

Massachusetts DOR's Misguided Audit Policy: Reflections on *Town Fair Tire*

by Morris N. Robinson

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"The power to tax involves the power to destroy," wrote U.S. Supreme Court Chief Justice John Marshall in 1819. Today, the Massachusetts Supreme Judicial Court respects Chief Justice Marshall's insight by placing limits on the rulemaking authority of the Massachusetts Department of Revenue. The court generally refuses to allow the DOR to create and then to enforce *retroactively* new interpretations of tax rules that significantly harm law-abiding businesses and individuals. *Town Fair Tire Centers, Inc. v. Commissioner*, decided on August 25, is a recent case in point. (For the decision, see *Doc 2009-19126* or *2009 STT 163-11*.)

The principal business of Town Fair Tire Centers Inc. was the retail sale and installation of automobile tires. Town Fair operated 60 stores in New England, including 18 stores in Massachusetts and three in New Hampshire. The DOR audited Town Fair and determined that it should have collected use taxes from Massachusetts residents who purchased tires from Town Fair's three stores in New Hampshire. The DOR then demanded payment of these use taxes from Town Fair, plus penalties and interest.

DOR auditors based their determination on a new tax presumption: Tires purchased out of state by Massachusetts residents will be used in Massachusetts. The DOR sought to enforce that presumption retroactively. That retroactive enforcement subjected Town Fair to significant harm, as follows:

- **Potential Losses.** Retroactive enforcement of the new presumption prevented Town Fair from collecting the use taxes from its customers. I estimate that those uncollected taxes, plus penalties and interest, approached \$1 million for all open years.
- **Potential Competitive Disadvantage.** Town Fair competes with other New Hampshire tire sellers that do not do business in Massachu-

setts and are therefore not bound by a Massachusetts DOR determination that a use tax be collected from Massachusetts residents. That unequal treatment of competitors is troubling in an industry known for its intense price competition and low profit margins.

DOR auditors based their audit position in *Town Fair* on a plausible interpretation of the use tax laws. The state supreme court, however, based its decision on a strict reading of the tax law as passed by the legislature. That dissonance is remarkable because the boundaries of the DOR's rulemaking authority were delineated by the Supreme Judicial Court nearly 30 years ago in *Xtra, Inc. v. Commissioner*, 380 Mass. 277, 402 N.E.2d 1324 (1980).

In *Xtra*, the court held that DOR auditors cannot create new interpretations of tax rules and seek to apply them retroactively. In the absence of officially promulgated regulations, the interpretation of the tax laws must be based on a strict reading of legislative intent, and ambiguities must be resolved in favor of the taxpayer. In short, under *Xtra*:

- The DOR's Audit Bureau *enforces* existing rules, without creative interpretation.
- The DOR's Rules and Regulations Bureau *interprets* the tax laws by promulgating regulations and all affected parties have the right to comment on the proposed rules before their implementation.

The *Xtra* holding respects Chief Justice Marshall's insight that the power to tax involves the power to destroy. It is consistent with rationality, notions of fundamental fairness, and due process of law.

The *Xtra* holding is the unarticulated basis for the court's *Town Fair* decision.¹ *Town Fair* merely extended *Xtra* to include presumptions. In *Town Fair*,

¹It is possible that the Supreme Judicial Court did not cite *Xtra* as authority in *Town Fair* because none of the six briefs submitted to the court in this case referred to *Xtra*. *Xtra* was brought to my attention by Attorney Kathleen King Parker, a partner with Pierce Atwood, who (with others) submitted one of Town Fair's amicus briefs.

Supreme Judicial Court Chief Justice Margaret Marshall based her decision on the strict interpretation of the Massachusetts use statute. That statute, by its strict terms, does not allow the DOR to assess and collect a use tax — unless the DOR can first prove that the tires are used or stored in Massachusetts.

That clear statutory requirement created an administrative problem for the DOR because the DOR cannot justify the expense of determining on a case-by-case basis whether tires purchased at Town Fair's three New Hampshire stores were used or stored in Massachusetts. Therefore, the DOR asked the court to recognize judicially and to apply retroactively a new presumption: Tires purchased by Massachusetts residents out of state are presumed used or stored in Massachusetts.

The DOR's policy confuses its enforcement role with its rulemaking role.

Chief Justice Marshall, however, refused to recognize the new presumption judicially. Rather, she insisted that this new presumption be grounded in

statute, as is the case in California, Nevada, and Wisconsin. Her insistence on new legislation would necessarily require full political consideration by the Massachusetts legislature and governor. It would also result in prospective application of the new presumption coupled with full due process for all affected businesses.

Despite the DOR's loss in *Town Fair*, it will likely continue to encourage its audit personnel to create and then to retroactively enforce new interpretations of tax rules that significantly harm law-abiding businesses and individuals.

Commissioner of Revenue Navjeet Bal should change DOR's policy for four reasons:

- The DOR's present policy confuses its enforcement role with its rulemaking role.
- The DOR's present policy demonstrates ignorance of (or contempt for) the court's judicially imposed limitations on the DOR's rulemaking authority as set forth in *Xtra* and *Town Fair*.
- The DOR's current policy results in needless litigation at substantial cost to both taxpayers and the commonwealth of Massachusetts.
- The DOR's current policy demonstrates contempt for businesses that must predict and calculate their tax obligations with reasonable certainty. ☆