



STATE BOARD OF EQUALIZATION  
PROPERTY AND SPECIAL TAXES DEPARTMENT  
450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0033  
916 327-6440 • FAX 916 324-2554  
www.boe.ca.gov

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Second District, Sacramento/Ontario

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Executive Director

March 17, 2006

To Interested Parties:

Enclosed is the Agenda for the March 28, 2006 Business Taxes Committee meeting. This meeting will address proposed Regulation 1125, *Two-party Exchange*, Regulation 1423, *Two-party Exchange*, Regulation 1123, *Supplier*, and Regulation 1420, *Supplier*.

Action 1 is a Consent Agenda item and consists of material that both industry and staff are in full agreement. However, if you wish discussion of this item at the meeting, please contact a Member of the Board prior to Friday, March 24, 2006, to request removal of the item from the Consent Agenda. In addition, please notify Mr. Arlo Gilbert at (916) 327-6440 after you contact a Member's Office.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at 9:30 a.m. on March 28, 2006, in Room 121 at the address shown above.

Sincerely,

David J. Gau  
Deputy Director  
Property and Special Taxes Department

DJG:ag

Enclosures

cc: (all with enclosures)  
Honorable John Chiang, Chair  
Honorable Claude Parrish, Vice Chairman  
Ms. Betty T. Yee, Acting Member, First District (MIC 71)  
Honorable Bill Leonard, Member, Second District (MIC 78)  
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)  
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)  
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)  
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)  
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)  
Mr. Thomas Hudson, Board Member's Office, Second District (via e-mail)  
Ms. Sylvia Tang, Board Member's Office, First District (via e-mail)  
Mr. Steve Kamp, Board Member's Office, First District (MIC 71)  
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)  
Mr. Ramon J. Hirsig (MIC 73)  
Ms. Kristine Cazadd (MIC 83)  
Mr. Robert Lambert (MIC 82)  
Mr. Randy Ferris (MIC 82)  
Ms. Sharon Jarvis (MIC 82)  
Ms. Carolee Johnstone (MIC 82)  
Mr. Todd Gilman (MIC 70)  
Mr. Kenneth Topper (via e-mail)  
Mr. Dave Hayes (MIC 67)  
Mr. Edward King (MIC 33)  
Mr. Lou Feletto (MIC 33)  
Ms. Leila Khabbaz (MIC 50)  
Mr. Arlo Gilbert (MIC 33)

**AGENDA —March 28, 2006 Business Taxes Committee Meeting**  
*Proposed new regulations 1125 and 1423 and revised regulations 1123 and 1420 regarding the primary liability for payment of the fuel tax in a two-party exchange of fuel.*

<p><b>Action 1 — Consent Items</b></p> <p>Regulation 1125, Two-party Exchange, Regulation 1423, Two-party Exchange, Regulation 1123, Supplier, and Regulation 1420, Supplier.</p>	<p>Adopt the proposed regulations as agreed upon by staff and interested parties.</p>
<p><b>Action 2 – Authorization to Publish</b></p>	<p>Recommend publication of Regulations as adopted in the above actions.</p> <p>Operative Date: January 1, 2007          Implementation: 30 days following OAL approval</p>

Issue Paper Number **05 - 014**



BOARD OF EQUALIZATION  
**KEY AGENCY ISSUE**

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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**Proposed new regulations 1125 and 1423 and revised regulations 1123 and 1420 regarding the primary liability for payment of the fuel tax in a two-party exchange of fuel.**

**I. Issue**

Should the State Board of Equalization (Board) adopt Regulation 1125 and Regulation 1423 and amend Regulation 1123 and Regulation 1420 to make the receiving supplier primarily liable for payment of the fuel tax in a two-party exchange of fuel?

**II. Alternative 1 - Staff Recommendation**

Staff recommends that proposed Motor Vehicle Fuel Tax Law Regulation 1125, *Two-party Exchange*, and Diesel Fuel Tax Law Regulation 1423, *Two-party Exchange*, be adopted: (1) to define a two-party exchange, delivering supplier, and receiving supplier; (2) to explain the conditions required to relieve the delivering supplier of the fuel tax liability; and (3) to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier. Also, staff recommends that Motor Vehicle Fuel Tax Law Regulation 1123, *Supplier*, and Diesel Fuel Tax Law Regulation 1420, *Supplier*, be amended to explain that a position holder or refiner delivering fuel to a receiving supplier under a two-party exchange contract remains primarily liable for the fuel tax unless the requirements of Regulation 1125 or Regulation 1423 are met. (Exhibit 2)

**III. Other Alternative(s) Considered**

Alternative 2 – Do not adopt the proposed new and amended regulations.

## IV. Background

The Motor Vehicle Fuel Tax Law and Diesel Fuel Tax Law 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)<sup>1</sup> is liable for the payment of motor vehicle fuel 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. 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. Under an authorized two-party exchange, the exchange of fuel between the delivering and receiving suppliers is a non-taxable transaction.

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

The Western States Petroleum Association (WSPA) has requested that the Board make the election to follow the IRS approach. WSPA requests 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 will 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.

Fuel Taxes Division staff agrees with WSPA's request and proposes Motor Vehicle Fuel Tax Law Regulation 1125, *Two-party Exchange*, and Diesel Fuel Tax Law Regulation 1423, *Two-party Exchange*. Staff also proposes amendments to Motor Vehicle Fuel Tax Law Regulation 1123, *Supplier*, and Diesel Fuel Tax Law Regulation 1420, *Supplier*.

### Discussion of proposed Regulations 1125 and 1423, Two-party Exchange.

The proposed regulations give, in subdivision (a), a general description of a two-party exchange and the reasons for a two-party exchange. Subdivision (a) also includes 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. In addition, the subdivision includes an explanation that only the transactions involving terminals located in this state are to be reported to the Board.

The term "two-party exchange" is not defined in R&T Code sections 7372 and 60063. Subdivision (b)(1) in the proposed regulations defines a "two-party exchange" as a transaction, other than a sale, that occurs at the time of removal of fuel across the rack and meets specific conditions. Subparagraphs (1)(A) through (1)(D) of subdivision (b) explain the conditions for a transaction to qualify as a two-party exchange.

(A) The terminal operator, delivering supplier, and receiving supplier are each registered with the Board to file electronic reports and returns.

(B) The terminal operator treats the receiving supplier in its books and records as the person that removes the fuel across the rack when reporting to the Board.

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

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(C) The two-party exchange is the subject of a written contract between the delivering supplier and 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.

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

The term “delivering supplier” is defined in subdivision (b)(2) as a licensed supplier who is a position holder of fuel in the terminal on whom the fuel tax is imposed on removal of the fuel from the rack except when the fuel is removed pursuant to a two-party exchange.

The term “receiving supplier” is defined in subdivision (b)(3) as a licensed supplier on whom the fuel tax is imposed only on the removal of fuel from the rack as a receiving supplier in a two-party exchange.

The point of taxation of motor vehicle fuel and diesel fuel is at the time the fuel is removed from the terminal rack. The supplier who holds an inventory position<sup>2</sup> in fuel at the terminal is primarily liable for the tax. In subdivision (c)(1), the regulations explain that, when a transaction satisfies the conditions and requirements of a two-party exchange contract, the delivering supplier shall be relieved of tax liability and the receiving supplier shall be liable for payment of the tax.

In subdivision (c)(2), the proposed regulations explain 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. This time period will give the receiving supplier time to report late loads and allow for other timing problems. 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.

In subdivision (c)(3), the proposed regulations clarify 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. The terminal operator, delivering supplier and receiving supplier must use the same fuel type and identifying information (e.g. bill of lading number) to report the two-party exchange. Also, the terminal operator must report to the Board the two-party exchange of fuel between the delivering supplier and receiving supplier. This will assist the Board in tracking and reconciling two-party exchanges.

Subdivision (e) of the proposed regulations 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.

- (1) The delivering supplier must report the two-party exchange and identify the receiving supplier to the terminal operator.
- (2) The delivering supplier must report to the Board the tax-free delivery of fuel to the receiving supplier.
- (3) The receiving supplier must report to the Board the tax-free receipt of fuel from the delivering supplier.
- (4) The receiving supplier must report to the Board the rack removal of fuel to its customers and the amount of tax due.

Subdivision (f) establishes an operative date of January 1, 2007, for the proposed regulations.

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<sup>2</sup> See Revenue and Taxation Code section 7332 (60010).

Discussion of proposed Regulations 1123 and 1420, Supplier.

Subparagraph (3)(C) was added to subdivision (b) of Regulations 1123 and 1420 to clarify that a position holder 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.

Subparagraph (4)(D) was added to subdivision (b) to Regulations 1123 and 1420 to clarify that a refiner 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.

## **V. Alternative 1 - Staff Recommendation**

### **A. Description of the Staff Recommendation**

Staff recommends that proposed Motor Vehicle Fuel Tax Law Regulation 1125, *Two-party Exchange*, and Diesel Fuel Tax Law Regulation 1423, *Two-party Exchange*, be adopted: (1) to define a two-party exchange, delivering supplier, and receiving supplier; (2) to explain the conditions required to relieve the delivering supplier of the fuel tax liability; and (3) to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier. Also, staff recommends that Motor Vehicle Fuel Tax Law Regulation 1123, *Supplier*, and Diesel Fuel Tax Law Regulation 1420, *Supplier*, be amended to explain that a position holder or refiner delivering fuel to a receiving supplier under a two-party exchange contract remains primarily liable for the fuel tax unless the requirements of Regulation 1125 or Regulation 1423 are met. Interested parties, including industry, are in agreement with the proposed regulations.

### **B. Pros of the Staff Recommendation**

- Allows suppliers and terminal operators to report taxable transactions in the same manner to both the Board and IRS.
- Provides a definition of a two-party exchange for industry and staff.
- Provides guidance to industry and staff as to who is responsible for the fuel tax under a two-party exchange.
- Provides clarification of what suppliers and terminal operators are required to report to the Board under a two-party exchange.

### **C. Cons of the Staff Recommendation**

- Shifts the liability for tax from the delivering supplier to the receiving supplier.
- The Automated Schedule Program System will need to be modified.

### **D. Statutory or Regulatory Change**

No statutory change is needed. The recommendation is to authorize publication of two new and two revised regulations.

**E. Administrative Impact**

- Requires notification of Board staff of the conditions and requirements for a two-party exchange.
- Requires notification to suppliers and terminal operators of the implementation, conditions, and requirements of a two-party exchange.
- Requires modification of the Automated Schedule Program System.

**F. Fiscal Impact**

**1. Cost Impact**

The workload associated with publishing the regulations, notification of staff, suppliers, and terminal operators, and programming is considered routine and any corresponding costs would be absorbed within the Board's existing budget.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

**G. Taxpayer/Customer Impact**

The proposed regulations are anticipated to have a positive impact on suppliers and terminal operators by implementing the two-party exchange in California and providing in the regulations a definition of two-party exchange, a clarification of who is liable for fuel tax under a two-party exchange, and the reporting requirements. Also, the proposed regulations will allow suppliers and terminal operators to report the same taxable transactions at the rack to the Board and IRS in the same manner.

**H. Critical Time Frames**

None.

**VI. Alternative 2**

**A. Description of the Alternative**

Do not adopt the proposed new and amended regulations.

**B. Pros of the Alternative**

- The Automated Schedule Program System will not need to be modified.

**C. Cons of the Alternative**

- Does not allow suppliers and terminal operators to report taxable transactions in the same manner to both the Board and IRS.

**D. Statutory or Regulatory Change**

None.

**E. Administrative Impact**

None.

**F. Fiscal Impact**

**1. Cost Impact**

None.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

**G. Taxpayer/Customer Impact**

Suppliers and terminal operators will report two-party exchanges of fuel at the terminal rack differently for the IRS and the Board.

**H. Critical Time Frames**

None.

Prepared by: Fuel Taxes Division, Property and Special Taxes Department

Current as of: March 3, 2006



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**PROPOSED NEW REGULATIONS 1125 AND 1423 AND REVISED  
REGULATIONS 1123 AND 1420 REGARDING THE PRIMARY LIABILITY  
FOR PAYMENT OF THE FUEL TAX IN A TWO-PARTY EXCHANGE OF  
FUEL.**

**Alternative 1 - Staff Recommendation**

Staff recommends that proposed Motor Vehicle Fuel Tax Law Regulation 1125, *Two-party Exchange*, and Diesel Fuel Tax Law Regulation 1423, *Two-party Exchange*, be adopted: (1) to define a two-party exchange, delivering supplier, and receiving supplier; (2) to explain the conditions required to relieve the delivering supplier of the fuel tax liability; and (3) to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier. Also, staff recommends that Motor Vehicle Fuel Tax Law Regulation 1123, *Supplier*, and Diesel Fuel Tax Law Regulation 1420, *Supplier*, be amended to explain that a position holder or refiner delivering fuel to a receiving supplier under a two-party exchange contract remains primarily liable for the fuel tax unless the requirements of Regulation 1125 or Regulation 1423 are met.

**Other Alternative(s) Considered**

**Alternative 2**

Do not adopt the proposed new and amended regulations.

**Background, Methodology, and Assumptions**

**Alternative 1 - Staff Recommendation**

Staff recommends that proposed Motor Vehicle Fuel Tax Law Regulation 1125, *Two-party Exchange*, and Diesel Fuel Tax Law Regulation 1423, *Two-party Exchange*, be adopted: (1) to define a two-party exchange, delivering supplier, and receiving supplier; (2) to explain the conditions required to relieve the delivering supplier of the fuel tax liability; and (3) to explain the reporting requirements of the terminal operator, delivering supplier, and receiving supplier. Also, staff recommends that Motor Vehicle Fuel Tax Law Regulation 1123, *Supplier*, and Diesel

## Revenue Estimate

Fuel Tax Law Regulation 1420, Supplier, be amended to explain that a position holder or refiner delivering fuel to a receiving supplier under a two-party exchange contract remains primarily liable for the fuel tax unless the requirements of Regulation 1125 or Regulation 1423 are met. Interested parties, including industry, are in agreement with the proposed regulations..

There is nothing in proposed Regulation 1125 or Regulation 1423 or proposed amendment to Regulation 1123 or Regulation 1420 that would impact revenue. The amendments allow suppliers and terminal operators to report taxable transactions in the same manner to both the Board and IRS. The proposed regulations also provide a definition of a two-party exchange and guidance to industry and staff as to who is held liable for fuel tax under a two-party exchange. Finally, the amendments provide clarification of what suppliers and terminal operators are required to report to the Board under two-party exchanges.

### **Alternative 2**

Do not adopt the proposed new and amended regulations.

## **Revenue Summary**

Alternative 1 - The staff recommendation does not have a revenue impact.

Alternative 2 – The alternative does not have a revenue impact.

## **Preparation**

Bill Benson, Jr., Research and Statistics Section, Legislative Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative Division, and Mr. Ed King, Chief, Fuel Tax Division, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of March 3, 2006

cc: Mr. David Gau

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.

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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.

Proposed New and Amended Regulations

(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:

Proposed New and Amended Regulations

(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.

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DIESEL FUEL TAX LAW  
Proposed Regulation 1423

**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.

Proposed New and Amended Regulations

(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 provision 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.

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