

# SENATE BILL REPORT

## SHB 2659

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As Reported By Senate Committee On:  
Transportation, March 2, 1998

**Title:** An act relating to special fuel and motor vehicle fuel taxes.

**Brief Description:** Regulating collection of special fuel taxes and motor vehicle fuel tax.

**Sponsors:** House Committee on Transportation Policy & Budget (originally sponsored by Representatives Fisher, K. Schmidt, Radcliff, O'Brien and Murray; by request of Governor Locke).

**Brief History:**

**Committee Activity:** Transportation: 2/25/98, 3/2/98 [DPA].

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### SENATE COMMITTEE ON TRANSPORTATION

**Majority Report:** Do pass as amended.

Signed by Senators Prince, Chair; Benton, Vice Chair; Wood, Vice Chair; Haugen, Goings, Heavey, Horn, Jacobsen, Morton, Oke, Patterson, Prentice, Rasmussen and Sellar.

**Staff:** Roger Horn (786-7839)

**Background:** Washington imposes a tax of 23 cents per gallon on motor vehicle fuel (gasoline) and special fuel (mainly diesel) used for on-road purposes. The Department of Licensing (DOL) is responsible for the collection of these motor fuel taxes. The taxes are paid to DOL by: (1) licensed fuel distributors who purchase untaxed fuel from refineries, terminals, or other licensed distributors and then sell the fuel, with taxes included, to unlicensed buyers; or (2) licensed special fuel bulk users, who purchase special fuel without fuel tax applied and pay tax to DOL for any fuel subsequently used on-road. Motor fuel on which fuel tax is not applied is subject to sales and use tax.

There are about 500 licensed special fuel distributors and 240 motor vehicle fuel distributors in Washington. In addition, about 27,000 persons hold special fuel user licenses that allow them to purchase special fuel into bulk storage without fuel tax applied and subsequently pay fuel tax on any of the fuel used on-road. Of this number, nearly 21,000 farmers, loggers and contractors, who have certified that they have no diesel-powered vehicles licensed for on-road use, have special licenses that exempt them from submitting tax reports to DOL.

In a 1994 report the Federal Highway Administration estimated that fuel tax was being evaded on 3 to 7 percent of gasoline gallons and 15 to 25 percent of diesel gallons in the United States. In 1996 a task force convened by the Legislative Transportation Committee (LTC) concluded that it is likely that there is significant evasion of fuel taxes occurring in Washington and made recommendations as to how the issue could be addressed.

There are several methods used to evade paying state fuel taxes. Following are four examples of evasion schemes.

One method, referred to as "daisy chaining," involves selling fuel several times in tax exempt transactions between licensed distributors. These transactions may be "paper transactions" where the fuel does not physically change hands. By daisy chaining, an evader creates an audit trail that is very difficult to trace and, if the ultimate taxable transaction is found, the distributor is often a fictitious company from which the fuel tax is not collectible.

A second type of evasion involves illegal importing and exporting of motor fuel. Because Washington borders on Oregon which does not apply fuel tax on diesel fuel, and British Columbia which has a different tax structure than Washington, cross-border smuggling can be very profitable. In addition, a distributor can evade taxation by purchasing fuel for export, in which case the fuel is purchased tax-free, and then selling the fuel in the state, collecting tax on the fuel, and not remitting the tax.

A third method of evasion is referred to as cocktailing or blending. In this scheme, untaxed fuels such as kerosene or recycled oil are blended with diesel fuel and the blended fuel is sold with tax included, but only the tax on the diesel fuel is remitted to the state.

A fourth method of avoiding taxation is by claiming an exemption on fuel that was used for taxable purposes. For example, licensed special fuel bulk users who purchase special fuel without the fuel tax applied can evade fuel taxes by under-reporting the amount of fuel used on-road.

Other states and the federal government have implemented law changes to address evasion that have resulted in significant revenue increases. These changes include moving the point of collection for motor vehicle fuel and special fuel taxes to a higher point on the fuel distribution chain, requiring that tax exempt fuel be dyed, and implementing measures to control illegal importing and exporting,

The federal government, which imposes taxes of 18.4 cents per gallon on gasoline and 24.4 cents per gallon on diesel fuel, collects the taxes directly from refiners and terminal operators (suppliers) who sell to distributors. The tax structure used by the federal government is referred to as "tax at the rack," referring to the terminal rack which is the platform or bay at which fuel from a refinery or terminal is delivered into trucks, railcars or vessels. The federal government also requires that any diesel fuel sold tax-free contain colored dye. At least 14 states have implemented tax at the rack and 27 require tax-exempt diesel fuel to be dyed.

Distributors are required to purchase a bond equivalent to three times their monthly fuel tax liability, up to a maximum of \$50,000. The minimum bond is \$500 for special fuel distributors and \$5000 for motor vehicle fuel distributors.

**Summary of Amended Bill:** Effective January 1, 1999, motor vehicle fuel and special fuel taxes are imposed at the time of removal of special fuel from a terminal rack in Washington. The refiner, terminal operator, or party owning the fuel at the time of removal is required to collect taxes on the fuel and remit them to DOL. For motor fuel that was removed from a terminal rack in another state and imported into Washington, the importer is liable for

paying the fuel tax. Motor fuel purchased from a supplier for direct export out of Washington is not taxed. Motor fuel suppliers, distributors, exporters, importers and blenders must be licensed with DOL.

An applicant for an importer or exporter license must be licensed or registered for motor fuel tax purposes in the states or countries in which the applicant intends to purchase or sell the special fuel, if licensing is required therein.

Dyed special fuel is exempt from the special fuel tax. A person may not operate a vehicle on a public road in this state with dyed special fuel in the vehicle's fuel supply tank, unless the use is authorized by the federal internal revenue code. Dyed special fuel must meet the dyed fuel requirements of the Internal Revenue Service. The penalty for using dyed special fuel to operate a vehicle upon the highways of the state is \$10 for each gallon of dyed special fuel placed into the vehicle's supply tank or \$1,000, whichever is greater. The penalties are deposited into the motor vehicle fund. Officers of the Washington State Patrol or other Commercial Vehicle Safety Alliance-certified officers are authorized to collect special fuel samples to check for the presence of dye.

Special fuel user licensing and reporting requirements are deleted. Special fuel users are not permitted to purchase clear diesel fuel into bulk storage without payment of the special fuel tax.

At the election of a distributor, farmers, logging companies and construction companies may purchase special fuel from card lock facilities directly into the supply tanks of nonhighway equipment or portable slip tanks for nonhighway use without payment of the special fuel tax. A distributor who sells special fuel in this manner is authorized to apply for a refund of taxes paid by the distributor on the fuel purchased by these users.

Interstate trucking companies licensed in Washington are eligible to obtain special authorization from the Department of Licensing that allows them to purchase nondyed special fuel for trucks engaged in interstate commerce without the payment of fuel tax at the time of purchase. The special authorization applies only to fuel purchased at cardlock facilities that elect to sell fuel in this manner and apply for a fuel tax refund on the fuel sold. Fuel tax for the fuel would be paid by a trucking company at the time it submits its quarterly International Fuel Tax Agreement tax return.

Distributors are required to remit special fuel taxes to the supplier of the fuel no later than two business days before the last day of the month following the month in which the fuel was purchased. The supplier must remit the taxes to the state on or before the tenth day of the month after which the distributor payments were due.

The shrinkage allowance for motor vehicle fuel taxes paid by distributors is increased from .25 percent to .3 percent. Special fuel distributors subject to pollution liability insurance agency fees (i.e., heating oil distributors) must file reports with DOL annually.

DOL is required to pay interest of 1 percent per month on special fuel and motor vehicle fuel tax refunds if the refund is issued more than 30 business days after the request for refund was received. A minimum of \$20 is set for refund claims, and DOL may waive the requirement to submit invoices with small refund requests. Refunds are not allowed until

motor fuel is used for a nontaxable purpose. A person may receive a refund of fuel taxes that were paid on clear special fuel that was inadvertently mixed with dyed special fuel.

The maximum bond required of suppliers, distributors, exporters, importers and blenders is set at \$100,000.

Provisions are made for the transition to collection of special fuel taxes at the terminal rack.

Interstate trucking companies that used more than 20 percent of their special fuel gallons out of state in the previous year may receive special authorization from DOL to purchase special fuel without payment of the special fuel tax at the time of purchase. This provision applies only to full truck-trailer loads of special fuel picked up at a terminal rack and delivered directly to the bulk storage facilities of the trucking company. Tax on the fuel is paid as part of the International Fuel Tax Agreement reconciliation at the end of each quarter.

Additional items are added to the information included in documentation carried by shippers of motor fuel.

DOL is given authority to (1) enter into cooperative agreements with other states or Canadian provinces; (2) address mutual issues pertaining to fuel tax administration, collection and enforcement; (3) require any person engaged in the business of selling, purchasing, distributing, storing or transporting special fuel to submit periodic reports regarding the distribution of such fuel; and (4) develop and adopt rules to implement this act.

Language is added to clarify that the ultimate liability for fuel taxes is upon the fuel user regardless of the manner in which fuel taxes are collected.

**Amended Bill Compared to Substitute Bill:** The striking amendment retains all of the language in the substitute bill and adds the following provision: Interstate trucking companies licensed in Washington are eligible to obtain special authorization from the Department of Licensing that allows them to purchase nondyed special fuel for trucks engaged in interstate commerce without the payment of fuel tax the time of purchase. The special authorization applies only to fuel purchased at cardlock facilities that elect to sell fuel in this manner and apply for a fuel tax refund on the fuel sold. Fuel tax for the fuel would be paid by a trucking company at the time it submits its quarterly International Fuel Tax Agreement tax return.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on January 1, 1999.

**Testimony For:** The bill would result in significantly increased gas tax revenue which is much needed for highway improvements. Tax evasion creates an unfair advantage for tax cheats who are competing against honest fuel distributors and retailers. The bill would make state law consistent with federal law. The number of licensees would be reduced dramatically. There is a great deal of evasion in Washington because it is so profitable.

**Testimony Against:** None.

**Testified:** PRO: Charlie Brown, Washington Oil Marketers; Dan Coyne, Washington State Council of Farmer Cooperatives; Greg Hanon, Western States Petroleum Association; John Woodring, Washington Trucking Association; Rick Judd, WSDOT.