

[Assembly Bill 1591](#) (Frazier)

Date: 01/06/16

Program: Motor Vehicle Fuel and Diesel Fuel Tax

Sponsor: Author

Revenue and Taxation Code Sections 7360 and 60050.

Effective: Immediately but operative 1st 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, (1) increases the gasoline tax by \$0.225 per gallon, (2) lowers the diesel fuel base tax rate from \$0.18 to \$0.13 per gallon, and (3) 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 3 years thereafter.

Purpose: According to the author, the purpose of this bill is to provide a long-term sustainable funding solution for transportation focused on relieving congestion, maintaining highways, and improving trade corridors.

Fiscal Impact Summary: Total excise tax revenues increase by \$2.135 billion in fiscal year (FY) 2016-17, and \$4.272 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.

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

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.

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

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.

Proposed Law: With respect to gasoline, this bill amends RTC Section 7360 to impose an additional \$0.225 per gallon tax on gasoline on and after the first day of the first calendar quarter 90 days after the bill’s effective date. 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 also left untouched. If passed, the total gasoline excise tax rate would be \$0.578 per gallon.

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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The bill also amends RTC Section 60050 to impose an additional \$0.30 per gallon tax on diesel fuel on and after the first day of the first calendar quarter 90 days after the bill's effective date. The diesel fuel base excise tax rate of \$0.18 is lowered to \$0.13 per gallon. If passed, the total diesel fuel excise tax rate would be \$0.43 per gallon.

The bill specifies that 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. No later than January 31, 2019, and by January 31 of every third year thereafter, the Department of Finance (DOF) will transmit the California Consumer Price Index (CPI) percentage change to the BOE. The CPI percentage change would cover all items from November of three calendar years to November of the prior calendar year. By March 1 of the same year as the effective date of the new rate, the BOE will use the inflation adjustment factor to compute the rate changes to the nearest tenth of a cent.

The bill also establishes the Road Maintenance and Rehabilitation Program¹³ and extends the Trade Corridors Improvement Fund; funds from the additional gasoline (\$0.225) and diesel fuel (\$0.30) excise taxes imposed by this bill are deposited in these accounts. The additional fuel excise tax funds would be used to address deferred maintenance on state highways and local streets and roads, and improve freight movement infrastructure.

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.¹⁴

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.¹⁵

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

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

¹³ Chapter 2 (commencing with Section 2030) to Division 3 of the Streets and Highway Code.

¹⁴ 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, Stats. 1989).

¹⁵ Assembly Bill 2114 (Ch. 1053, Longville).

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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

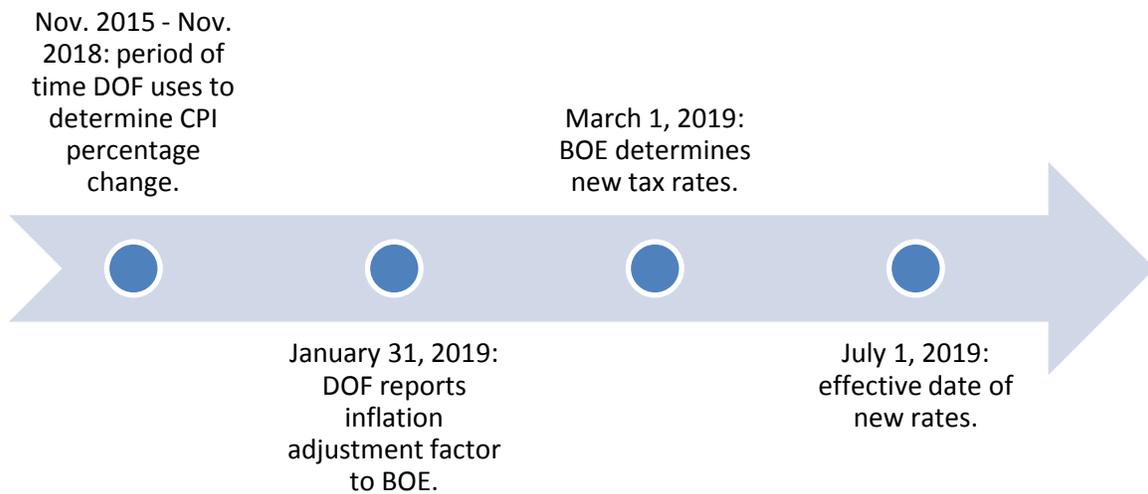
July 1, 2013: Retain July 1, 2012 rate

July 1, 2014: Increase of \$0.01

July 1, 2015: Increase of \$0.02

Commentary:

- 1. Effect of the bill.** This bill creates a permanent funding source for state and local government to address road maintenance through an additional \$0.225 per gallon tax on gasoline and an additional \$0.30 per gallon tax on diesel fuel. Overall, gasoline excise taxes increase from the FY 2015-16 rate of \$0.30 to \$0.578 per gallon, and diesel fuel excise taxes increase from the FY 2015-16 rate of \$0.13 to \$0.43 per gallon.
- 2. Inflation-adjusted rate provisions.** The bill requires the BOE to recompute the excise tax rates beginning July 1, 2019, and every third year thereafter. The DOF must provide the inflation adjustment factor to BOE by January 31, and the BOE computes the rate by March 1 of the same year as the new rate. The first recomputation would occur July 1, 2019, with the DOF using the three-year period of November 2015 to November 2018 to determine the CPI percentage change.



The subsequent excise tax rate changes would be effective July 1, 2022, using November 2019 to November 2021.

- 3. Delayed operative date.** The bill contains an urgency clause and is effective immediately, but the proposed surtaxes are operative on the first day of the calendar quarter following 90 days from the bill’s effective date. Since gasoline and diesel fuel excise taxes are paid on a calendar month basis, and the International Fuel Tax Agreement (IFTA)¹⁶ returns are due quarterly, the delayed operative date benefits the impacted industry and the BOE. With respect to the gasoline taxes, as currently drafted, it appears the delayed operative date could be interpreted to apply to only the base rate (\$0.18) and the proposed additional tax (\$0.225). BOE staff will work with the author’s office to ensure that the additional rate change of \$0.173, will also be delayed. There appears to be a similar

¹⁶ The International Fuel Tax Agreement (IFTA) is an agreement among states and Canadian provinces to simplify the reporting of fuel use taxes by interstate motor carriers. The purpose of IFTA is to establish and maintain the concept of one fuel use license for carriers operating qualified motor vehicles interstate. An IFTA license allows a taxpayer to file one tax report to cover all member jurisdictions.

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issue with the diesel fuel tax rate changes proposed by this bill, except that the base rate of \$0.18 is permanently reduced to \$0.13. That reduction would also need to be delayed, consistent with the diesel fuel tax increase of \$0.30 per gallon.

4. **This bill makes permanent most 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 nor does it change the current 1.75% sales surtax on diesel fuel. The bill also changes the additional gasoline excise tax from the 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. Except for the diesel fuel sales surtax rate of 1.75%, which was 1.87% during the first year, this bill reverts back to the sales and excise tax rates that were in effect during the first year of the fuel tax swap.
5. **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 an excise tax rate of \$0.10 would bring in \$100 worth of 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.

6. **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.
7. **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 implementation date. However, a timely implementation of the gasoline and diesel fuel excise taxes proposed by this bill would generate significantly more revenues than the potential revenues from a floor stock.
8. **Local jurisdictions should see an increase in sales and use tax revenues.** 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.¹⁷ 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).

¹⁷ RTC Sections 6011 (sales price) and 6012 (gross receipts).

Accordingly, the proposed \$0.225 per gallon gasoline tax increase generates additional local sales and use tax revenue, and additional revenue in those districts that impose district taxes.

9. **Related bills.** Measures from last year include the following: [SB 321](#) (Beall) authorizes the BOE to make specified adjustments to the gasoline tax swap using a five-year average fuel price estimate, and more frequent rate adjustments on an annual basis or at a six-month interval, under specified conditions. [SB 433](#) (Berryhill) requires the DOF, instead of the BOE, to determine the annual excise tax rate adjustment for gasoline and diesel fuel under the fuel tax swap provisions for the FYs 2016-17 through 2020-21. [SB 1x 1](#) (Beall), among other things, also imposes an additional \$0.125 per gallon gasoline tax and \$0.30 per gallon tax on diesel fuel. All of the above bills are currently inactive.

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

Revenue Impact:

Background, Methodology, and Assumptions. This bill contains an urgency measure and is effective immediately. The Governor has until September 30, 2016 to sign or veto bills and the proposed tax increases become operative 90 days after the effective date. Therefore, for revenue estimation purposes, staff assumes a January 1, 2017 implementation date.

BOE staff forecasted FY 2014-15 gasoline and diesel gallons to FY's 2016-17 and 2017-18 using growth rates provided by the Department of Finance. Based on these growth rates, 15.235 billion gallons of gasoline and 2.935 billion gallons of diesel are expected to be used on roads in FY 2016-17. BOE staff assumes price elasticities of -0.1 for gasoline and -0.2 for diesel and applied them to these figures.¹⁸

Gasoline Revenues. This bill increases the gasoline tax by \$0.225 per gallon. Revenues increase by \$1.702 billion in FY 2016-17 (half-year impact). The revenue effect is a \$3.386 billion increase in FY 2017-18, the first fiscal year for which the bill is in effect for an entire year.

Diesel Fuel Revenues. The diesel fuel excise tax increases by \$0.30 per gallon. Revenues increase by \$433 million in FY 2016-17 (half-year impact). The revenue effect of this change on revenues is an \$886 million increase in FY 2017-18, the first fiscal year for which the bill is in effect for an entire year.

Consumer Price Index (CPI) Adjustment. The California Department of Finance is forecasting a 7.4% increase in the California CPI over the next three calendar years. This implies a \$0.043 increase in the gasoline tax rate and a \$0.032 increase in the diesel tax rate starting in FY 2019-20.

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, or for the 1.75% sales and use surtax on diesel that also remains in effect.

¹⁸ The general price elasticity of demand formula is: $e_p = (Q1 - Q2) / ((Q1 + Q2) / 2) / (P1 - P2) / ((P1 + P2) / 2)$, 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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