

[Assembly Bill 1442](#) (O'Donnell and Brough)

Date: 02/27/15

Program: Fuel Taxes

Sponsor: California Independent Oil Marketers Association (CIOMA)

Revenue and Taxation Code Sections 7318 and 8651.8

Effective: January 1, 2016

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***This analysis only addresses the provisions that impact the Board of Equalization (BOE).***

**Summary:** Increases the allowable percentage of gasoline blended into E85, from 15% to 21%, and makes corresponding changes to the definition of gasohol.

**Purpose:** To provide incentives to produce fuel products with lower emissions and carbon intensity.

**Fiscal Impact Summary:** Increased refunds and foregone motor vehicle fuel tax revenues of \$228,000 annually.

**Existing Law:** Under current law the state imposes an excise tax of \$0.18 per gallon on use fuels.<sup>1</sup> The law defines "fuel"<sup>2</sup> to include any combustible gas or liquid used in an internal combustion engine for propulsion on the highway except fuel taxed as a motor vehicle fuel (gasoline) or diesel fuel.<sup>3</sup>

The Use Fuel Tax Law (UFTL) sets the excise tax rate for ethanol and methanol containing not more than 15 percent gasoline and sets the excise tax rate at one half the \$0.18 rate specified in Section 8651 (\$0.09). Ethanol and methanol containing more than 15 percent gasoline is defined as gasohol under the Motor Vehicle Fuel Tax Law (MVFTL).<sup>4</sup> Although the use fuel tax is imposed on the use of the fuel, the vendor who sells or delivers such fuel into a fuel tank is required to collect the tax from the user and provide a receipt.<sup>5</sup>

Under the MVFTL, the state imposes an excise tax of \$0.30 per gallon<sup>6</sup> (\$0.18 excise tax and \$0.12 surtax) on the removal of gasoline (except for aviation gasoline) at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person. Refund of the excise tax paid on gasoline is allowed under certain circumstances to certain persons.<sup>7</sup> For claims filed on and after January 1, 2011, a gasoline tax refund is allowed to any person who buys and uses gasoline for the purpose of producing a blended fuel that is used to operate a motor vehicle on the state's highways when that blended fuel is taxed as a use fuel.<sup>8</sup>

**Proposed Law:** This bill amends RTC Section 7318 to change the definition of gasohol and Section 8651.8 to increase the allowable percentage of gasoline blended into E85, from 15% to 21%.

As a tax levy, this bill becomes effective immediately.

**In General.** Under the UFTL, vendors and users are required to have permits with the BOE and file returns.<sup>9</sup> Use fuel vendor responsibilities include reporting and paying the use fuel tax on alcohol fuels,

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<sup>1</sup> Use Fuel Tax Law (UFTL), Part 3 (commencing with Section 8601) of Division 2 of the Revenue and Taxation Code (RTC)).

<sup>2</sup> UFTL Section 8604.

<sup>3</sup> Motor Vehicle Fuel Tax Law (MVFTL), Part 2 (commencing with Section 7301), and the Diesel Fuel Tax Law (DFTL), Part 31 (commencing with Section 60001), of Division 2 of the RTC.

<sup>4</sup> MVFTL Section 7318.

<sup>5</sup> UFTL Section 8732.

<sup>6</sup> For FY 2015-16, the gasoline excise tax rate is set at \$0.30 per gallon.

<sup>7</sup> MVFTL Section 8101.

<sup>8</sup> SB 1485 (Ch. 493, Stats. 2012).

<sup>9</sup> A "vendor" includes every person who sells fuel in this state and places, or causes to be placed, the fuel into any receptacle on a motor vehicle from which fuel is supplied for the propulsion of the vehicle.

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including E85, delivered into motor vehicle fuel tanks.<sup>10</sup> The vendor is required to collect and remit to the BOE the \$0.09 per gallon use fuel tax on the full volume of E85 sold or dispensed from a retail pump. In contrast, the blenders (producers of blended use fuel) are not required to have special permits from the BOE for a person producing an alcohol fuel containing 15 percent or less gasoline or diesel fuel, whether the alcohol fuel is produced within a petroleum terminal or below the rack.

The BOE handles various gasoline tax administrative functions including, but not limited to: registration, licensing, return processing, auditing, and appeals. The State Controller's office (SCO) is responsible for the collection of delinquent gasoline taxes and issuance of excise tax refunds for gasoline not used on highway. The gasoline tax collection point is different from the use fuel tax; the gasoline tax is generally collected high up the distribution chain at the terminal "rack" level.<sup>11</sup> Users are required to file tax returns and pay taxes owed on fuel used in a taxable manner for purchases not previously taxed.

Alcohol fuel blends are the result of blending two components, ethanol or methanol fuel and gasoline or diesel fuel. E85 fuel is a product of blending ethanol fuel and gasoline. The blending location has an effect on the gasoline tax. If the blended E85 is provided at the "rack" level, then the blended product is a use fuel and the total blended volume is subject to the use fuel tax, with the vendor responsible for reporting and paying the tax.

Thus, if the E85 is blended below-the-rack, where the two component fuels are purchased separately and blended elsewhere in the distribution chain, the gasoline tax has been paid and passed on by the supplier at the "rack." The gasoline blended with the ethanol (the resulting E85 fuel) is then subject to the use fuel tax on the full volume, which includes the tax-paid gasoline.

**Background:** Current Air Resources Board regulations<sup>12</sup> specify that the minimum allowable percentage of ethanol for E85 is 79 percent. The current specifications for E85 according to the California Division of Measurement Standards<sup>13</sup> reference the ASTM International (f.k.a. American Society for Testing and Materials), specification, "Standard Specification for Fuel Ethanol (Ed75-Ed85) for Automotive Spark-Ignition Engines D5798."<sup>14</sup> That standard covers a fuel blend of denatured ethanol and 15 to 25 additional hydrocarbons for use in spark-ignition automobiles.

### **Commentary:**

- 1. Effect of the bill.** By increasing the allowable percentage of gasoline blended into E85, from 15% to 21%, the resulting blend would be taxed at a lower rate than is currently imposed on the gasoline portion.
- 2. There are no administrative concerns with the increase of gasoline blended into E85 from 15% to 21%.** BOE's UFTL duties include registration, returns, collection, audits, and refunds. The proposed change in the specified blending percentage of E85 and gasohol fuels does not increase administrative difficulties.

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<sup>10</sup> E85 fuel, an ethanol and gasoline blend, is the most predominant blended fuel under the UFTL.

<sup>11</sup> The terminal rack level is a level in the distribution chain at a refinery or a storage and distribution facility at the end of a pipeline where gasoline is delivered through a mechanism (the "rack" as it leaves the refinery or storage facility) into ground transportation, such as a truck, trailer, or railroad car.

<sup>12</sup> Section 2292.4, Specifications for E-85 Fuel Ethanol, Article 3 of Chapter 5 of Division 3 of Title 13 of the California Code of Regulations.

[https://govt.westlaw.com/calregs/Document/ID7F07C10D46911DE8879F88E8B0DAAAE?viewType=FullText&originalContext=documenttoc&transitionType=CategoryPageItem&contextData=\(sc.Default\)](https://govt.westlaw.com/calregs/Document/ID7F07C10D46911DE8879F88E8B0DAAAE?viewType=FullText&originalContext=documenttoc&transitionType=CategoryPageItem&contextData=(sc.Default))

<sup>13</sup> Section 4146, Specifications – E85 Fuel Ethanol, Article 5 of Chapter 6 of Division 9 of Title 4 of the California Code of Regulations. [http://www.cdfa.ca.gov/dms/programs/general/2015DMS\\_FldRefMan/122015FRMCh6-4100-4081Part12.pdf](http://www.cdfa.ca.gov/dms/programs/general/2015DMS_FldRefMan/122015FRMCh6-4100-4081Part12.pdf)

<sup>14</sup> ASTM D5798-14, Standard Specification for Ethanol Fuel Blends for Flexible-Fuel Automotive Spark-Ignition Engines, ASTM International, West Conshohocken, PA, 2014, [www.astm.org](http://www.astm.org). See this link for an abstract: <http://www.astm.org/Standards/D5798.htm>

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- 3. **The SCO administers the specific gasoline tax refund provisions.** The refund of the gasoline tax for purposes other than operating a vehicle on the state's public highways and other exempt uses is administered by the SCO.
- 4. **Below-the-rack blenders sell the E85 with tax-paid gasoline and are authorized to obtain a refund.** As explained previously, below-the-rack blenders are already authorized to obtain a refund of the tax-paid gasoline component of the E85, as provided by law and as authorized by the SCO.

**Administrative Costs:** Any costs to BOE would be absorbable.

**Revenue Impact:**

**Background, Methodology, and Assumptions.** This bill changes the definition of gasohol and increases the allowable percentage of gasoline blended into E85, from 15% to 21%, and current law allows reimbursement of that portion of the gasoline that was taxed prior to blending. Blending occurs by different processes, referred to as "above the rack" and "below the rack." This variation requires different computations to calculate the proper revenue impact, which we have identified as a "refund" impact for below the rack blenders, and a "foregone revenue" impact for above the rack blenders. To determine the "below the rack" revenue impact, the amount of ethanol reported is subtracted from the amount of E85 fuel reported. Multiplying the "below the rack" blend by either 15 or 21% yields the amount of gasoline eligible for refund. The difference between the two types of fuel blend for the corresponding fiscal years yields the difference in tax refund.

Blended fuel contains differing amounts of gasoline, from 15% (E85) to 21% (E79). Thus, as the amount of gasoline blended into E85 increases, the state experiences "foregone" revenue from the decreased ethanol revenues. Although the data indicates that most of the E85 blending occurs below the rack, not at the rack, for revenue estimate purposes we have attempted to quantify the above the rack impact. To the extent the industry changes production methods and volumes and blends more E85 at the rack, the revenue difference could grow.

Based on available data, a revenue impact is estimated as follows:

E85									
<i>fy</i>	<i>Blended Fuel E85</i>	<i>Blend Fuel Above Rack</i>	<i>Blend Fuel Below Rack</i>	<i>15% gasoline</i>	<i>Gasoline Rate</i>	<i>Refund</i>	<i>Ethanol Content</i>	<i>Ethanol Rate</i>	<i>Ethanol Revenue</i>
2011-12	5,827,381	197,742	5,629,639	844,446	0.357	\$ 301,467	4,785,193	0.09	\$ 430,667
2012-13	6,128,219	242,607	5,885,612	882,842	0.360	\$ 317,823	5,002,770		\$ 450,249
2013-14	7,958,169	132,869	7,825,300	1,173,795	0.395	\$ 463,649	6,651,505		\$ 598,635

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E79

<i>fy</i>	<i>Blended Fuel E85</i>	<i>Blend Fuel Above Rack</i>	<i>Blend Fuel Below Rack</i>	<i>21% gasoline</i>	<i>Gasoline Rate</i>	<i>Refund</i>	<i>Ethanol Content</i>	<i>Ethanol Rate</i>	<i>Ethanol Revenue</i>
2011-12	5,827,381	197,742	5,629,639	1,182,224	0.357	\$ 422,054	4,447,415	0.09	\$ 400,267
2012-13	6,128,219	242,607	5,885,612	1,235,979	0.360	\$ 444,952	4,649,634		\$ 418,467
2013-14	7,958,169	132,869	7,825,300	1,643,313	0.395	\$ 649,109	6,181,987		\$ 556,379

**Revenue Summary.** Accounting for both the “foregone” gasoline tax revenue and the increase in gasoline tax refunds yields a total revenue impact of \$150,987 in FY 2011-12, \$158,911 in FY 2012-13, and \$227,717 in FY 2013-14, which is computed as follows:

<b>Fiscal Year</b>	<b>Refund Diff, Gasoline E85-E79</b>	<b>Foregone Revenue Diff.</b>	<b>Total Revenue Impact E85-E79</b>
2011-12	\$ 120,587	\$ 30,400	\$150,987
2012-13	\$ 127,129	\$ 31,782	\$158,911
2013-14	\$ 185,460	\$ 42,257	\$227,717

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.