

DATE: June 2, 2009

TO: House Committee on Tax Policy

FROM: William E. Hamilton
Treatment of sales taxes on diesel fuel purchased/consumed by motor carriers
House Bill 4953 – Sponsor: Rep. Kathy Angerer

RE: House Bill 4954 – Sponsor: Rep. John Proos

This memo is a preliminary analysis of the fiscal impacts of House Bills 4953 and 4954. The House Fiscal Agency will update this analysis as more information is presented in committee and through discussions with interested parties and the Michigan Department of Treasury.

A SUMMARY OF HOUSE BILLS 4953 AND 4954 AS INTRODUCED 5-19-09

Together the two bills would change the way sales tax is collected on diesel fuel purchased by interstate motor carriers. **House Bill 4953** would amend the General Sales Tax Act to exempt from sales tax diesel fuel used in a "qualified commercial motor vehicle" by an "interstate motor carrier." **House Bill 4954** would amend the Streamlined Sales and Use Tax Revenue Equalization Act (SSUTREA) to specify that the tax is to be levied on the use or consumption of diesel fuel by interstate motor carriers both purchased in the state and purchased outside of the state. If the bills are enacted, sales taxes on the purchase or consumption of diesel fuel by interstate motor carriers would be collected entirely through quarterly International Fuel Tax Agreement (IFTA) reports; sales tax would not be imposed on interstate motor carriers at the time of fuel purchase.

The two bills should not change total state revenue. However, as explained in detail later, it is anticipated that more money would flow to the Michigan Transportation Fund and less to the School Aid Fund and revenue sharing than under current law.

Background

Interstate motor carriers¹ currently pay fuel taxes under two statutes: the Motor Carrier Fuel Tax Act (MCFTA) and the Streamlined Sales and Use Tax Revenue Equalization Act (SSUTREA).

¹ As defined by the Motor Carrier Fuel Tax Act, a "motor carrier" means: (1) 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 1 other state or Canadian province; and (2) 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.

The act further defines a "Qualified commercial motor vehicle" as a motor vehicle used, designed, or maintained for transportation of persons or property and either (1) Having 3 or more axles regardless of weight; (2) Having 2 axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds or 12,000 kilograms; or (3) Is used in a combination of vehicles, if the weight of that combination exceeds 26,000 pounds or 12,000 kilograms gross vehicle or registered gross vehicle weight.

Under these definitions, only "interstate" motor carriers are subject to the MCFTA. Qualified commercial motor vehicles which never operate outside the state are not subject to the MCFTA – they pay fuel taxes "at the pump" under the Motor Fuel Tax Act. In the balance of this analysis, we will use "motor carrier" to mean "interstate motor carriers."

The Motor Carrier Fuel Tax provides for a tax of 15 cents per gallon of diesel fuel consumed by motor carriers in Michigan. The MCFTA assumes a consumption rate of 4 miles per gallon; every four miles driven in Michigan equates to a gallon of diesel fuel consumed and 15 cents in tax liability under the MCFTA.

Like the MCFTA, the SSUTREA tax on diesel fuel is a consumption tax, based on gallons of diesel fuel consumed by motor carriers in Michigan. The tax rate is 6% of the statewide average retail price of diesel fuel as determined by the Michigan Department of Treasury. If the posted price of diesel fuel is \$2.50 per gallon, the 6% SSUTREA tax is approximately 13 cents per gallon.

The SSUTREA is effectively a proxy for the sales tax; it is like a use tax in that it captures the equivalent of the sales tax for motor carriers who drive in Michigan, and thus use diesel fuel in Michigan, but who do not purchase fuel in Michigan. Or to put it another way: it equalizes the tax liability of motor carriers who drive in Michigan but purchase fuel in other states with those who drive in Michigan and purchase fuel in Michigan (and who thereby pay the sales tax reflected in the posted pump price).

Both the MCFTA and the SSUTREA diesel taxes are collected as a single tax through the International Fuel Tax Agreement (IFTA). Motor carriers file a quarterly IFTA form which indicates miles driven by state and computes the applicable fuel taxes due each state. For each four miles driven in Michigan—that is, for each gallon of diesel fuel consumed in Michigan—a motor carrier would pay 28 cents per gallon, 15 cents under the MCFT, and 13 cents under SSUTREA (assuming a retail price of \$2.50 per gallon). The IFTA form doesn't split the two taxes.

If a motor carrier purchased fuel in Michigan, they would receive credit for the Motor Fuel Tax and sales tax paid "at the pump," against the tax liability computed on the IFTA form. For example, if the motor carrier owed \$1,500 for the quarter based on miles driven in Michigan, but had already paid \$500 in taxes on fuel purchased in Michigan, the net tax due to the state would be \$1,000. Conversely, if the motor carrier had already paid \$2,000 in taxes "at the pump," and owed \$1,500 in taxes as computed on the IFTA form, they would receive a credit or refund of \$500.

House Bills 4953 and 4954, would change collection of state sales tax on diesel fuel purchased by motor carriers. House Bill 4953 would amend the General Sales Tax Act to exempt from the sales tax diesel fuel used in a "qualified commercial motor vehicle" by an "interstate motor carrier." House Bill 4954 would amend the Streamlined Sales and Use Tax Revenue Equalization Act to specify that the tax is to be levied on the use or consumption of diesel fuel by interstate motor carriers both purchased in the state and outside of the state. If the bills are enacted, sales taxes on the purchase or consumption of diesel fuel by interstate motor carriers would be collected entirely through quarterly International Fuel Tax Agreement (IFTA) reports; sales tax would not be imposed on interstate motor carriers at the time of fuel purchase.

It is our understanding that the intent of these bills is to lower the cost of diesel motor fuel "at the pump," and thus make diesel fuel sold in Michigan more price-competitive with the neighboring states. Even though motor carriers would eventually pay the same amount through IFTA reports, truck stop operators argue that motor carriers are nonetheless sensitive to the price charged at the pump.

Although not stated in the bills, it is assumed that the posted pump price of diesel fuel would continue to include or reflect applicable sales taxes. Operators of Michigan-only diesel cars and

trucks would still have to pay sales tax "at the pump." Only qualified motor carriers would be able to obtain a credit for the amount of the sales tax from the truck stop operator, presumably by showing a valid IFTA registration at the time of purchase.

Fund Shift Problem

Revenue from state motor fuel taxes, both the Motor Fuel Tax Act and the Motor Carrier Fuel Tax Act, is credited to the Michigan Transportation Fund (MTF).

When fuel is purchased in Michigan, the sales tax is paid "at the pump," and the related sales tax revenue is credited to various funds in accordance with constitutional and statutory earmarks—primarily to the School Aid Fund and revenue sharing.

When a motor carrier has paid more taxes "at the pump" than are due on his or her IFTA report, the resulting credit is taken entirely from MTF, even though part of the tax paid "at the pump" is sales tax.

Although SSUTREA is a type of sales or use tax, the SSUTREA describes the tax imposed on diesel fuel as a *specific tax* on fuel. As a result, revenue generated from the tax is governed by Article IX, Section 9 of the constitution—it is dedicated to transportation and doesn't follow the constitutional and statutory earmarks for sales tax.

According to IFTA reporting data, as reported by the Michigan Department of Treasury, approximately 115 million more gallons of diesel are consumed in Michigan by motor carriers than are purchased in Michigan. Because more diesel fuel is consumed by motor carriers than is purchased in Michigan, there is, under current law, a kind of fund shift due to the fact that the SSUTREA is treated as a specific motor fuel tax and not as a sales tax. The MTF receives more and the School Aid Fund and local revenue sharing receive less than those funds would otherwise receive if the SSUTREA tax on diesel were treated as sales tax and not as a specific motor fuel tax. Assuming an average retail price of \$2.50 per gallon, and 115 million more gallons consumed than purchased, the fund shift under current law would be approximately \$15 million. The two bills would magnify this fund shift.

The two bills should not change total state revenue. However, they would probably magnify the current fund shift: more money would flow to the Michigan Transportation Fund and less to the School Aid Fund and revenue sharing than under current law. Assuming 375 million motor carrier diesel gallons purchased in Michigan, and 490 million motor carrier diesel gallons consumed in Michigan, and assuming an average retail price of \$2.50 per gallon, the amount of the fund shift under the proposed bills would be approximately \$63.7 million; that is, the MTF would receive \$63.7 million more than if the SSUTREA tax on diesel fuel were treated as sales tax and not as a specific tax on motor fuel; the School Aid Fund and revenue sharing would receive approximately \$63.7 million less in total.

It is not clear if the bills could be amended to provide a mechanism whereby the Michigan Department of Treasury would be directed to compensate for the computed fund shift on a quarterly or annual basis.