



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

Date:	04/11/12	Bill No:	Senate Bill 1396
Tax Program:	Sales and Use Motor Vehicle Fuel Diesel Fuel	Author:	Dutton
Sponsor:	BOE Member George Runner	Code Sections:	RTC 6011, 6012, 7360 and 60050
Related Bills:		Effective Date:	Upon enactment

BILL SUMMARY

This bill provides a sales and use tax exclusion with respect to sales of motor vehicle fuel (gasoline) and diesel fuel, of amounts charged in excess of \$3.88 and \$3.52 per gallon (which approximates a retail price of \$4.00), respectively. The bill also maintains the current excise tax rates for gasoline and diesel fuel and permits the Board of Equalization (BOE) to reduce, but not increase, the excise tax rates in the future exercise of its fuel tax swap¹ rate calculation responsibilities.

ANALYSIS

CURRENT LAW

Under the **Motor Vehicle Fuel Tax Law** (Part 2 (commencing with Section 7301) of Division 2 of the Revenue and Taxation Code (RTC)), the state currently imposes an excise tax of \$0.357 per gallon (\$0.18 excise tax and \$0.177 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.

Under the **Diesel Fuel Tax Law** (Part 31 (commencing with Section 60001) of Division 2 of the RTC), the state currently imposes an excise tax of \$0.13 per gallon on the removal of diesel fuel at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person.

In general, current federal law (Section 4081 of the Internal Revenue Code) imposes an excise tax of \$0.184 per gallon on producers for the removal of gasoline from a terminal or refinery, or upon importers for the entry of gasoline into the United States. This section also imposes an excise tax on clear diesel fuel and kerosene at a rate of \$0.244 per gallon.

Additionally, Parts 1, 1.5, and 1.6 of Division 2 of the RTC impose state **sales and use taxes**, local sales and use taxes, and district transactions and use taxes, respectively, on all tangible personal property, including gasoline and diesel fuel, sold at retail. A state and local sales and use tax rate (7.25%) is imposed on taxable sales and purchases of tangible personal property. The fuel tax swap provided an exemption, operative July 1, 2010, from the state General Fund portion of the sales and use tax rate on sales and purchases of gasoline. Conversely, an additional General Fund sales and use tax was imposed on sales of diesel fuel at the rate of 1.87% effective July 1, 2011. The rate of this additional tax is increased to 2.17% effective July 1, 2012, and is

¹ See the "BACKGROUND" on page four of this analysis for a detailed explanation of the fuel tax swap.

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reduced to 1.94% effective July 1, 2013, and to 1.75% effective on and after July 1, 2014.

Under the existing Sales and Use Tax Law, the \$0.184 cents per gallon federal excise tax and the \$0.357 per gallon state excise tax are included in the measure (i.e. gross receipts or sales price) on which sales or use tax on the retail sale or purchase of gasoline is computed.

With respect to sales of diesel fuel, the measure on which the sales and use tax on the retail sale or purchase of diesel fuel is computed only includes the federal excise tax of \$0.244 per gallon.

Summary of California State Taxes on Gasoline and Diesel Fuel

The following table provides a brief description of the statewide sales and use tax and the excise tax on gasoline (additional transactions and use taxes, also known as district taxes, are levied by various local jurisdictions and are not reflected in this table):

Gasoline	07/01/10	07/01/11	07/01/12
General Fund Sales Tax ²	0%	0%	0%
Local Sales Tax	2.25%	2.25%	2.25%
Excise Tax	35.3 cents/gallon	35.7 cents/gallon	36.0 cents/gallon

The next table provides a brief description of the statewide sales and use tax and the excise tax on diesel fuel (additional transactions and use taxes, also known as district taxes, are levied by various local jurisdictions and are not reflected in this table):

Diesel Fuel	07/01/11	07/01/12	07/01/13	07/01/14
Total Statewide Base Sales Tax	7.25%	7.25%	7.25%	7.25%
Additional Sales Tax	1.87%	2.17%	1.94%	1.75%
Combined Sales Tax ³	9.12%	9.42%	9.19%	9%
Excise tax	13 cents/gallon	10 cents/gallon	To be determined by BOE	To be determined by BOE

PROPOSED LAW

This bill would amend RTC Sections 6011 and 6012 to provide a sales and use tax exclusion, with respect to sales of gasoline and diesel fuel, of amounts charged in excess of \$3.88 and \$3.52 per gallon, respectively. This measure would also amend RTC Sections 7360 and 60050 to maintain the current excise tax rates for gasoline and diesel fuel and permit the BOE to reduce, but not increase, the excise tax rates in the future exercise of its fuel tax swap rate calculation responsibilities.

Sales and Use Tax Exclusion. This bill would amend Sections 6011 and 6012 of the Revenue and Taxation Code to exclude from the definition of “sales price” and “gross receipts” the amount charged at the retail level for gasoline and diesel fuel as follows:

Gasoline: excludes the amount charged at the retail level in excess of three dollars and eighty-eight cents (\$3.88) per gallon for gasoline, including federally-imposed and state-imposed excise taxes, but excluding state-imposed sales and use taxes.

² The amount of the General Fund rate (6% effective July 2010; 5% effective July 1, 2011, and thereafter), foregone by the State, which is offset by the increased gasoline excise tax.

³ The additional sales and use tax revenue is offset by the lower excise tax revenue for diesel fuel. District taxes are in addition to this amount.

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Diesel fuel: excludes the amount charged at the retail level in excess of three dollars and fifty-two cents (\$3.52) per gallon for diesel fuel, including federally-imposed excise taxes, but excluding state-imposed excise, sales, and use taxes.

Cap on Excise Tax. Section 7360 would be amended to impose an excise surtax on **gasoline** of seventeen and three-tenths cents (\$0.173) per gallon on and after July 1, 2010 and before July 1, 2012. On and after July 1, 2012, the surtax is seventeen and seven-tenths cents (\$0.177) per gallon. Additionally, this bill specifies that the excise surtax rate, as adjusted by the BOE, beginning with the fiscal year (FY) 2013-14, shall not exceed the rate of \$0.177 per gallon.

Section 60050, which imposes an excise tax on **diesel fuel** of \$0.13 per gallon, was amended to specify that the excise tax rate, as adjusted by the BOE, beginning with the 2012-13 FY, shall not exceed the rate of \$0.13 per gallon.

Excise Tax Rate Adjustment. As provided in the fuel tax swap, the BOE would continue to be charged with the responsibility of adjusting the excise tax rate for both gasoline and diesel fuel each year. The determination of the rates for both fuels continues to use a two-step process; a look-forward and a look-back (also referred to as the rate setting and the true-up). However, this bill would amend that process so that instead of balancing the overall revenues derived from the imposition of state excise tax and sales or use tax on sales of gasoline and diesel fuel, this bill would instead require the BOE to adjust the excise tax rates for gasoline and diesel fuel only when the overall revenues derived from these fuels would result in setting the state's excise tax at an amount below the cap rate (\$0.357 for gasoline / \$0.13 for diesel).

For **gasoline**, this bill requires the excise tax rate to be adjusted as follows:

Section 7360(b)(2): For FY 2013-14 and each FY thereafter, the BOE shall estimate the amount of revenue loss attributable to the General Fund sales tax exemption for gasoline and the revenue derived from the excise surtax (\$0.177). If the estimated revenue from the excise surtax exceeds the estimated General Fund sales tax revenue loss, then the excise surtax shall be adjusted to generate the amount of excise tax revenue that will equal the General Fund sales tax **revenue loss**. The rate will continue to be set by March 1 of the preceding FY, and that adjusted rate is effective July 1 of the state's next FY.

Section 7360(b)(3): Beginning with the rate adjustment on or before March 1, 2014, the adjustment specified in (b)(2) shall also take into account the extent to which the actual amount of revenues derived from the excise surtax and the **revenue loss** attributable to the General Fund sales tax exemption resulted in a net revenue gain or loss for the FY ending prior to the rate being set by March 1. The bill specifies that the rate resulting from the true-up, beginning with the FY 2013-14, shall not exceed the rate of \$0.177 per gallon.

For **diesel fuel**, this bill requires the excise tax rate to be adjusted as follows:

Section 60050(b)(2): For FY 2012-13 and each FY thereafter, the BOE shall estimate the amount of revenue loss attributable to the excise tax rate reduction (\$0.13) for diesel fuel and the revenue derived from the additional General Fund sales and use tax on sales of diesel fuel (1.87% effective July 1, 2011, 2.17% effective July 1, 2012, 1.94% effective July 1, 2013, and 1.75% on July 1, 2014). If the estimated revenue gain from the additional General Fund sales and use tax exceeds the estimated revenue loss from the reduced excise tax rate, then the excise surtax shall be adjusted to generate a revenue loss that will equal the amount

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of revenue from the additional General Fund sales and use tax **revenue gain**. The rate will continue to be set by March 1 of the preceding FY, and that adjusted rate is effective July 1 of the state's next FY.

Section 60050(b)(3): For each year, beginning with the rate adjustment on or before March 1, 2013, the adjustment specified in (b)(2) shall also take into account the extent to which the actual amount of revenues derived from the additional General Fund sales and use tax and the **revenue loss** attributable to the reduced excise tax rate resulted in a net revenue gain or loss for the FY ending prior to the rate being set by March 1. The bill specifies that the rate resulting from the true-up, beginning with FY 2012-13, shall not exceed the rate of \$0.13 per gallon.

As an urgency statute, the bill would become effective immediately, but certain provisions would be operative on the specified dates.

BACKGROUND

In late March 2010, two "fuel tax swap" measures were enacted (ABx8 6, Ch. 11, and SB 70, Ch. 9), that made several changes to the imposition and rates of state taxes on transactions involving transfers of gasoline and diesel fuel. Minor revisions were made to the fuel tax swap provisions with the passage of AB 105 (Ch. 6, Stats. 2011). This fuel tax swap is intended to be revenue neutral, so that the state's total tax revenues from the sale of gasoline and diesel fuel would not be increased or decreased, nor would taxpayers' share of the tax burden be affected. To maintain revenue neutrality, these "swap" provisions require the BOE to adjust the excise tax rates, beginning on July 1, 2011, for gasoline and July 1, 2012, for diesel – either upwards or downwards – so that the overall revenues derived from the imposition of state excise tax and sales or use tax on sales of gasoline and diesel fuel remain the same. The BOE is required to determine the adjusted excise tax rates by March 1 of the fiscal year immediately preceding the applicable fiscal year.

A statewide sales and use tax rate (7.25%) is imposed on taxable sales and purchases of tangible personal property. The fuel tax swap provided an exemption, operative July 1, 2010, from the state General Fund portion of the sales and use tax rate on sales and purchases of gasoline. Conversely, an additional sales and use tax was imposed on sales of diesel fuel of 1.87% effective July 1, 2011. The rate of this additional tax is increased to 2.17% effective July 1, 2012, and is reduced to 1.94% effective July 1, 2013, and to 1.75% effective on and after July 1, 2014.

To offset the General Fund sales and use tax reduction for gasoline, the excise tax rate for gasoline was increased; the current excise tax rate for gasoline is \$0.357 per gallon. The complimentary offset for the additional sales and use tax for diesel fuel was a reduction of the diesel fuel excise tax; the current excise tax rate for diesel fuel is \$0.13 per gallon. As required by the fuel tax swap, the BOE recently approved adjusted excise tax rates for both gasoline, at \$0.360 per gallon, and diesel fuel, at \$0.10 per gallon, to take effect July 1, 2012.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by BOE Member George Runner and is intended to place a cap on sales and excise taxes on fuel to help save taxpayers money and help lower fuel taxes on California industries so that they can create jobs.
- 2. The BOE would no longer need to estimate revenue neutrality.** The fuel tax swap was meant to be revenue neutral, so that the state's tax revenues would not

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be increased or decreased, nor would the taxpayers' share of the tax burden be affected. To maintain revenue neutrality, the provisions of the "swap" require the BOE to adjust the excise tax rates – either upwards or downwards, beginning on July 1, 2011, for gasoline and July 1, 2012, for diesel, so that the overall revenues derived from the imposition of state excise tax and sales and use tax on sales of gasoline and diesel fuel remain the same.

This bill would instead require the BOE to adjust only one side of the equation, so that the result would be an excise tax rate adjustment that would not exceed the specified excise tax rate amounts (\$0.357 per gallon for gasoline / \$0.13 per gallon for diesel fuel), but would allow these specified rates to be lowered.

The intent of the bill appears to be to allow for the adjustment of the respective excise tax rates so that the rates may be lowered, or increased, but shall not be increased to an amount that exceeds the cap. Staff believes there are technical corrections that can be made and we are available to assist the author in order to clarify that intent.

- 3. The impact of 'effective immediately' on the excise tax rates.** The bill specifies that the excise surtax rate for **gasoline**, on and after July 1, 2012, would be \$0.177 per gallon; this combined with the existing base excise tax rate results in a combined excise tax rate of \$0.357 per gallon for gasoline. Future excise tax rate adjustments for gasoline, as specified in the bill, would not exceed this amount. As required under the existing provisions of the fuel tax swap, on February 29, 2012, the BOE approved an adjusted excise tax rate for gasoline, at \$0.360 per gallon, to take effect July 1, 2012. If this bill were to pass prior to July 1, 2012, the BOE would need to communicate that the rate of \$0.357 would be effective July 1, 2012, instead of the rate previously determined to be \$0.360. This excise tax rate change would affect all parties in the fuel supply chain, including suppliers, wholesalers, and retailers. If this bill were to pass anytime after July 1, 2012, the current fuel tax swap rate provisions would be effective and the adjusted rate of \$0.360 would be in effect, up to the effective date of the passage of this bill.

The **diesel fuel** excise tax rate would not be similarly affected. Although this bill immediately affects the computation of the diesel fuel excise tax rate for FY 2012-13, which would require the BOE to set the rate for that FY by March 1, 2012, this bill's amendments would result in the same rate as recently determined by the BOE. On February 29, 2012, the BOE approved an adjusted excise tax rate for diesel fuel, at \$0.10 per gallon, to take effect July 1, 2012. The same conditions for lowering the diesel fuel excise tax rate as specified in this bill, as proposed to be amended in Section 60050(b)(2), existed at the time the BOE set the rate on February 29, 2012. Therefore, upon passage of this bill, the diesel fuel excise tax rate would be \$0.10 per gallon.

- 4. For the sales tax exclusion, the operative date could be burdensome.** A new sales and use tax exclusion would require the BOE to notify affected retailers of the change in the law. This can be accomplished through various means, including mailing inserts, electronic mail, internet postings, special notices, and other means to advise the affected taxpayers. Once taxpayers are notified of the change, they would be required to re-program their registers and pumps so that tax would not be collected on excluded transactions. Additionally, if this bill is passed, and depending on the date of passage, the excise tax rate on gasoline could be changed from one rate to another, theoretically within days of the rate changes going into effect.

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Although the excise tax rate is generally imposed on the supplier, other parties, such as the wholesalers and the retailers, would be affected.

There could be a positive impact to distributors and wholesalers if the price of the fuel were to remain above the sales and use tax exclusion amounts (\$3.88 for gasoline and \$3.52 for diesel fuel), since there would be no need to adjust the prepayment rates. The stability of tax rates on fuel could reduce the need for an increase in the prepayment of sales taxes on retailers and help to reduce the overall tax and compliance burden associated with prepayment rate changes.

For the above reasons, the author may wish to consider a delayed implementation to provide the BOE and the affected industry sufficient time to implement the changes. BOE staff is available to work with the author to address the effect of an immediate operative date of the proposed statute.

5. **The sales and use tax exclusion for gasoline and diesel fuel would have different impacts on the state and local governments.** Under the current fuel tax swap provisions, the state no longer receives sales and use tax revenues from taxes imposed under RTC Sections 6051, 6051.3, 6051.15, 6201, 6201.3, and 6201.15 on the sale and purchase of gasoline. However, portions of the state tax and the local government portion of the statewide sales and use tax are still imposed. The effect of the sales and use tax exclusion for sales of gasoline on amounts charged in excess of \$3.88 per gallon would only be realized by local governments, not the state.

There would be a shared, but disproportionately larger, effect on the state from the effect of the sales and use tax exclusion for sales of diesel fuel on amounts charged in excess of \$3.52 per gallon, since the state imposes an additional sales or use tax on diesel fuel.

6. **Transportation funding could be reduced.** As explained previously, this bill would require the BOE to make future adjustments to the gasoline and diesel fuel excise tax rates only under conditions when the excise tax rates would be lowered. Under these provisions, for example, the BOE would not adjust the gasoline excise tax rate when the revenue losses from the General Fund sales and use tax exemption exceed the revenues derived from the excise surtax on gasoline. Under the existing fuel tax swap provisions, the BOE would have been required to estimate, or take into account, the actual revenue loss from the General Fund sales and use tax exemption in order to balance the revenues. In its most basic terms, the fuel tax swap was intended to maintain overall revenues that would have been derived from the imposition of state excise tax and sales and use tax on sales of gasoline and diesel fuel prior to the enactment of the fuel tax swap.

However, it could be argued that, even though the excise tax rates have been capped, this bill caps the rates at amounts that are still above the excise tax rates that were used to estimate fuel tax revenues in the Governor's January budget, thereby not resulting in a revenue loss when compared to estimated budget revenues.

COST ESTIMATE

An additional administrative workload would be realized as a result of the need to notify affected parties in the fuel supply chain, including suppliers, wholesalers, retailers and the public. Additional costs may be associated with revised returns, publications, special notices, internet postings, mailings, and increased inquiries. A detailed cost estimate of the workload impact is pending.

REVENUE ESTIMATE

This bill would provide a sales and use tax exclusion for the sales of gasoline and diesel fuel on amounts (excluding the specified taxes) above \$3.88 and \$3.52 per gallon, respectively.

REVENUE SUMMARY

Motor Vehicle Fuel. According to the Energy Information Administration, California retail gasoline averaged \$4.04 during the first quarter of 2012. We do not have available to us a current, reliable forecast of California retail gasoline prices. Instead we assume that the future change in California retail prices from the 2012 first quarter price of \$4.04 will be similar to the nation's. In other words, though the national average price of gasoline is lower than California's, we assume that both prices follow a proportionally similar future pattern. Specifically, we have used the April 9th economic forecast from the firm IHS Global Insight, which forecasts a myriad of economic variables, one of which is the national price of gasoline.

The resulting California gasoline price forecast shows a maximum retail price of \$4.46 in the second quarter, and declines to \$4.03 by the fourth quarter of 2012. The average retail price for all of 2012 is \$4.19, while the average price for 2013 is \$4.16.

As noted earlier, this bill would cap the sales and use tax at a pre-sales tax price of \$3.88 (which equates to a retail price of \$4.00). We project the revenue loss to be \$237 million in FY 2012-13. However, current law known as the "fuel tax swap" complicates the timing of this loss. With respect to gasoline, the fuel tax swap eliminated the state portion of the sales and use tax, and replaced it with an increased excise tax rate with the intent of revenue neutrality. The revenue neutrality is achieved via a "true-up" mechanism in subsequent years.

Thus, the \$237 million projected revenue loss for FY 2012-13 is split between \$91 million in lower sales and use tax revenues to local government, and \$146 million in lower excise tax revenue to the state, which would occur after FY 2012-13 due to the timing of the fuel tax swap.

Additionally, this bill caps the excise rate at 35.7 cents per gallon. Currently, the rate is scheduled to be increased to 36.0 cents per gallon in FY 2012-13. This excise rate cap would result in a revenue loss to state special funds of \$7.5 million. A second impact of the excise rate cap is that the bill would preclude the rate from being raised to complete the fuel tax swap "true-up" for FY 2011-12. The related revenue loss is \$195 million.

Thus, the total cumulative loss related to FY 2012-13 gasoline sales from the bill's cap on gasoline prices is \$439 million.

Diesel Fuel. According to the Energy Information Administration, California retail diesel fuel averaged \$4.26 during the first quarter of 2012. We do not have available to us a current, reliable forecast of California retail diesel prices. Additionally, IHS Global

Insight does not forecast diesel prices. Instead, we assume that the future change in California diesel prices follows a similar pattern to that of gasoline.

The resulting California diesel price forecast shows a maximum retail price of \$4.71 in the second quarter, and declines to \$4.25 by the fourth quarter of 2012. The average retail price for all of 2012 is \$4.42, while the average price for 2013 is \$4.39.

We project the sales and use tax loss related to the diesel fuel cap to be \$107 million in FY 2012-13. This loss would be shared between local governments (\$32 million) and state special funds (\$75 million).

Qualifying Remarks. As noted above, the retail price of gasoline and diesel assumed in this analysis drives off of a forecast provided by IHS Global Insight. This forecast is updated monthly, usually by the 10th of the month. Thus, the revenue estimates in this analysis can be updated monthly as the bill moves through the legislative process.

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