

[Senate Bill 16](#) (Beall)

Date: 05/13/15

Program: Motor Vehicle Fuel and Diesel Fuel Tax

Sponsor: Author

Revenue and Taxation Code Sections 7360 and 60050

Effective: Immediately but operative 61 days after enactment

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*This analysis is limited to the provisions which impact the Board of Equalization (BOE).*

**Summary:** Imposes a ten cents (\$0.10) per gallon surtax on motor vehicle fuel (gasoline), and twelve cents (\$0.12) per gallon surtax on diesel fuel, for five years, and equivalent rate one-time floor stock tax.

**Summary of Amendments:** Among other things, the amendments since the previous analysis provide a 60-day delayed operative date and impose a one-time floor stock tax on gasoline and diesel fuel inventories.

**Purpose:** To create a temporary funding source for the state, counties, and cities to address road maintenance needs.

**Fiscal Impact Summary:** Total excise and sales tax revenues increase by \$1.048 billion in fiscal year (FY) 2015-16, and \$1.863 billion in FY 2016-17.

**Existing Law:** The existing Motor Vehicle Fuel Tax Law (MVFTL)<sup>1</sup> and the Diesel Fuel Tax Law<sup>2</sup> generally impose excise tax on gasoline and diesel fuel upon:

- The removal (except for aviation gasoline) at the refinery or terminal rack.
- The entry into the state; and
- The sale to an unlicensed person.

For FY 2015-16, the gasoline excise tax rate is set at \$0.30 per gallon, and at \$0.13 per gallon on diesel fuel.<sup>3</sup>

Currently, as part of the “fuel tax swap” measures, since July 1, 2010, retail sales of gasoline are exempt from the state’s 6% General Fund rate. These provisions also increased the sales and use tax rate on retail diesel fuel sales and purchases to offset the loss related to the diesel fuel excise tax rate reduction, resulting in the additional sales and use tax rates detailed below (fuel tax swap).

Under the MVFTL, the Metropolitan Transportation Commission (Commission) has the authority to levy a local tax on gasoline to fund transportation projects.<sup>4</sup> The Commission is made up of nine Bay Area members that include the City and County of San Francisco, and the counties of Alameda, Contra Costa, Marin, Napa, San Mateo, Santa Clara, Solano, and Sonoma.

Additionally, the Local Motor Vehicle Fuel Taxation Law<sup>5</sup> authorizes counties to impose countywide excise taxes on gasoline at increments of one cent per gallon, provided a majority of the voters approve the proposition. The funds collected must be used only for purposes authorized by Article XIX of the California Constitution, such as transportation planning and construction. To date, however, no county imposes a local fuel tax under this authority.

<sup>1</sup> Part 2 (commencing with Section 7301) of Division 2 of the Revenue and Taxation Code (RTC).

<sup>2</sup> Part 31 (commencing with Section 60001) of Division 2 of the RTC.

<sup>3</sup> The rate was set, as required by statute, at the Board of Equalization (BOE) hearing on February 24, 2015: <http://www.boe.ca.gov/meetings/pdf/2015/022415-022615M.pdf>

<sup>4</sup> Chapter 12 (commencing with Section 8500) of Part 2 of Division 2 of the RTC.

<sup>5</sup> Part 4 (commencing with Section 9501) of Division 2 of the RTC.

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The sales and use tax law provides that the excise tax on gasoline is included in the computation of locally-imposed sales and use tax.<sup>6</sup> The excise tax imposed on diesel fuel is *not* subject to sales or use tax.<sup>7</sup>

In addition, federal law imposes additional per gallon taxes on gasoline and diesel fuel of \$0.184 and \$0.244, respectively.

**The fuel tax swap:** In 2010, the Legislature enacted two “fuel tax swap” measures<sup>8</sup> that changed the imposition and rates of state taxes on gasoline and diesel fuel, and require the BOE to determine the appropriate excise tax rate adjustments to maintain revenue neutrality. The gasoline tax changes became operative on July 1, 2010, and the diesel fuel tax changes became operative July 1, 2011.

These provisions<sup>9</sup> exempt sales and purchases of gasoline from the state General Fund sales and use tax rate. To offset the revenue loss related to this partial exemption, the law increased the gasoline excise tax rate from \$0.18 per gallon to \$0.353 per gallon.<sup>10</sup> Conversely, the statute<sup>11</sup> reduced the diesel fuel excise tax rate from \$0.18 to \$0.13 per gallon but increased<sup>12</sup> the sales and use tax rate on diesel fuel sales and purchases to offset the loss related to the diesel fuel excise tax rate reduction, resulting in the following rates:

1.87% effective July 1, 2011

2.17% effective July 1, 2012

1.94% effective July 1, 2013

1.75% effective July 1, 2014, and thereafter.

The fuel tax swap provisions require the BOE to maintain revenue neutrality so that the revenues derived from the increased gasoline excise tax and the increased diesel sales and use tax equals the revenues that would have been derived had the gasoline sales and use tax partial exemption and the diesel fuel excise tax reduction, respectively, not occurred.

RTC Sections 7360 and 60050 require the BOE to adjust the gasoline and diesel fuel excise tax rates, to maintain revenue neutrality. For gasoline, the BOE determines: (1) whether the sales and use tax revenue loss related to the partial exemption was fully offset by the adjusted rate, and (2) the projected sales and use tax revenue loss for the next FY, considering forecasted gasoline prices and consumption.

For diesel fuel, the BOE determines: (1) whether the revenue gain from the increased sales and use tax rate on diesel fuel sales and purchases was fully offset by the adjusted diesel fuel excise tax rate, and (2) the projected sales and use tax revenue gain for the next FY, considering forecasted diesel fuel prices and consumption.

By March 1 each year, the BOE must determine the rate adjustments that apply the following July 1.

**Proposed Law:** This bill amends RTC Section 7360 to impose a \$0.10 per gallon surtax on gasoline on and after the 61<sup>st</sup> day after the bill’s effective date. The subparagraph is inoperative in any FY in which the Road Maintenance and Rehabilitation Program (Road Program, which this bill creates) has not been authorized, pursuant to Streets and Highway Code Section 2030 (b).

<sup>6</sup> Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200) and voter approved Transactions and Use Tax levied at varying rates by some cities, counties, and special taxing jurisdictions in various cities and counties within the state and which are distributed to those local agencies (Parts 1.6 and 1.7, commencing with Section 7251).

<sup>7</sup> Section 6011(b)(3), defines “sales price,” and Section 6012(a)(4) defines “gross receipts.”

<sup>8</sup> [ABx8 6](#), (Ch. 11, Stats. 2010) and [SB 70](#) (Ch. 9, Stats. 2010). These provisions were re-enacted in 2011 by [AB 105](#) (Ch. 6, Statutes 2011).

<sup>9</sup> RTC Section 6357.7.

<sup>10</sup> RTC Section 7360.

<sup>11</sup> RTC Section 60050.

<sup>12</sup> RTC Sections 6051.8 and 6201.8.

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The bill also amends RTC Section 60050 to impose a \$0.12 per gallon surtax on diesel fuel on and after the 61<sup>st</sup> day after the bill's effective date. The subdivision is also inoperative in any FY in which the Road Program has not been authorized.

Sections 7361.2 and 60050.2 impose a one-time floor stock tax of \$0.10 and \$0.12 per gallon, respectively, for the storage of tax-paid gasoline or diesel fuel intended for sale and held by the supplier, wholesaler, or retailer owning \$1,000 or more gallons on the 61<sup>st</sup> day after the bill's effective date.

Sections 7653.2 and 60201.4 require the floor stock tax return to be filed with the BOE on the 121<sup>st</sup> day after the bill's effective date. The floor stock tax return reports the number of gallons of gasoline or diesel fuel held by the supplier, wholesaler, or retailer owning \$1,000 or more gallons on the 61<sup>st</sup> day after the bill's effective date. Funds are made payable to the Controller.

The bill adds Chapter 2 (commencing with Section 2030) to Division 3 of the Streets and Highway Code to among other things, authorize the Road Program for FYs 2015-16 to 2019-20. If the Legislature does not reauthorize the program beyond the 2019-20 FY, the surtax would terminate June 30, 2020. The temporary fuel surtax funds would be used to address deferred maintenance on state highways and local streets and roads.

This bill contains an urgency clause and becomes effective immediately, but the tax increases have a delayed operative date of 61 days.

**Background:** In 1990, voters approved Proposition 111 which, among other things, increased the tax rate on most motor vehicle fuels from \$0.09 to \$0.14 per gallon, effective August 1, 1990. Further, on January 1, 1991, and each January 1 thereafter through 1994, the excise tax increased by \$0.01 per gallon to the current \$0.18 per gallon.<sup>13</sup>

In 2000, the California Legislature changed the point of taxation up the chain of distribution from the first distribution of the fuel to the removal of the fuel from the refinery or terminal rack. The legislation also provided for a floor stock tax and a backup tax, which applies to the sale and/or delivery of gasoline into the fuel tank of a motor vehicle on which the tax has not been paid or the tax on the fuel has been refunded.<sup>14</sup>

Upon enactment of the fuel tax swap in March 2010, the gasoline excise tax rate was increased and included a floor stock tax, which is a way to equalize the excise tax paid on fuel held in inventory by a supplier, wholesaler or retailer prior to the effective date of a tax increase and fuel purchased after the tax increase. Having a large fuel inventory before a tax rate increase takes effect can bring about a small windfall to a seller, who can raise the selling price of the fuel purchased prior to the increase and attribute the increase in price to the tax rate increase. Since the diesel fuel excise tax rate was decreased, there was no need for a floor stock tax.

**In General:** The fuel tax swap requires the BOE to determine the excise tax rates for gasoline and diesel fuel on an annual basis. The legislation set the excise tax rate for the first year of the swap and required the BOE to adopt a "revenue-neutral" excise tax rate for each ensuing FY. The calculation requires the BOE staff to develop a forecast of both consumption and price for both gasoline and diesel fuel. Staff works closely with Department of Finance (DOF) and adopts DOF's consumption forecasts.

BOE's rate calculation also takes into account the "true-up" portion, which is the one-year look-back period to determine the difference between what was estimated for the previous FY and what was actually collected.

Since enactment of the "fuel tax swap," the BOE has adjusted the gasoline excise tax rates to maintain the required revenue neutrality through incremental increases and decreases as follows:

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<sup>13</sup> Senate Constitutional Amendment 1 (Proposition 111) in the June direct primary election, made operative Assembly Bill 471 (Ch. 106, Stats. 1989) and Senate Bill 300 (Ch. 105, St. ats. 1989).

<sup>14</sup> Assembly Bill 2114 (Ch. 1053, Longville).

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July 1, 2011: Increase of \$0.004

July 1, 2012: Increase of \$0.003

July 1, 2013: Increase of \$0.035

July 1, 2014: Decrease of \$0.035

July 1, 2015: Decrease of \$0.060

The BOE adjusted the diesel fuel excise tax rate with both increases and decreases, as follows:

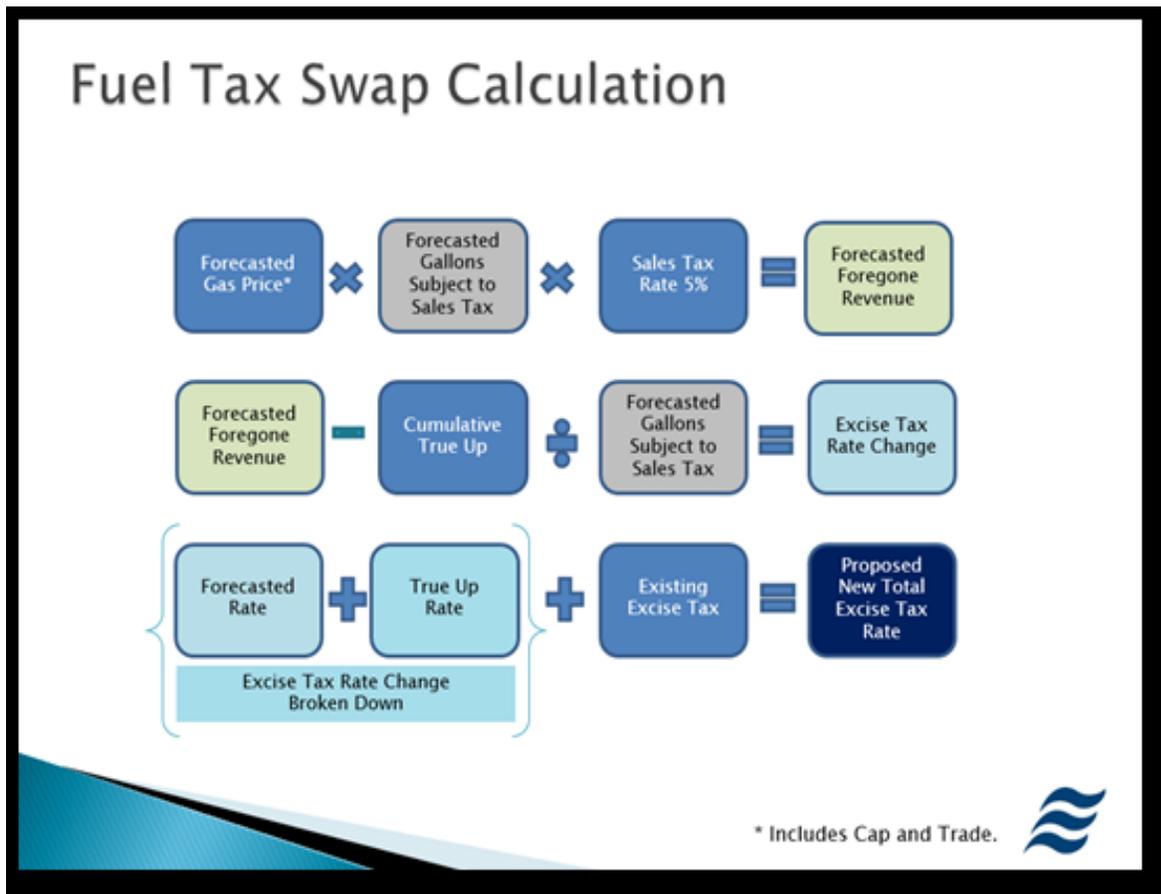
July 1, 2012 : Decrease of \$0.03

July 1, 2013: Retain July 1, 2012 rate

July 1, 2014: Increase of \$0.01

July 1, 2015: Increase of \$0.02

The following chart depicts the fuel tax swap calculation:



### Commentary:

- 1. Effect of the bill.** This bill creates a temporary funding source for state and local government to address road maintenance through a \$0.10 per gallon surtax on gasoline and \$0.12 per gallon surtax on diesel fuel.
- 2. The May 13, 2015 amendments** make the proposed surtaxes operative 60 days after enactment. The amendments also add floor stock tax provisions.
- 3. Delayed operative date.** The bill contains an urgency clause and is effective immediately, but the proposed surtaxes are operative 61 days after the bill's effective date. However, a more cost effective delayed operative date would be the *first day of the month* 60 days from the bill's effective date since gasoline and diesel fuel excise taxes are paid on a calendar month basis. Administrative

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costs are higher if the tax rate changes take effect in the middle of a month and BOE requires “split” returns filed for a partial monthly period.

4. **Floor stock tax provisions.** As explained previously, a floor stock tax equalizes the excise tax paid on those fuel gallons held in inventory by a supplier, wholesaler or retailer prior to the effective date of a tax increase and those gallons purchased after the tax increase. Having a large fuel inventory before a tax rate increase takes effect can bring about a small windfall to a seller, who can raise the selling price of the fuel purchased prior to the increase and attribute the price increase to the tax rate increase. Since this bill contains a sizeable gasoline and diesel fuel excise tax rate increase, a floor stock tax is imposed on those persons owning 1,000 or more gallons on the 61<sup>st</sup> day after the bill’s effective date. Floor stock tax returns are due to BOE on the 121<sup>st</sup> day after the effective date.
5. **Temporary language may need amending.** The gasoline and diesel fuel surtaxes shall be inoperative in any FY in which the Road Program has not been reauthorized pursuant to Streets and Highway Code Section 2030(b). However 2030 (c) specifies that the increased excise tax rates “associated with the revenues referenced in subdivision (a) of Section 2031” are terminated at the end of the 2019-20 FY if the Legislature does not reauthorize the Road Program. Section 2031 (a) specifies that the “revenues” from the \$0.10 of the gasoline and diesel fuel surtaxes are deposited in the Road Account, without reference to the remaining \$0.02 from the diesel fuel surtax, which is deposited in the Trade Corridors Improvement Fund. As worded, it implies the \$0.02 is permanent.
6. **The BOE currently co-administers the state’s excise tax on gasoline with the Controller.** The BOE handles various gasoline tax administrative functions including, but not limited to: identifying and notifying taxpayers, developing floor stock tax returns, revising existing returns, modifying computer programming, carrying out compliance and audit efforts to ensure proper reporting, revising publications, and increasing investigative activities. However, the Controller processes gasoline tax payments and refunds.
7. **Local jurisdictions should see an increase in sales and use tax revenues.** Existing Sales and Use Tax Law expressly includes within the definition of “gross receipts” and “sales price” the amount of any tax imposed by the state under the MVFTL.<sup>15</sup> Accordingly, retailers are required to include within their computation of sales or use tax on their sales or purchases of gasoline, any state excise tax. Therefore an increase in gasoline tax results in an increase in sales and use tax revenues. Although the fuel tax swap provides a state General Fund sales and use tax exemption on gasoline sales, a statewide base sales and use tax rate of 2.25% that is dedicated to local governments will continue to apply (with higher tax rates in certain districts with voter-approved district tax rates).  
  
Accordingly, under this bill, the proposed \$0.10 excise tax increase on each gallon of gasoline generates additional local sales and use tax revenue, with additional amounts for those districts imposing district taxes.
8. **Indirect fuel tax swap impact.** This bill’s fuel surtax provisions are excluded from the fuel tax swap. However, the fuel tax swap does not exclude impacts on fuel prices, including legislative excise tax increases. Fuel excise tax increases may therefore indirectly increase fuel prices. The two main components of the fuel tax swap are consumption and fuel prices. As this bill has an indirect effect on a main component of the fuel tax swap calculation, the BOE would need to balance the fuel tax swap including the indirect effect on the fuel prices. BOE staff is still evaluating this impact.
9. **Related bills.** [SB 321](#) (Beall) authorizes the BOE to make specified adjustments to the gasoline tax swap using a five-year average fuel price estimate, and more frequent rate adjustments on an annual basis or at a six-month interval, under specified conditions. [SB 433](#) (Berryhill) requires the DOF, instead of the BOE, to determine the annual excise tax rate adjustment for gasoline and diesel fuel under the “fuel tax swap” provisions for the FYs 2016-17 through 2020-21.

<sup>15</sup> RTC Sections 6011 (sales price) and 6012 (gross receipts).

**Administrative Costs:** This bill requires the BOE to immediately modify computer programming, revise publications, process additional returns and payments, carry out compliance and audit efforts to ensure proper reporting, and increase investigative activities. Additionally, BOE staff would need to identify and register additional taxpayers due to the floor stock tax. BOE fuel tax swap responsibilities would include explanation of the indirect effect tax rate changes have on the fuel tax swap rate calculation. A detailed cost estimate is pending.

## Revenue Impact:

**Background, Methodology, and Assumptions. Excise Tax Impact.** This bill contains an urgency measure and is effective immediately. However the proposed surtaxes become operative 61 days after the effective date. Since the governor has until October 11, 2015 to sign or veto bills, for revenue estimation purposes we assume a December 11, 2015 implementation date. Gasoline and diesel consumption is proportional to days of the FY. Floor stock tax returns are due 121 days after the effective date.

DOF forecasts 14.742 billion gallons of gasoline to be consumed on roads in each of the next two FYs. DOF staff forecasts 2.624 billion gallons of diesel to be consumed on roads in FY 2015-16 and 2.679 billion gallons in FY 2016-17. BOE staff assumes a price elasticity of -0.1 for gasoline and -0.2 for diesel and applied them to the consumption figures.<sup>16</sup>

**Floor Stock Taxes.** The bill imposes floor stock taxes of \$0.10 for gasoline and \$0.12 for diesel for suppliers, wholesalers and retailers owning more than 1,000 gallons.

For revenue estimation purposes, BOE staff assumes that the portion of gasoline sold for consumption on roads (98%) is an accurate estimate of numbers of gallons of gasoline and diesel owned by suppliers, wholesalers and retailers owning more than 1,000 gallons. Staff also assumes an average inventory of 3.5 days of gasoline and diesel (two deliveries per week).

**Sales and Use Tax Impacts.** Gasoline and diesel sales and use taxes are affected differently because the gasoline tax is subject to revenue neutrality regarding the sales and use tax (see Existing Law section of this analysis).

**Summary.** This bill will increase gasoline and diesel excise tax revenues by \$1.007 billion in FY 2015-16 and \$1.790 billion in FY 2016-17. The FY 2015-16 is a partial year estimate (effective date of December 11, 2015) and includes floor stock revenues of \$13.8 million for gasoline and \$2.9 million for diesel. Total associated state and local sales and use tax revenues will rise by \$41.2 million in FY 2015-16 and \$73.1 million in FY 2016-17. Total excise and sales tax revenues rise by \$1.048 billion in FY 2015-16 and \$1.863 billion in FY 2016-17.

	FY 2015-16	FY 2016-17
	(Millions)	
Excise Tax Revenues	\$1,007.0	\$1,790.0
Gas	\$830.0	\$1,470.0
Diesel	\$177.0	\$320.0
State and Local Sales and Use Tax Revenues	\$41.2	\$73.1
General Fund and 2011 Local Revenue Fund (5.0%, applied only to diesel)	\$8.9	\$16.0
Education Protection (0.25%, 0.125% in FY 2016-17, applied only to diesel)	\$0.4	\$0.4
Uniform State and Local Taxes, Includes Fiscal Recovery Fund in 2015-16 (2.25%)	\$22.7	\$40.3
Special District Tax (*0.92%)	\$9.3	\$16.5
Total Excise and Sales Taxes	\$1,048.2	\$1,863.1

<sup>16</sup> The general price elasticity of demand formula is:  $e_p = (Q_1 - Q_2) / ((Q_1 + Q_2) / 2) / (P_1 - P_2) / ((P_1 + P_2) / 2)$ , where P = price and Q = sales. For a range of price elasticities, see *The upside hedge value of California's global warming policy given uncertain future oil prices*, James Fine, Christopher Busch, Remy Garderet, 2012.

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**Indirect Fuel Tax Swap Impacts.** The gasoline and diesel fuel tax swaps are revenue neutral, but they would be indirectly affected by this bill because the surtax is assumed to be passed on to consumers, resulting in higher gasoline and diesel prices. The gasoline and diesel tax swaps are each linked to sales prices per gallon. The impacts are different for gasoline and diesel.

For gasoline, the bill raises the price by \$0.10 per gallon. The 5% General Fund rate prior to implementation of the gasoline tax swap implies a \$0.005 per gallon increase in the fuel tax swap rate. This additional price is not reflected in the FY 2015-16 gasoline surtax rate, which is set to be \$0.12 per gallon.<sup>17</sup> However, if enacted, the next time the gasoline surtax rate is set (for FY 2016-17), forecasts of gasoline prices for purposes of setting a revenue-neutral rate would be \$0.005 per gallon higher than they would have been without this measure.

For diesel, the bill raises the price by \$0.12 per gallon. The diesel surcharge rate is 1.75%, so the bill raises diesel taxes by \$0.0021 per gallon. Unlike gasoline, this impact will be reflected in higher diesel prices when the new tax rate is paid. To keep diesel prices revenue neutral to its pre-swap rate of \$0.18 per gallon, the measure's indirect effect would reduce the rate by \$0.0021 per gallon the next time it is set.

**Qualifying Remarks.** This analysis only considers revenue impacts for taxes and fees administered by the BOE. With the exception of forecasting price elasticity impacts, this revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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<sup>17</sup> The total excise tax rate on gasoline for FY 2015-16 will be \$0.30 per gallon.