DRAFT

STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date:	**03/27/12**	Bill No:	**Senate Bill 1243**
Tax Program:	**Sales and Use Tax**	Author:	**Lowenthal**
Sponsor:	**Author**	Code Sections:	**RTC 6385**
Related Bills:		Effective Date:	**Upon enactment**

BILL SUMMARY

This bill repeals the January 1, 2014 sunset date on the existing sales and use tax exemption for fuel and petroleum products (such as bunker fuel) sold to water common carriers.

ANALYSIS

CURRENT LAW

Under current **Section 6385 of the Sales and Use Tax Law**, sales of fuel and petroleum products to water common carriers, for immediate shipment outside this state, are exempt from tax when used in the conduct of the common carrier's activities after the first out-of-state destination. The exemption requires a water common carrier to only pay tax on the fuel needed to get from California to its first out-of-state destination. Section 6385 defines "first out-of-state destination" as the first point reached outside this state by a common carrier in the conduct of its business as a common carrier at which cargo or passengers are loaded or discharged, cargo containers are added or removed, fuel is bunkered, or docking fees are charged. The water common carrier is required to furnish the seller of fuel or petroleum products an exemption certificate in writing, specifying the quantity of fuel or petroleum products exempt from sales and use taxation. This exemption is scheduled to sunset on January 1, 2014.

Description of the Sales and Use Tax Rate. The statewide sales and use tax rate (7.25%) imposed on taxable sales and purchases of tangible personal property is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by various local jurisdictions and are not reflected in this chart):

Rate	Jurisdiction	Purpose/Authority
3.9375%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)
1.0625%	State (Local Revenue Fund 2011)	Counties to fund public safety programs (RTC Sections 6051.15 and 6201.15)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)

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Rate	Jurisdiction	Purpose/Authority
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

PROPOSED LAW

This bill would amend Section 6385 of the Sales and Use Tax Law to eliminate the January 1, 2014 sunset date on the existing sales and use tax exemption for fuel and petroleum products (such as bunker fuel) sold to water common carriers.

The bill would take effect immediately as a tax levy.

BACKGROUND

Until July 15, 1991, sales of fuel and petroleum products to water, air, and rail common carriers were exempt from tax when used in the conduct of the carrier's common carrier activities after the first out-of-state destination. The exemption for bunker fuel purchased by qualified waterborne vessels was dependent upon the amount of bunker fuel on board the vessel prior to refueling. If the quantity of bunker fuel on board the vessel on arrival at the California port was sufficient to enable the vessel to reach its first out-of-state destination, then the bunker fuel loaded at the California port would have been entirely exempt from tax. However, if the quantity of bunker fuel needed on the voyage from the California port to the first out-of-state destination and the amount used while in port exceeded the quantity of fuel on board the vessel on arrival at the California port, the amount of that excess was subject to tax. The exemption was repealed in 1991 by AB 2181 (Ch. 85, 1991) and SB 179 (Ch. 88, 1991). From July 15, 1991 through December 31, 1992, sales of bunker fuel were subject to tax.

In response to the repeal of the exemption, the Pacific Merchant Shipping Association sponsored AB 2396 (Ch. 905, 1992) to combat what they claimed was a disastrous tax law change. They argued that the repeal of the exemption for water common carriers resulted in a decline in the number of ships which bunker in California ports. The re-establishment of the exemption was designed to increase bunker activity in California.

Beginning January 1, 1993, as amended by Section 1.5 of Chapter 905 of 1992, Section 6385 once again granted an exemption for bunker fuel for certain uses. That measure, however, contained a sunset provision which would have repealed the exemption on January 1, 1998. Assembly Bill 366 (Ch. 615, 1997) extended the sunset provision until January 1, 2003, and also required the Legislative Analyst's Office (LAO) to study the effects of the bunker fuel exemption and prepare a report of their findings.

The LAO issued their report www.lao.ca.gov/2001/bunker_fuel/012501_bunker_fuel.pdf in 2001 on the effect of the bunker fuel exemption, and concluded "On this tax policy basis, we recommend that the Legislature remove the existing sunset for the current partial (sales and use tax) exemption for bunker fuel sales, and make the exemption permanent. This would result in the (sales and use tax) being levied in the future only on the portion of the fuel purchased in California which is consumed between California and the first out-of-state destination. This action would result in treating bunker fuel sales similarly to other export sales and place California ports on par with other U.S.

out-of-state ports." The Pacific Merchant Shipping Association sponsored Senate Bill 145 (Perata) during the 2002 Legislative Session to extend the sunset date for the bunker fuel exemption until January 1, 2013. SB 145 passed the Legislature, but was vetoed by the Governor. As a result of the Governor's veto of SB 145, the sales and use tax exemption for sales of bunker fuel sunsetted as of January 1, 2003. Thus, from January 1, 2003, through March 31, 2004, sales of bunker fuel, once again, became subject to tax.

Subsequently, SB 808 (Ch. 712, Stats. 2003), which was authored by then Senator Karnette and sponsored by the PMSA and the International Long Shore Workers Union, reinstated the sales and use tax exemption for bunker fuel sold to water common carriers. The Legislature found and declared that in addition to the negative economic impact of not having a sales tax exemption, there was also a health impact related to the increased production of petroleum coke, which is an alternative refining product to bunker fuel.

SB 808 also required the LAO to submit a report assessing the impacts of the exemption. The LAO released an updated report in November 2007, and found that the effects of the exemption had not changed since their 2001 report. www.lao.ca.gov/2007/tax_expenditures/tax_ The LAO concluded "On this tax policy basis, we recommend that the Legislature remove the existing sunset for the current partial (sales and use tax) exemption for bunker fuel sales, and make the exemption permanent. This would result in the (sales and use tax) on fuel purchased in California being levied in the future only on the portion which is consumed between California and a ship's arrival at its first out-of-state destination. This action would permanently result in treating bunker fuel sales similarly to other export sales and place California ports on par with other out-of-state ports in the nation."

COMMENTS

1. **Sponsor and Purpose.** The author is sponsoring this bill to make the sales and use tax exemption for bunker fuel permanent in order to protect port-related jobs.

2. **Sales tax law for air and rail common carriers.** Section 6357.5 of the Sales and Use Tax Law contains an exemption for fuel and petroleum products sold to an air common carrier for immediate consumption or shipment in the conduct of its business on an international flight. An international flight is defined as a flight whose final destination is a point outside of the United States. Fuel purchased for domestic flights is not included in the exemption.

   Fuel sold to rail common carriers remains subject to the sales tax.

3. **The BOE does not foresee any administrative problems with this bill.** Since the BOE is already administering the sales and use tax exemption for the sale or use of fuel and petroleum products used by a water common carrier, eliminating the sunset date would not pose a problem.

4. **This bill would revise the definition of "first out-of-state destination."** As previously stated, current law defines "first out-of-state destination" as the first point reached outside this state by a common carrier in the conduct of its business as a common carrier at which cargo or passengers are loaded or discharged, cargo containers are added or removed, fuel is *bunkered*, or docking fees are charged. The bill would replace the term "*bunkered*" with "*transferred*." According to the

author's office, the term "*bunkered*" is outdated. Over the last several years, the term bunkered fuel has been replaced with marine or maritime fuel.

The BOE staff notes that, in general, the term *transferred* is more expansive than the terms *bunkered*, or *taken on*, or *loaded onto*. Fuel *transferred* can imply, for instance, that fuel is purchased and not actually delivered onto the vessel, which would, in turn, broaden the definition of "first out-of-state destination." According to the author's office, the phrase "fuel is transferred" still has the same meaning as fuel is bunkered, which means that fuel is taken on and/or loaded onto the vessel. According to the author's office, replacing the term "bunkered" with "transferred" simply corrects an outdated reference and is not intended to expand the exemption for qualified purchases of fuel and petroleum products by a water common carrier.

COST ESTIMATE

The BOE would incur some minor, absorbable costs to notify affected retailers and revise applicable publications.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The United States Energy Information Administration reports that sales of maritime fuels in California for Fiscal Year 2010-11 amounted to 1,403,673,200 gallons. Since there are 42 gallons to a barrel of maritime fuels, sales of maritime fuels in barrels amounted to 33.4 million barrels. The Pacific Merchant Shipping Association (PMSA) reports that the average price per barrel for maritime fuels sold in California was $89.11 during the FY 2010-11. Total annual sales of maritime fuels are estimated to be $2,976.3 million. (33.4 million barrels x $89.11 per barrel = $2,976.3 million.)

A portion of these sales will remain taxable as it is used prior to the first out-of-state destination. In a study done by Price Waterhouse for the PMSA, it was estimated that 12% of maritime fuels is used prior to the first out-of-state destination. If we apply this percentage to the $2,976.3 million in sales, $357.2 million in sales of maritime fuels will remain subject to the sales and use tax. The remaining $2,619.1 million in sales will be exempt from the sales and use tax under this bill.

The exemption for maritime fuels used after the first out-of-state destination will be repealed as of January 1, 2014. Maritime fuels sales have declined significantly; and the PMSA predicts that they will continue to decline over time. Information from the LA/Long Beach Ports shows the following maritime fuels sales:

Barrels Delivered

Month	2010	2011	% Change
May	2,391,929	1,412,473	-40.95%
June	2,040,435	1,558,871	-23.60%
July	2,161,804	1,364,253	-36.89%
August	1,916,046	1,072,555	-44.02%
September	1,508,065	1,251,852	-16.99%
October	1,997,985	1,333,189	-33.27%
November	1,958,582	1,381,754	-29.45%
December	1,559,232	1,754,865	12.55%
Total	15,534,078	11,129,812	-26.58%

Based on information from the LA/Long Beach Port and PMSA, maritime fuels sales are estimated to decline from between 40% and 60%. Therefore, the sales of maritime fuels that would be subject to the sales and use tax, if the exemption is not continued, are estimated to be between $1,047.6 million and $1,571.5 million. ($2,619.1 million x 40% = $1,047.6 million; $2,619.1 million x 60% = $1,571.5 million.)

REVENUE SUMMARY

The revenue loss from exempting from the sales and use tax maritime fuels sold to a water common carrier, for immediate shipment outside this state for consumption in the conduct of its business as a common carrier after the first out of state destination would be as follows:

Revenue Effect

Maritime fuels Sales	between	$ 1,047.6 million	and	$ 1,571.5 million
General Fund loss (3.94%)	between	$ 41.3 million	and	61.9 million
Fiscal Recovery loss (0.25%)	between	2.6 million	and	3.9 million
Local Revenue Fund 2011 loss (1.06%)	between	11.1 million	and	16.7 million
Local Tax loss (2.00%)	between	21.0 million	and	31.4 million
Special District loss (1.5%)*	between	15.7 million	and	23.6 million
Total	between	$ 91.7 million	and	$ 137.5 million

* Nearly all of the maritime fuels are sold in jurisdictions with a tax rate of 8.75%.

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