



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #762

Oil Company Assessment -- Exemptions and the International Fuel Taxation Agreement (DOT -- Transportation Finance)

Bill Agency

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

CURRENT LAW

Certain specified uses of gasoline and diesel fuel, which are primarily nonhighway uses, are exempt from the state motor vehicle fuel tax.

State law requires interstate commercial carriers to pay the state motor vehicle fuel tax on fuel used in Wisconsin, regardless of where the fuel was purchased. The state is a member of the International Fuel Taxation Agreement (IFTA), which provides a standardized motor fuel tax reporting system and collection procedure for interstate motor carriers.

GOVERNOR

Extend the current gasoline and diesel fuel exemptions to the state motor vehicle fuel excise tax for licensed exporters and for fuel sold for use by a federal agency to the proposed oil company assessment. Income derived from the first sale in this state of biodiesel fuel or ethanol blended with gasoline to create motor fuel consisting of at least 85% ethanol (E85) would not be included in the supplier's gross receipts and would not be subject to the assessment.

The bill contains no provisions related to treatment of the proposed oil company assessment under IFTA.

DISCUSSION POINTS

Fuel Tax Exemptions

1. Under current law, there are the following exemptions from the state's 30.9 cents per gallon motor vehicle fuel tax: (a) fuel exported from this state by a licensed exporter; (b) fuel sold to the federal government; (c) fuel sold for use in urban mass transportation; (d) gasoline used for nonhighway purposes and delivered in a quantity of at least 100 gallons if the user (generally, a farmer) has obtained an exemption card in advance; (e) gasoline sold to a general aviation fuel dealer for use in an aircraft, provided it is delivered directly into the dealer's storage tank in a quantity of at least 100 gallons; (f) diesel fuel sold for use as heating oil, which is generally dyed diesel fuel; (g) diesel fuel sold for use in trains; (h) diesel fuel sold for nonhighway use, which is generally dyed diesel fuel; and (i) diesel fuel exported by an unlicensed person who has paid the tax on it to the destination state, as evidenced by a bill of lading.

2. As introduced, the bill would only extend the current law motor vehicle fuel excise tax exemptions for licensed exporters and for fuel sold for use by a federal agency to the proposed oil company assessment. The following table lists the amount of gallons exempted from the state motor vehicle fuel tax by type of exemption for 2005-06, based on Department of Revenue reports. However, the dyed home heating oil exemption amount is based on U.S. Department of Energy data on residential consumption of distillate in Wisconsin for 2005. The table also lists the estimated revenues that would be generated if the oil company assessment were applied to each exempt use.

<u>Type of Exemption</u>	<u>Gallons Exempted</u>	<u>Estimated Annual Oil Company Assessment Revenue</u>
Dyed Home Heating Oil	133,498,000	\$6,465,000
Nonfarming Off-Road	24,085,019	1,166,000
Agriculture	18,743,504	908,000
Native Americans	8,220,966	398,000
Taxis	3,954,919	192,000
Waste Management	2,953,661	143,000
Mass Transit	2,732,907	132,000
Aviation	66,217	3,000
Nondyed Heating Oil	<u>33,620</u>	<u>2,000</u>
Total	194,288,813	\$9,409,000

3. In a March 19, 2007, memorandum to the Joint Committee on Finance, the Department of Administration (DOA) Secretary indicated that the Governor's intent was to impose the oil company assessment only on motor vehicle fuel that has an end use of propelling motor vehicles in certain circumstances. As a result, under the Governor's modified recommendation, all of the current exemptions to the motor vehicle fuel tax would be extended to the proposed oil

company assessment.

4. DOA's revenue estimate for the oil company assessment was derived based on Department of Transportation (DOT) fuel consumption estimates for only those gallons currently subject to the motor vehicle fuel excise tax. As a result, the revenue estimate under the bill does not include any revenues associated with extending the proposed oil company assessment to include uses that are currently exempt from the state motor vehicle fuel tax. In addition, the revenue reestimate shown in LFB Paper #760 reflects the Governor's intent, not the actual language in the bill. Therefore, no adjustment would need to be made to the estimated revenues to reflect the Governor's modified recommendation identified in the DOA memorandum.

5. The Governor's Budget in Brief indicates that the oil company assessment is aimed at assessing oil companies for a portion of their "excess profits." The Governor's proposal contains "anti-pass-through" provisions, aimed at making it illegal for oil suppliers to pass on the oil company assessment to consumers. Therefore, the administration contends that consumers or end users of the fuel would not see an increase in the cost of fuel.

6. The state's transportation program is based on a user-financing concept. This is done by segregating certain transportation-related revenues, such as the motor vehicle fuel tax and vehicle registration and drivers' license fees, in the transportation fund. Such revenues are then used to fund transportation-related expenditures. In keeping with this concept, most of the uses that are exempt from the state's motor vehicle fuel tax are not taxed because the fuel is used for off-road purposes. Limiting the assessment to only fuel supplied for use in highway purposes may be seen as being consistent with the current, user-financing concept of funding transportation.

7. However, if the oil company assessment, as the administration contends, would not be passed on to consumers, then extending the oil company assessment to nonhighway uses may not be inconsistent with the highway user fee policy. Also, if, as the administration states, the policy goal is aimed at assessing oil companies for a portion of their profits, then applying the assessment on all petroleum-based fuel products on which oil companies make profits could be seen as being consistent with this goal. Approving the Governor's original recommendations related to the exemptions to the oil company assessment, as introduced under SB 40, would subject most fuel products delivered by fuel suppliers to the state to the oil company assessment. Adjusting for changes in projected consumption of the fuel, this would increase revenues by an estimated \$7,000,000 in 2007-08 and \$9,400,000 in 2008-09.

Ethanol Exemption

8. The bill would exempt income derived from the first sale in this state of biodiesel fuel or ethanol blended with gasoline to create motor fuel consisting of at least 85% ethanol (E85) from the oil company assessment. According to the Wisconsin Office of Energy Independence, 2.7 million gallons of the ethanol portion of E85 fuel were sold in Wisconsin in 2006, compared to 2005, when 723,000 gallons were sold. In addition, an estimated 600,000 gallons of the biomass portion of biodiesel will be consumed in Wisconsin in 2006-07, compared to 2005-06, when an estimated 275,000 gallons were sold. Both of these products have experienced significant annual

percentage growth in consumption in the state in recent years. This makes it difficult to project the reduction in motor vehicle fuel tax revenues that would occur if these fuels were exempted from the state's motor vehicle fuel tax. However, assuming consumption of E85 and biodiesel would double during the biennium and reach 6.6 million gallons annually, exempting these fuels from the proposed oil company assessment reduces revenues from the proposed assessment by an estimated \$580,000 in the biennium.

9. Pure ethanol is not subject to the motor vehicle fuel tax until it is blended with a petroleum-based fuel and sold. Ethanol is typically blended in-stream with petroleum-based fuel as tankers are filled at terminal facilities, and is taxed at the time the blended fuel is first sold, under the state's motor vehicle fuel tax. The bill would not exempt the ethanol portion of gasohol, which generally contains up to 10% ethanol, or other blends below 85% ethanol from the oil company assessment. Therefore, the receipts from the first sale of ethanol-blended fuel at the terminal facilities would be subject to the oil company assessment.

10. Wisconsin Energy Statistics, 2006, indicates that 123.0 million gallons of ethanol were blended with gasoline and consumed in the state in 2005. In 2006, according to the state Office of Energy Independence, 130.4 million gallons of ethanol blended with gasoline were consumed in the state. With reformulated gas requirements and increased ethanol production in the state, nearly half of all gasoline consumed in the state contains some ethanol. Based on U.S. Department of Energy forecasts, consumption of ethanol is expected to grow at an average, annual rate of nearly 5% per year through 2012. Applying this growth rate to Wisconsin's 2006 consumption amounts, it is estimated that the state will consume approximately 137 million gallons of ethanol in 2007, 144 million gallons in 2008, and 151 million gallons in 2009.

11. Several existing state and federal programs have been designed to promote the development of ethanol production and the use of ethanol as a renewable energy source. In addition, under the bill, the Department of Commerce would administer a \$30.0 million renewable energy grant and loan program under the Wisconsin Development Fund (WDF), which could fund up to 50% of the costs of a renewable energy project. The bill would specifically require the Department of Commerce to make a grant of up to \$5.0 million from the proposed grant program for the construction of a specific ethanol plant. Also, in recent biennia, legislative proposals have been introduced to require all gasoline sold in Wisconsin to contain at least 10% ethanol.

12. Exempting the ethanol portion of non-E85 motor vehicle fuel from the proposed oil company assessment may be seen as being consistent with these state and federal program efforts to develop and promote ethanol production and consumption. If the ethanol portion of motor vehicle fuel were exempted from the oil company assessment, revenues to the transportation fund from the proposed oil company assessment would be reduced by an estimated \$12.1 million during the biennium. Based on current fuel consumption projections, this exemption would grow to \$12.7 million annually if every gallon of gasoline currently consumed in Wisconsin contained 10% ethanol.

13. Conversely, exempting ethanol from the oil company assessment could distort the state's fuel market by giving ethanol companies a price advantage, or price subsidy, compared to

petroleum-based fuel products. Like oil companies, though a much less established industry, ethanol companies have also begun to experience significant profits in recent years. Therefore, if the oil company assessment is not passed on to consumers, and the policy goal is to make all fuel producers share some of their profits by paying for some of the costs of maintaining state roads on which a portion of those profits were generated, then making income derived from the sale of ethanol-based fuel subject to the oil company assessment could be seen as an equitable policy decision. If the oil company assessment is eventually passed on to consumers, then, in keeping with a user-financing concept for the state's transportation program, making state motorists who purchase ethanol-blended fuel pay their share of cost could also be seen as an equitable policy decision.

International Fuel Tax Agreement

14. The federal Intermodal Surface Transportation Efficiency Act of 1991 required most states to join IFTA by September 30, 1996. Currently, all states are members of IFTA. Wisconsin has been a member since 1989. Under IFTA, a carrier operating in two or more member states must apply for an annual fuel tax license from one of the states. That state becomes the carrier's base state and the license from that state permits the carrier to operate in all IFTA states. IFTA guidelines require the base state to be chosen according to where carriers' vehicles are registered and where carriers have operations that permit them to make records available for audit.

15. To pay motor fuel taxes, carriers send a quarterly return to the base state. The return reports all miles traveled, fuel purchased, and fuel tax already paid "at the pump" to each member state. Also, the return shows fuel taxes owed to each member state and any refunds owed the carrier. Each state's taxes are calculated on the basis of the number of miles traveled in the state and the carrier's fuel efficiency. The carrier pays any net amount due when the report is filed. If the carrier owes taxes to other states, the base state makes those payments for the carrier. If other states owe the carrier refunds, the base state refunds any overpayments and then collects the refunds from the other states. The carrier must keep records to support the information on its return. Each base state audits the carriers registered there, on behalf of all IFTA states.

16. On average, over the past five years, motor carriers operating under IFTA purchased 8.1 million fewer gallons per year in Wisconsin than were used in Wisconsin. Therefore, under IFTA procedures, 8.1 million gallons of fuel purchased each year in other states were effectively imported (due to their usage here) to Wisconsin, and eventually taxed by Wisconsin.

17. IFTA tax rates are adjusted on a quarterly basis by IFTA member states. States with taxes or fees that are price-based, similar to the proposed oil company assessment, are able to include those taxes in their IFTA tax rates. These states can adjust their IFTA rates on a quarterly basis to reflect changes in the price of the fuel product. However, because suppliers would be prohibited from reflecting the oil company assessment in the fuel prices charged to consumers, the state's IFTA tax rate of 32.9 cents per gallon (a 30.9 cents per gallon motor vehicle fuel excise tax and a two cent per gallon petroleum inspection fee) would not be adjusted to reflect the proposed oil company assessment.

18. The state would receive revenue from the oil company assessment on the first sale of

fuel subject to IFTA that is sold in Wisconsin by fuel suppliers. However, if the state's IFTA tax rate is not adjusted to reflect the proposed oil company assessment, the state would not receive any revenue from the oil company assessment on fuel purchased outside Wisconsin, but used in the state.

19. DOT's diesel fuel consumption estimates for the 2007-09 biennium included the net IFTA gallons, which reflect that, over the past five years, fewer net gallons of diesel fuel were purchased in Wisconsin than were used in Wisconsin. These consumption estimates were the basis for DOA's revenue estimate for the oil company assessment. If the trend of the past five years continues, these consumption estimates would overstate the gallons of diesel fuel that would be subject to the assessment by the net amount of IFTA gallons on which the proposed oil company assessment would not be paid. In order to reflect these gallons, estimated revenues from the oil company assessment should be adjusted downward by \$300,000 in 2007-08 and \$400,000 in 2008-09.

20. Some interstate motor carriers may believe that the state cannot truly prohibit fuel suppliers from passing on the cost of the oil company assessment in the price of their product. If this belief is widely held, carriers may choose to purchase their fuel outside the state in order to avoid the oil company assessment, especially since the carriers would know that they would not receive credit for the assessment through the IFTA process. Such a perception could hurt the fuel sales of in-state fuel retailers. Also, because the proposed oil company assessment is outside of the IFTA process, the state would not recoup any oil company assessment revenues from any reduced in-state fuel sales even if the carrier uses the fuel in the state. Therefore, if any such reduction in in-state fuel purchases were to occur, the state's motor vehicle fuel tax revenues could be somewhat reduced.

ALTERNATIVES TO BILL

A. Oil Company Assessment Exemptions

1. Approve the Governor's original recommendation to exempt only fuel sold by licensed exporters and fuel sold for use by a federal agency from the oil company assessment. Increase estimated revenues to the transportation fund by \$7,000,000 in 2007-08 and \$9,400,000 in 2008-09 to reflect that these gallons were not included in the revenue estimates for the oil company assessment.

ALT A1	Change to Bill Revenue	Change to Base Revenue
SEG	\$16,400,000	\$16,400,000

2. Extend all the current law exemptions to the motor vehicle fuel tax to the proposed oil company assessment in order to reflect the Governor's modified recommendation. (Since SB 40, the Governor's original proposal, did not assume any revenues associated with the broader base of

gallons being subject to the proposed oil company assessment, this alternative would not change revenues from the amounts originally assumed.)

B. Ethanol and Biodiesel Exemptions

1. Approve the Governor's recommendation to exempt gross revenues derived from the sale of E85 and biodiesel from the oil company assessment.

2. In addition to Alternative 1, exempt all gross revenues derived from the sale of the ethanol portion of motor vehicle fuel from the oil company assessment (the ethanol portion of all types of gasohol and reformulated gasoline would be exempt from the oil company assessment). Decrease estimated transportation fund revenues from the assessment by \$5,060,000 in 2007-08 and \$7,040,000 in 2008-09 to reflect this broader exemption.

ALT B2	Change to Bill Revenue	Change to Base Revenue
SEG	- \$12,100,000	\$0

3. Delete provision (income derived from any ethanol or biodiesel product included in motor vehicle fuel would be subject to the oil company assessment). Increase estimated transportation fund revenues from the assessment by \$250,000 in 2007-08 and \$330,000 in 2008-09.

ALT B3	Change to Bill Revenue	Change to Base Revenue
SEG	\$580,000	\$580,000

C. International Fuel Tax Agreement

1. Decrease the estimated revenues to the transportation fund associated with the proposed oil company assessment by \$300,000 in 2007-08 and \$400,000 in 2008-09 to reflect that, under IFTA, the state would not receive any revenue from the oil company assessment associated with fuel purchased outside Wisconsin, but used in Wisconsin. (No adjustment to the taxable gallons associated with these fuel sales was included in the revenue estimate under the Governor's recommendations.)

ALT C1	Change to Bill Revenue	Change to Base Revenue
SEG	- \$700,000	\$0

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