House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

DIESEL TAX COLLECTION & SIMPLIFICATION

House Bill 5734 as enrolled
Public Act 667 of 2002
Sponsor: Rep. Keith Stallworth

House Bill 5735 as enrolled
Public Act 668 of 2002
Sponsor: Rep. Doug Hart

House Bill 5736 as enrolled
Public Act 669 of 2002
Sponsor: Rep. Larry Julian

Second Analysis (1-16-03)
House Committee: Transportation
Senate Committee: Transportation and Tourism

THE APPARENT PROBLEM:

In its brochure entitled "Diesel Fuel Equity and Simplification," the Michigan Department of Transportation (MDOT) reports that department officials remain committed to having 90 percent of the state's roads in good condition by the year 2007. However, with recent revenue shortfalls during the state's economic downturn, which began during the first quarter of 2001, additional resources are necessary if the road repair promise is to be kept.

The Federal Highway Administration estimates that trucks may be responsible for up to 40 percent of the costs to design, build, repair, and maintain the roads upon which they travel. In recent years, the department estimates that trucks have contributed less than 16 percent to Michigan's transportation budget.

Some say that the trucking industry's contribution has not kept pace with its fair share, because truckers pay 4 cents less per gallon of diesel fuel than do automobile drivers when they buy a gallon of gasoline. The truckers' taxation rate is lower per gallon because when the four-cent gasoline tax increase passed the state legislature in 1997, truckers' four-cent increase was stripped from the final bill. However at the time, truckers argued that while their rate seemed lower, the imposition of the six percent sales tax on diesel fuel had the result of increasing their effective tax rate.

Instead of the same 19-cent tax rate as most drivers pay at the pump, truckers file for refunds--known as the diesel discount--through a complicated taxation system on diesel fuel. See *BACKGROUND INFORMATION*, "Historical Overview," below. Put as simply as possible, the system works as follows: Truck drivers pay 9 cents per gallon at the diesel pump. They then file a quarterly tax return to pay an additional 12 cents per gallon to the state. Then they file a quarterly tax return in which they apply for a 6 cents per gallon rebate. That means the effective tax on diesel is 15 cents--9 cents, plus 12 cents, minus 6 cents.

Because the Motor Carrier Fuel Tax Act is complex, there is evidence of a substantial amount of tax evasion. According to an October 2001 report by the auditor general, the delinquency rate for Michigan *interstate* carriers is greater than 30 percent--nearly one-third never pay their full share of diesel taxes. What's more, the delinquency rate for Michigan *intrastate* truckers is likely to be as high as 18 percent. The report notes that there is a significant group of motor carriers who file tax returns that show no activity, requesting a refund only, and it has been learned that many of these are inaccurate. The dishonesty to evade taxes is difficult to curtail because there are a large number of collection points in the diesel fuel distribution system. According to committee testimony, the Department of Treasury, which handles the tax collections, must interact with 40,000 motor carrier accounts, 1,300 diesel fuel retailers, and 12 suppliers. (In contrast, the department interacts with only 12 suppliers of gasoline fuel.) Collection of motor fuel taxes involves 50 different tax forms.

The fiscal year 2002-2003 executive budget includes an additional $44.0 million in revenue from "a comprehensive package of diesel tax and collection simplification reforms," because more money is needed to repair Michigan's roads and bridges. To fill that gap in funding, a tax increase on diesel fuel would have to be enacted by the legislature. However, some additional revenue--perhaps as much as $10 million--could be raised through simplification of the tax collection system. See *BACKGROUND INFORMATION*, "Improved Tax Collections," below.

In order to increase the tax revenue from the sale of diesel fuel *without increasing the tax rate*, legislation has been introduced to simplify the tax collection system so that all truckers--both interstate and intrastate--pay the same effective tax rate per gallon of diesel fuel at the pump.

THE CONTENT OF THE BILLS:

The bills would amend various acts to simplify the diesel fuel tax collection system. The bills are tie-barred to each other so that none could become law unless the others also were enacted. A more detailed explanation of each bill follows. The bills would take effect on April 1, 2003.

House Bill 5735 would amend the Motor Fuel Tax Act (MCL 207.1008 et al.) to eliminate the current two-tiered system of collecting the diesel tax, but retain the 15-cent per gallon tax. The bill would repeal sections 90 and 91, which define "industrial process reseller" and "fuel vendor" and mandate that people falling under these definitions be licensed. The bill also would delete the licensure requirement for retail diesel dealers, but would require the licensure of retail marine diesel dealers.

Currently, the diesel fuel tax of 15 cents per gallon is collected as follows:

-Two categories of tax collectors (those who sell or deliver to a supplier, importer, vendor, retail dealer, or marine retail dealer; and, those who deliver fuel into the bulk storage tank of a motor carrier) both collect 9 cents of tax per gallon.

-Then, these tax collectors collect and remit to the Revenue Division of the Department of Treasury an additional 6 cents of tax per gallon, if in addition, the person to whom he or she sells does any of three things: uses the diesel fuel in a motor vehicle that is not issued a decal under the Motor Carrier Fuel Tax Act; sells or delivers into the fuel supply tank of a motor vehicle that is not licensed under the Motor Carrier Fuel Tax Act; or, delivers undyed diesel fuel into a storage tank of a person who is not licensed under either the Motor Fuel Tax Act or the Motor Carrier Fuel Tax Act.

-The act specifies that 15 cents of tax per gallon is collected and remitted by all others who import, sell, distribute, deliver, or use diesel fuel.

Under House Bill 5735, all of these provisions would be eliminated. However, the overall current diesel tax rate of 15 cents per gallon would be retained. Additionally, the bill would delete a provision that motor fuel is exempt from the tax if it is sold by a supplier to a licensed industrial process reseller for resale to an industrial end user who uses the fuel for an exempt purpose.

Further, House Bill 5735 would define "retail marine diesel dealer" to mean a person who sells or distributes diesel fuel to an end user in this state for use in boats or other marine vessels. The bill also would prohibit a person from delivering diesel fuel into the fuel supply tank of an end user's boat or other marine vessel, or making a bulk delivery of diesel fuel to an unlicensed end user, unless licensed as a retail marine diesel dealer under the act. The bill would create a $50 retail marine diesel dealer license fee, and require that retail marine diesel dealers file quarterly reports concerning the amount of dyed diesel fuel sold for a taxable purpose, as they remit the tax to the Department of Treasury, on or before the 20th day of the month following the close of each reporting period. [Currently under this provision of the law, *all* vendors who deliver diesel fuel must be licensed as retail diesel dealers and make these quarterly reports, not only marine diesel dealers.]

In addition and currently under the law, a licensed retail diesel dealer may claim a deduction for tax paid under the act, on sales of undyed diesel fuel in amounts of 100 gallons or less that is sold tax-free for a nontaxable purpose. Under the bill, a retail diesel dealer could claim a refund, rather than a deduction. In addition, currently under the law a person who is licensed under the act and registered with the federal government as an ultimate vendor may apply for a refund, or claim a deduction for tax paid on K-1 kerosene that is sold tax-free through a blocked pump, if the seller meets certain requirements. Under the bill, such vendors would not be licensed under the act, but instead only registered with the federal government.

Finally, the law now prohibits a person from operating or maintaining a motor vehicle on Michigan public highways with dyed diesel fuel in the fuel supply tank, but makes several exceptions to the prohibition. The bill also would make exception for a passenger vehicle with a capacity of 10 or more that operates over regularly traveled routes expressly provided for in a certificate of authority issued by the Department of Transportation, a municipal franchise, a municipal license, a municipal permit, a municipal agreement, or a municipal grant.

House Bill 5734 would amend the Motor Carrier Fuel Tax Act (MCL 207.211 et al.) to require that a motor carrier licensed under the act pay a road tax calculated on the amount of motor fuel consumed in qualified commercial motor vehicles on public roads or highways, and that the tax be at the rate of 15 cents per gallon. Currently the act sets a rate of 21 cents per gallon, but allows a 6 cent per gallon credit against the 21 cent tax imposed. Under the bill, the 6 cents per gallon credit (filed on each quarterly return) would be eliminated.

The bill also would change the definition of "motor carrier" to mean (i) a person who operates or causes to be operated a qualified commercial motor vehicle on a public road or highway in this state and at least one other state or Canadian province; (ii) a person who operates or causes to be operated a qualified commercial motor vehicle on a public road or highway in this state and who is licensed under the International Fuel Tax Agreement. Currently "motor carrier" means a person who operates or causes to be operated a qualified commercial motor vehicle on a public road or highway in this state.

In addition, the bill would change the definition of "qualified commercial motor vehicle." Currently under the law a "qualified commercial motor vehicle does not include a recreational vehicle, a road tractor, truck or truck tractor owner by a farmer and used in connection with the farmer's farming operation and not used for hire, a school bus, a bus defined and certificated under the Motor Bus Transportation Act, or a bus operated by a public transit agency (in any of five specified ways). However, a qualified commercial motor vehicle includes a farmer's vehicle used in connection with the farmer's farming operation if the vehicle bears out-of-state registration plates of a state that does not give similar treatment to vehicles from this state. House Bill 5734 would retain all of these provisions and specify in addition that "qualified commercial motor vehicle" would not include "a road tractor, truck, or truck tractor used exclusively in this state."

House Bill 5736 would amend the Use Tax Act (MCL 205.92 et al.) to impose a diesel fuel use tax on interstate motor carriers.

More specifically, the bill would add definitions for "interstate motor carrier," "qualified commercial motor vehicle," "diesel fuel," and "interstate fleet motor carrier." "Interstate fleet motor carrier" would be defined to mean a person engaged in the business of carrying persons or property, other than themselves, their employees, or their own property, for hire across state lines, whose fleet mileage was driven at least 10 percent outside of this state in the immediately preceding tax year. "Interstate motor carrier" would mean a person who operates or causes to be operated a qualified commercial motor vehicle on a public road or highway in this state and at least one other state or Canadian province. "Qualified commercial motor vehicle" would mean that term as defined in subdivisions (i), (j), and (k) of Section 1 of the Motor Carrier Fuel Tax Act. "Diesel fuel" would mean that term as defined in subsection (2)(p) of the Motor Fuel Tax Act.

Currently the law levies a specific tax for the privilege of using, storing, or consuming tangible personal property at a rate equal to 6 percent of the price of the property or applicable services. House Bill 5736 would amend the act to specify that beginning April 1, 2003, the term "price" as it is used in the Use Tax Act would mean, with respect to diesel fuel used by interstate motor carriers in a qualified commercial motor vehicle, the statewide average retail price of a gallon of self-serve diesel fuel as determined and certified quarterly by the department, rounded down to the nearest 1/10 of a cent. Under the bill, this use tax on diesel fuel used by interstate motor carriers would be collected under the International Fuel Tax Agreement.

However, under the law, the use tax does not apply to property sold if during the transaction a tax is paid under the General Sales Tax Act. Consequently, House Bill 5736 specifies that beginning April 1, 2003, in lieu of this exclusion, an interstate motor carrier would be entitled to a credit under the Use Tax Act of 6 percent of the price of diesel fuel purchased in the state, and used in a qualified commercial motor vehicle. Under the bill the credit would be claimed on the returns filed under the International Fuel Tax Agreement.

BACKGROUND INFORMATION:

History of the diesel fuel discount. The Citizens Research Council prepared a CRC Memorandum entitled "The Taxation on Diesel Fuel" to provide an historical overview of the Motor Carrier Fuel Tax Act, and to describe how the tax was collected under four different scenarios. That report is available at www.crcmich.org.

Improved tax collection by the Department of Treasury. The Department of Treasury Office of Revenue and Tax Analysis (ORTA) has indicated that an additional $3.9 million would be realized from improved compliance as a result of the institution of a new electronic reporting system during fiscal year 2003, and that estimate increases during the two subsequent fiscal years. During fiscal year 2004, tax system simplification is expected to yield $19.1 million in revenue, and during fiscal year 2005, $29.5 million.

According to earlier testimony, the improved compliance will result from the installation of computer-based systems for monitoring the movement of motor fuels--both gasoline and diesel fuel--through the distribution process (including refineries, pipelines, and distributors). ORTA estimates that the first year of implementation would realize an additional $1.95 million from improved collection of gasoline excise taxes, and $6.45 million from improved collection of diesel fuel excise tax. The House Fiscal Agency notes that it has not independently confirmed the ORTA's $8.4 million estimate of increased revenue as a result of these changes.

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that House Bills 5734 and 5735 could result in a decrease in Michigan Transportation Fund (MTF) revenue of $1.7 million. Based on the current P.A. 51 formula this would result in decreases in Comprehensive Transportation Fund revenue of $170,000; in State Trunkline Fund revenue of $598,200; and, in MTF distributions to local road agencies of $931,800.

However, the agency notes that the reduction in MTF revenue would be offset to the extent that additional revenue could be realized from the improvements to collection systems that would be implemented by the Department of Treasury. The Department of Treasury's Office of Revenue and Tax Analysis (ORTA) has estimated that improved collection as a result of diesel tax simplification, coupled with improved computerized monitoring systems, would result in increases of $3.9 million, $19.1 million and $29.5 million in MTF revenue in the first, second and third year of implementation, respectively. In addition, ORTA estimates that the increased diesel fuel tax collections would increase Michigan's share of federal highway funds by $11.8 million in the third year of implementation. The House Fiscal Agency notes, however, that it has not independently confirmed the ORTA estimates.

Further, the agency estimates that the changes to the Use Tax Act proposed in House Bill 5736 would increase state revenue by $4.5 million (given a scenario in which diesel fuel was priced at $1 per gallon, and using consumption data from calendar year 2000). This additional revenue would be distributed in accord with the current constitutional and statutory distribution of use tax revenue: one-third to the school aid fund ($1.5 million), and two-thirds to the general fund (3.0 million). The agency notes that in a scenario in which diesel fuel was priced at $1.25 per gallon, there would be a $5.7 million increase in revenue, and if the fuel were priced at $1.50 per gallon, then a $6.8 million increase in revenue. However, fluctuations in consumption data would either lower or increase the revenue estimate. (6-4-02)

A detailed explanation of the bills that would simplify the diesel tax has been prepared by the House Fiscal Agency, to describe the processes of tax collection, revenue generation, and tax distribution, and the ways those processes would change if House Bills 5734-5736 were enacted into law. That analysis is available on the LSIS web site.

The Senate Fiscal Agency concurs with these projections. (12-11-02)

ARGUMENTS:

For:

The House Fiscal Agency notes that Michigan's current system for taxing diesel fuel is very complex, and as a result of that complexity, compliance is poor. In fact, there is evidence that *intrastate* motor carriers--those doing business only in Michigan--apply for the diesel discount decals but never file a Motor Carrier Fuel Tax form. A recent performance audit of the Michigan Department of Treasury, Motor

Fuel, IFTA/Motor Carrier, Tobacco Taxes and Registration Division completed by the Office of the Auditor General indicates a significant amount of tax evasion. For example, as of March 31, 2000, there were 9,043 intrastate motor carriers in the state licensed by the division, and in August that year, there were 2,497 Michigan motor carriers who were delinquent in filing their returns for the quarter ending December 31 in 1999, as well as 2,867 delinquent for the quarter ending March 31, 2000. It seems that a significant number of Michigan truckers use the diesel decal in order to get the 6-cent discount at the pump, but never file to pay the additional 12-cents tax due under the MCFT. These operators would end up paying only 9 cents "at the pump." It seems they may forgo their claim to the 6-cent sales tax discount, in order to avoid paying the additional 12 cents due under the MCFT, figuring they are still ahead by 6 cents a gallon.

House Bills 5735 and 5734 would eliminate this method of tax evasion, since House Bill 5734 would exempt intrastate motor carriers from the MCFT, and House Bill 5735 would end the diesel discount. As a result, for intrastate truckers, the entire motor fuel tax would be collected "at the pump."

For:
These bills would reduce the number of tax collection points. The House Fiscal Agency notes that currently, diesel taxes are collected at a number of different points in the fuel distribution system. Part of the Motor Fuel Tax (MFT) is collected at the supplier level (just as is the gasoline excise tax), and part of the MFT is collected at the retail level by service stations and truck stops. Further, part of the tax collection process involves the completion of the MCTF returns by thousands of individual motor carriers who are required to file. According to the Department of Transportation, the tax collection officers at the Department of Treasury must collect taxes from 12 suppliers, 1,300 truck stop owners and other diesel fuel retailers, and also 40,000 motor carrier accounts.

House Bills 5735 and 5734 would make fuel suppliers the sole collection point for the MFT on diesel fuel, just like gasoline. This would reduce the number of collection points for the MFT from thousands of services stations and truck stops to a relatively small number of suppliers. Reducing the collection points for the tax should increase the ability of the Department of Treasury to assess, audit, and collect the MFT. In addition, House Bill 5734 eliminates 9,000 Michigan carriers from the authority of the MCFT, so that none would have to file returns.

For:
This three-bill diesel fuel tax package is far better than the original four-bill package that originally also included House Bill 5733, and it is better for two reasons. First, that package would have raised taxes for truckers; this package does not. Second, the bill now eliminated--House Bill 5733--would have diverted about $30 million of the estimated $46 million in added revenue from the tax hike, directly to the Department of Transportation, instead of distributing it to local road agencies through the P.A. 51 transportation distribution formula. The distribution formula under Public Act 51 gives 39.1 percent of the money to state roads, 39.1 percent to county roads, and 21.8 percent to cities and villages, and the current state fuel tax on diesel is allocated using that formula. However, under the original four-bill package, the local road commissions and the eligible local units of government would have received only about $10 million, and the rest--85 percent of the revenue--would have gone directly to the Department of Transportation. This same type of diversion to the department occurred in 1997 when the state gas tax was increased four cents to 19 cents a gallon, and one penny of that increase went directly to MDOT to repair state bridges, while only three cents was distributed through the P.A. 51 distribution formula.

For:
This legislation keeps Michigan's taxes on truckers competitive with near-by states--indeed, Michigan's rate would be the lowest of all, at 21 cents (on diesel fuel priced at $1 a gallon)--a 15 cent fuel tax plus a 6 percent sales (or for interstate truckers passing through, a 6 percent 'use') tax. According to the Department of Transportation, the combined taxes on diesel fuel of neighboring jurisdictions are as follows: Wisconsin at 30.3 cents; Illinois at 29.6 cents; Indiana at 27 cents; Ohio at 25 cents; and Ontario Province at 34.51 cents

Response:
Michigan is one of only eight states that charges a sales tax on fuel purchases. Most states place a surcharge on the fuel purchase that is paid quarterly, and consequently the impact of the surcharge is less visible to the customer at the point of sale. According to committee testimony, truck-stop owners who operate along the state's borders will face a steep reduction in their business profits (and Michigan will experience a significant drop in diesel fuel sales, and hence tax revenue, overall) when the diesel discount is eliminated. The reason is that the pump price for a gallon of diesel fuel that will be highlighted on the Michigan station-owners' highway

signs will reflect the 15 cent diesel tax, plus the six percent sales tax. In contrast, their competitors in nearby states will post prices without having to note the surcharge of the fuel purchase that the customer will later pay the state.

Against:

The original diesel fuel tax package that included House Bill 5733 and also raised diesel fuel taxes was a far better legislative package. That four-bill package would have raised more than $35 million in much needed revenue for Michigan road projects. That revenue, and more, is very much needed for road improvement projects. According to the Department of Transportation, vehicle miles traveled in Michigan increased 58 percent from 1980 through 2000. During the same time, the number of line miles has increased only three percent. To make progress against road congestion, the state needs to expand key freeway routes. These projects are enormously expensive, and road users will need to help cover the costs. For example, the proposed reconstruction and widening of just six miles of I-94 in Detroit are estimated to cost $1.3 billion dollars. Further, widening and improving I-75 and major local roads in Oakland County have an estimated price tag of $1 billion. The proposed diesel fuel tax increase that originally was proposed and has now been withdrawn was very small indeed, when it is compared with the costs that must be incurred to expand and improve Michigan's road system.

What is more, the original four-bill package, which would have directed 85 percent of the revenue raised to the Department of Transportation for highway repair, also would have fixed all of the state's defective bridges. During the committee hearing, MDOT officials testified that they planned to dedicate 15 percent of the four-cent increase in the diesel fuel tax to the repair of bridges throughout the state. Local road agencies have long argued that bridge repair deserves more funding under the Michigan Transportation Fund. Although the original package would not have funded bridge repair work through the P.A. 51 distribution formula, it would have dedicated an additional $5.5 million to restore every bridge on the department's "Critical Bridge" list--a total of 203 priority bridge repair projects.

Against:

Truckers point out that when the gas tax was increased to 19 cent per gallon in 1997, they received a 30 percent increase in their licensing fees. They also argue that there is currently a recession in the trucking industry, and many small lines are struggling to stay in operation. An increase in the diesel fuel tax could not come at a worse time, according to the spokesmen for the industry.

Analyst: J. Hunault

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.