

[Senate Bill 1](#) (Beall)

Date: 04/21/16

Program: Motor Vehicle Fuel and Diesel Fuel Tax

Sponsor: Author

Revenue and Taxation Code Sections 6051.8, 6201.8, 7360, and 60050.

Effective: Immediately but sales and use tax provisions operative July 1, 2016, and excise tax provisions operative on the first day of the first calendar quarter 90 days after enactment.

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

Summary: Among its provisions, imposes an additional \$0.12 per gallon gasoline tax, changes the diesel fuel base rate to \$0.13 per gallon and imposes an additional \$0.22 per gallon diesel fuel surtax. The bill also eliminates the fuel tax swap revenue neutrality adjustment, and increases the existing additional sales and use surtax from 1.75% to 5.25% for diesel fuel.

This bill also adds a fuel tax rate adjustment for inflation and a fleet fuel efficiency factor, as specified, beginning January 1, 2019, and every 3 years thereafter.

Summary of Amendments: Among other things, the amendments since the previous analysis increase the existing sales and use surtax on diesel fuel from 1.75% to 5.25%, and adds a fuel efficiency factor, as specified, that the BOE would use to adjust the gasoline and diesel fuel tax rates, beginning January 1, 2019, and every 3 years thereafter.

Purpose: According to the author, the purpose of this bill is to create a long-term funding source for the state, counties, and cities to address transportation and road maintenance needs.

Fiscal Impact Summary: Total state excise tax and sales and use tax revenues increase by \$1.524 billion in fiscal year (FY) 2016-17, and \$2.736 billion in FY 2017-18.

Existing Law: The existing Motor Vehicle Fuel Tax Law (MVFTL)¹ and the Diesel Fuel Tax Law² impose excise taxes on gasoline and diesel fuel when any of the following events occur:

- Removal at the refinery or terminal rack
- Entry into the state
- 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.³

Since July 1, 2010, as part of the “fuel tax swap” measures, 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.⁴ 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.

¹ Part 2 (commencing with Section 7301) of Division 2 of the RTC.

² Part 31 (commencing with Section 60001) of Division 2 of the RTC.

³ 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>

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

Additionally, the Local Motor Vehicle Fuel Taxation Law⁵ 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.

Locally-imposed sales and use tax ordinances include provisions identical to those contained in Part 1 (commencing with Section 6001) relating to sales and use tax. The sales and use tax law provides that the excise tax on gasoline is included in the base for computation of sales and use tax.⁶ The excise tax imposed on diesel fuel is *not* subject to sales or use tax.⁷

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” measures⁸ 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 provisions⁹ exempt sales and purchases of gasoline from the state General Fund portion of the sales and use tax rate. To offset the revenue loss related to this partial exemption, except for aviation gasoline, the law increased the gasoline excise tax rate from \$0.18 per gallon to \$0.353 per gallon.¹⁰ Conversely, the statute¹¹ reduced the diesel fuel excise tax rate from \$0.18 to \$0.13 per gallon but increased¹² 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 equal 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.

⁵ Part 4 (commencing with Section 9501) of Division 2 of the RTC.

⁶ 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).

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

⁸ [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).

⁹ RTC Section 6357.7.

¹⁰ RTC Section 7360. Aviation gasoline continues to be taxed at \$0.18 per gallon, as this fuel was already exempt from sales and use tax and therefore was excluded from the fuel tax swap gasoline excise tax rate increase.

¹¹ RTC Section 60050.

¹² RTC Sections 6051.8 and 6201.8.

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Proposed Law: This bill amends RTC Sections 6051.8, and 6201.8, to increase the existing additional sales and use tax on diesel fuel from 1.75% to 5.25%, effective July 1, 2016. The bill directs 1.75% of the sales and use tax rate to be transferred quarterly to the Transportation Debt Service Fund, with the remainder of the net revenues to be estimated by the BOE, with Department of Finance concurrence, and transferred quarterly to the Public Transportation Account in the State Transportation Fund.

With respect to gasoline, this bill amends RTC Section 7360 to impose an additional \$0.12 per gallon tax on gasoline, except aviation gasoline, on the first day of the first calendar quarter 90 days after enactment. The bill also deletes the revenue neutrality provisions of the current fuel tax swap, but retains the additional fuel tax swap excise tax of \$0.173. The base rate of \$0.18 is left untouched. If passed, the total gasoline excise tax rate would be \$0.473 per gallon.

The bill also amends RTC Section 60050 to impose an additional \$0.22 per gallon tax on diesel fuel on the first day of the first calendar quarter 90 days after enactment. The diesel fuel base excise tax rate of \$0.18 is amended to \$0.13 per gallon. If passed, the total diesel fuel excise tax rate would be \$0.35 per gallon.

Beginning July 1, 2019, and every three years thereafter, both the gasoline and diesel fuel excise tax rates are recomputed by an inflation adjustment factor and a fuel efficiency factor. The BOE computes the rate changes based on information provided by the Department of Finance (DOF), beginning January 31, 2019, and every third year thereafter. The BOE determines the rate by March 1 of the same year as the effective date of the new rate.

The inflation adjustment factor is based on the percentage change in the California Consumer Price Index from November of four calendar years prior to November of the prior calendar, as provided by DOF. The fuel efficiency factor is determined by the BOE, but is based on the estimated change in the average fuel efficiency of the overall California motor vehicle fleet over the same periods of time, as provided by DOF.

The bill adds Chapter 2 (commencing with Section 2030) to Division 3 of the Streets and Highway Code to among other things, establish the Road Maintenance and Rehabilitation Account and the Trade Corridors Improvement Fund, both of which account for the deposit of the additional gasoline and diesel fuel excise taxes imposed by this bill. The additional fuel excise tax 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 sales and use tax provisions are operative July 1, 2016, and the excise tax provisions are operative on the first day of the first calendar quarter 90 days after enactment.

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.¹³

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.¹⁴

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. Since the diesel fuel excise tax rate was decreased, there was no need for a floor stock tax.

¹³ 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).

¹⁴ Assembly Bill 2114 (Ch. 1053, Longville).

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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:

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

Commentary:

- 1. Effect of the bill.** Governor Brown called a Special Session of the Legislature to enact permanent and sustainable funding, repair the state’s transportation and critical infrastructure, and complement local infrastructure efforts. This bill creates a permanent funding source for state and local government to address road maintenance through an additional \$0.12 per gallon tax on gasoline and an additional \$0.22 per gallon tax on diesel fuel. The bill also increases the existing sales and use surtax on diesel fuel from 1.75% to 5.25%, operative July 1, 2016. Overall, gasoline excise taxes increase from the FY 2015-16 rate of \$0.30 to \$0.473 per gallon, and diesel fuel excise taxes increase from the FY 2015-16 rate of \$0.13 to \$0.35 per gallon.
- 2. The April 21, 2016 amendments,** among other things, increase the existing sales and use surtax on diesel fuel from 1.75% to 5.25%, and add a fuel efficiency factor, as computed by the DOF, for future adjustments to the gasoline and diesel fuel excise tax rates. **The July 14, 2015 amendments** increased the proposed gasoline tax from \$0.10 to \$0.12 per gallon, deleted the fuel tax swap revenue neutrality adjustment and changed the adjusted gasoline excise tax rate in effect for FY 2015-16 from \$0.12 to \$0.173, permanently decreased the proposed diesel fuel base rate from \$0.18 to \$0.13 per gallon, increased the additional diesel fuel surtax from \$0.12 to \$0.22 per gallon, and eliminated the fuel tax swap revenue neutrality adjustment. The bill indexes the fuel tax rates for inflation beginning January 1, 2019, and every 3 years thereafter.
- 3. Delayed operative date.** The bill contains an urgency clause and is effective immediately, but the proposed sales and use surtax increase is operative July 1, 2016. In order to provide the BOE and retailers sufficient time to implement the increase, the BOE suggests a delayed operative date consistent with the gasoline and diesel fuel excise tax rate increases – the first day of the first calendar quarter following 90 days from the bill’s effective date.
- 4. This bill essentially makes permanent the fuel tax swap provisions.** Although this bill deletes the fuel tax swap revenue neutrality adjustment provisions, it does not make any changes to the gasoline sales tax exemption. It does not delete the current 1.75% sales surtax on diesel fuel, but rather increases that rate to 5.25%. The bill also changes the additional gasoline excise tax from the

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current \$0.12 back to the original \$0.173 imposed during the first year of the fuel tax swap. The diesel fuel tax base rate of \$0.18, that was reduced to \$0.13 with the fuel tax swap and is adjusted annually, is permanently changed to \$0.13. Excluding the additional excise tax rate increases, and except for the diesel fuel sales surtax rate of 5.25%, which was 1.87% during the first year, this bill essentially reverts back to the sales and excise tax rates that were in effect during the first year of the fuel tax swap.

5. **The bill lacks floor stock tax provisions.** 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. If the author wishes to consider a floor stock tax, the BOE would need an even longer delayed operative date. However, an urgent implementation of the gasoline and diesel fuel excise tax rate increases proposed by this bill would generate significantly more revenues than the potential floor stock tax revenues.
6. **Bill lacks final reconciliation provisions.** Under current law, BOE staff annually recommend an excise tax rate for gasoline and diesel fuel to ensure that the state did not collect more in taxes than it would have collected under the tax structure in place prior to the 2010 fuel tax swap legislation. The BOE compares revenues actually received with the revenues originally projected to determine the difference. The difference from the prior fiscal year is reconciled when setting the coming fiscal year's excise tax rate. For example, if the BOE originally projected that a \$0.10 excise tax rate would bring in \$100 in revenue (the amount necessary for revenue neutrality), but it brought in only \$90, the BOE would have under-collected by \$10 and would have to make up the difference in the coming year's excise tax rate setting.

This bill simply changes the excise tax rates and removes the revenue neutrality provisions, but does not reconcile remaining discrepancies for FY 2015-16 and the portion of FY 2016-17 before the new rates takes effect. As a result, some over- or under-collection of the gasoline and diesel fuel excise taxes may remain unreconciled.

7. **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.
8. **Local jurisdictions should also see an increase in sales and use tax revenues from gasoline.** 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.¹⁵ 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 \$0.12 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.

¹⁵ RTC Sections 6011 (sales price) and 6012 (gross receipts).

- 9. Existing law allows the BOE to adjust the prepayment rate so tax evasion issues would be minimized.** In order to combat tax evasion, current law requires wholesalers, and suppliers of certain fuels, including diesel fuel, to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuel at any point after removal from the terminal rack. Retailers or other fuel sellers prepay the sales tax to their suppliers, and claim a credit for the prepaid tax paid to the supplier when they file their sales and use tax returns.

By March 1 of each year, the law requires the BOE to establish the sales tax prepayment that will be in effect from July 1 through June 30 of the following year. Generally, new prepayment rates take effect July 1. However, if the rate changes, or the diesel fuel prices change and the established rate result in or could result in prepayments that consistently exceed or are significantly lower than the retailer's sales tax liability, existing law allows the BOE to adjust the rate. With a 3.5% rate increase proposed, the prepayment rate may require adjustment (currently the rate is 22.5 cents per gallon). This adjustment, if necessary, will combat potential issues related to tax evasion associated with a higher tax.

- 10. Fuel Efficiency Adjustment.** BOE staff have been unable to obtain data regarding the estimated change in the average fuel efficiency of the overall California motor vehicle fleet, which is needed in order to compute the possible future tax rate impact. The DOF is responsible for transmitting the "estimated percentage change in the average fuel efficiency of the overall California motor vehicle fleet." This information does not appear to be maintained by DOF, nor does it appear to be readily available through California or federal agencies.

Additionally, the exact wording is used for both the gasoline excise tax and the diesel fuel excise tax. Does the author intend for the same percentage change to be used for different types of fuels? Should the fuel efficiency factor for gasoline and diesel fuel be mutually exclusive of certain types of "motor vehicles?" Is the fuel efficiency adjustment intended to be similar to the excise taxes on cigarettes – ultimately leading to an ever increasing tax on an ever decreasing taxpayer base?

- 11. Related bills.** [AB 1591](#) (Frazier), among other things, increases the gasoline tax by \$0.225 per gallon, lowers the diesel fuel base tax rate from \$0.18 to \$0.13 per gallon, and imposes an additional \$0.30 per gallon tax on diesel fuel. Also eliminates the fuel tax swap revenue neutrality adjustment, but adds a fuel tax rates inflation adjustment operative July 1, 2019, and every three years thereafter.

Costs: BOE administrative costs related to this bill are attributable to the immediate computer programming modification, publication and return revisions, and carrying out compliance and audit efforts to ensure proper reporting. A detailed cost estimate is pending.

Revenue Impact:

Background, Methodology, and Assumptions. This bill contains an urgency measure and is effective immediately. However the proposed gasoline and diesel fuel excise tax increases become operative 90 days after the effective date. The sales and use surtax rate change is effective July 1, 2016. Since this a special session bill, for revenue estimation purposes, staff assumes the Governor has until September 30, 2016 to sign or veto bills, and a January 1, 2017 implementation date for the gasoline and diesel fuel excise tax rate changes. Gasoline and diesel consumption is proportional to days of the fiscal year.

DOF forecasts 15.193 billion gallons of gasoline to be consumed on roads in FY 2016-17 and 15.117 billion gallons in FY 2017-18. DOF staff forecasts 2.732 billion gallons of diesel to be consumed on roads in FY 2016-17 and 2.794 billion gallons in FY 2017-18. BOE staff assumed a price elasticity of -0.1 for gasoline and -0.2 for diesel and applied them to the consumption figures.¹⁶

¹⁶ 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 discussion of price elasticities, see *Fuel Price Elasticity: Synthesis*, Washington State Department of Transportation, 2007.

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Sales and use tax law provides that the excise tax on gasoline is included in the base for computation of sales and use tax. Therefore, the change in revenue from increasing the excise tax on gasoline would be subject to local and district sales and use taxes. The local uniform sales and use tax rate is 2.25%. The average statewide local districts sales and use tax rate is 0.96%, implying an average local sales and use tax rate of 3.21%.

The state revenue impacts are shown in the table below. Gasoline and diesel fuel excise tax and state sales tax revenues combined increase a total of about \$2.7 billion in fiscal year 2017-18, the first complete fiscal year the additional taxes are in effect. Local sales and use tax revenues (not shown in the table) would increase \$58 million in fiscal year 2017-18.

	FY 2016-17 (Half-Year, Millions)	FY 2017-18 (Millions)
Excise Tax Revenues	\$1,206.5	\$2,414.0
Gas	\$908.0	\$1,807.0
Diesel	\$298.5	\$607.0
Revenues From Diesel Surcharge Rate Increase (5.25%, up 3.50% from 1.75% Under Current Law)	\$317.0	\$322.2
Total State Excise Tax and Sales Tax Revenues	\$1,523.5	\$2,736.2

Consumer Price Index (CPI) Adjustment. The DOF is forecasting a 7.5% increase in the California CPI over the three FYs 2015-16 to 2018-19. This implies a \$0.009 increase in the gasoline tax rate and a \$0.017 increase in the diesel tax rate starting in FY 2018-19.

Fuel Efficiency Adjustment. BOE staff have been unable to obtain data regarding the estimated change in the average fuel efficiency of the overall California motor vehicle fleet, which the BOE would need in order to compute the possible future tax rate impact.

Qualifying Remarks. This analysis only considers revenue impacts for fuel excise taxes 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.

This revenue estimate does not account for any direct or indirect effects as a result of the elimination of the fuel tax swap revenue neutrality provision, or for the 5% sales and use tax exemption for gasoline that remains in effect.