

DIESEL MOTOR FUEL TAXES



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FISCAL ANALYSIS

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HOUSE BILL 5734 (H-1)

Sponsor: Rep. Keith Stallworth
House Committee: Transportation

FLOOR ANALYSIS - 6/4/02

Analyst: William Hamilton

HOUSE BILL 5735 (H-2)

Sponsor: Rep. Doug Hart
House Committee: Transportation

HOUSE BILL 5736 (H-2)

Sponsor: Rep. Larry Julian
House Committee: Transportation

SUMMARY

House Bills 5734 (H-1) and 5735 (H-2) would amend the two statutes which provide for the taxation of diesel fuel used in motor vehicles: (a) the Motor Carrier Fuel Tax Act, and (b) the Motor Fuel Tax Act. HB 5736 (H-2) would amend the Use Tax Act to make that tax applicable to diesel fuel consumed in Michigan.

We estimate that the changes proposed in House Bills 5734 (H-1) and 5735 (H-2) would result in a decrease in Michigan Transportation Fund (MTF) revenue of \$1.7 million. Based on the current Act 51 formula this would result in decreases in Comprehensive Transportation Fund revenue of \$170,000, State Trunkline Fund revenue of \$598,200, and MTF distributions to local road agencies of \$931,800.

However, this reduction in MTF revenue would be offset to the extent that additional revenue was realized from improved tax collection as a result of simplification and improved collection systems. The Michigan Department of Treasury's Office of Revenue and Tax Analysis (ORTA) has estimated that improved collections 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 has not independently confirmed the ORTA estimates.

We estimate that the changes to the Use Tax Act proposed in House Bill 5736 (H-2) would increase state revenue by \$4.5 million - based on diesel fuel priced at \$1.00 per gallon (excluding Michigan motor fuel and sales taxes). This additional revenue would be distributed in accordance with the current constitutional and statutory distribution of Use Tax revenue: 1/3 to the School Aid Fund (\$1.5 million), and 2/3 to the General Fund (\$3.0 million). To the extent that diesel fuel prices were greater than \$1.00 per gallon, the revenue increase would be greater - a total of \$5.7 million with fuel at \$1.25 per gallon, and \$6.8 million with fuel at \$1.50 per gallon.

Note that the above estimates are based on calendar year 2000 diesel fuel purchase and consumption data from the Michigan Department of Treasury.

Note: In the balance of this analysis the bills are discussed in what we believe is a logical order - rather than in their numerical sequence. Also note that our analysis of the "As Introduced" version of the bills, including a description of the current tax system, is found on the Michigan Legislature website (www.michiganlegislature.org).

House Bill 5735 (H-2) would amend the Motor Fuel Tax Act to eliminate the 6-cent discount currently available to motor carriers. As a result, the pump price of diesel fuel would reflect the total tax rate of 15 cents per gallon. Unlike the bill of introduction, HB 5735 (H-2) would not increase the tax rate for diesel fuel under the Motor Fuel Tax Act - the tax would remain at the current rate of 15 cents per gallon.

Note that Michigan also imposes a 6% sales tax on motor fuel sales. Assuming diesel fuel costs of \$1.00 per gallon, the total effective tax rate on diesel fuel "at the pump" is 21-cents per gallon - 15 cents in Motor Fuel Tax plus 6 cents in Sales Tax. Under current law, the 15 cents from the Motor Fuel Tax is credited to the Michigan Transportation Fund (MTF), and the 6 cents from the Sales Tax would be divided according to constitutional and statutory earmarks - primarily to the School Aid Fund (73%) and local revenue sharing (24%).

Under current law, part of the Motor Fuel Tax on diesel fuel is collected from suppliers and part of the tax is collected from retailers (truck stops and service stations). HB 5735 (H-2) would make motor fuel *suppliers* the sole collection point for all diesel fuel taxes imposed under the Motor Fuel Tax Act. This is the same way the Motor Fuel Tax on gasoline is collected. Although the 19-cent per gallon gasoline tax is reflected in the pump price, the tax is actually collected by the Michigan Department of Treasury from motor fuel *suppliers*.

Unlike the bill as introduced, the H-2 substitute does not increase the tax on LP gas used as motor fuel; the tax rate would remain at 15 cents per gallon.

House Bill 5734 (H-1) would amend the Motor Carrier Fuel Tax (MCFT) Act to change the definition of "motor carrier" subject to the Act. Under HB 5734 (H-1) only *interstate* motor carriers would be subject to the Act. Michigan *intrastate* motor carriers would not be subject to the Act and would no longer have to file quarterly MCFT tax returns. Michigan intrastate motor carriers would effectively pay diesel taxes under the Motor Fuel Tax Act "at the pump."

The H-1 substitute would lower the tax rate from the current tax rate of 21 cents per gallon to 15 cents per gallon and eliminate the 6-cent sales tax refund for fuel purchased in Michigan. The effective tax rate would be 15 cents per gallon.

House Bill 5736 (H-2) would amend the Use Tax Act to make the tax applicable to diesel fuel consumed in Michigan. Effectively the tax would only apply to interstate motor carriers who drove in Michigan but who purchased fuel outside of Michigan. Interstate motor carriers who purchased fuel in Michigan would be credited for Sales Tax paid.

The application of Use Tax to diesel fuel consumption is a way of equating the tax rates for motor carriers who purchase motor fuel in Michigan with those who purchase motor fuel out-of-state. There would be no disincentive for the purchase of fuel in Michigan based on tax rates. As noted above, those who purchased motor fuel in Michigan - which under HB 5734 (H-1) would include all Michigan intrastate motor carriers - would pay 15 cents per gallon in Motor Fuel Tax "at the pump," plus 6% Sales Tax applied to the purchase price. *Interstate* motor carriers who did not purchase motor fuel in Michigan would pay 15 cents per gallon in Motor Carrier Fuel Tax plus 6% Use Tax applied to the statewide average retail price of diesel fuel. All motor carriers would effectively pay the same tax rate: 15 cents per gallon plus 6% Sales Tax or Use Tax.

Use Tax revenue is distributed in accordance with the current constitutional and statutory earmarks: 1/3 to the School Aid Fund and 2/3 to the General Fund.

Note: House Bills 5734, 5735, and 5736 are tie-barred to each other. The tie-bars to HB 5733, a bill to amend Public Act 51 of 1951, which were included in the bills as introduced, are not included in the substitutes.

Fiscal Impacts - Transportation Revenue

The changes proposed in the substitutes to House Bills 5734 and 5735 would affect state-restricted transportation revenue through increased compliance, through elimination of the current "sales tax refund", and through a decrease to the Motor Carrier Fuel Tax rate. Those changes are described in further detail below ¹:

Increased Compliance - Under the current tax system, motor carriers effectively pay 9 cents at the pump and are supposed to pay an additional 6 cents later (quarterly) on MCFT or International Fuel Tax Agreement (IFTA) forms. There is evidence to suggest that some motor carriers only pay the 9 cents at the pump and never file to pay the additional 6 cents. By collecting the entire 15-cent per gallon tax at the supplier level, House Bills 5735 and 5734 would eliminate this potential source of fraud.

Sales Tax Credit/Lower MCFT Rate - Eliminating the 6-cent sales tax refund from the Motor Carrier Fuel Tax Act could increase MTF revenue. However, this increase would be offset by the reduction in the actual tax rate from 21 cents to 15 cents per gallon.

We estimate that the net effect of the above changes to diesel tax statutes would be to decrease MTF revenue by \$1.7 million. Based on the current Act 51 formula this would result in decreases in Comprehensive Transportation Fund revenue of \$170,000, State Trunkline Fund revenue of \$598,200, and MTF distributions to local road agencies of \$931,800. Note that this reduction in MTF revenue would be offset to the extent that additional revenue was realized as a result of tax simplification and improved collection systems. The fiscal impacts of tax simplification and improved collection systems are discussed further below.

Fiscal Impacts - Use Tax Revenue

We estimate that the proposed amendment to the Use Tax Act would increase state revenue by \$4.5 million - assuming diesel fuel priced at \$1.00 per gallon. This additional revenue would be distributed in accordance with the current constitutional and statutory distribution of Use Tax revenue: 1/3 to the School Aid Fund (\$1.5 million), and 2/3 to the General Fund (\$3.0 million).

To the extent that diesel fuel prices were greater than \$1.00 per gallon, the revenue increase would be greater - \$5.7 million with fuel at \$1.25 per gallon, and \$6.8 million with fuel at \$1.50 per gallon.

Simplification/New Tax Monitoring Systems

One of the effects of the proposed amendments to the Motor Fuel Tax Act would be to move the collection point for the diesel fuel excise tax back to the fuel supplier level - the same as is now the case with the gasoline excise tax. This would reduce the number of collection points for the Motor Fuel Tax from thousands of service stations and truck stops to a relatively small number of suppliers. This change would allow the Michigan Department of Treasury to more effectively monitor the movement and distribution of motor fuels. Reducing the collection points for the tax should increase the ability of the Michigan Department of Treasury to assess, audit, and collect the Motor Fuel Tax ²

The Michigan Department of Treasury has indicated that the benefits of tax simplification would be enhanced through the implementation of a proposed new computerized system to monitor the movement of motor fuels and the collection of motor fuel taxes. ORTA has estimated that diesel tax simplification, coupled with improved tax collection systems, would result in an increase of \$3.9 million in state-restricted (MTF) transportation revenue in the first year, \$19.1 million in the second year, and \$29.5 million in the third year of implementation.

In addition, because the current formula for the distribution of federal highway funds to states is based, in part, on state diesel fuel usage, and state contributions to the federal Highway Trust Fund by commercial vehicles, increased collection of state diesel fuel taxes could result in additional federal funds for Michigan. ORTA estimates that additional diesel tax collections as a result of simplification and new collection systems would result in an additional \$11.8 million in federal revenue to Michigan in the third year of implementation. The House Fiscal Agency has not independently confirmed the ORTA revenue estimates.

¹ The fiscal impact estimates are based on 2000 diesel fuel purchase and consumption data from the Michigan Department of Treasury.

² In addition, by eliminating Michigan intrastate motor carriers from the authority of the Motor Carrier Fuel Tax Act, HB 5734 would exempt over 9,000 intrastate carriers from filing quarterly MCFT returns.

The Executive budget recommendations for FY 2002-03 included a \$2.2 million MTF grant to the Department of Treasury for (mostly) one-time costs for the implementation of the improved motor fuel tax monitoring and collection system. The MTF grant for the Michigan Department of Treasury is an item of difference in both the Transportation and General Government appropriations bills for FY 2002-03.

Do House Bills 5734, 5735, and 5736 Increase Taxes?

For the most part, no. The bills would have no impact on the net tax liability for those who purchase fuel in Michigan. The bills could result in increases in total tax due from interstate motor carriers who do not purchase fuel in Michigan.

Those who purchase fuel in Michigan - including all Michigan intrastate motor carriers - would effectively pay 15 cents per gallon Motor Fuel Tax "at the pump" plus a 6% Sales Tax. That is the same as the current effective tax rate.

Interstate motor carriers who did not buy fuel in Michigan would pay a 15-cent Motor Carrier Fuel Tax for each gallon consumed in Michigan, plus a 6% Use Tax on those gallons. At a fuel price of \$1.00 per gallon the net tax paid would be 21 cents per gallon - 15 cents in Motor Fuel or Motor Carrier Fuel Tax, plus 6% (6 cents) in Use Tax. That would be the same as the current Motor Carrier Fuel Tax rate for this class of taxpayer - 21 cents per gallon. However, to the extent that diesel motor fuel is priced at more than \$1.00 per gallon, the effective tax rate under the bills could be greater than 21 cents. If average fuel prices were \$1.50 per gallon, the interstate motor carrier who did not purchase fuel in Michigan would pay 15 cents per gallon in Motor Carrier Fuel Tax plus 6% Use Tax (9 cents) for a total of 24 cents per gallon.

Note that this potential tax increase would apply only to interstate motor carriers who drove in Michigan but who purchased fuel outside of Michigan. And the tax increase would only be with respect to current law. That class of taxpayer, interstate motor carriers who drove in Michigan but who purchased fuel outside of Michigan, would be paying the same as those who purchased fuel in Michigan - including all Michigan intrastate motor carriers - and would experience the same relative tax increase that occurs whenever fuel prices rise and the Sales Tax is applied to a higher sales price.

Would Pump Prices Increase?

Yes - at truck stops that currently advertise fuel prices net of the 6-cent "diesel discount". In other words, truck stops whose pump price now reflects only the 9-cent tax paid by eligible motor carriers would have to include the full 15 cent tax in the pump price.

Some argue that the increase in the tax at the pump (even without increasing the actual tax), could influence purchase decisions of interstate motor carriers. Some argue that these changes would make it less likely that interstate motor carriers would purchase fuel in Michigan. If true, this could also result in a reduction in secondary sales made at truck stops and service stations and thus a reduction in related Sales Tax collections.

It is not clear to what extent the current system (artificially low tax at the pump and the sales tax refund) affects motor carriers' fuel purchase decisions. Others argue that the filing requirements associated with the current system discourage fuel purchases in Michigan. In order to obtain the sales tax refund motor carriers now must file a Treasury Supplemental Motor Carrier Tax Report in addition to the quarterly IFTA form. Under the provisions of House Bills 5735 and 5734 the tax liability of motor carriers who purchased fuel in Michigan would be satisfied "at the pump."

The following table compares taxation of diesel fuel under current law with provisions of House Bills 5735 (H-2), 5734 (H-1), and 5736 (H-2).

MFT = Motor Fuel Tax Act (Applied to Fuel Purchased in Michigan)

MCFT = Motor Carrier Fuel Tax Act (Applied to Fuel Consumed in Michigan)

	Current Law	House Bills 5735 (H-2), 5734 (H-1), and 5736 (H-2)
Diesel Powered Cars & Light Trucks (<u>Not</u> Motor Carriers)	<p>Tax Rates MFT - 15 cents per gallon at the pump MCFT - No tax Net = 15 cents per gallon fuel tax</p> <p>Plus 6% Sales Tax on purchase price</p> <p>MFT Collection Point 9 cents collected from supplier 6 cents collected at retail</p>	<p>Tax Rates MFT - 15 cents per gallon at the pump MCFT - No tax Net = 15 cents per gallon in fuel tax</p> <p>Plus 6% Sales Tax on purchase price</p> <p>MFT Collection Point All 15 cents collected from supplier</p>
Michigan Motor Carriers Fuel Purchased in Mich. Miles Driven in Mich.	<p>Tax Rates MFT - 9 cents per gallon at the pump MCFT - 21 cents per gallon due for Michigan miles, less 9-cent credit for MFT paid, less 6 cent sales tax refund Net = 15 cents per gallon in fuel tax Plus 6% Sales Tax on purchase price</p> <p>MFT/MCFT Collection Point 9 cents collected from supplier 6 cents quarterly on MCFT form</p>	<p>Tax Rates MFT - 15 cents per gallon at the pump MCFT - No tax Net = 15 cents per gallon in fuel tax Plus 6% Sales Tax on purchase price</p> <p>MFT/MCFT Collection Point All 15 cents collected from suppliers.</p> <p>Truckers who operated exclusively in Michigan would no longer be <i>motor carriers</i> and would not file MCFT form.</p>
Motor Carriers (Interstate) Purchased Fuel in Mich. Miles Driven in Mich.	<p>Tax Rates MFT - 9 cents per gallon at the pump MCFT - 21 cents per gallon due for Michigan miles, less 9 cent per gallon credit for MTF paid, less 6 cent sales tax refund Net = 15 cents per gallon in fuel tax Plus 6% Sales Tax on purchase price</p> <p>MFT/MCFT Collection Point 9 cents collected from supplier 12 cents quarterly on IFTA form, less 6 cents refund on supplemental Treasury form.</p>	<p>Tax Rates MFT - 15 cents per gallon at the pump MCFT - 15 cents per gallon due on Michigan miles, less 15 cents per gallon credit for MFT paid Net = 15 cents per gallon in fuel tax Plus 6% Use Tax less credit for 6% Sales Tax paid at the pump.</p> <p>MFT/MCFT Collection Point 15 cents collected from supplier Motor carrier Michigan miles reconciled on quarterly on IFTA forms</p>
Motor Carriers Purchased Fuel Outside Mich. Miles Driven in Mich.	<p>Tax Rates MFT - No tax due. MCFT - 21 cents per gallon for miles driven in Michigan Net = 21 cents per gallon in fuel tax No Sales or Use Tax</p> <p>MFT/MCFT Collection Point Collected on quarterly on IFTA form</p>	<p>Tax Rates MFT - No tax due. MCFT - 15 cents per gallon for miles driven in Michigan Net = 15 cents per gallon in fuel tax 6% Use Tax</p> <p>MFT/MCFT Collection Point Collected on quarterly on IFTA form</p>