



Motor Fuel Tax Calculation Methods - Adjustable Rates (2010)

The following information outlines four alternative methods for calculating fuel tax utilizing an adjustable rate and the administrative issues associated with each method. The first method is based on general sales tax, the second method is a modified version of general sales tax but incorporates a historical average retail price that is pre-paid by the retailer, the third method is a hybrid of method one and method two, and the fourth method is based on an adjusting price index application.

Historically, fuel tax rates have typically been based on cents per gallon rate. This predetermined value is added to the retail or wholesale price of the fuel. The total price is displayed to the customer and includes all excise taxes.

Method One – General Sales Tax Component

In the past three decades, a number of states have integrated their taxation structure to include some form of sales tax, which is typically defined as a percentage of the retail selling price, remitted by the retailer via a monthly sales tax return. This approach to taxing has the advantage of automatically increasing taxes collected per gallon as the price of fuel increases. Adversely, revenue from fuel taxes will decline if the price of fuel decreases.

The following issues should be considered before a state mandates a taxing structure based on a percentage of the retail sales price.

1. Fuel taxes are currently collected by virtually all states somewhere in the wholesale distribution chain. The collection of tax on the retail selling price will require a dramatic increase in the number of registrations and regular filers. This will create a significant administrative cost for both the states and the fuel dealers.
2. Current retail gasoline pumps are designed to include all taxes in a total price (per gallon) of the fuel and are not equipped to calculate an additional percentage tax on the total sale. Customers at a retail station have an expectation that the amount on the pump is the total sale. If a state attempts to collect tax in addition to the selling price, the ability for a customer to buy \$20.00 worth fuel will be extremely complicated.
3. The majority of retail service stations are convenience stores. The compliance related to collecting and remitting sales tax, as well as maintaining records to support sales made by many of the independent dealers in this industry, is widely considered to be very poor. This means that not only will there be a significant cost associated with the registration and filing by these dealers, but there will likely be significant compliance issues requiring substantial enforcement resources.
4. Returns and records would be based on sales dollars rather than gallons. This change would affect the current approach to fuel tracking, as gallons are tracked at the wholesale level and dollars would have to be tracked at the retail level.
5. A unique return processing and math audit program dedicated to this sales tax will potentially be required to process the information and tax collected as a sales tax.



6. Special care must be taken to deal with the normal exemptions routinely offered for sales subject to sales tax versus the limited exemptions allowed for most highway fuels. Allowing these exemptions would compound the administrative burdens associated with the administration of this tax.

Method Two - Modified General Sales Tax Component- Prepaid Sales Tax

Based on the problems associated with the implementation of a traditional sales tax, many states have opted for a modified version based on a historical average retail price. This approach calls for periodic determination of an average retail sales price for a recent time period, and a calculation of sales tax associated with the sale of a single gallon. The tax is converted to some number of cents, usually rounded to a tenth of a cent, per gallon that is either added to a fixed rate or is the entire tax amount to be collected per gallon. This sales tax component is pre-paid by the retailer to the wholesaler at the time the fuel is purchased. (The pre-paid sales tax component may be collected by the terminal supplier of the fuel depending upon the state’s fuel tax collection structure.)

The following issues should be considered before a state mandates a modified sales tax approach based on an historical average price. This method has fewer administrative issues than the general sales tax approach, but significant issues remain.

1. This approach resolves registration, filing, and collection issues (if there are no varying local taxes) by allowing the tax to be administered and collected in the same manner, from the same businesses, as traditional highway excise taxes.
2. The state must be prepared to routinely gather the necessary information to calculate an average price. In addition, the information should be collected timely and conveyed to all applicable parties. This approach to taxing has the advantage of automatically increasing taxes collected per gallon as the price of fuel increases. Adversely, revenue from fuel taxes will decline if the price of fuel decreases. Also, the average price may be skewed due to the time lag between the period used to establish the average cost and actual costs reported in the current period
3. The tax rate will change on a periodic basis, usually on an annual or semi- annual basis. The rate changes will require taxpayers to timely change their system to both collect and report tax at the correct rates.
4. Returns, math audit programs, and billing programs used by states to evaluate the accuracy of returns will require revision each time rates change. States will be required to maintain historical rate schedules and historical math audit and billing programs in order to process amended returns and/or adjustments related to prior periods.
5. Taxpayers reporting late loads in current periods may be reporting at the wrong rate. Taxpayers will also need the ability to amend or correct prior period reporting based on the historical rates.
6. Taxpayers will incur liabilities for uncollected taxes if rate changes are not timely implemented.
7. Inventories stored at a point in the wholesale chain after the point of taxation, will have the wrong rate of tax imbedded in the price, potentially requiring the collection of a floor tax or refunds.

Method Three- General Sales Tax in Combination with Pre-Paid Sales Tax Collection (Hybrid of Method One and Method Two)

This option combines method one and method two in that an average sales tax is pre-paid by the retailer to the wholesaler at the time the fuel is sold, and the retailer also reports sales of fuel and remits the sales tax on the monthly sales tax return, taking credit for the pre-paid sales tax amount that was paid to the wholesaler. Again, the pre-paid sales tax component may be charged by the terminal supplier of the fuel, depending upon the state’s fuel tax collection structure.



This method would generate additional revenue via the retailer’s sales tax return if the sales price of the fuel increases during the month. Conversely an overpayment/credit scenario would arise for the retailer if the price of fuel decreases during the month, resulting in a loss of revenue for the state.

The complexities associated with Method One and Method Two would also apply and would be further complicated by the need for the state to process possible credits due the retailer.

Method Four – Price Indexing Component

A fourth option is an adjusting rate based on something other than average sales price, such as the federally published consumer price index (CPI) changes or average wholesale prices as compiled by the federal Energy Information Administration (EIA). As with the average sales price, the approach will require certain changes to the traditional cents per gallon fixed tax rate.

1. The state must be prepared to calculate and distribute changes in rate on a timely basis. The rate can still increase or decrease based on the direction of the CPI used in the calculation. These fluctuations should be less dramatic than those created through the use of an average sales price. Also, the time lag between the period used to establish a rate and actual prices reported in the current periods is reduced.
2. The tax rate will change on a periodic basis, usually annually or semi-annually. The rate changes will require taxpayers to timely change their system to both collect and report tax at the correct rates.
3. Returns, math audit programs, and billing programs used by states to evaluate the accuracy of returns will require revision each time rates change. States will be required to maintain historical rate schedules and historical math audit and billing programs in order to process amended returns and/or adjustments related to prior periods.
4. Taxpayers reporting late loads in current periods may be reporting at the wrong rate. Taxpayers will also need the ability to amend or correct prior period reporting based on the historical rates.
5. Inventories stored at a point in the wholesale chain after the point of taxation, will have the wrong rate of tax imbedded in the price, potentially requiring the collection of a floor tax or refunds.

Conclusion

Each method of adjusting fuel tax rates offers an opportunity to increase revenues based on the effects of inflation without additional legislation, creating a revenue base that better mirrors rising costs. Each approach also presents administrative burdens for both industry and the states. Any state considering a change from their current taxing structure should be prepared to deal with these issues and costs.