IN THE TERRITORIAL COURT OF THE VIRGIN ISLANDS

DIVISION OF ST. CROIX AT KINGSHILL

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| ARMSTRONG FORD, INC., Plaintiff, vs. VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE, Defendant. | ) | CIVIL NO. 676/1993<br><br>ACTION FOR REDETERMINATION OF GROSS RECEIPTS TAXES<br><br>NOT FOR PUBLICATION |

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**Cabret, J.**

**MEMORANDUM OPINION**
(December 23, 1999)

Armstrong Ford, Inc. ("Armstrong Ford") owned and operated an automobile dealership on St. Croix. In May of 1993, the Virgin Islands Bureau of Internal Revenue ("VIBIR") assessed Armstrong Ford for a deficiency in the company's payment of its gross receipt taxes for the nine-month period of April through December 1990.[1] Armstrong Ford subsequently filed this action for a redetermination of VIBIR's gross receipts tax deficiency notice. For reasons which follow, VIBIR's deficiency assessment will be sustained.

## I. FACTS AND PROCEDURAL BACKGROUND

The evidence of record shows that in conducting its business, Armstrong Ford engaged in two types of transactions. First, Armstrong Ford engaged in retail sales of new and used automobiles. The company financed its purchase of automobiles for inventory through loans obtained from the Bank of Nova Scotia (the "Bank"). Second, Armstrong Ford engaged in intercompany transactions which included automobile sales, leases, repairs and miscellaneous other transactions with affiliated companies. It is Armstrong Ford's accounting of these transactions that lies at the heart of the instant dispute with VIBIR.

### A. Retail Sales

Armstrong Ford acquired and sold its inventory of automobiles under a "floor plan agreement" with the Bank. At trial, Armstrong Ford did not produce the floor plan agreement in effect during 1990; however, it produced a copy of a 1992 agreement with the Bank.[2] The relevant provision of the 1992 agreement provided:

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[1] By the time VIBIR determined the amount of Armstrong Ford's gross receipts tax deficiency, the limitations period for the returns filed for the first quarter of 1990 had expired. *See* V.I. Code Ann. tit. 33, § 1161 (1994). Therefore, VIBIR's determination was limited to the returns filed for the months of April through December 1990.

[2] Armstrong Ford's in-house accountant testified that she was unable to locate the floor plan agreement prior to the 1992 agreement. The prior agreement was in effect from 1977 until it was superseded by the 1992 agreement. According to this witness, both these agreements were "standard" in that they contained essentially the same terms. *See* Plaintiff's Ex. 6. The 1992 agreement was admitted into evidence without objection at trial.

> [Armstrong Ford] agrees that upon payment to the Seller[3] by the Bank, and to the greatest extent allowed by the terms of the Security Agreement delivered by [Armstrong Ford] to the Bank, the Bank shall be entitled to all the rights to which the Seller was entitled before the payment to the Seller, including title to and ownership of the motor vehicle(s) to which the Invoice or Cash Draft applies.[4]

In a Stipulation of Facts, the parties described the arrangement underlying the floor plan agreement as follows:

> When Armstrong Ford sells a vehicle which as been financed by the Bank of Nova Scotia, the proceeds are delivered to the bank. The Bank of Nova Scotia then deducts its loan balance and the balance of the proceeds is then separately deposited into an account in the name of Armstrong Ford.[5]

Under this agreement, the Bank considered itself a creditor of Armstrong Ford. In this regard, the parties further stipulated that the Bank never owned the vehicles sold by Armstrong Ford that were subject to the Bank's liens, and the Bank never listed these vehicles as assets of the Bank. Consistent with this stipulation, the parties agreed that the Bank never sold vehicles through Armstrong Ford or considered any sales by Armstrong Ford as being a sale by the Bank. Finally, the Bank never insured vehicles in the possession of Armstrong Ford, although it did require Armstrong Ford to insure the vehicles and name the Bank as an insured pursuant to the Bank's liens.

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[3] The floor plan agreement collectively defined "the Seller" as the wholesalers of automobiles to Armstrong Ford, including Ford Motor Company, Mitsubishi of the Caribbean, Inc., Suzuki Del Carib, and Plaza Motors Corporation.

[4] *See* Plaintiff's Ex. 3, para. 5.

[5] Stipulation of Facts, Para. 37(f).

Based on its understanding of the floor plan agreement, Armstrong Ford excluded the gross revenues from its retail sales of cars purchased under the agreement from its report of gross receipts to VIBIR. According to Armstrong Ford, these revenues were not subject to gross receipts taxes because the funds were kept in trust for remittance to the Bank pursuant to a security agreement between Armstrong Ford and the Bank until the security liens were satisfied.[6] The only revenue subject to such tax, Armstrong Ford claimed, is any amount which remained in the account after the Bank deducted the balance due on the loans.

In support of this assertion, Armstrong Ford presented testimony from its certified public accountant, Leonard Chasen. Chasen testified that from 1980 through 1990 he advised Armstrong Ford to exclude from gross receipts all amounts representing revenue from car sales which were owed to the Bank. He further testified that VIBIR audited Armstrong Ford for ten consecutive years, reviewed the company's income tax and gross receipts tax returns each time and never challenged Armstrong Ford's method of calculating its gross receipts tax liability.

**B. Intercompany Sales**

The evidence showed that Armstrong Ford is a closely-held corporation and affiliated through common ownership with other companies including The Buccaneer, Inc., Automotive Services Ltd., Preferred Rentals, Inc., Tourism Industries, Inc., Companion, Inc., Christiansted Port Terminal Corp., Cruzan Motors TC, Ltd., Haywood Street Redevelopment Corp., and Meridian Engineering, Inc. It appears that Armstrong Ford conducted numerous transactions

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[6] Plaintiff's Ex. 4

with these affiliated companies during the period in question. When Armstrong Ford computed its gross receipts tax for this period, it excluded revenues received from its affiliated companies in these transactions. Armstrong Ford contended that the bulk of these funds was from the transfer of cash in the form of advances or loans for the operation of the automobile dealership, not from the sale of goods, and that they were therefore not subject to the gross receipts tax. Armstrong Ford further contended that even if the transfers were otherwise subject to the gross receipts tax, the transfers are exempt from such tax in this case because they came from a related company.

The evidence at trial concerning these transactions was conflicting. According to Bonnie Priess, Armstrong Ford's in-house accountant at the time, "the intercompany transfers are loans that are made from other companies to Armstrong [Ford]. They also are composed of--mainly of lease payments that go into what belong to the inter-companies such as the Buccaneer or Companion."[7] In support of this testimony, Armstrong Ford introduced a copy of an internal accounting worksheet it used to compute the gross receipts tax. Under a column titled "Inter-Co." are dollar figures for the months in question. The total of these figures is $1,384,030.[8] There are no other explanations of the monthly figures or the total amount. At trial, Priess was asked: "Of that figure, were you able to determine how much of those were lease payments and how much were common loans? A: I would say it's under 50,000 [for lease payments]."[9] Later

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[7] Tr. at 21.

[8] Plaintiff's Ex. 5

[9] Tr. at 21.

in her testimony, Priess stated that if Armstrong Ford sold the Buccaneer a vehicle for transporting guests, it was her "feelings" that it would be recorded as a sale through the Bank of Nova Scotia.[10] When asked by counsel if she had reviewed any files to support this speculation, Priess equivocated further stating that one of the inter-company transactions "may have been" the sale of a vehicle. "but I am not sure."[11] An explanatory note attached to Armstrong Ford's financial statement for the period in question adds some clarification:

> Inter-company transactions for the years ended December 31, 1991 and 1990 include the purchase of vehicles from Automotive Services, Limited and the sale of vehicles to Meridian Engineering, Inc. and The Buccaneer, Inc.
>
> The Company also provided maintenance and repair services to Preferred Rentals, Inc. and Tourism Industries, Inc. for the years ending 1991 and 1990 amounting to approximately $272,000 and $210,000, respectively. All other transactions with related companies were not material in amount.[12]

There is no other evidence indicating the nature or amount of the disputed intercompany transactions.

### C. Armstrong Ford's Tax Returns and VIBIR's Audit

Using cash basis accounting in reporting its gross receipts for the 1990 calendar year,[13] Armstrong Ford reported total gross receipts of $3,790,401.39 and paid $151,616.34 in gross

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[10] Tr. at 25.

[11] Tr. at 26.

[12] Plaintiff's Ex. 10 at 9.

[13] Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions are generally taken in the taxable year in which they are paid. Treas. Reg. §1.461-1(a)(1).

receipts taxes.[14] In calculating its gross receipts, Armstrong Ford deducted the following items: (1) amounts payable to the Bank pursuant to its floor plan agreement; (2) amounts received from intercompany transactions; (3) highway use taxes; and (4) license fees.[15] On its 1990 income tax return, Armstrong Ford used the accrual method of accounting[16] and reported total gross receipts or sales of $15,481,512.00[17].

VIBIR audited Armstrong Ford's 1990 income and gross receipts tax returns and discovered the large discrepancy between the two returns with respect to the total amount of gross revenue reported. According to VIBIR, when Armstrong Ford calculated it gross receipts tax, it inappropriately deducted revenues received through its floor plan arrangement with the Bank. For the nine month period in question, the improper deduction resulted in additional gross receipts of $4,008,615. In addition, VIBIR found that Armstrong Ford improperly deducted revenues earned through intercompany transactions which, for the nine month period, resulted in

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[14] Pursuant to title 33, sections 43 and 44 of the Virgin Islands Code, a gross receipts tax of four percent is assessed on monthly gross receipts.

[15] Armstrong Ford's deductions for highway use taxes and license fees are not at issue in this case.

[16] Under the accrual method of accounting, a liability is incurred and is generally taken into account in the taxable year in which all events establishing the fact of the liability have occurred, the amount of the liability can be established with reasonable accuracy, and economic performance has occurred with respect to the liability. Applicable provisions of the Internal Revenue Code, the Income Tax Regulations, and other guidance established by the Secretary of the Treasury determine how the liability is taken into account. Treas. Reg. §1.461-(a)(2).

[17] The financial statements that comprise Plaintiff's Ex. 10 indicate "revenues" of $15,405,977.00 and "other income" of $75,535.00 for the year 1990. These two amounts, when added, are equal to the gross receipts of $15,481,512.00 reported on line one of Plaintiff's Ex. 9, Armstrong Ford's 1990 income tax return.

additional gross receipts of $1,384,030. Finally, after accounting for these improper deductions, VIBIR found an additional $4,617,513 in revenues that Armstrong Ford reported on its income tax return but did not report on its gross receipts tax return. VIBIR attributed this discrepancy to Armstrong Ford's practice of calculating its gross receipts under cash basis accounting and calculating its income under an accrual basis. Based on these findings, VIBIR concluded that Armstrong Ford under reported its gross receipts from April though December of 1990 and issued the taxpayer a notice of tax deficiency in the amount of $400,406. [18] Armstrong Ford then filed the instant Petition for Redetermination of Gross Receipt Tax Liability.

## II. DISCUSSION

In support of its Petition for Redetermination, Armstrong Ford asserts that VIBIR erred in: (1) concluding that the revenue collected under its floor plan agreement with the Bank was gross receipts attributable to the taxpayer; (2) concluding that the revenue from its affiliated company transactions are gross receipts within the meaning of the Virgin Islands Code; and (3) adjusting the gross receipts based on its finding that the taxpayer used a different method of accounting for the receipts than it used in accounting for income. Before considering each of these assertions, the Court will briefly discuss the statutory scheme governing the Virgin Islands gross receipts tax and address the parties' respective burdens of proof.

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[18] Armstrong Ford reported gross receipts of $2,826,003.20 and paid gross receipts taxes of $113,040.12. In its recalculation, the VIBIR adjusted gross receipts to $12,836,163.43 and the gross receipts tax liability to $513,446.53. The resulting tax deficiency of $400,406 was calculated by deducting $113,040.12 (gross receipts taxes paid) from $513,446.53 (adjusted gross receipts tax liability).

**A. Gross Receipts Tax Scheme**

Under Virgin Islands law, every entity doing business in the territory must report their gross receipts and pay a tax of four percent on the gross receipts of such business. V.I. Code Ann. tit. 33, § 43 (a) (1994). The term "gross receipts" is defined by the Code as

> all receipts, cash or accrued, of the taxpayer for services or derived from trade, business, commerce or sales, and the value accruing from the sale of tangible personal property or services, or both, including rentals, fees and other involvements, however, designated, without any deduction on account of the cost of the property sold, the cost of materials used, labor cost, royalties, taxes, interest or discount paid, and any other expenses whatsoever.

V.I. Code Ann. tit. 33, § 43 (b) (1994). As is evident from the plain language of section 43 (b), the Legislature intended that gross receipts "shall be truly gross and not subject to the deduction of business expenses." Port Constr. Co. v. Gov't of the Virgin Islands, 359 F.2d 663, 665 (1966). All forms of business organizations are subject to the gross receipts tax unless specifically exempted, and all such entities are required to determine their gross receipt tax liability under the method of accounting regularly used by the taxpayer. *See* V.I.R. & Regs. tit.33, §43-2 (1986).

**B. Burden of Proof**

When the government notifies a taxpayer of a deficiency in their payment of gross receipts taxes and the taxpayer challenges the notice, courts afford the deficiency assessment "a presumption of correctness." Anastasato v. Commr of Internal Revenue., 794 F.2d 884, 886 (3rd Cir. 1986). "This presumption is a procedural device that places the burden of producing evidence to rebut the presumption on the taxpayer." Id. In cases involving unreported income, however, the presumption of correctness does not arise until the government first provides "evidence linking the taxpayer to the tax-generating activity." Id. at 887. Once the government produces such foundational evidence, the deficiency determination "is entitled to a presumption of correctness and . . . the burden of production as well as the ultimate burden of persuasion is placed on the taxpayer." Id. To meet this burden and rebut the presumption, the taxpayer is required to present "credible and relevant evidence sufficient to establish that the determination was erroneous." Id.

There are several reasons why the taxpayer has this burden, including the "normal evidentiary rule imposing proof obligations on the moving party[,] . . . the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the Code." United States v. Rexach, 482 F.2d 10, 16 (1st Cir. 1973). Indeed, the Virgin Islands Code clearly requires taxpayers to "keep such records as are adequate and necessary for them to prepare the several reports required by [gross receipts tax statutes]." V.I. Code Ann. tit. 33, § 48 (1994). *See also* id. at § 701 (requiring taxpayers to "keep such records, render such statements, make such returns, and comply with such rules and regulations as the Director may from time to time prescribe.").

The specific record-keeping requirement for gross receipts taxpayers are promulgated under title 33, section 48-2 of the Virgin Islands Rules and Regulations. Section 48-2 requires that for the purpose of preparing gross receipts tax returns, all taxpayers must keep and maintain the following records:

(1) Sales invoices covering all sales on account.
(2) Cash receipts or sales invoices covering cash sales.
(3) Receipts for fees, rentals, or other remunerations.
(4) Cash register tapes if no sales invoices or cash receipts are maintained.
(5) Copies of bills of sale for the sale of real and personal property and contracts for services, other than those covered by sales invoices or cash receipts.

V.I. R. & Regs. tit. 33, §48-2 (a) (1)-(5) (1986). In addition, title 33, sections 44-2 and 48-1 of the Rules and Regulations reiterate the requirement that taxpayers "maintain sufficient books and records to show their tax liability." Id. at § 44-2; *accord* § 48-1.

**C. The Floor Plan Agreement**

As stated above, when Armstrong Ford reported its gross receipts, it deducted revenues from sales of cars purchased under its floor plan agreement with the Bank. Armstrong Ford argues that VIBIR's deficiency assessment based on car sales is erroneous for two reasons. First, Armstrong Ford contends that this revenue is not attributable to the company because Armstrong Ford is merely a "conduit" for payment to the Bank of the revenue from automobile sales. Second, Armstrong Ford asserts that VIBIR is estopped from assessing the deficiency because the company relied on VIBIR's past audits in which it did not account for the revenue as gross receipts. The Court finds both assertions are without merit.

**1. Armstrong Ford is not a Conduit**

The Court notes initially that Armstrong Ford is unquestionably linked to the tax-generating activity at issue here. *See* Anastasato, 794 F.2d at 886. Armstrong Ford does not dispute this fact but rather challenges VIBIR's characterization of the activity. Thus, for the purpose of reviewing Armstrong Ford's floor plan agreement with the Bank, VIBIR's deficiency notice is entitled to a presumption of correctness and will not be disturbed unless Armstrong Ford has presented "credible and relevant evidence sufficient to establish that the determination was erroneous." Id.

Without belaboring the point, Armstrong Ford has not presented any evidence showing that it is merely a conduit of the sales revenues for the Bank. Instead, the evidence shows that the Bank never owned the vehicles or sold the vehicles. Thus, Armstrong Ford cannot be the Bank's "conduit" or any other euphemism for "agent." Furthermore, as stated above, the plain language of section 43 (b). includes as gross receipts "the value accruing from the sale of tangible personal property . . . without any deduction on account of the cost of the property sold[.]" V.I. Code Ann. tit. 33, § 43 (b) (1994) (emphasis supplied). Armstrong Ford derived the receipts in question from the sales of automobiles, which are tangible personal property. And, despite Armstrong Ford's arguments to the contrary, by deducting the loan balances owed to the Bank for the vehicles, the taxpayer was merely deducting the cost of the property sold. This practice is clearly prohibited by section 43 (b).

Notwithstanding this statutory language, Armstrong Ford presents case law which purportedly supports its position that its gross receipts include only the profit earned on car sales: Travel Services, Inc v. Government of the V.I., 904 F.2d 186 (3rd Cir. 1990) and Tax Review Bd of Philadelphia v. Elster & Prager, 178 A.2d 611 (Pa. 1962). Both cases are inapposite.

In Travel Services, the Third Circuit addressed whether the Virgin Islands gross receipts tax statutes are preempted by a federal statute governing taxes levied on airline travel. The plaintiff, a travel agency, contended that its commissions on airline ticket sales were not taxable as gross receipts because 49 U.S.C. § 1513 prohibits states from taxing the sale of airline tickets or the gross receipts derived therefrom. The Third Circuit found that the commissions paid to the plaintiff, who was an agent of the airlines, were "commissions paid for the service of selling airline tickets. A tax on these commissions is not a tax on gross receipts from the sale of air transportation prohibited by § 1513(a); it is merely a tax on compensation paid for a service." Travel Services, 904 F.2d at 188.

This instant case is clearly distinguishable. Foremost, there is no federal statute which prevents the Virgin Islands from taxing gross receipts obtained from car sales. Indeed, but for the fact that local taxation of airline ticket sales by travel agents is preempted by federal law, such sales would be subject to the gross receipts tax in the Virgin Islands. *Cf.* Pan American World Airways v. Government of the V.I., 459 F.2d 387 (3rd Cir. 1972) (airline would be subject to gross receipts tax imposed upon persons and entities doing business in the Virgin Islands pursuant to statutory definition of the phrase "gross receipts" unless it could show that its activity was not "business in the Virgin Islands" and that revenue from ticket sales and cargo carriage were not receipts of such business). In addition, Armstrong Ford is not the Bank's agent and the profit earned on vehicle sales is not a commission paid by the Bank. Instead, the evidence showed that despite the Bank's security interest, Armstrong Ford owned the vehicles, sold the vehicles and earned income based on the difference between the cost of goods sold and the selling price. Again. Virgin Islands law does not allow "any deduction on account of the cost of the property sold[.]" V.I. Code Ann. tit. 33, § 43 (b) (1994). Therefore, the Court concludes that Armstrong Ford's reliance on Travel Services is misplaced.

Armstrong Ford's reliance on Elster suffers from similar infirmities. In Elster, the Supreme Court of Pennsylvania addressed whether a newspaper salesperson was liable for the payment of a mercantile tax based upon gross receipts from newspaper sales or only upon his commissions earned from newspaper sales. The mercantile tax statutes distinguished factors and commissioned agents from retail vendors and buyers for resale. According to the court, if the seller was a factor or commission agent. he would be subject to the mercantile tax on his commissions only. Elster, 178 A.2d at 612. However, if the seller was a retail vendor of goods, or a buyer for resale, he would be taxed on his gross receipts. Id. The court concluded that under state law the salesperson was a commission agent rather than a retail vendor or buyer for resale and therefore subject to tax only on commissions earned. Id. The court's decision was based on principles of agency, noting that the suppliers, not the vendor, established the retail price, that the vendor did not maintain any inventory and that items spoiled or damaged when received were returned to the suppliers. The most salient question, the court ruled, is whether the seller gets title to the goods. "For 'in a sale title passes to the buyer, while in a consignment to a factor title remains in the principal, but the possession passes to the factor, and the factor is liable, not to pay a price, but to account for the proceeds of the goods when sold; and if it appears that the depositor of the goods reserves a right to take them back, the transaction is considered a consignment and the consignee a factor.' 35 C.J.S. Factors § 1, p. 499 (1966)." Id. The court found that in Elster, title to the goods remained with the suppliers while the seller had possession of the goods and was liable to the suppliers for the proceeds of the sale of the goods. Id. Thus, the Court concluded, the seller was only liable for the tax on his commission. Id.

The evidence in the instant case clearly distinguishes it from Elster. Unlike the state mercantile tax law analyzed in Elster, the Virgin Islands gross receipts tax statute does not distinguish between the gross receipts of factors or agents on the one hand and retail vendors or buyers for resale on the other. Even if our statute did distinguish between these two types of vendors, under the analysis used in Elster, the gross receipts from vehicle sales are clearly attributable to Armstrong Ford. Unlike the factor in Elster, Armstrong Ford holds title to the vehicles and earns its income from profits on car sales.

In conclusion, a review of the evidence shows that Armstrong Ford's flooring plan with the Bank was simply a financing agreement under which the automobile dealership was loaned funds to acquire an inventory of vehicles for sale to the public and, in exchange, the Bank was granted a security interest in the inventory and its proceeds. Arguably, without this financing arrangement Armstrong Ford could have purchased inventory by some other means such as by cash. Regardless of the method employed to acquire inventory, the statute clearly proscribes any deduction from gross receipts for amounts attributable to the cost of the inventory sold. Therefore, Armstrong Ford's arguments on this issue must fail.

**2. Estoppel**

Armstrong Ford argues that VIBIR is estopped from assessing a tax deficiency in this instance because VIBIR audited the company for ten consecutive years and never challenged its method of determining its gross receipts tax liability. In support of its position, Armstrong Ford relies upon United States v. Asmar, 827 F.2d 907 (3rd Cir.1987), where the Third Circuit discussed the four elements that a litigant must prove to succeed in an estoppel claim against the government: (1) misrepresentation of fact (2) that results from affirmative misconduct (3) which the recipient reasonably relied upon (4) to his detriment.[19] Id. at 912. Contrary to Armstrong Ford's assertion that all four elements exist here, the Court concludes that there is no evidence of detrimental reliance and even if there was, Virgin Islands case law provides that the government is not estopped by the unauthorized or incompetent acts of its agents. *See* Hess Oil Virgin Islands Corp. v. Quinn, 16 V.I. 380 (D.V.I. 1979).

In support of its argument that it detrimentally relied on VIBIR's failure to properly scrutinize the automobile sales revenues in the past, Armstrong Ford asserts that if it had "known that this procedure would not be acceptable to the Government in the future, Armstrong Ford could certainly have adjusted its sales prices to cover these costs[.]"[20] There is no evidence to support this assertion, however, and it is just as likely that Armstrong Ford sold vehicles during this period for a price which the market would bear, without regard to liability for gross receipts taxes.

Furthermore, as a consequence of the government's failure to properly scrutinize Armstrong Ford's gross receipts tax returns, the taxpayer continued to underreport its gross receipts and consequently underpay its gross receipts tax liability. The immediate benefit to Armstrong Ford was that for ten years it retained for its use money that it never should have

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[19] Although a traditional estoppel defense only requires proof of three elements, due to considerations of sovereign immunity, separation of powers and public policy, a litigant claiming estoppel against the government must also prove affirmative misconduct. Asmar, 827 F.2d at 912.

[20] Plaintiff's Post Trial Br. at 11.

retained in the first place. *See* Heckler v. Community Health Services of Crawford County, 467 U.S. 51, 104 S.Ct. 2218, 81 L.Ed.2d 42 (1984). Thus, even if Armstrong Ford's assertion regarding price adjustments was supported by the evidence, it could only be said that the dealership suffered a detriment if the Court limited its focus to the nine month period at issue. Over the long term, Armstrong Ford unquestionably benefitted from VIBIR's flawed audits.

Moreover, in Quinn, which involved facts similar to the instant case, the District Court rejected the estoppel argument advanced by Armstrong Ford here. In that case, the taxpayer asserted that the government was estopped from assessing a gross receipts tax against certain oil sales because, although it knew of the sales, the government failed to assess the tax in past years. The evidence showed that when the government audited the taxpayer's books and records in 1975, it noted the problem and a technical advisor concluded that the sales were not subject to gross receipts taxes. In 1977, however, an assistant attorney general researched the issue and concluded that the sales were subject to the tax. It was at this juncture, the District Court found, that the government took the official position that the taxpayer was indebted for gross receipts taxes and filed the deficiency in question. Based on this evidence, the court concluded that

> although [the government] made no attempt to collect gross receipts taxes on . . . sales of the type here involved prior to 1974, there was never a consensus on whether or not such sales were within the grant of exemption. The conduct of the examining governmental agents in failing to properly scrutinize these transactions to determine whether they were subject to gross receipts taxes does not amount to a manifestation by the Commissioner of Finance as to the taxability, vel non, of those transactions. *See* 33 V.I.C. §§ 1491, 1492; *see also* Country Gas Service v. United States, 405 F.2d 147 (5th Cir. 1969); Twitchco, Inc. v. United States, 348 F. Supp. 330 (M.D. Ala. 1972).

Quinn, 16 V.I. at 394. Importantly, the Court further concluded that the "inaction on the part of the government did not give rise to the equitable defense of estoppel . . . [because] [t]he Government is neither bound nor estopped by the unauthorized or incompetent acts of its agents which the law does not sanction or permit. *See* In re Hooper's Estate, 5 V.I. 518, 359 F.2d 569 (3d Cir. 1966)." Id. at 395. Accordingly, the court held that although the government was "mistaken as to the taxability of the sales . . . in question, [it] is not now barred by the doctrine of equitable estoppel from correcting that prior legal error. *See, e.g.*, Automobile Club of Michigan v. Commissioner of Internal Revenue, 353 U.S. 180, 77 S. Ct. 707, 1 L. Ed. 2d 746 (1957); Twitchco, Inc. v. United States, 348 F. Supp. 330, 333 (M.D. Ala. 1972)." Id. (footnotes omitted).

Likewise, in the instant case VIBIR is not bound by the prior acts of its agents in not accounting for vehicle sale revenues as gross receipts. Although VIBIR failed to raise the issue during the previous ten years when it audited Armstrong Ford, neither did the government agency affirmatively state that these revenues were not gross receipts. Instead, as in Quinn, it appears that the failure to properly scrutinize these revenues was the result of incompetence and the government is neither estopped by these incompetent acts nor "barred by the doctrine of equitable estoppel from correcting that prior legal error." Quinn, 16 V.I. at 395.

For these reasons, the Court concludes that Armstrong Ford has not met its burden of establishing that VIBIR's determination of a tax deficiency resulting from retail auto sales was erroneous, and VIBIR's deficiency assessment in this regard will therefore be sustained.

**D. Intercompany Transactions**

Armstrong Ford advances two arguments in support of its position that it is not liable for gross receipts taxes on funds obtained through intercompany transactions. First, Armstrong Ford argues that the bulk of these funds came from the transfer of cash in the form of advances or loans for the operation of the automobile dealership and not for the sale of goods and are therefore not subject to gross receipts taxes. Second, Armstrong Ford contends that the transfers are exempt from gross receipts taxes because title 33, section 43 (f) of the Virgin Islands Code exempts receipts from intercompany transactions. The Court disagrees with both assertions.

Before discussing the merits of these arguments, the Court notes that, as with the evidence concerning the floor plan agreement, the evidence here unquestionably links Armstrong Ford to the tax-generating activity at issue. *See* Anastasato, 794 F.2d at 886. Indeed, here again Armstrong Ford does not dispute that it is linked to the tax-generating activity, but rather challenges VIBIR's characterization of the activity. Thus, for the purpose of reviewing Armstrong Ford's intercompany transactions, VIBIR's deficiency notice is entitled to a presumption of correctness and will not be disturbed unless the Court finds that Armstrong Ford has presented "credible and relevant evidence sufficient to establish that the determination was erroneous." Id.

Turning to the merits of Armstrong Ford's arguments, the Court finds that Armstrong Ford has produced only scant evidence and speculation testimony supporting its assertion that the bulk of funds received from intercompany transactions constituted loan proceeds. The only evidence supporting this assertion was the unsubstantiated testimony of its in-house accountant, Bonnie Priess. Priess' testimony established only that these intercompany transfers could have constituted loans, lease payments and car sales. In any event, revenues from the latter two types of transactions are characterized as gross receipts under the Code, *see* V.I. Code Ann. tit. 33, § 43 (b) (1994), and Priess could only speculate as to portion that constituted loans. Similarly, Armstrong Ford's financial statement only summarily stated that the "related party transactions" included "the sale of vehicles to Meridian Engineering, Inc. and The Buccaneer, Inc." without providing the amount received from those sales.[21] In addition, contrary to Priess' testimony, the financial statement did not reference any loans under its notes on related company transactions, but showed that these intercompany revenues included receipts for "maintenance and repair services to Preferred Rentals, Inc. and Tourism Industries, Inc. for the years ending 1991 and 1990 amounting to approximately $272,000 and $210,000, respectively."[22]

Not only does the conflicting evidence produced by Armstrong Ford lack credibility, it shows that the taxpayer failed to maintain the adequate records required by Virgin Islands law. *See, e.g.*, V.I. R. & Regs. tit. 33, § 44-2 (1986) (requiring gross receipts taxpayers to "maintain sufficient books and records to show their tax liability."). Under these circumstances, the Court concludes that Armstrong Ford has not met its burden of presenting "credible and relevant evidence sufficient to establish that the determination was erroneous." *See* Anastasato, 794 F.2d at 886.

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[21] Plaintiff's Ex.10 at 9.

[22] Id.

The Court also disagrees with Armstrong Ford that these revenues are exempt from the gross receipts tax because they came from intercompany transactions. Armstrong Ford's argument is based on a gross receipts exemption provided to small business under title 33, section 43 (f) of the Virgin Islands Code. This section exempts the first $5,000 in monthly gross receipts for individual businesses with less than $150,000 in annual gross receipts. V.I. Code Ann. tit. 33, § 43(f) (1994). To prevent a large business from fragmenting itself into smaller businesses to take advantage of the exemption, section 43 (f) further provides that

> Notwithstanding any other provisions of law to the contrary, if an individual, firm, partnership, or any other association, is a member of a controlled group of more than one business at any time during the taxable period, then for purposes of this section, the gross receipts of all of such businesses shall determine the amount of the exemption granted hereunder to each member of such controlled group. If a corporation is a member of a controlled group of corporations at any time during the taxable period, then, for purposes of this section, the gross receipts of the entire controlled group shall determine the amount of the exemption granted hereunder to each and every member of such controlled group.

Id.

In essence, this provision treats the members of controlled groups as a single entity for purposes of this exemption. Armstrong Ford argues that if related companies are treated as a single entity for exemption purposes, then transactions between these companies should be treated as transactions among a single entity for determining its gross receipts. Based on this argument, Armstrong Ford asserts that sales between members of controlled groups should not be subject to gross receipts tax. The Court disagrees.

It is well-settled that statutory provisions granting tax exemptions are to be narrowly and strictly construed. V.I. Bd. of Realtors v. Wheatley, 6 V.I. 185 (D.V.I. 1967). There is nothing in the language of section 43(f) or elsewhere in the Virgin Islands Code which even remotely suggests that the Legislature intended to exempt revenues received from intercompany transactions from the gross receipts tax. Instead, this section requires related companies to aggregate their gross receipts to determine whether the entire controlled group is entitled to a single $5,000 monthly exemption. Accordingly, the Court concludes that this assertion has no merit.

**E. Adjustment Resulting from Accounting Methods**

As stated above, when VIBIR audited Armstrong Ford's returns, it found an additional $4,617,513 in revenues that Armstrong Ford reported on its income tax return but did not report on its gross receipts tax return. The VIBIR agent who performed the audit attributed this discrepancy to Armstrong Ford's practice of calculating its gross receipts under cash basis accounting and calculating its income under an accrual basis. At trial, the agent testified: "the way the gross receipt tax law works, it says that the gross receipt tax is suppose to compute on the taxpayer's method of accounting. And, they were on accrual basis so I computed the gross receipt taxes on the accrual basis."[23] Based on this recalculation, VIBIR made an upward adjustment of $4,617,513 on Armstrong Ford's gross receipts.

Armstrong Ford asserts that VIBIR's upward adjustment was erroneous because "there is no law in the Virgin Islands which requires a taxpayer to report his gross receipts taxes on the same basis as he reports his income tax returns."[24] This assertion ignores the plain language of

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[23] Tr. at 82.

[24] Plaintiff's Post-trial Br. at 18.

title 33, section 43-2 of the Virgin Islands Rules and Regulations which provides that "[g]ross receipts shall be determined under the method of accounting regularly used by the taxpayer." V.I.R. & Regs. tit. 33, § 43-2 (1986). Accordingly, this assertion has no merit.

## III. CONCLUSION

For the foregoing reasons, the Court concludes that Armstrong Ford is not entitled to a redetermination of VIBIR's gross receipts tax deficiency notice. The evidence showed that VIBIR assessed Armstrong Ford for a deficiency in its gross receipts because the company improperly excluded receipts obtained from retail auto sales and intercompany transactions when it reported its gross receipt for the period of above April through December 1990 and because the company improperly changed its method of accounting when it reported the gross receipts. Armstrong Ford had the burden of establishing by relevant and credible evidence that these assessments were erroneous. Because Armstrong Ford failed to meet this burden, VIBIR's deficiency assessment will be sustained.

**MARIA M. CABRET**
**Territorial Court Judge**

ATTEST:
YVONNE V. WESSELHOFT
Clerk of the Court

By: Judith McWard
Deputy Clerk

Dated: 12/24/99