

SUBJECT: Reducing fraud in motor-fuels tax collection

COMMITTEE: Ways and Means — committee substitute recommended

VOTE: 9 ayes — Oliveira, McCall, Bonnen, Y. Davis, Heflin, Hilbert, Keffer, T. King, Ramsay

0 nays

2 absent — Craddick, Sadler

SENATE VOTE: On final passage, April 27 — voice vote

WITNESSES: No public hearing

BACKGROUND: State motor-fuels tax collections total about \$2.5 billion annually. After deducting 1 percent of motor-fuels taxes for enforcement, 25 percent goes to the available school fund and the remainder to the state highway fund. The gasoline tax, enacted in 1923, and the diesel fuel tax, enacted in 1941, are each currently 20 cents per gallon. The first sale or use of fuel in Texas is taxable. Broad exemptions to the motor fuels taxes exist for agricultural, various industrial and commercial, marine, railway engine, and off-road uses. Sales to sources out of state are also exempt from the state tax, even for uses subject to the tax in this state.

In general, motor fuels taxes are collected from distributors permitted to sell gasoline and diesel fuel to retailers. Most gasoline sold in Texas is purchased by consumers to fuel their private automobiles. The gasoline tax must be paid at the time of sale, regardless of whether the use is exempted or not. People are entitled to a refund of gasoline taxes paid for an exempted use.

However, diesel fuel may be sold without collecting the diesel fuel tax. At the time of the sale, a permitted supplier need not collect the tax if the purchaser furnishes a signed statement stipulating that:

- ! the purchaser does not operate any diesel-powered motor vehicles on public highways;
- ! all of the diesel fuel will be consumed by the purchaser, meaning none

will be resold; and

- ! none of the diesel fuel will be delivered into the fuel supply tanks of motor vehicles.

The signed statement from the purchaser relieves the permitted supplier from the burden of proof that the sale was not taxable. However, no single purchase of more than 3,000 gallons of diesel fuel and no sale of diesel fuel beyond 10,000 gallons in any calendar month may be made tax-free, as above. In addition, a taxable use of any part of the fuel purchased tax-free under a signed statement forfeits the right to purchase diesel fuel tax-free for one year and is subject to criminal penalties.

Certain diesel fuel users called bonded permit holders may purchase diesel fuel without paying the tax to the supplier. To qualify, the purchases must be predominantly for non-highway use. Bonded permit holders report and pay taxes to the state on the portion of diesel fuel that is delivered into the fuel supply tanks of their motor vehicles.

DIGEST:

CSSB 1547 would establish new documentary requirements for shippers, suppliers, dealers, and purchasers of motor fuels, including dyed diesel fuel, and define civil and criminal penalties for violations.

Penalties for tax evasion. CSSB 1547 would make any evasion of or attempt to evade the state motor fuels tax, including attempts to blend fuel to escape taxation, a second-degree felony, punishable by two to 20 years in prison and an optional fine of up to \$10,000. The importation, sale, use, distribution, or storage of fuel within the state on which taxes were imposed but had not been paid to or reported by a permitted person would be a second-degree felony. A permitted person would include the holder of a distributor's, supplier's, liquefied gas dealer's, interstate trucker's, diesel-tax prepaid user's, dyed-diesel-fuel bonded user's, or agricultural bonded user's permit.

The bill would increase the statute of limitations for these and other felony offenses related to evasion of motor fuels taxes to seven years from three years. This would not apply to offenses for which prosecution had become barred by limitation before the effective date of the bill.

Importation, exportation, and transportation of motor fuel. CSSB 1547 would require distributors to maintain an itemized statement showing, by

load, the number of gallons of all gasoline received during the previous calendar month for export and the location of the loading, exported from Texas by destination state or country, and imported to Texas by destination state or country. The bill would prohibit a person from importing or exporting motor fuel by any means without a shipping document issued by the terminal or bulk plant operator. The shipping document would have to include:

- ! the name and physical address of the terminal or bulk plant;
- ! the name and federal employer identification number (EIN), or a social security number if no EIN was available, of the carrier transporting the fuel;
- ! the date the motor fuel was loaded;
- ! the type and number of gallons of the motor fuel;
- ! the destination of the fuel as represented by the name of the purchaser and the number of gallons to be delivered, if delivery was to only one state;
- ! the name, EIN, permit number, and physical address of the purchaser;
- ! the name of the person responsible for paying the tax, if different from the permitted supplier or the distributor; and
- ! any other information deemed necessary by the comptroller.

Each terminal would have to post a notice in a conspicuous location near the point where shipping papers were received. This notice would have to describe the duties of importers and exporters under state law. Failure to post this notice would subject the terminal or bulk plant operator to a civil penalty of \$100 each day.

An importer that acquired motor fuel for import by cargo tank would have to obtain an import verification number from the comptroller. This number would have to be written on the shipping document. Each cargo tank delivery would require its own import verification number. Failure to obtain an income verification number would incur a civil penalty between \$25 and \$200 and would be considered a Class B misdemeanor, punishable by up to 180 days in jail and/or a maximum fine of \$2,000.

An importer or exporter could deliver motor fuel only to the destination state or states indicated on the shipping document. Importers or exporters wishing to divert the delivery of a single cargo tank would have to obtain a diversion number from the comptroller. This diversion number would have to be written on the shipping document. Each diverted delivery would require its own

diversion number. Failure to obtain a diversion number would incur a civil penalty between \$25 and \$200 and would be a Class B misdemeanor.

Diversions and accuracy of shipping documents. If the motor fuel was to be delivered to more than one state, the terminal would have to document the split loads by issuing shipping documents that listed the destination state of each portion of the motor fuel. Terminals, bulk plants, carriers, permitted distributors, and purchasers would have to retain their respective copies of the shipping document for at least four years. Failure to retain required documents would be a third-degree felony, punishable by two to 10 years in prison and an optional fine of up to \$10,000.

A person who issued or accepted a shipping document that did not conform to these requirements would be liable for a civil penalty of \$2,000 or five times the amount of unpaid tax, whichever was greater, for each occurrence. Transportation of motor fuels under a false shipping document or without a shipping document would constitute a third-degree felony. The acceptance of fuel without an accurate shipping document by a dealer would be a second-degree felony.

Dyed diesel fuels. The bill would recognize dyed diesel fuels as a class of motor fuel. Federal rules require diesel fuels to be dyed if they are not subject to federal taxation. CSSB 1547 would continue to permit the tax-free sale of dyed diesel fuel if the purchaser possessed a proper exemption number and furnished a signed statement described above. The bill would authorize dyed-diesel-fuel and agricultural bonded permit holders to buy more than 10,000 gallons a month.

CSSB 1547 would require suppliers to maintain an itemized statement showing, by load, the number of gallons of all diesel fuel received during the previous calendar month for export, exported from Texas by destination state or country, and imported to Texas by destination state or country. This statement also would have to differentiate between dyed and undyed diesel fuel by showing the number of gallons sold to purchasers, end user or agricultural user numbers, or dyed-diesel-fuel or agricultural bonded permit numbers, as appropriate.

The bill would prohibit a person from selling or holding dyed diesel fuel for any use that the person knew or should have known was a taxable use of the

fuel. A notice stating that the diesel fuel was dyed, permitted for nontaxable uses only, and subject to penalty if used for a taxable purpose would have to be provided by a permitted supplier or seller to a buyer. Notice would have to appear on each shipping document, bill of lading, cargo manifest, and invoice accompanying the sale or removal of the dyed diesel fuel.

The bill would prohibit a person from altering the strength or composition of dye used in dyed diesel fuel with the intent of evading payment of tax for a taxable use of the fuel. No person could operate a motor vehicle on a public highway using dyed motor fuels except for uses expressly permitted by federal law. A person who violated this law would commit a Class C misdemeanor, punishable by a maximum fine of \$500.

Tax-free sales of diesel fuel to exempted purchasers. CSSB 1547 would limit the types of diesel fuel sales that could be made without collecting the motor fuels tax. Sales of dyed diesel fuel and of undyed diesel fuel used only for agricultural purposes could be made tax-free if the purchaser furnished an appropriate signed statement and an exemption number issued by the comptroller. Purchasers of dyed diesel fuel would have to apply for an end user number, and purchasers of undyed diesel fuel would need an agricultural user exemption number, to purchase diesel fuel without paying the tax. Exemption holders would remain subject to the 3,000- and 10,000-gallon limits as under current law.

Reporting requirements. CSSB 1547 generally would impose stricter reporting and record-keeping requirements on all parties involved in the sale, distribution, and use of motor fuels.

The records of each intrastate and interstate transportation of motor fuel would have to be reported in a form and manner determined by the comptroller by the 25th day of the month following each calendar quarter. The bill would require distributors and others liable for payment of the tax to file all reports and to remit taxes by the 25th of each month for taxes due for the previous month. The comptroller would have to establish the forms for all these reports, which could include an electronic form of reporting. The bill would stipulate that the failure of a person subject to reporting requirements to obtain proper forms or software would be no excuse for failing to file proper reports.

The bill would require the comptroller to cancel a distributor's, supplier's, dyed-diesel-fuel bonded user's, or agricultural bonded user's permit if no purchase, sale, or use of gasoline or diesel fuel had been reported by the permit holder during the prior nine months. This requirement would apply to taxable and non-taxable sales and uses of motor fuels.

Effective date. CSSB 1547 would take effect September 1, 2000, and would apply to the importation, exportation, and first sale of motor fuel occurring on or after that date. Current law would remain in effect for motor fuel imported, exported, or first sold before that date.

SUPPORTERS
SAY:

CSSB 1547 represents a compromise between all parties interested in the proper collection of state motor fuels taxes. The bill would refine the current system for tax collection by increasing permit holders' reporting responsibilities, imposing new restrictions on the importation and exportation of fuel, limiting the tax-free sale of undyed diesel fuel to agricultural users only, enabling the comptroller to require reports in an electronic format, defining blending, limiting the validity of inactive permits, and creating new criminal offenses and penalties. It would provide a maximum benefit at a minimum cost to distributors, consumers, and the state.

This bill would increase state motor-fuels tax collections by making it more difficult for people to evade their responsibilities to pay taxes and report on their dealings. By 2004, the bill would bring in more than \$60 million a year, including more than \$25 million in federal matching funds. The bill would provide stiff penalties for people who evaded their responsibilities to keep records and pay their taxes.

CSSB 1547 would protect law-abiding wholesale distributors and suppliers, especially small businesses, because it would not force them to pay the sales tax up front instead of when the fuel was sold. Such up-front payments amount to \$200,000 a month for the average distributor, whose profit margin averages a half-cent to a cent per gallon. The state does not require wholesalers or retailers to pay sales taxes before goods are sold, and it should not require fuel suppliers to pay before their goods are sold.

Responsible fuel companies keep accurate, complete records of their shipments, taxes collected, and non-tax sales. This bill would not hurt their operations or place undue burdens on them. It would, however, make it

immensely more difficult for unscrupulous distributors to collect taxes from retailers and not turn them over to the state. Under current law, distributors can evade taxes by:

- ! claiming that fuel will be sold out of state and selling it in Texas;
- ! claiming that fuel is sold for agricultural purposes, or some other exempt use, when it was not;
- ! swapping tanker trucks full of fuel with other distributors in complicated sale transactions that are difficult to trace back to the original purchaser;
- ! blending fuel with other products to change the volume of the fuel sold to retailers, so that extra taxes are collected by the distributor;
- ! altering shipping documents, manifests, and invoices to disguise actual amounts of fuel purchased, transported, or sold; and
- ! using permits that have been inactive for a year or more to obtain fuel when the permit holder is not actively involved in the business.

CSSB 1547 would close this partial list of loopholes. It would not make fraud impossible, but it would make it much more difficult. The Comptroller's Office has significant experience in enforcing motor-fuels tax collection and would be able to manage these new requirements easily, especially as more and more of these records would be provided in electronic formats. Reports coming in to the comptroller from the terminals and suppliers could be analyzed quickly to discover discrepancies, vastly reducing the time required for audits and increasing their effectiveness.

The bill would recognize and provide for the regulation of dyed diesel fuels, which by law must be used solely for non-taxable purposes. This "tax or dye" system increases the accountability for these fuels and reduces the chances for fraud. The bill would provide strong penalties and enforcement mechanisms for people who illegally used dyed fuel for taxable uses. It would allow only agricultural bonded permit users to purchase non-dyed fuel tax-free. Permitted wholesalers would have to report their sales, broken out by dyed and non-dyed fuel.

**OPPONENTS
SAY:**

The only way to reduce fraud significantly and to maximize federal highway funding is to impose and collect motor fuels taxes at the terminal. In the late 1980s, the federal government shifted its collection of federal fuels taxes from distributors to refiners. Overnight, tax collections rose 22.5 percent with no increase in overall sales. The state tax is assessed on the same products and

for virtually the same uses as the federal tax. It should be collected at the same time. The state could phase the requirement in over the next several years to reduce the immediate shock it might have on distributors.

NOTES:

The House committee substitute added a requirement that shipping documents include the federal EIN or social security number if the EIN was not available. The substitute also would delay the bill's effective date by one year, to September 1, 2000.

As introduced, SB 1547 would have created a new body of motor-fuels tax law that would have moved the point of collection to the terminal from the wholesaler. It would have created 10 new licenses, new exemptions, and new procedures for calculating, remitting, and refunding taxes. It also would have altered the allocation of the gasoline tax.