

STATE BOARD OF EQUALIZATION

Board Meeting Date --- June 27, 2006 ---- Sacramento

PUBLIC HEARING

Original Distribution - Blue Route Slip Revised Distribution - Green Route Slip Late Distribution - Pink Route Slip

UPS NDA

- | | |
|--|---|
| <input type="checkbox"/> Honorable Claude Parrish, Vice Chair | <input type="checkbox"/> Honorable John Chiang, Chair (3) |
| <input type="checkbox"/> Mr. Neil Shah, Deputy – Senior Advisor
100 West Broadway, Suite 300
Long Beach, CA 90802-4431 | 660 South Figueroa St., Suite 2050
Los Angeles, CA 90017-3477 |
| | <input type="checkbox"/> Ms. Marcy Jo Mandel, Deputy Controller
600 Corporate Point, Suite 1000
Culver City, CA 90230 |

- | | | | | | |
|--------|--------------------------|-------------------------------------|--------|--------------------------|---------------------|
| MIC:71 | <input type="checkbox"/> | Ms. Mira Tonis | MIC:73 | <input type="checkbox"/> | Mr. Ramon Hirsig |
| MIC:72 | <input type="checkbox"/> | Honorable John Chiang, Chair | MIC:80 | <input type="checkbox"/> | Mr. Gary Evans |
| | <input type="checkbox"/> | Mr. Tim Treichelt | | <input type="checkbox"/> | Ms. Cathy Stroh |
| | <input type="checkbox"/> | Mr. Chris Schutz | | <input type="checkbox"/> | Ms. Rose Smith |
| MIC:73 | <input type="checkbox"/> | Ms. Marcy Jo Mandel | | | |
| | <input type="checkbox"/> | Ms. Melanie Darling | MIC:82 | <input type="checkbox"/> | Mr. Randy Ferris |
| MIC:78 | <input type="checkbox"/> | Honorable Bill Leonard(2) | | <input type="checkbox"/> | Ms. Monica Brisbane |
| MIC:33 | <input type="checkbox"/> | Mr. Ed King | | <input type="checkbox"/> | Mr. Robert Lambert |
| MIC:43 | <input type="checkbox"/> | Ms. Randie L. Henry | | <input type="checkbox"/> | Mr. John Waid |
| MIC:46 | <input type="checkbox"/> | Mr. Stephen Rudd | | <input type="checkbox"/> | Ms. Ani Kindall |
| MIC:49 | <input type="checkbox"/> | Mr. Joseph Young | | <input type="checkbox"/> | Ms. Jean Ograd |
| MIC:50 | <input type="checkbox"/> | Ms. Leila Khabbaz | | <input type="checkbox"/> | Ms. Sharon Jarvis |
| | <input type="checkbox"/> | Ms. Lisa Andrews | | <input type="checkbox"/> | Mr. Bradley Heller |
| MIC:56 | <input type="checkbox"/> | Ms. Lynn Bartolo | | | |
| | <input type="checkbox"/> | Mr. Todd Keefe | MIC:83 | <input type="checkbox"/> | Ms. Kristine Cazadd |
| MIC:61 | <input type="checkbox"/> | Mr. Stanley Siu | MIC:85 | <input type="checkbox"/> | Mr. David Levine |
| MIC:63 | <input type="checkbox"/> | Mr. David Gau | | <input type="checkbox"/> | Mr. Steve Ryan |
| MIC:64 | <input type="checkbox"/> | Mr. Dean Kinnee | | <input type="checkbox"/> | Mr. Jeff Vest |
| | <input type="checkbox"/> | Ms. Sherry Kinkle | | <input type="checkbox"/> | Mr. Lucian Khan |
| MIC:66 | <input type="checkbox"/> | Ms. Margaret S. Shedd | | <input type="checkbox"/> | Mr. Jeff Angeja |
| MIC:69 | <input type="checkbox"/> | Ms. Karen Johnson | MIC:92 | <input type="checkbox"/> | Mr. Jeff McGuire |
| MIC:70 | <input type="checkbox"/> | Mr. Todd Gilman | | | |

COMMENT:

revision requests should be directed to: Christopher Rees, 327-3431, Board Proceedings Division – MIC 80
total Recp: 50

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Item F2
Prpsd Amndmnts to
Mtr Veh. Fuel & Diesel Tx



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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State Controller, Sacramento

RAMON J. HIRSIG
Executive Director

May 12, 2006

INTERESTED PARTIES:

**NOTICE OF PROPOSED REGULATORY ACTION
BY THE
STATE BOARD OF EQUALIZATION**

**REGULATIONS 1125 AND 1423, TWO-PARTY EXCHANGE,
AND REGULATIONS 1123 AND 1420, SUPPLIER,
FOR PURPOSES OF THE MOTOR VEHICLE FUEL TAX LAW
AND DIESEL FUEL TAX LAW**

PUBLIC HEARING: JUNE 27, 2006

NOTICE IS HEREBY GIVEN:

The State Board of Equalization (the Board), pursuant to the authority vested in it by sections 7372, 8251, 60063, and 60601 of the Revenue and Taxation Code, proposes to adopt Regulation 1125, Two-Party Exchange, in Title 18, Division 2, Chapter 1, and Regulation 1423, Two-Party Exchange, in Title 18, Division 2, Chapter 3, of the California Code of Regulations, relating to Two-Party Exchange, and to amend existing Regulation 1123, Supplier, in Title 18, Division 2, Chapter 1, of the California Code of Regulations, and existing Regulation 1420, Supplier, in Title 18, Division 2, Chapter 3, of the California Code of Regulations. A public hearing on the proposed regulatory action will be held in Room 121, 450 N Street, Sacramento, at 1:30 p.m., or as soon thereafter as the matter may be heard, on Tuesday, June 27, 2006. At the hearing, any person interested may present statements or arguments orally or in writing relevant to the proposed regulatory action. The Board will consider written statements or arguments if received by the time of the public hearing.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current law provides that primary liability for motor vehicle fuel tax under the Motor Vehicle Fuel Tax Law and primary liability for diesel fuel tax under the Diesel Fuel Tax Law is imposed on, among others, the position holder in a terminal and the refiner, on removal of motor vehicle fuel or diesel fuel from the terminal or refinery, if the fuel is removed at the rack. The Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law contain provisions, in sections 7372,

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subdivision (b) and 60063, subdivision (b), respectively, that permit the Board to relieve the position holder or refiner from primary liability for payment of the motor vehicle fuel or diesel fuel tax imposed on them and to hold another person primarily liable for the tax, under certain conditions. The Board is permitted to adopt regulations it deems appropriate in order to implement this provision.

Regulation 1125, Two-Party Exchange, and Regulation 1423, Two-Party Exchange, are proposed to be promulgated to implement section 7372 of the Motor Vehicle Fuel Tax Law and section 60063 of the Diesel Fuel Tax Law, respectively. The regulations are proposed to provide a general description of a two-party exchange and the reasons for a two-party exchange, to define a two-party exchange, delivering supplier, and receiving supplier, to explain the conditions that must be met in order to relieve the delivering supplier of the fuel tax liability, and to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier.

The amendments to Regulation 1123, Supplier, and Regulation 1420, Supplier, are proposed to clarify that the delivering supplier, either the position holder or the refiner, under a two-party exchange remains primarily liable for the tax due on removal of motor vehicle fuel or diesel fuel from the terminal or refinery rack if the requirements for a two-party exchange pursuant to Regulation 1125 and Regulation 1423, respectively, are not met.

COST OR SAVINGS TO STATE OR LOCAL AGENCIES OR SCHOOL DISTRICTS

The Board has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the proposed regulatory action will result in no direct or indirect cost or savings to any state agency, or any local agency or school district that is required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code, or other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5(a)(8), the Board makes an initial determination that the adoption of proposed Regulations 1125 and 1423 and proposed amendments to Regulations 1123 and 1420 will have no significant statewide adverse economic impact directly affecting business.

The adoption of the proposed regulations and proposed amendments will neither create nor eliminate jobs in the State of California, nor result in the elimination of existing businesses, nor create or expand business in the State of California.

The regulations and amendments as proposed will not be detrimental to California businesses in competing with businesses in other states.

The proposed regulations may affect small business.

COST IMPACT ON PRIVATE PERSON OR BUSINESSES

There will be no adverse economic impact on private businesses or persons because the proposed regulatory action implements existing statutory provisions and does not impose any additional compliance or reporting requirements on private persons or businesses.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Proposed Regulations 1125 and 1423 and Regulations 1123 and 1420 have no comparable federal regulations.

AUTHORITY

Sections 7372, 8251, 60063, and 60601 of the Revenue and Taxation Code.

REFERENCE

Sections 7372 and 60063 of the Revenue and Taxation Code.

CONTACT

Questions regarding the substance of the proposed regulation should be directed to Ms. Carolee Johnstone, (916) 323-7713, email Carolee.Johnstone@boe.ca.gov, or by mail to State Board of Equalization, Attn: Carolee Johnstone, MIC:82, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Diane Olson, Regulations Coordinator, telephone (916) 322-9569, fax (916) 324-3984, e-mail Diane.Olson@boe.ca.gov or by mail at State Board of Equalization, Attn: Diane Olson, MIC: 80, P.O. Box 942879, 450 N Street, Sacramento, CA 94279-0080.

ALTERNATIVES CONSIDERED

The Board must determine that no alternative it considered or that has otherwise been brought to its attention would be more effective in carrying out the purpose for which this action is proposed or would be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared a statement of reasons and an underscored version (express terms) of the proposed regulation. Both of these documents and all information on which the proposal is based are available to the public upon request. The rulemaking file is available for public

inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulations and amendments are available on the internet at the Board's website <http://www.boe.ca.gov>.

ADDITIONAL COMMENTS

Following the hearing, the Board may, in accordance with law, adopt the proposed regulations and amendments if the text remains substantially the same as described in the text originally made available to the public. If the Board makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for fifteen days before adoption of the regulations and amendments. The text of any modified regulation will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified regulation will be available to the public from Ms. Olson. The Board will consider written comments on the modified regulation for fifteen days after the date on which the modified regulation is made available to the public.

STATE BOARD OF EQUALIZATION



Gary Evans, Acting Chief
Board Proceedings Division

INITIAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY

PROPOSED REGULATIONS 1125 AND 1423, TWO-PARTY EXCHANGE, AND
PROPOSED AMENDMENTS TO REGULATIONS 1123 AND 1420, SUPPLIER

Regulations 1125 and 1423 are proposed to explain the requirements and conditions which must be met before the State Board of Equalization (Board) will permit the primary liability for motor vehicle fuel tax and diesel fuel tax, respectively, to be transferred from the delivering supplier to the receiving supplier under a two-party exchange of fuel and to provide definitions of relevant terms. Amendments to Regulations 1123 and 1420 are proposed to clarify that the primary liability for fuel tax will remain with the delivering supplier if the requirements of Regulations 1125 and 1423, respectively, are not met.

Specific Purpose

The purpose of proposed Regulation 1125 is to interpret, implement, and make specific Revenue and Taxation Code section 7372 of the Motor Vehicle Fuel Tax Law. The purpose of proposed Regulation 1423 is to interpret, implement, and make specific Revenue and Taxation Code section 60063 of the Diesel Fuel Tax Law. These regulations are necessary to provide guidance to taxpayers affected by these statutes. The purpose of the proposed amendments to Regulations 1123 and 1420 is to address the effects of proposed Regulations 1125 and 1423, respectively, on the existing regulations.

Factual Basis

Proposed Regulations 1125 and 1423 provide a description of a two-party exchange and relevant definitions and discuss the requirements and conditions that must be met for the primary liability for fuel taxes to be transferred from the delivering supplier to the receiving supplier pursuant to a two-party exchange. Regulation 1125 addresses a two-party exchange with respect to the Motor Vehicle Fuel (MVF) Tax Law, and Regulation 1143 addresses a two-party exchange with respect to the Diesel Fuel Tax Law. Otherwise, they are textually identical, as are the proposed amendments to Regulations 1123 and 1420.

The Board is proposing Regulations 1125 and 1423 for the following reasons. Current MVF and Diesel Fuel Tax Laws impose a fuel tax on the removal of motor vehicle fuel and diesel fuel from a terminal or refinery rack. The supplier (position holder or refiner)¹ is liable for the payment of MVF tax and diesel fuel tax to the State. However, both fuel tax laws, under Revenue and Taxation Code sections 7372 and 60063, respectively, permit the Board to accept payment of the fuel taxes from the person who receives the motor vehicle fuel or diesel fuel at the terminal or refinery rack in a two-party exchange, if the Internal Revenue Service (IRS) authorizes payment of federal fuel taxes by the receiving party under a two-party exchange contract or agreement. The supplier remains primarily liable for the fuel tax until the fuel tax is paid and credited to the account of the supplier.

¹ See Revenue and Taxation Code sections 7372, 7334, and 7338 (60010, 60011, and 60033).

The Board may, however, relieve the supplier from primary liability and hold another person primarily liable for payment of the tax if the IRS has authorized the receiving party to pay the federal fuel tax, if the IRS has made another person primarily liable for payment of the tax, and if the Board elects to follow the IRS approach of accepting fuel tax from the receiving party under a two-party exchange contract.

The federal American Jobs Creation Act of 2004 authorized the IRS to receive payment of federal fuel taxes from the receiving party under a two-party exchange contract and made the receiving party primarily liable for the federal fuel tax.

Western States Petroleum Association (WSPA) requested that the Board make the election to follow the IRS approach. WSPA requested that the Board permit the receiving party under a two-party exchange contract to become the primary taxpayer for payment of the California fuel taxes collected at the terminal or refinery rack. Election of this approach would allow suppliers and terminal operators to report taxable transactions in the same manner to both the IRS and the Board. Other states that impose a fuel tax at the terminal rack have successfully implemented the two-party exchange.

Proposed Regulations 1123 and 1420 are the result of the Board's election to follow the IRS approach. These regulations provide, in subdivision (a), a general description of a two-party exchange, the reasons for a two-party exchange, and an explanation that fuel subject to the exchange may be held in terminals located in one or more states and may include more than one fuel type and that only the transactions involving terminals located in this state should be reported to the Board.

Since "two-party exchange" is not defined in the MVF or Diesel Fuel Tax Laws, subdivision (b)(1) in the proposed regulations defines a "two-party exchange." Subparagraphs (1)(A) through (1)(D) of subdivision (b) explain the conditions for a transaction to qualify as a two-party exchange. The term "delivering supplier" is defined in subdivision (b)(2), and the term "receiving supplier" is defined in subdivision (b)(3).

Further, since, under circumstances other than those involving a two-party exchange, the supplier who is a refiner or who holds an inventory position in fuel at the terminal is primarily liable for the tax at the time the fuel is removed from the rack, the regulations explain, in subdivision (c)(1), that, when a transaction satisfies the conditions and requirements of a two-party exchange contract, the delivering supplier shall be relieved of the fuel tax liability and the receiving supplier shall be liable for payment of the tax. Subdivision (c)(2) explains that the receiving supplier must report the two-party exchange and remit the tax on a tax return filed within three months after the close of the calendar month in which the fuel was received. The second sentence clarifies that a receiving supplier can receive a refund of any overpayment of fuel tax. The third sentence clarifies that, when all the parties report a transaction as a two-party exchange to the Board, the transaction may not be reversed nor may the taxes be refunded to the receiving supplier. Subdivision (c)(3) clarifies that, if the receiving supplier fails to report or remit the tax on a two-party exchange, the delivering supplier shall remain primarily liable for the taxes due on the removal of fuel from the rack.

Subdivision (d) of the proposed regulations explains the general reporting requirements of the terminal operator, delivering supplier, and receiving supplier, and subdivision (e) explains the reporting requirements for delivering and receiving suppliers that must be met in order for an exchange of fuel to qualify as a two-party exchange and shift the imposition of fuel tax liability to the receiving supplier. Paragraphs (1) through (4) of subdivision (e) clarify what must be reported. Subdivision (f) establishes an operative date of January 1, 2007, for the proposed regulations.

Amendments to Regulations 1123 and 1420 are proposed to add subparagraphs (3)(C) and (4)(D) to subdivision (b) to clarify that the position holder or refiner, respectively, delivering fuel to a receiving supplier under a two-party exchange contract remains liable for the tax unless all the requirements of the two-party exchange regulation are met and to establish an operative date.

Pursuant to Government Code section 11346.2, subdivision (b)(3), the only reasonable alternative to promulgating proposed Regulations 1125 and 1423 was to not promulgate these regulations. Although the regulations impose minor additional record keeping responsibilities on small businesses such as terminal operators, these additional responsibilities are offset by the advantages gained by conforming the two-party exchange process in California with the two-party exchange process in other states and with the Internal Revenue Service. The fuel industry, including the position holders, refiners, and terminal operators, supports adoption of these regulations. No other private businesses or persons will be affected by these regulations.

Pursuant to Government Code section 11346.2, subdivision (b)(4), the Board has determined that adoption of the proposed regulations will not have a significant adverse economic impact on private business or persons. The regulations are proposed to interpret, implement, and make specific the authorizing statutes. These regulations and amendments will clarify the interpretation and administration of a two-party exchange under the MVF and Diesel Fuel Tax Laws. Therefore, the Board has determined that these regulations and amendments should be adopted.

MOTOR VEHICLE FUEL TAX LAW
Proposed amendment to Regulation 1123

Regulation 1123. SUPPLIER.

(a) RETURNS. All suppliers must prepare and file returns with the Board to report tax on motor vehicle fuel. Returns are due at the end of the month following the calendar month in which the motor vehicle fuel was removed, entered, or sold, unless the Board requires that a return be filed for a different period. A terminal operator who also is a position holder in motor vehicle fuel within the terminal or is jointly and severally liable for the tax is required to file both the terminal operator report and the supplier return.

(b) IMPOSITION OF TAX. Tax applies to each supplier as follows:

(1) **BLENDER.** A blender is required to pay the tax on the removal or sale of motor vehicle fuel blended outside the bulk transfer/terminal system. The number of gallons of blended motor vehicle fuel subject to the tax is the difference between the total number of gallons of blended motor vehicle fuel removed or sold and the number of gallons of tax-paid motor vehicle fuel used to produce the blended motor vehicle fuel.

(2) **ENTERER.**

(A) An enterer is required to pay the tax when the enterer imports motor vehicle fuel into the state by means outside of the bulk transfer/terminal system.

(B) An enterer is required to pay the tax when the enterer removes or sells motor vehicle fuel within a pipeline or terminal to an unlicensed person.

(C) An enterer is required to pay the tax when the entry is by bulk transfer and the enterer is not a licensed supplier.

(D) For purposes of proper imposition of tax, entry occurs when fuel is brought into the state, provided, however, that when entry is by bulk transfer, entry occurs as follows:

1. When fuel is received at a marine terminal, entry occurs at the landside of the flange.

2. When fuel is removed from a vessel in this state to a lighter for the purpose of lightering, entry occurs at the vessel side of the flange upon the removal of fuel from a vessel in this state to the lighter; provided, however, that if the lighter unloads or discharges the fuel at a marine terminal, then entry occurs at the land side of the flange as to the fuel received at the marine terminal. As used herein, "lightering" is the use of small, shallow-draft boats in transshipment to shore of oil or other fuel from a large, deep-draft vessel unable to dock at shore facilities because of shallow water. The small boats are called lighters.

3. When fuel is removed from a vessel in this state to another vessel in this state, and the fuel is not unloaded or discharged at a marine terminal, then entry occurs when the fuel is brought into the state.

(3) POSITION HOLDER.

(A) A position holder that holds an inventory position in the motor vehicle fuel as reflected on the records of the terminal operator is required to pay the tax when the motor vehicle fuel is removed from the terminal rack.

(B) A position holder is required to pay the tax when the position holder removes or sells motor vehicle fuel within or without the bulk transfer/terminal system to an unlicensed person.

(C) For reporting periods commencing on or after January 1, 2007, a position holder that delivers motor vehicle fuel to a receiving supplier under a two-party exchange contract shall remain liable for the tax due on the removal of motor vehicle fuel from the terminal rack unless all Regulation 1125 requirements are met.

(4) REFINER.

(A) A refiner is required to pay the tax when the motor vehicle fuel is removed at a terminal rack located at a refinery.

(B) A refiner is also required to pay the tax when the removal of motor vehicle fuel is by bulk transfer (e.g., transfer by pipeline or vessel) and the refiner or the owner of the motor vehicle fuel immediately before the removal is not a licensed supplier.

(C) A refiner is required to pay the tax when the refiner removes or sells motor vehicle fuel within or without the bulk transfer/terminal system to an unlicensed person.

(D) For reporting periods commencing on or after January 1, 2007, a refiner that delivers motor vehicle fuel to a receiving supplier under a two-party exchange contract shall remain liable for the tax due on the removal of motor vehicle fuel from the terminal rack located at a refinery unless all Regulation 1125 requirements are met.

(5) TERMINAL OPERATOR. A terminal operator is jointly and severally liable for and may be required to pay the tax when the motor vehicle fuel is removed at the rack if both subsections (A) and (B) below apply:

(A) The position holder with respect to the motor vehicle fuel is a person other than the terminal operator and is not a licensed supplier.

(B) The terminal operator is not a licensed supplier and either (i) does not have an unexpired notification certificate from the position holder as required by the Internal

Revenue Service or (ii) has an unexpired notification certificate from the position holder, but has reason to believe or knows that any information in the certificate is false.

(6) THROUGHPUTTER. A throughputter is required to pay the tax when the throughputter removes or sells motor vehicle fuel within or without the bulk transfer/terminal system to a person who is not a licensed supplier.

Authority: Sections 7372 and 8251 Revenue and Taxation Code

Reference: Sections 7307, 7308, 7309, 7310, 7311, 7312, 7324, 7326, 7329, 7332, 7333, 7334, 7335, 7336, 7338, 7339, 7340, 7341, 7360, 7362, 7363, 7365, 7366, 7368, 7369, 7370, 7371, 7372, 7451, 7651, and 7652.5, Revenue and Taxation Code.

MOTOR VEHICLE FUEL TAX LAW
Proposed Regulation 1125

Regulation 1125. TWO-PARTY EXCHANGE

(a) GENERAL.

In a typical two-party exchange, two suppliers who own motor vehicle fuel in terminals, i.e., who are position holders (pursuant to Section 7332 of the Revenue and Taxation Code), agree to give each other access to the motor vehicle fuel each owns. Both suppliers have customers in the same terminal areas. One supplier (the delivering supplier) owns fuel in one terminal, and the other supplier (the receiving supplier) owns fuel, usually in a different terminal. Each supplier agrees to exchange fuel it owns for fuel the other supplier owns. A two-party exchange contract allows each supplier to have rack removal capability at a terminal where the other supplier is a position holder, in order to supply fuel to its customers in that terminal area. The receiving supplier takes the place of the delivering supplier when the motor vehicle fuel is removed from the terminal at the rack. A two-party exchange may involve fuel held in terminals located in one or more states and may involve one or more types of fuel. For purposes of this regulation, however, at least one of the terminals involved in a two-party exchange must be located in this state, and the requirements for reporting transactions to the Board pursuant to this regulation pertain only to transactions involving terminals located in this state.

(b) DEFINITIONS.

(1) Notwithstanding Section 7337 of the Revenue and Taxation Code, “two-party exchange” means a transaction, other than a sale, that occurs at the time of removal of motor vehicle fuel across the rack and that meets all the following conditions:

(A) The terminal operator, delivering supplier, and the receiving supplier are each registered with the Board to file electronically and have filed electronically with respect to the subject two-party exchange; and

(B) The terminal operator treats the receiving supplier in its books and records as the person that removes the motor vehicle fuel across a terminal rack for purposes of reporting the two-party exchange to the Board; and

(C) The two-party exchange is the subject of a written contract between the delivering supplier and the receiving supplier, acceptable evidence of which includes, but is not limited to, exchange statements, exchange differential invoices, exchange reconciliations, or any other similar writing between the parties; and

(D) All of the reporting requirements set forth in subdivisions (d) and (e) of this section are met.

(2) “Delivering supplier” means a supplier, licensed pursuant to Section 7451 of the Revenue and Taxation Code, who is the position holder of the motor vehicle fuel in the terminal on whom the motor vehicle fuel tax is imposed on removal of motor vehicle fuel from the rack for all purposes other than for a two-party exchange.

(3) “Receiving supplier” means a supplier, licensed pursuant to Section 7451 of the Revenue and Taxation Code, on whom the motor vehicle fuel tax is imposed only on removal of motor vehicle fuel from the rack as the receiving supplier under a two-party exchange.

(4) “Terminal,” as defined in Section 7339 of the Revenue and Taxation Code, includes, for purposes of this regulation, a terminal located at a refinery.

(c) LIABILITY FOR TAX.

(1) The delivering supplier is primarily liable for taxes imposed under Section 7362 or Section 7363(a) of the Revenue and Taxation Code, except, when a transaction satisfies the conditions and requirements for a two-party exchange, the delivering supplier shall be relieved of motor vehicle fuel tax liability and the receiving supplier shall become primarily liable for payment of motor vehicle fuel taxes on the motor vehicle fuel removed pursuant to the two-party exchange.

(2) The receiving supplier must report the two-party exchange and remit any tax due on a tax return filed within three months after the close of the calendar month in which the motor vehicle fuel was received. The receiving supplier may claim a refund for any amounts applied by the Board to the account of the receiving supplier under a two-party exchange contract. When all parties report a transaction as a two-party exchange, the receiving supplier may not file a claim for refund of the tax on the grounds that the transaction was not a two-party exchange.

(3) If the receiving supplier fails to report or remit taxes in conformity with this regulation, then the delivering supplier shall remain primarily liable for taxes due on the removal of the motor vehicle fuel from the rack.

(d) REPORTING REQUIREMENTS – GENERALLY.

(1) The terminal operator must report to the Board the two-party exchange of motor vehicle fuel between the delivering supplier and the receiving supplier.

(2) The terminal operator, the delivering supplier, and the receiving supplier must each use the same identifying information (e.g., bill of lading number) to refer to or otherwise report the subject two-party exchange.

(3) The terminal operator, the delivering supplier, and the receiving supplier must each enter the same fuel type on any report that includes a two-party exchange.

(e) REPORTING REQUIREMENTS – DELIVERING AND RECEIVING SUPPLIERS. The following reporting requirements must be met in order for an exchange of motor vehicle fuel to qualify as a two-party exchange and to shift imposition of the motor vehicle fuel tax liability from the delivering supplier to the receiving supplier.

(1) The delivering supplier must report the two-party exchange and identify the receiving supplier to the terminal operator; and

(2) The delivering supplier must report to the Board a tax-free delivery of motor vehicle fuel to the receiving supplier; and

(3) The receiving supplier must report to the Board a tax-free receipt of motor vehicle fuel from the delivering supplier; and

(4) The receiving supplier must report to the Board the rack removal of motor vehicle fuel to its customers and the amount of tax due.

(f) OPERATIVE DATE. The provisions of this regulation are operative January 1, 2007.

Authority: Sections 7372 and 8251 Revenue and Taxation Code

Reference: Sections 7362, 7363, 7368, 7369, 7372, 7451, 7651, 7652.5, 8301, and 8302 Revenue and Taxation Code.

DIESEL FUEL TAX LAW
Proposed Amendment to Regulation 1420

Regulation 1420. SUPPLIER.

(a) RETURNS. All suppliers must prepare and file returns with the Board to report tax on diesel fuel. Returns are due at the end of the month following the calendar month in which the diesel fuel was removed, entered, or sold, unless the Board requires that a return be filed for a different period. A terminal operator who also is a position holder in diesel fuel within the terminal or is jointly and severally liable for the tax is required to file both the terminal operator return and the supplier return.

(b) IMPOSITION OF TAX. Tax applies to each supplier as follows:

(1) **BLENDER.** A blender is required to pay the tax on the removal or sale of diesel fuel blended outside the bulk transfer/terminal system. The number of gallons of blended diesel fuel subject to the tax is the difference between the total number of gallons of blended diesel fuel removed or sold and the number of gallons of tax-paid diesel fuel used to produce the blended fuel.

(2) **ENTERER.**

(A) An enterer is required to pay the tax when the enterer imports diesel fuel into the state by means outside of the bulk transfer/terminal system.

(B) An enterer is required to pay the tax when the enterer removes or sells diesel fuel within a pipeline or terminal to an unlicensed person.

(C) An enterer is required to pay the tax when the entry is by bulk transfer and the enterer is not a licensed supplier.

(D) For purposes of proper imposition of tax, entry occurs when fuel is brought into the state, provided, however, that when entry is by bulk transfer, entry occurs as follows:

(1) When fuel is received at a marine terminal, entry occurs at the landside of the flange.

(2) When fuel is removed from a vessel in this state to a lighter for the purpose of lightering, entry occurs at the vessel side of the flange upon the removal of fuel from a vessel in this state to the lighter; provided, however, that if the lighter unloads or discharges the fuel at a marine terminal, then entry occurs at the land side of the flange as to the fuel received at the marine terminal. As used herein, "lightering" is the use of small, shallow-draft boats in transshipment to shore of oil or other fuel from a large, deep-draft vessel unable to dock at shore facilities because of shallow water. The small boats are called lighters.

(3) When fuel is removed from a vessel in this state to another vessel in this state, and the fuel is not unloaded or discharged at a marine terminal, then entry occurs when the fuel is brought into the state.

(3) POSITION HOLDER.

(A) A position holder that holds an inventory position in the diesel fuel as reflected on the records of the terminal operator is required to pay the tax when the diesel fuel is removed from the terminal rack.

(B) A position holder is required to pay the tax when the position holder removes or sells diesel fuel within or without the bulk transfer/terminal system to an unlicensed person.

(C) For reporting periods commencing on or after January 1, 2007, a position holder that delivers diesel fuel to a receiving supplier under a two-party exchange contract shall remain liable for the tax due on the removal of diesel fuel from the terminal rack unless all Regulation 1423 requirements are met.

(4) REFINER.

(A) A refiner is required to pay the tax when the diesel fuel is removed at a terminal rack located at a refinery.

(B) A refiner is required to pay the tax when the removal of diesel fuel is by bulk transfer (e.g., transfer by pipeline or vessel) and the refiner or the owner of the diesel fuel immediately before the removal is not a licensed supplier.

(C) A refiner is required to pay the tax when the refiner removes or sells diesel fuel within or without the bulk transfer/terminal system to an unlicensed person.

(D) For reporting periods commencing on or after January 1, 2007, a refiner that delivers diesel fuel to a receiving supplier under a two-party exchange contract shall remain liable for the tax due on the removal of diesel fuel from the terminal rack located at a refinery unless all Regulation 1423 requirements are met.

(5) TERMINAL OPERATOR. A terminal operator is jointly and severally liable for and may be required to pay the tax when the diesel fuel is removed at the rack if both subsections (A) and (B) below apply, or if subsection (C) applies:

(A) The position holder with respect to the diesel fuel is a person other than the terminal operator and is not a licensed supplier.

(B) The terminal operator is not a licensed supplier and either (i) does not have an unexpired notification certificate from the position holder as required by the Internal

Revenue Service or (ii) has an unexpired notification certificate from the position holder, but has reason to believe or knows that any information in the certificate is false.

(C) The terminal operator provides any person with a bill of lading, shipping paper, or similar document which falsely indicates that the undyed or unmarked diesel fuel which is removed from the terminal is dyed or marked in accordance with the United States Environmental Protection Agency or the Internal Revenue Service requirements.

(6) THROUGHPUTTER. A throughputter is required to pay the tax when the throughputter removes or sells diesel fuel within or without the bulk transfer/terminal system to a person who is not a licensed supplier.

Authority: Sections 60063 and 60601 Revenue and Taxation Code

Reference: Sections 60003, 60004, 60006, 60007, 60008, 60009, 60010, 60011, 60012, 60013, 60015, 60021, 60022, 60023, 60029, 60030, 60031, 60032, 60033, 60035, 60050, 60051, 60052, 60053, 60054, 60055, 60059, 60060, 60061, 60062, 60063, 60131, and 60201, Revenue and Taxation Code.

Regulation 1423. TWO-PARTY EXCHANGE

(a) GENERAL.

In a typical two-party exchange, two suppliers who own diesel fuel in terminals, i.e., who are position holders (pursuant to Section 60010 of the Revenue and Taxation Code), agree to give each other access to the diesel fuel each owns. Both suppliers have customers in the same terminal areas. One supplier (the delivering supplier) owns fuel in one terminal, and the other supplier (the receiving supplier) owns fuel, usually in a different terminal. Each supplier agrees to exchange fuel it owns for fuel the other supplier owns. A two-party exchange contract allows each supplier to have rack removal capability at a terminal where the other supplier is a position holder, in order to supply fuel to its customers in that terminal area. The receiving supplier takes the place of the delivering supplier when the diesel fuel is removed from the terminal at the rack. A two-party exchange may involve fuel held in terminals located in one or more states and may involve one or more types of fuel. For purposes of this regulation, however, at least one of the terminals involved in a two-party exchange must be located in this state, and the requirements for reporting transactions to the Board pursuant to this regulation pertain only to transactions involving terminals located in this state.

(b) DEFINITIONS.

(1) Notwithstanding Section 60048 of the Revenue and Taxation Code, “two-party exchange” means a transaction, other than a sale, that occurs at the time of removal of diesel fuel across the rack and that meets all the following conditions:

(A) The terminal operator, delivering supplier, and the receiving supplier are each registered with the Board to file electronically and have filed electronically with respect to the subject two-party exchange; and

(B) The terminal operator treats the receiving supplier in its books and records as the person that removes the diesel fuel across a terminal rack for purposes of reporting the two-party exchange to the Board; and

(C) The two-party exchange is the subject of a written contract between the delivering supplier and the receiving supplier, acceptable evidence of which includes, but is not limited to, exchange statements, exchange differential invoices, exchange reconciliations, or any other similar writing between the parties; and

(D) All of the reporting requirements set forth in subdivisions (d) and (e) of this section are met.

(2) “Delivering supplier” means a supplier licensed pursuant to Section 60131 of the Revenue and Taxation Code, who is the position holder of the diesel fuel in the terminal

on whom the diesel fuel tax is imposed on removal of diesel fuel from the rack for all purposes other than for a two-party exchange.

(3) “Receiving supplier” means a supplier licensed pursuant to Section 60131 of the Revenue and Taxation Code, on whom the diesel fuel tax is imposed only on removal of diesel fuel from the rack as the receiving supplier under a two-party exchange.

(4) “Terminal” as defined in Section 60033 of the Revenue and Taxation Code, includes, for purposes of this regulation, a terminal located at a refinery.

(c) LIABILITY FOR TAX.

(1) The delivering supplier is primarily liable for taxes imposed under Section 60051 or Section 60052(a) of the Revenue and Taxation Code, except, when a transaction satisfies the conditions and requirements for a two-party exchange, the delivering supplier shall be relieved of diesel fuel tax liability and the receiving supplier shall be liable for payment of diesel fuel taxes on the diesel fuel removed pursuant to the two-party exchange.

(2) The receiving supplier must report the two-party exchange and remit any tax due on a tax return filed within three months after the close of the calendar month in which the diesel fuel was received. The receiving supplier may claim a refund for any amounts applied by the Board to the account of the receiving supplier under a two-party exchange contract. When all parties report a transaction as a two-party exchange, the receiving supplier may not file a claim for refund of the tax on the grounds that the transaction was not a two-party exchange.

(3) If the receiving supplier fails to report or remit taxes in conformity with this regulation, then the delivering supplier shall remain primarily liable for taxes due on the removal of the diesel fuel from the rack.

(d) REPORTING REQUIREMENTS – GENERALLY.

(1) The terminal operator must report to the Board the two-party exchange of diesel fuel between the delivering supplier and the receiving supplier.

(2) The terminal operator, the delivering supplier, and the receiving supplier must each use the same identifying information (e.g., bill of lading number) to refer to or otherwise report the subject two-party exchange.

(3) The terminal operator, the delivering supplier, and the receiving supplier must each enter the same fuel type on any report that includes a two-party exchange.

(e) REPORTING REQUIREMENTS – DELIVERING AND RECEIVING SUPPLIERS. The following reporting requirements must be met in order for an exchange of diesel fuel to qualify as a two-party exchange and to shift the diesel fuel tax liability from the delivering supplier to the receiving supplier.

(1) The delivering supplier must report the two-party exchange and identify the receiving supplier to the terminal operator; and

(2) The delivering supplier must report to the Board a tax-free delivery of diesel fuel to the receiving supplier; and

(3) The receiving supplier must report to the Board a tax-free receipt of diesel fuel from the delivering supplier; and

(4) The receiving supplier must report to the Board the rack removal of diesel fuel to its customers and the amount of tax due.

(f) OPERATIVE DATE. The provisions of this regulation are operative January 1, 2007.

Authority: Sections 60063 and 60601 Revenue and Taxation Code

Reference: Section 60051, 60052, 60053, 60054, 60063, 60131, 60201, 60204, 60604, and 60605 Revenue and Taxation Code.

INITIAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY

PROPOSED REGULATIONS 1125 AND 1423, TWO-PARTY EXCHANGE, AND
PROPOSED AMENDMENTS TO REGULATIONS 1123 AND 1420, SUPPLIER

Regulations 1125 and 1423 are proposed to explain the requirements and conditions which must be met before the State Board of Equalization (Board) will permit the primary liability for motor vehicle fuel tax and diesel fuel tax, respectively, to be transferred from the delivering supplier to the receiving supplier under a two-party exchange of fuel and to provide definitions of relevant terms. Amendments to Regulations 1123 and 1420 are proposed to clarify that the primary liability for fuel tax will remain with the delivering supplier if the requirements of Regulations 1125 and 1423, respectively, are not met.

Specific Purpose

The purpose of proposed Regulation 1125 is to interpret, implement, and make specific Revenue and Taxation Code section 7372 of the Motor Vehicle Fuel Tax Law. The purpose of proposed Regulation 1423 is to interpret, implement, and make specific Revenue and Taxation Code section 60063 of the Diesel Fuel Tax Law. These regulations are necessary to provide guidance to taxpayers affected by these statutes. The purpose of the proposed amendments to Regulations 1123 and 1420 is to address the effects of proposed Regulations 1125 and 1423, respectively, on the existing regulations.

Factual Basis

Proposed Regulations 1125 and 1423 provide a description of a two-party exchange and relevant definitions and discuss the requirements and conditions that must be met for the primary liability for fuel taxes to be transferred from the delivering supplier to the receiving supplier pursuant to a two-party exchange. Regulation 1125 addresses a two-party exchange with respect to the Motor Vehicle Fuel (MVF) Tax Law, and Regulation 1143 addresses a two-party exchange with respect to the Diesel Fuel Tax Law. Otherwise, they are textually identical, as are the proposed amendments to Regulations 1123 and 1420.

The Board is proposing Regulations 1125 and 1423 for the following reasons. Current MVF and Diesel Fuel Tax Laws impose a fuel tax on the removal of motor vehicle fuel and diesel fuel from a terminal or refinery rack. The supplier (position holder or refiner)¹ is liable for the payment of MVF tax and diesel fuel tax to the State. However, both fuel tax laws, under Revenue and Taxation Code sections 7372 and 60063, respectively, permit the Board to accept payment of the fuel taxes from the person who receives the motor vehicle fuel or diesel fuel at the terminal or refinery rack in a two-party exchange, if the Internal Revenue Service (IRS) authorizes payment of federal fuel taxes by the receiving party under a two-party exchange contract or agreement. The supplier remains primarily liable for the fuel tax until the fuel tax is paid and credited to the account of the supplier.

¹ See Revenue and Taxation Code sections 7372, 7334, and 7338 (60010, 60011, and 60033).

The Board may, however, relieve the supplier from primary liability and hold another person primarily liable for payment of the tax if the IRS has authorized the receiving party to pay the federal fuel tax, if the IRS has made another person primarily liable for payment of the tax, and if the Board elects to follow the IRS approach of accepting fuel tax from the receiving party under a two-party exchange contract.

The federal American Jobs Creation Act of 2004 authorized the IRS to receive payment of federal fuel taxes from the receiving party under a two-party exchange contract and made the receiving party primarily liable for the federal fuel tax.

Western States Petroleum Association (WSPA) requested that the Board make the election to follow the IRS approach. WSPA requested that the Board permit the receiving party under a two-party exchange contract to become the primary taxpayer for payment of the California fuel taxes collected at the terminal or refinery rack. Election of this approach would allow suppliers and terminal operators to report taxable transactions in the same manner to both the IRS and the Board. Other states that impose a fuel tax at the terminal rack have successfully implemented the two-party exchange.

Proposed Regulations 1123 and 1420 are the result of the Board's election to follow the IRS approach. These regulations provide, in subdivision (a), a general description of a two-party exchange, the reasons for a two-party exchange, and an explanation that fuel subject to the exchange may be held in terminals located in one or more states and may include more than one fuel type and that only the transactions involving terminals located in this state should be reported to the Board.

Since "two-party exchange" is not defined in the MVF or Diesel Fuel Tax Laws, subdivision (b)(1) in the proposed regulations defines a "two-party exchange." Subparagraphs (1)(A) through (1)(D) of subdivision (b) explain the conditions for a transaction to qualify as a two-party exchange. The term "delivering supplier" is defined in subdivision (b)(2), and the term "receiving supplier" is defined in subdivision (b)(3).

Further, since, under circumstances other than those involving a two-party exchange, the supplier who is a refiner or who holds an inventory position in fuel at the terminal is primarily liable for the tax at the time the fuel is removed from the rack, the regulations explain, in subdivision (c)(1), that, when a transaction satisfies the conditions and requirements of a two-party exchange contract, the delivering supplier shall be relieved of the fuel tax liability and the receiving supplier shall be liable for payment of the tax. Subdivision (c)(2) explains that the receiving supplier must report the two-party exchange and remit the tax on a tax return filed within three months after the close of the calendar month in which the fuel was received. The second sentence clarifies that a receiving supplier can receive a refund of any overpayment of fuel tax. The third sentence clarifies that, when all the parties report a transaction as a two-party exchange to the Board, the transaction may not be reversed nor may the taxes be refunded to the receiving supplier. Subdivision (c)(3) clarifies that, if the receiving supplier fails to report or remit the tax on a two-party exchange, the delivering supplier shall remain primarily liable for the taxes due on the removal of fuel from the rack.

Subdivision (d) of the proposed regulations explains the general reporting requirements of the terminal operator, delivering supplier, and receiving supplier, and subdivision (e) explains the reporting requirements for delivering and receiving suppliers that must be met in order for an exchange of fuel to qualify as a two-party exchange and shift the imposition of fuel tax liability to the receiving supplier. Paragraphs (1) through (4) of subdivision (e) clarify what must be reported. Subdivision (f) establishes an operative date of January 1, 2007, for the proposed regulations.

Amendments to Regulations 1123 and 1420 are proposed to add subparagraphs (3)(C) and (4)(D) to subdivision (b) to clarify that the position holder or refiner, respectively, delivering fuel to a receiving supplier under a two-party exchange contract remains liable for the tax unless all the requirements of the two-party exchange regulation are met and to establish an operative date.

Pursuant to Government Code section 11346.2, subdivision (b)(3), the only reasonable alternative to promulgating proposed Regulations 1125 and 1423 was to not promulgate these regulations. Although the regulations impose minor additional record keeping responsibilities on small businesses such as terminal operators, these additional responsibilities are offset by the advantages gained by conforming the two-party exchange process in California with the two-party exchange process in other states and with the Internal Revenue Service. The fuel industry, including the position holders, refiners, and terminal operators, supports adoption of these regulations. No other private businesses or persons will be affected by these regulations.

Pursuant to Government Code section 11346.2, subdivision (b)(4), the Board has determined that adoption of the proposed regulations will not have a significant adverse economic impact on private business or persons. The regulations are proposed to interpret, implement, and make specific the authorizing statutes. These regulations and amendments will clarify the interpretation and administration of a two-party exchange under the MVF and Diesel Fuel Tax Laws. Therefore, the Board has determined that these regulations and amendments should be adopted.

REGULATION HISTORY

TYPE OF REGULATION: Fuel Tax
REGULATIONS: Adopt 1125, *Two-Party Exchange* and 1423, *Two-Party Exchange*
Amend 1123, *Supplier* and 1420, *Supplier*
PREPARATION: Arlo Gilbert
LEGAL CONTACT: Carolee Johnstone

SUMMARY OF REGULATORY CHANGE

Current law provides that primary liability for motor vehicle fuel tax under the Motor Vehicle Fuel Tax Law and primary liability for diesel fuel tax under the Diesel Fuel Tax Law is imposed on, among others, the position holder in a terminal and the refiner, on removal of motor vehicle fuel or diesel fuel from the terminal or refinery, if the fuel is removed at the rack. The Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law contain provisions, in sections 7372, subdivision (b) and 60063, subdivision (b), respectively, that permit the Board to relieve the position holder or refiner from primary liability for payment of the motor vehicle fuel or diesel fuel tax imposed on them and to hold another person primarily liable for the tax, under certain conditions. The Board is permitted to adopt regulations it deems appropriate in order to implement this provision.

Regulation 1125, *Two-Party Exchange*, and Regulation 1423, *Two-Party Exchange*, are proposed to be promulgated to implement section 7372 of the Motor Vehicle Fuel Tax Law and section 60063 of the Diesel Fuel Tax Law, respectively. The regulations are proposed to provide a general description of a two-party exchange and the reasons for a two-party exchange, to define a two-party exchange, delivering supplier, and receiving supplier, to explain the conditions that must be met in order to relieve the delivering supplier of the fuel tax liability, and to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier.

The amendments to Regulation 1123, *Supplier*, and Regulation 1420, *Supplier*, are proposed to clarify that the delivering supplier, either the position holder or the refiner, under a two-party exchange remains primarily liable for the tax due on removal of motor vehicle fuel or diesel fuel from the terminal or refinery rack if the requirements for a two-party exchange pursuant to Regulation 1125 and Regulation 1423, respectively, are not met.

CURRENT REGULATIONS HISTORY

June 27, 2006: Public Hearing
May 13, 2006: 45-Day public comment begins.
May 12, 2006: Notice of public hearing published in California Regulatory Notice Register, Register 2006, No. 19-Z, e-mailed and US mail to interested parties.
March 28, 2006: Board authorized publication. (Vote 5-0)
January 26, 2006: 2nd Interested Parties Meeting
December 7, 2005: 1st Interested Parties Meeting

Sponsor: Board Staff

Support: None
Oppose: None