Legislative Fiscal Bureau

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May 31, 2007 Joint Committee on Finance Paper #761

Oil Company Assessment (DOT -- Transportation Finance)

Bill Agency

[LFB 2007-09 Budget Summary: Page 528, #3]

CURRENT LAW

No provision.

GOVERNOR

Establish an oil company assessment that would initially apply to motor vehicle fuel sales on the first day of the second calendar quarter beginning after the effective date of the bill. Deposit the revenues from the assessment to the transportation fund and estimate increased revenues to the fund at $116,710,000 in 2007-08 and $158,460,000 in 2008-09 (the revenue numbers reflect revisions made in LFB Issue Paper #760).

Impose, for the privilege of doing business in this state, an assessment on each motor vehicle fuel supplier at the rate of 2.5% of the supplier's gross receipts in each calendar quarter. Specify that the assessment would apply to the gross receipts that are derived from the first sale in this state of motor vehicle fuel received by the supplier for sale in this state, for sale for export to this state, or for export to this state.

Specify the following for purposes of determining the amount of the oil company assessment to be imposed: (a) income derived from the first sale in this state of biodiesel fuel or ethanol blended with gasoline to create gasoline consisting of at least 85 percent ethanol (E85) would not be included in the supplier's gross receipts and would not be subject to the assessment (the ethanol portion of gasohol, which generally contains up to 10% ethanol, would not be excluded from the assessment); (b) with regard to a transfer of motor vehicle fuel from a supplier to a related party, the point of first sale in this state is the date of such transfer, and the gross receipts are calculated on a monthly basis using an index to be determined by rule by the Department of Revenue (DOR); and (c) there is only one point of first sale in this state with regard to the sale of the same motor vehicle fuel.

Specify that any person, including a terminal operator, who is not licensed by the state as a motor vehicle fuel supplier or exporter, and who either used any motor vehicle fuel in this state or has possession of any motor vehicle fuel, other than that contained in a motor vehicle's fuel tank, for which the assessment has not been paid or for which no supplier has incurred liability for paying the assessment, would be required to file a report, in the manner described by DOR. Require such persons to pay the oil company assessment based on the purchase price of the motor vehicle fuel. These provisions would capture smaller entities that handle fuel, or any person who handles fuel, on which the assessment has yet to be paid.

Prohibit any supplier who is subject to the oil company assessment from taking any action to increase or influence the selling price of motor vehicle fuel in order to recover the amount of the assessment. Specify that any supplier who takes such action would be subject to a penalty equal to either the amount of the gain the supplier received from any increase in the selling price that is implemented in order to recover the assessment amount or imprisonment of not more than six months, or both. Specify that, at the DOR Secretary's request, the Attorney General may represent this state, or assist a district attorney, in prosecuting any case arising from the administration and enforcement of the oil company assessment.

Allow DOR to audit any supplier who would be subject to the oil company assessment to determine whether the supplier has taken any action to increase or influence the selling price of motor vehicle fuel in order to recover the amount of the assessment. Require the Department to annually submit a report to the Governor and the Legislature that contains information on any audits conducted in relation to this authority in the previous year. This audit authority would be in addition to any other audits the Department conducts relative to the oil company assessment.

DISCUSSION POINTS

Background

1. A simplified view of the fuel market structure in the United States is that product begins at the crude oil stage, is refined into an end use, passes through interstate pipelines to local terminals, and is then trucked to the local retail station. The refining, pipeline, terminal, and retail station assets of the fuel supply chain may be owned by one company, but generally involve several different companies. During the fuel delivery process, the majority of fuel product can change hands a number of times from the refinery to the retail station. Other fuel can go from the refinery to the retail station in one transaction. Each buyer and seller of the fuel has costs and profit expectations associated with each transaction, which generally results in the fuel price increasing with each transaction.

2. At any stage of the fuel delivery process, fuel is sold under a variety of contract arrangements or in single sale, or "spot", transactions. Contracted transactions generally involve the ongoing delivery of fuel product between two parties under contracts that specify the product price, delivery and other charges, and volume guarantees. Spot market transactions refer to the one-time sale of a quantity of fuel at a convenient transfer point, such as the refiner, port, or pipeline junction, or terminal. However, that one-time quantity of fuel can go through a succession of spot transactions if the fuel is resold by traders, dealers, jobbers (those who purchase fuel at the terminal and transfer the product to a retail outlet), and/or independent marketers. While there may be some lag, it is generally believed that retail prices will over time reflect changes in the spot market price of fuel (also referred to as the "rack price" when sold at the terminal). The rack price is the point of sale at which price data is most often tracked.

3. Wisconsin has over 4,100 retail gasoline outlets, which are made up of three predominant types: (a) refiner-owned and operated stations; (b) branded, independent retailer outlets, which lease the retail outlet or brand name from the brand-owned company, or are in some part independently owned and operated; and (c) unbranded, independent outlets, which are owned and operated by an independent business owner with no connection to an oil refiner. Some terminal companies and jobbers also own, operate, or lease branded and unbranded retail outlets. Branded, independent outlets make up the largest share of state's stations, with unbranded, independent retail outlet owners making up the next largest share of stations, and major oil company or refiner-owned and operated outlets making up only a small share of stations.

4. Refiner-owned stations receive fuel directly from that company's terminal assets, which stems from that company's refiners. Similarly, branded, independent stations are typically under contract for supply directly from the brand company's terminal assets, which often stems from the brand company's refining assets. In exchange for this access to supply, and for other services, including marketing, these stations pay a specified premium in the price for the fuel purchased from the brand company. During times of tight fuel supply, these retailers are given some priority in obtaining fuel from the brand company. However, contracts between the brand company and their retailers typically only guarantee a specified percentage of the retailer's volume, which during tight supply periods may require these branded stations to purchase the remainder of their fuel supply needs on the spot market. The unbranded, independent stations generally purchase unbranded fuel on the spot market through jobbers, or at the terminal, but some larger independents also contract for fuel with one or more refiners.

Anti-Pass-Through Provision

5. The Governor's proposal contains an "anti-pass-through" provision, which prohibits fuel suppliers from taking any action to increase or influence the selling price of motor vehicle fuel in order to recover the amount of the assessment. The bill would make it illegal for oil suppliers to pass on the oil company assessment to consumers. In his Budget in Brief, the Governor indicated that the oil company assessment is aimed at assessing oil companies for a portion of their "excess profits". The administration contends that, under the anti-pass-through provision, consumers or end users of the fuel would not see an increase in the cost of fuel associated with the oil company

assessment.

6. The administration indicates that the oil company assessment proposal would allow the state to recoup some of the oil industry profits generated in Wisconsin. They contend that by depositing the revenues from the oil company assessment in the transportation fund, the state is requiring oil companies to pay their fair share of the cost of building and maintaining the state roads on which a portion of those profits were generated.

7. A recent Wisconsin Department of Agriculture, Trade and Consumer Protection report, cited earlier this year by the Governor, indicated that in 2006 oil companies had net income of $113.3 billion compared to $39.5 billion for the top five pharmaceutical companies, $17.0 billion for the top five retailers, and $3.5 billion for the top five agriculture/industrial equipment manufacturers. According to the U.S. Congressional Research Service, the net income of the nine largest oil companies, which are involved in the exploration, refining, and retail marketing of petroleum products, increased by nearly 270% during the four-year period from 2002 through 2005. During that same time period, their profit margin increased from 4.3% to 8.2%. For comparison, according to the U.S. Department of Commerce, Bureau of Economic Analysis, total corporate net income before taxes nationwide grew by 97.6% during the same period.

8. While oil company profits have increased significantly, much debate exists as to whether federal or state governments should intervene in the fuel market. Some federal and state policymakers have contended that oil refiners, due to their market power and crude-to-refined product margins, have the ability to implement anti-competitive marketing and pricing strategies, which help generate these record profits. In addition, vertical integration of the oil industry (ownership of retail gasoline stations by the petroleum industry itself) and direct refiner-to-retailer market sales have also been a concern. State and federal legislation to limit the market power of oil companies has been introduced and, in some instances, enacted. However, the proposed oil company assessment would impact more than just the refiner-owned fuel supply companies that purportedly have this market power and have accumulated record profits in recent years.

9. Some concern exists as to whether the state has the legal authority to regulate what costs a private company can pass on to its customers. The administration cites a 1988 U.S. Supreme Court decision (*Puerto Rico Department of Consumer Affairs v. Isla Petroleum Corp.*), as upholding states' authority to limit oil companies from passing on a tax to their customers. In the *Puerto Rico* case, the Supreme Court reviewed a lower court decision relating to a system of price controls, including an excise tax on petroleum companies, established by the territory of Puerto Rico. The Puerto Rico statute also prohibited the oil refiners from passing the cost of the tax through to retailers. The oil companies challenged the Puerto Rico regulation on the grounds that Puerto Rico's authority to regulate the price that oil companies can charge their consumers was preempted by the U.S. Congress when it allowed federal fuel price controls, enacted in 1973, under the Emergency Petroleum Allocation Act (EPAA), to expire. The oil companies contended that when Congress left the arena of federal price regulation, it intended for the petroleum market to be free of any price controls by any government. Therefore, they argued that under the Supremacy Clause of the U.S. Constitution (Article VI), the authority to regulate fuel prices would reside with

the federal government and not the government of Puerto Rico.

10. The U.S. Supreme Court disagreed with the oil companies' contention. In its *Puerto Rico* decision, the court stated that "….there can be no federal preemption of state law in vacuum without any constitutional text or federal statute to assert it". They found that Puerto Rico was not preempted by the Supremacy Clause from regulating fuel prices. However, it should be noted that the Supreme Court's opinion did not specifically address the anti-pass-through provision of the Puerto Rico statute. Rather, the opinion discussed the authority of states to regulate fuel prices.

11. It may be more likely that Wisconsin motor vehicle fuel suppliers would litigate the proposed anti-pass-through provision on the grounds that it violates the Commerce Clause of the U.S. Constitution (Article I, Section VIII). A 1983 Supreme Court of New York, Appellate Division, decision (*Shell Oil Company v. New York State Tax Commission*) held that a New York statute that prohibited oil companies from passing on a gross receipts tax to consumers violated the Commerce Clause. In its ruling, the court concluded that "it appears clear to us that the practical effect of prohibition (anti-pass-through) is to shift the direct burden of the tax from the companies' New York customers to their out-of-state customers". The New York Court noted that their conclusion is placed squarely under the holding of a U.S. Supreme Court decision (*Maryland v. Louisiana, 1981*), in which the Supreme Court ruled that the practical application of a similar Louisiana law would have the effect of insulating in-state consumers from the burden of a tax while passing the tax on to the out-of-state customers of the same company.

12. Wisconsin Legislative Council staff indicate that because the proposed anti-pass-through provision under the bill is similar to the provision struck down in the *Shell Oil* case, it would appear that the proposed anti-pass-through provision in the bill raises the same legal issue. That is, whether the provision would violate the Commerce Clause because its practical effect would be to pass on the cost of the assessment to the out-of-state customers of the Wisconsin suppliers subject to the assessment. Council staff indicate that because the *Shell Oil* decision is a decision of a New York court, it is not a precedent for purposes of review of the constitutionality of the proposed anti-pass-through provision under the bill. However, Council staff note that the New York court's rationale may be indicative of how another court would assess a Commerce Clause challenge to the constitutionality of the proposed anti-pass-through provision.

13. Council staff indicate that, read literally, the proposed anti-pass-through provision under the bill would prohibit the pass through of the assessment in the sales price of products sold anywhere, not just in Wisconsin. Therefore, it could be argued that the effect of the proposed anti-pass-through provision would not be to shift the burden of the assessment to the out-of-state customers of state fuel suppliers. However, Council staff also note that, given the difficulty of determining whether a supplier has passed on the assessment to customers inside or outside of Wisconsin, a court may not see a significant difference between the anti-pass-through provision under the bill and the provision invalidated in the *Shell Oil* case.

14. The Governor of Pennsylvania would also apply an anti-pass-through provision to his proposed oil company profits tax. Oil industry officials have indicated that they would likely

litigate the Pennsylvania provision, if enacted. Similarly, in Wisconsin, it is likely the oil industry will litigate swiftly in the hope that successful litigation would put an end to any efforts by other states to enact similar provisions. The likelihood of litigation also raises the question of what would happen to the expected revenues from the assessment if the oil companies are successful in litigation and the anti-pass-through provision is deemed unconstitutional. A court could rule that the state could still collect the tax without the anti-pass-through provision, which would have no impact on the projected revenues. Conversely, a court may be reluctant to defy the Legislature and place the burden of the tax onto the very consumers that the provision was designed to protect. Due to this uncertainty, the Committee could consider specifying that if the anti-pass-through provision is deemed unconstitutional, the oil company assessment would remain in place. Such a statement may also help protect the state from an injunction preventing the state from collecting and expending the assessment proceeds until the validity of the anti-pass-through provision is resolved.

15. Bringing action against a motor vehicle fuel supplier that manipulates the price of its products in order to recoup the cost of the oil company assessment could be difficult. Oil companies that supply motor vehicle fuel to Wisconsin also process many other petroleum and energy products in which they could pass on the cost of the assessment to consumers, including products used for asphalt, plastics, heating and aviation fuel, and natural gas. Oil companies also provide advertising, marketing, equipment, and services to their branded franchise owners, and could pass the cost of the assessment on through these products. Oil companies also contract for the purchase of ethanol from ethanol producers in the state to blend gasohol and could pass on a portion of the cost of the assessment in those contracts.

16. Monitoring fuel price changes to determine compliance with the anti-pass-through provision could also prove impractical. As mentioned earlier, a fuel product may be bought and sold several times before it reaches consumers and tracking the costs of each buyer and seller could be difficult. DOR would likely audit the sale of fuel at the terminal level, or spot market, where fuel prices can change very quickly, which also changes the value of fuel owned and held by a company at the time of those price changes. Therefore, any subsequent sale of that fuel would likely reflect the spot market price at the date and time of the sale, rather than the price at the time the fuel was purchased. In addition, some sellers may price fuel based on the anticipated replacement cost of the fuel, rather the sunk cost of fuel they have purchased. This dynamic pricing environment could make it difficult to determine whether the price and volume of the fuel sold includes the value of the oil company assessment.

17. The bill would provide DOR three audit staff to audit the compliance of oil companies relative to the proposal assessment, including whether a company is passing through the tax. During the Joint Finance Committee's agency briefings on the Governor's 2007-09 budget recommendations, the DOR Secretary indicated that he was confident that the Department could develop an audit model that would ensure compliance with the anti-pass-through provision. DOR indicates that each auditor position has the ability to perform six to eight audits per year. They note that while there are over 150 registered suppliers subject to the oil company assessment, over 90% of the revenue from the oil company assessment would come from the largest 15 suppliers. Therefore, the Department indicates that, over a four-year audit cycle, these audit positions could

select, audit, and review the 15 largest suppliers, as well as several smaller suppliers, to ensure compliance. [See LFB Issue Paper #763 for additional information on DOR's plan to administer and enforce the proposed oil company assessment.]

18. At 30.9 cents per gallon, the state currently has the second-highest excise tax rate on gasoline behind Washington state's 34.0 cents per gallon rate. However, including all state environmental taxes on gasoline and state sales taxes, the state's 32.9 cents per gallon rate, which includes a two cent per gallon petroleum inspection fee, ranks fifth among the states. The following table indicates where Wisconsin would rank in total state gasoline taxes paid by consumers if the oil company assessment is not passed on and if it is eventually passed on.

Rank of States With Highest Total Gasoline Tax Rates*

Assuming No Pass Through			Assuming Pass Through		
Rank	State	Gasoline Rate	Rank	State	Gasoline Rate
1	California	38.3¢	1	California	38.3¢
2	Michigan	34.3	**2**	**Wisconsin**	**37.9**
3	Washington	34.1	3	Michigan	34.3
4	Illinois	34.0	4	Washington	34.1
5	**Wisconsin**	**32.9**	5	Illinois	34.0
6	New York	32.7	6	New York	32.7
7	Indiana	32.4	7	Indiana	32.4
8	Pennsylvania	32.2	8	Pennsylvania	32.2
9	Rhode Island	31.1	9	Rhode Island	31.1
10	North Carolina	30.2	10	North Carolina	30.2

* Rates based on information supplied by DOT as of July, 2006. Sales taxes and other price-based taxes are reflected on a per gallon equivalent rate, based on a price of $2.60 per gallon.

Impact of the Anti-Pass-Through Provision on Wisconsin's Fuel Market

19. Some evidence suggests that regulating the prices that can be charged for fuel products could impact the supply of that product to the regulated area. The federal government and other states have attempted to intervene in the gasoline and diesel fuel market with some sort of price controls. In the case of the federal price controls of the 1970s, a report by the Federal Trade Commission's Bureau of Economics concluded that the price controls led to the adoption of higher-cost production methods and sporadic shortages that were manifested in gasoline lines at retail outlets. More recently, the State of Hawaii passed legislation that put in place price controls that set weekly caps on wholesale gas prices based on an average of prices in other areas of the country, with allowances made for transportation costs to Hawaii. The price controls were implemented in September, 2005, a period that coincided with the Hurricane Katrina natural disaster, which tightened fuel supply throughout the United States. By May, 2006, the Legislature suspended the price control mechanism over concerns that the controls inhibited fuel supply to Hawaii and actually increased prices.

20. At a price of $2.50 cents per gallon, less the state and federal taxes, the 2.5% oil company assessment on gross receipts would be approximately five cents per gallon for gasoline and 4.8 cents per gallon for diesel fuel. A company that sells 500 million gallons of gasoline in the state would generate nearly $1.0 billion in taxable gross receipts. That company would have to absorb $24.8 million annually in oil company assessments on those receipts because it would not be able to reflect these costs in the fuel product price. Such an intervention in the pricing of fuel could impact that company's decisions on where to deliver fuel supply.

21. Periodically, either nationally or regionally, or both, the fuel supply experiences interruptions. Seasonal issues, reformulated gasoline requirements, pipeline or other structural issues, international events, or natural disasters like Hurricane Katrina in 2005, can all have a significant impact on fuel supply. During such tight fuel supply periods, the proposed anti-pass-though provision could put state fuel retailers at a disadvantage for fuel supply given its potential impact on profitability. It may be conceivable that, during periods of tight fuel supply, suppliers may choose to supply fuel to other states within the Midwest region rather than realize reduced profits in Wisconsin associated with having to absorb the cost of the oil company assessment. Such a decision could further tighten the fuel supply for certain retail outlets in the state, which could exacerbate the temporary fuel price spikes that typically occur during a tight fuel supply event. It could also lead to more frequent tight fuel supply events.

22. Such events would also likely affect the various types of retailers in the state differently. Refiners could continue to supply their own retail outlets with fuel. As Wisconsin retail prices increase to reflect the increased spot market prices resulting from the tightened supply, and possibly the movement of supply to other states, depending on their profit margins, these refiner-owned outlets could substantially benefit from their continued supply in the short term. Branded, independent retailers would likely only receive the portion of the fuel that is guaranteed by their brand suppliers during a tight supply period. Their branded suppliers could choose to sell the non-guaranteed supply amount to retail outlets in other states, where the fuel would not be subject to the oil company assessment, or on the spot market, where, in the short term, they may receive a higher price than the contract price established with their branded retailers in Wisconsin. If fuel is moved out of state during periods of short supply, unbranded, independent retailers, which are more typically found in the state's rural areas, would likely be impacted the most. These retailers would typically have no guaranteed supply, and thus would be bidding for a limited fuel supply against other in-state independent retailers, as well as against out-of-state retailers, who would have a price advantage because the fuel supplied to them would not be subject to the assessment.

23. Also, the oil company assessment could affect fuel suppliers differently. Some Wisconsin suppliers buy fuel under contract at a price that closely reflects the spot market price and sell that fuel at another spot market price. While such suppliers sell a significant amount of fuel, they have smaller price margins and do not generate the same level of profits as the large, refining fuel producers who also supply fuel to the state. Some of these suppliers, or wholesalers, are significant payers of the state's motor vehicle fuel tax and would be subject to the proposed oil company assessment. However, they indicate that their average price margin on the fuel they supply would be less than the estimated five cent per gallon oil company assessment under the bill.

Therefore, they contend that if they have to absorb the cost of the oil company assessment, they may be forced out of the fuel supply business in Wisconsin, which could further impact the state's fuel supply.

Fuel Suppliers Subject to the Oil Company Assessment

24. Under the bill, fuel suppliers who are currently subject to the motor vehicle fuel tax would also be subject to the oil company assessment. In 2006, there were 65 licensed, unrestricted suppliers that remit motor vehicle fuel tax revenues to the state. There are 86 other restricted suppliers, or suppliers that deliver across state lines, who also remit state motor vehicle fuel taxes. Many of these 151 suppliers are small suppliers that likely generate a smaller profit margin on the sale of a gallon of fuel compared to the large oil refiners. Therefore, a five cent per gallon oil company assessment could make it difficult for some smaller suppliers to remain profitable.

25. Under the Governor's proposal, 15 fuel suppliers would pay over 99% of the oil company assessments. Therefore, smaller suppliers could be exempted from the proposed oil company assessment without a big reduction in estimated revenues. The exemption could be based on the level of annual gross receipts generated by the supplier. Such an exemption would be similar to the current exemption to the state's recycling surcharge, which exempts businesses with less than $4 million in gross receipts from the surcharge. Under an exemption that would exempt suppliers with gross receipts of less than $10.0 million, it is estimated that only 15 companies would continue to be subject to the assessment and revenues from the assessment would be reduced by an estimated $1.75 million in the biennium. However, exempting certain suppliers would also provide those suppliers with a price advantage on their fuel sold in the state compared to the fuel suppliers who would remain subject to the assessment. In addition, there may be other suppliers among the remaining 15 firms that are not "oil companies" and those firms may also operate with lower profit margins. A small supplier exemption would not help these firms.

26. Concern may exist that exempting only certain suppliers would treat the various fuel suppliers in the state differently. Another alternative would be to exempt the first $10 million in gross receipts for all suppliers. This would remove most fuel suppliers from having to pay the oil company assessment and would also provide some relief from the assessment for all suppliers. This provision would be similar to the state's beer excise tax, which provides a tax credit on the first 50,000 barrels to brewers who produce less than 300,000 barrels per year. It is estimated that such an exemption would lower revenues from the proposed oil company assessment by $8.4 million in the biennium.

Stability of the Oil Company Assessment as a Revenue Source

27. The oil company assessment would be similar to a sales tax on motor vehicle fuel in that the assessment would be based on the price of fuel, except that it would be paid as the fuel is supplied for sale in the state rather that at the fuel pump at retail. One primary concern related to a price-based revenue source is the stability of the revenue generated from the tax. This concern is exacerbated relative to gasoline and diesel fuel because the tax is only applied to two items,

compared to a larger base of items for the state's general sales tax. Fuel prices can fluctuate significantly during a year. For example, according to WisconsinGasPrices.com, the average, daily price of regular, unleaded gasoline was $2.68 per gallon on April 1, 2006, rose to $3.15 per gallon in mid-August, 2006, receded to $2.20 per gallon by early November, 2006, and then rose again to a mid-May, 2007, price of $3.28 per gallon. Such price fluctuations could make projecting revenue from the oil company assessment difficult and could result in revenues being much higher than expected during periods of unexpected high fuel prices and lower than expected during periods of low fuel prices.

28. During the 1995-97 budget deliberations, an oil franchise fee was proposed that was similar to the proposed oil company assessment in that fuel price would have been a factor in the amount of the fee paid. In order to limit the effect of price fluctuations, the oil franchise fee proposal would have established minimum and maximum price boundaries, within which the price basis for the fee could fluctuate. Initial minimum and maximum weighted average prices for all grades of gasoline and diesel fuel would have been established in statute and then DOR would have been required to adjust these minimum and maximum amounts on April 1 of each year, based on the percentage change in the average consumer price index during the previous year.

29. A similar mechanism could be established to limit possible fluctuations in the revenues generated from the oil company assessment. The estimate of the oil company assessment revenues assumed an average yearly price of $2.50 per gallon for gasoline and diesel fuel. (although prices have increased well above this level this spring, the May, 2007, forecast of the economy by Global Insight, Inc., projects that the average price per gallon for gasoline will be $2.59 for 2007, $2.43 for 2008, and $2.45 for 2009). In order to limit fluctuations around this price, an initial minimum price for all grades of gasoline and diesel fuel of $2.40 per gallon could be established for the period of October, 2007, through March 31, 2008, and a maximum retail price could be established at $2.60 per gallon for the same period. If fuel prices fall below the minimum price per gallon, the oil company assessment would be applied to the $2.40 minimum price less the state and federal excise taxes on motor vehicle fuel. The maximum retail price of $2.60 would be used if the actual price is higher. DOR could be required to adjust the minimum and maximum fuel price amounts on April 1, 2008, and each April 1 thereafter, to reflect changes in the average, annual consumer price index. Alternatively, the minimum and maximum amounts could be fixed, with future changes depending upon legislative action in subsequent sessions.

Alternatives to the Oil Company Assessment

30. Under the 1983-85 biennial budget, the Legislature adopted an indexing formula for the state's motor vehicle fuel tax that provided automatic, annual adjustments in the tax rate. Under 2005 Act 85, annual indexing of the fuel tax rate was repealed, effective after the April 1, 2006, adjustment. It is estimated that the repeal of indexing will reduce revenues to the transportation fund by $102.6 million through the 2007-09 biennium.

31. One of the policy reasons identified by legislators and others who favored the repeal of automatic indexing was that, under indexing, the state's fuel taxes were allowed to increase

without a vote of the Legislature. However, this policy concern would not be an issue if the Committee and Legislature would vote to statutorily set tax rates at the levels that the indexing adjustment would have produced for the 2007-09 biennium. The motor vehicle fuel tax rate could be set at 31.9 cents per gallon on October 1, 2007, 32.5 cents per gallon on April 1, 2008, and 33.2 cents per gallon on April 1, 2009, to reflect estimated inflation levels. The following table shows the additional revenues associated with this alternative and the proposed oil company assessment. In addition, there would be additional growth in revenues in 2009-10 associated with the April 1, 2009, adjustment under this alternative.

Comparison of Additional Fuel Tax Revenues Under
An Inflation-Based Alternative and the Oil Company Assessment
(In Millions)

Year	Inflation-Based Alternative	Oil Company Assessment	Difference
2007-08	$28.6	$116.6	-$88.0
2008-09	57.3	158.3	-101.0
Total	$85.9	$274.9	-$189.0

32. Adopting an increase to the existing motor vehicle fuel tax rate unrelated to what indexing would have produced would be another alternative for raising additional revenue. Each one cent increase in the state's motor vehicle fuel tax rate would generate an additional $55.9 million in the 2007-09 biennium.

Transportation Finance

33. The bill would deposit the revenues from the oil company assessment in the transportation fund and would increase estimated revenues to the fund by $116,570,000 in 2007-08 and $158,280,000 in 2008-09. The oil company assessment would become the third-largest revenue source for the transportation fund, behind the motor vehicle fuel tax and motor vehicle registration fee. However, since the product base for the oil company assessment would be almost identical to the motor vehicle fuel tax, the oil company assessment would not significantly broaden or diversify the fund's revenue base.

34. The additional revenue source would increase the options available to address current and future transportation needs. In 2006-07, current revenues to the transportation fund are projected to be exceeded by current expenditure levels. During deliberations on the 2005-07 budget adjustment bill, DOT estimated that the 2005-07 biennium-ending deficit in the transportation fund would be $49 million. Subsequently, the adjustment bill provided DOT authority to lapse funds from unencumbered balances to eliminate this deficit (since reestimated at $47 million).

35. In addition, it has been contended that the state's current transportation funding levels are not keeping up with the current transportation needs. During the 2005-07 session, the

Joint Legislative Committee on Transportation Needs and Financing ("Road to the Future Committee") estimated that nearly $700 million in additional funding would be needed in 2006-07 to fund certain benchmarks for DOT's state and local highway programs and local transit programs.

36. Conversely, some believe that no transportation fund revenue increases should be enacted until the fund becomes a truly segregated fund in which none of the fund's revenues are used to fund non-transportation-related programs, as has been done in recent biennia. The Governor's budget proposal would continue this trend by using $73.3 million in 2007-08 and $90.9 million in 2008-09 for general fund purposes.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to impose an oil company assessment on each motor vehicle fuel supplier at the rate of 2.5% of the supplier's gross receipts in each calendar quarter. Specify that the assessment would apply to the gross receipts that are derived from the first sale in this state of motor vehicle fuel received by the supplier for sale in this state, for sale for export to this state, or for export to this state.

ALT 1	**Change to Bill** Revenue	**Change to Base** Revenue
SEG	$0	$274,850,000

2. Modify the Governor's recommendation by doing one or more of the following:

a. Delete the anti-pass-through provision and penalties associated with the oil company assessment.

b. Specify that if the anti-pass-through provision of the oil company assessment is found to be unconstitutional, the assessment would continue to apply.

c. Exempt suppliers with annual gross receipts of less than $10 million from the oil company assessment. Reduce estimated revenue by $750,000 in 2007-08 and $1,000,000 in 2008-09.

ALT 2c	**Change to Bill** Revenue	**Change to Base** Revenue
SEG	- $1,750,000	$0

d. Exempt the first $10 million in suppliers' annual gross receipts from the oil company assessment. Reduce estimated revenue by $3,600,000 in 2007-08 and $4,800,000 in 2008-09.

ALT 2d	**Change to Bill** Revenue	**Change to Base** Revenue
SEG	**-** $8,400,000	$0

e. Establish a minimum price for all grades of motor vehicle fuel at $2.40 per gallon and a maximum price at $2.60 per gallon, from October 1, 2007, to March 31, 2008 (if prices fell below or rose above these prices, the oil company assessment would be applied to these prices less the state and federal motor vehicle fuel tax rates). Require DOR to adjust the minimum and maximum fuel price amounts on each April 1, thereafter, to reflect changes in the average, annual consumer price index during the prior calendar year.

f. Establish a minimum price for all grades of motor vehicle fuel at $2.40 per gallon and a maximum price at $2.60 per gallon (if prices fell below or rose above these prices, the oil company assessment would be applied to these prices less the state and federal motor vehicle fuel tax rates).

3. Delete provision. Instead, establish statutory changes in the motor vehicle fuel tax on October 1, 2007, April 1, 2008, and April 1, 2009, to reflect estimated changes in the inflation level. Specify that the fuel tax rate would be set at to 31.9 cents per gallon on October 1, 2007, 32.5 cents per gallon on April 1, 2008, and 33.2 cents per gallon on April 1, 2009. Reduce estimated transportation fund revenues by $88,110,000 in 2007-08 and $101,160,000 in 2008-09 compared to the bill. Base revenues would increase by $28.6 million in 2007-08 and $57.3 million in 2008-09.

ALT 3	**Change to Bill** Revenue	**Change to Base** Revenue
SEG	**-** $188,950,000	$85,900,000

4. Delete provision. Instead, increase the motor vehicle fuel tax rate by one of the following amounts, effective October 1, 2007, and modify estimated transportation fund revenues by the corresponding amounts:

	Rate Increase	2007-08 Revenue Change to Bill	2007-08 Revenue Change to Base	2008-09 Revenue Change to Bill	2008-09 Revenue Change to Base	Biennial Revenue Change to Bill	Biennial Revenue Change to Base
a.	1.0 Cent	-$92,928,000	$23,642,000	-$126,044,000	$32,236,000	-$218,972,000	$55,878,000
b.	1.5 Cents	-81,107,000	35,463,000	-109,926,000	48,354,000	-191,033,000	83,817,000
c.	2.0 Cents	-69,286,000	47,284,000	-93,808,000	64,472,000	-163,094,000	111,756,000
d.	2.5 Cents	-57,465,000	59,105,000	-77,690,000	80,590,000	-135,155,000	139,695,000
e.	3.0 Cents	-45,644,000	70,926,000	-61,572,000	96,708,000	-107,216,000	167,634,000
f.	3.5 Cents	-33,823,000	82,747,000	-45,454,000	112,826,000	-79,277,000	195,573,000
g.	4.0 Cents	-22,002,000	94,568,000	-29,336,000	128,944,000	-51,338,000	223,512,000
h.	4.5 Cents	-10,181,000	106,389,000	-13,218,000	145,062,000	-23,399,000	251,451,000
i.	5.0 Cents	1,640,000	118,210,000	2,900,000	161,180,000	$4,540,000	279,390,000

5. Delete provision.

ALT 5	**Change to Bill** Revenue	**Change to Base** Revenue
SEG	**-** $274,850,000	$0

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