statutory penalties for conspiracy to evade taxes.*

*Tax fraud is not a victimless crime. It adversely affects every citizen of our state for we are being cheated out of much-needed revenue. We are determined to make sure that our motor fuels tax dollars are for paving our highways, not lining the pockets of criminals.*

## RECOMMENDATIONS

### **Total Accountability**

Because of weaknesses in the motor fuels statute, the Division of Taxation does not have a clear idea how much taxable fuel is sold in New Jersey. For this reason, the Commission believes strongly that the single most important reform of the system should be a change in the statute to require total accountability for all transactions in the fuel distribution system, regardless of whether the ultimate use of the fuel will be taxable. The statute should empower the Director of the Division of Taxation to promulgate regulations necessary to provide such accountability, resulting in the tracking of all fuel.

It is difficult to require total accountability for a product, the definition of which is too narrow. The statute now defines as taxable only that product "used, offered for sale or sold for use..for the purpose of generating power for the propulsion of motor vehicles upon the public highways." This definition limits the Division's ability to track all fuel to its ultimate use, whether that use is taxable or not.

The Commission recommends that the statute be rewritten to change the definition of motor fuel motor vehicle fuel to "any fuel capable of propelling of motor vehicles when used in spark-ignited or compression-ignited internal combustion engines." The statute should then classify motor fuel as two types: gasoline or special fuel.

### **Point of Collection**

Another key issue developed at the hearings is

that the statute is unclear as to where some taxes should be collected.

Gasoline. The motor fuel tax on gasoline should be collected at the first sale at the terminal. The exemption on sales for exportation should be eliminated and refund claims required instead. Other tax-free transfers currently permitted should also be eliminated.

Special Fuel. The motor fuel tax on special fuel should be collected at the sale to the first retail dealer or special fuel user and the tax remitted to the state by the seller. Fuel sold for off-highway use and home heating use should continue to be exempt from taxation but sales should be fully documented to justify the exemptions to the Division of Taxation.

### **Licensing and Bonding**

The Commission investigation found numerous instances in which records indicated that fuel passed through several companies before reaching the retail level, yet when these companies were tracked, many were found to be fronts or "paper" companies. The fuel was probably delivered directly to the retailer and the paperwork fabricated to facilitate evasion of the taxes. To thwart such schemes and enhance accountability, the Commission recommends that all fuel distribution firms be licensed by and accountable to the Division of Taxation.

Current "special" licenses that allow for the sale of both taxable and non-taxable fuel should be repealed.



The license fee schedule should be modernize, with the Division Director authorized to set the fees.

All those in the distribution chain ultimately responsible for collecting the taxes should be bonded, and the amount of the bonds should be set by the Director.

### **Recordkeeping and Reporting**

To promote accountability, recordkeeping and reporting should be required of all participants in the distribution chain, whether or not they collect and remit taxes. Both the statute and regulations should provide a clear audit trail to the taxpayer. Recordkeeping and reporting of taxable and non-taxable transactions should be required of all terminals, all transporters, and all entities engaged in the wholesale and retail distribution of fuel. Sealed meters should be required at the retail level. Terminals should file regular reports of all inventory, including all commingled inventory. A manifest system, similar to that developed for the hazardous waste transportation industry, should be devised to more accurately and effectively track motor fuel.

All invoices for the sale of fuel should require certain specific information about the origin and destination of that fuel and set forth the specific amount of tax. All requests for refunds should be accompanied by detailed records.

The statute and regulations should require third-party reporting on the movement of fuel into, out of and within the state. Transporter reports should include the movement of fuel by common or contract carrier, pipeline, railroads or barges.

### **Civil and Criminal Penalties**

Administrative powers of the Director of Taxation should be strengthened to include increased authority in the areas of license revoca

tion, inspection, and testing and analysis. Civil penalties for violations of reporting and payment requirements should be enhanced. Stop-sale and confiscation powers should be provided for use in appropriate cases.

The statute should allow the Division of Taxation to assess tax and interest against either the supplier or the purchaser if the first responsible party does not or cannot pay the tax, or if inadequate recordkeeping or reporting has prevented a clear audit trail.

Reiterating a recommendation made in the Commission's report on the garment industry, conspiracy to evade taxes, including motor fuel taxes, should be made a criminal offense. Criminal penalties should be increased for violations of motor fuel tax recordkeeping reporting and payment provisions.

As the Commission has at least twice previously recommended (in its checking cashing and garment industry reports), the state should adopt its own currency transaction reporting (CTR) statute.

Systematic checks of meters, gauges and measuring devices by weights and measure inspectors would provide a cross-check of the reports filed by fuel merchants and distributors. Cross-checking aside, fines and penalties should be increased for violations of weights and measures standards at the retail level as well as in the supply chain. Greater authority should be given to the State Office of Weights and Measures as well as to such agencies on the local level to issue citations and impose fines. Possibly, some portion of the fines collected could be retained locally as a financial inducement to enforce weights and measures standards.

To thwart those who use daisy chains to conceal their tax evasion, consideration should be given to imposing personal liability on corporate officers for violations of the motor fuel tax provisions.

**Division of Taxation: Administration and Collection**

Responsibility for administration and collection of motor fuel tax should be shifted out of the Miscellaneous Tax section, which currently administers several state taxes, and a new Motor Fuel Tax Section should be created. The Commission is aware of the State's current fiscal difficulties. However, with at least \$40 million dollars -- and perhaps more -- in lost revenues at stake, such a new unit would pay for itself many times over.

Emphasis should be given to upgrading current data collection and analysis systems. This recommendation is particularly important if the statute and regulations are changed to require greater accountability. The initial investment required for training and implementation should more than pay off in the long run.

The statute should give the Director of the Division authority to institute cooperative programs with other state agencies and to provide for joint audits with other states. The state should also create and maintain a Motor Fuel Tax Task Force comprised of state and local representatives. Federal agencies should be invited and encouraged to participate.

Rewards should be offered for the successful prosecution of violators, similar to the system employed by the IRS. The Division should institute a toll-free hotline for reporting motor fuel tax violations.

## ACKNOWLEDGMENTS

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