Legislative Analysis

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REVISE SALES TAX RATE/DISTRIBUTION; EXEMPT MOTOR FUEL FROM SALES TAX; REVISE MOTOR FUEL TAX RATES/DISTRIBUTION

House Bill 4539 as enrolled
Public Act 467 of 2014
Sponsor: Rep. Wayne Schmidt

House Bills 5477 and 5493 as enrolled
Public Acts 468 and 475 of 2014
Sponsor: Rep. Rob VerHeulen

Complete to 2-10-15

A SUMMARY OF HOUSE BILLS 4539, 5477, & 5493 AS ENROLLED

House Bill 4539 would amend the General Sales Tax Act to exempt gasoline and diesel motor fuel from the sales tax after October 1, 2015, and provide for a one percentage point increase on the 4% portion of the sales tax rate (increasing the total sales tax rate from 6% to 7%).

House Bill 5477 would amend the Motor Fuel Tax Act (2000 PA 403). That act currently contains fixed tax rates of 19 cents per gallon for gasoline and 15 cents per gallon for diesel motor fuel. House Bill 5477 would amend the act to instead impose tax rates that would change annually through a process defined in the bill. For the 12-months beginning October 1, 2015, and for each 12-month period thereafter, the per-gallon tax rates for gasoline and diesel motor fuel would be computed by multiplying the *average wholesale gasoline price* and the *average wholesale diesel fuel price*, respectively, by 14.9%. The computed tax rates would be rounded up to the nearest 1/10 of 1 cent.

The bill would establish a *rate floor* and a *rate ceiling* for the computed motor fuel tax rates. The initial *rate floor* for the 12-month period beginning October 1, 2015, would be 41.7 cents per gallon for both gasoline and diesel motor fuel.

The bill would establish tax rates for *alternative fuels* as defined in the bill.

The bill would also change the current distribution of motor fuel tax revenues for two fiscal years – the fiscal years ending September 30, 2016, and September 30, 2017.

House Bill 5493 would amend the Motor Carrier Fuel Tax Act to make the motor fuel tax rates in that act consistent with the rates established in House Bill 5477.

House Bills 4539, 5477, and 5493 are all tie-barred to **House Joint Resolution UU**, which would amend the Michigan Constitution to, among other things, increase the maximum permitted state general sales and use taxes from 6% to 7% after October 1,

2015, and, at the same time, exempt gasoline and diesel motor fuel sales from the state's general sales and use taxes after October 1, 2015. House Joint Resolution UU would become part of the constitution only if approved by voters at the May 5, 2015, regular election.

Estimates of the fiscal impacts of the package of bills on motor fuel revenue, the School Aid Fund (SAF), Constitutional Revenue Sharing, the Michigan Transportation Fund (MTF), the Comprehensive Transportation Fund (CTF), the Recreation Improvement account, and state General Fund/General Purpose (GF/GP) revenue for FY 2014-15 through FY 2022-23 are contained in a chart on the last page of this analysis.

DETAILED SUMMARY OF HOUSE BILL 5477:

Amendments to Section 8

Section 8 of the Motor Fuel Tax Act establishes motor fuel tax rates for gasoline and diesel motor fuel. The current motor fuel tax rates are 19 cents per gallon for gasoline and 15 cents per gallon for diesel motor fuel. Under House Bill 5477, these rates would remain in effect through September 30, 2015. Beginning October 1, 2015, gasoline and diesel motor fuel tax rates would change annually through a process defined in the bill.

Beginning October 1, 2015, the motor fuel tax rate for gasoline would be determined by the Michigan Department of Treasury by multiplying the *average wholesale gasoline, price* – a defined term in the bill – by 14.9%. The bill would establish a similar process for determining the motor fuel tax rate for diesel motor fuel, i.e. the motor fuel tax for diesel motor fuel would be determined by the Michigan Department of Treasury by multiplying the *average wholesale diesel fuel price* – a defined term in the bill – by 14.9%. The computed tax rates would be rounded up to the nearest 1/10 of 1 cent.

The bill would establish a *rate floor* and a *rate ceiling* for the computed motor fuel tax rates. The initial *rate floor* for the 12-month period beginning October 1, 2015, would be 41.7 cents per gallon for both gasoline and diesel motor fuel. The *rate floor* for each year beginning October 1, 2016, would be the rate floor for the immediately preceding 12-month period multiplied by 1 plus the lesser of .05 or the *inflation rate*.

Rate floor, *rate ceiling*, *inflation rate*, and *index* (meaning the Detroit Consumer Price Index) are new defined terms in the Section 3 of the bill.

House Bill 5477 would define *inflation rate* to mean the percentage change in the Detroit Consumer Price Index (CPI), or an alternative index if the Detroit CPI is no longer published, for each 12 month period ending June 30, "*converted to decimals and reduced by the total percentage change between 41.7 cents and the rate floor in effect on October 1 of the year immediately preceding the year in which the current rate is in effect, converted to decimals*." The bill states that if the inflation rate number is negative, the inflation rate is zero. As a result, during a period of declines in the Detroit CPI, the computed motor fuel tax rates would not fall below the prior year's computed rates.

Beginning October 1, 2015, the *rate ceiling* for each rate computed under provisions of the bill would be the rate floor for the applicable period plus 5 cents per gallon. As a result, for the initial 12-month period beginning October 1, 2015, the motor fuel tax rates for both gasoline and diesel motor fuel would be no less than 41.7 cents per gallon and no more than 46.7 cents per gallon.

The gasoline and diesel motor fuel tax rates established under provisions of the bill would take effect on October 1, 2015, for the 12-month period ending September 30, 2016. New rates would be calculated to take effect on October 1 of each subsequent year for each applicable 12-month period.

Note that the percentage figure used in the bill, 14.9%, is simply a factor in the annual calculation of the per-gallon *specific* motor fuel tax rates. Just as under current law, an individual taxpayer's liability under the Motor Fuel Tax Act would be based on the quantity of motor fuel sold or consumed.

While the 14.9% figure is fixed in the bill, the other components of the rate calculation, *average wholesale gasoline price*, with respect to the gasoline tax rate, and the *average wholesale diesel fuel price*, with respect to the diesel motor fuel tax rate, would be variable. As a result, the annual motor fuel tax rates established in the bill would likely change from year-to-year within limits established in the bill.

Also note, that House Bill 5477 would not change the point of collection for the tax or the persons liable for the tax. Under current law, the *fuel supplier* is liable for the tax when taxable fuel is removed from a *terminal* across a *rack*. *Fuel supplier*, *terminal*, and *rack* are all defined terms in the Motor Fuel Tax Act. This would not change under the provisions of House Bill 5477.

House Bill 5477 would not change current tax exemptions. Sections 30 through 48 of the Motor Fuel Tax Act currently provide exemptions from the tax for non-highway uses and for fuel use by government entities and educational institutions. These exemptions would not change under the provisions of House Bill 5477.

In addition, House Bill 5477 would not change the current tax rates for aviation fuel, established under Section 203 of the State Aeronautics Code (1945 PA 327). The aviation fuel tax rate is currently 3 cents per gallon, less a 1 and ½ cent per gallon credit for airlines operating scheduled interstate operations. This would not change under the provisions of House Bill 5477.

House Bill 5477 would also amend Section 8, by adding new Subsection 9 to require the Department of Treasury, beginning with the rate in effect on October 1, 2015, to publish notice of the tax rates established under Section 8 no later than 30 days before the effective date of the rates.

House Bill 5477 would also amend Section 8 by adding new Subsection 10, which states that the department's determination of the *average wholesale diesel fuel price*, *average*

wholesale gasoline price, *inflation rate*, *rate ceiling*, *rate floor*, *wholesale diesel fuel price*, *wholesale gasoline price*, or *tax rates* established under Section 8 "*are presumed to be correct and shall not be set aside unless an administrative tribunal or court of competent jurisdiction finds the department's determination to be clearly erroneous*."

Other Definitions Related to the Section 8 Amendments

House Bill 5477 would amend Section 2 to add the following definitions:

"Average wholesale diesel fuel price" is defined in the bill to mean "the statewide average wholesale price of diesel fuel as determined by the department based upon a 12-month rolling average of the wholesale diesel fuel price." The initial tax rates for the year beginning October 1, 2015, would be computed from the 12-month rolling *average wholesale diesel fuel price* for the period July 1, 2013, through June 30, 2014. The initial tax rates computed for the year beginning October 1, 2016, and for each subsequent year, would be based on the 12-month rolling average period that ended on the last day of the month 3 months prior to the date on which the rate is determined under Section 8(1)(b) becomes effective, i.e. the 12-month period ending June 30 of each year.

"Average wholesale gasoline price" is defined in the bill to mean "the statewide average wholesale price of gasoline as determined by the department based upon a 12-month rolling average of the gasoline wholesale price." The initial tax rates for the year beginning October 1, 2015, would be computed from the 12-month rolling *average wholesale gasoline price* for the period July 1, 2013, through June 30, 2014. The initial tax rates computed for the year beginning October 1, 2016, and for each subsequent year, would be based on the 12-month rolling average period that ended on the last day of the month 3 months prior to the date on which the rate is determined under Section 8(1)(b) becomes effective, i.e. the 12-month period ending June 30 of each year.

House Bill 5477 would amend Section 6 to add the following definitions:

"Wholesale diesel fuel price" is defined as "the price per gallon of self-serve undyed No.2 ultra-low sulfur diesel fuel charged by a licensed supplier to a purchaser at the time of removal from a terminal across the rack, as determined by the department, based on available pricing data that best reflect or approximate Michigan rack prices as reported by the United States Energy Administration, the Oil Price Information Service, or a similar nationally recognized source for such pricing data, whether publicly available or available only by subscription." State and federal motor fuel taxes, sales taxes, and regulatory fees would be excluded from the bill's "wholesale diesel fuel price" definition.

"Wholesale gasoline price" is defined as "the price per gallon of self-serve unleaded regular gasoline charged by a licensed supplier to a purchaser at the time of removal from a terminal across the rack, as determined by the department, based on available pricing data that best reflect or approximate Michigan rack prices as reported by the United States Energy Administration, the Oil Price Information Service, or a similar nationally recognized source for such pricing data, whether publicly available or available only by

subscription." State and federal motor fuel taxes, sales taxes, and regulatory fees would be excluded from the bill's "wholesale gasoline price" definition.

Alternative Fuels

The Motor Fuel Tax Act currently recognizes only one motor fuel, other than gasoline and diesel motor fuel, i.e. liquefied petroleum gas (LPG). Section 152 currently imposes a 15-cent-per-gallon motor fuel tax on LPG when used as a motor fuel. Over the last eight fiscal years, this tax has generated between $350,000 and $415,000 in revenue for credit to the MTF.

House Bill 5477 would amend Section 151, to define *alternative fuels* to mean "*a gas, liquid, or other fuel that, with or without adjustment or manipulation of pressure or temperature, is capable of being used for the generation of power to propel a motor vehicle, including but not limited to, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, hydrogen compressed natural gas, or hythane*." The bill would amend Section 152 to establish a tax rate for *alternative fuels* equal to the diesel motor fuel tax rate computed in Section 8 for the applicable period.

House Bill 5477 would amend Sections 151 through 155 to provide for the licensing of alternative fuel dealers, the basis for measuring alternative fuels for taxation, the method of collection, and exemptions from the motor fuel tax on alternative fuels.

House Bill 5477– Other Changes

Definitions – House Bill 5477 would amend Section 2 to strike a definition of "heating oil" – a defined term which is not actually used anywhere in the act.

Ethanol/Bio-Diesel Fuel Tax Rates – House Bill 5477 would amend Section 8 to strike language that had established differential tax rates for ethanol and biodiesel fuels. These provisions expired and are no longer in effect.

Credit to Fuel Suppliers – Section 14 of current law allows *fuel suppliers* to deduct 1.5% of the quantity of gasoline subject to the motor fuel tax "to allow for the cost of collecting the tax." Both the prior House-passed and Senate-passed versions of this bill, Substitutes H-4 and S-13, had reduced this deduction to 1.0%. House Bill 5477 as enrolled does not amend this section.

As noted above, House Bill 5477 does not change the point of collection for motor fuel taxes. Although the retail price of fuel purchased "at the pump" currently includes federal and state excise taxes, those taxes are not actually collected from the retailer, (i.e. service station). Motor fuel taxes are collected from *fuel suppliers* as defined in Section 5 of the Motor Fuel Tax Act.

Penalties for Using Dyed Diesel Fuel in Motor Vehicles – In addition to its use as a fuel to propel motor vehicles, diesel fuel has other uses, including as a fuel for farm equipment, and construction equipment. The Motor Fuel Tax Act provides for the untaxed use of diesel fuel for those uses. However, untaxed diesel fuel is dyed, and the

Motor Fuel Tax Act provides penalties for the use of dyed, i.e. untaxed, diesel fuel in motor vehicles.

House Bill 5477 would amend Section 122 to increase the civil penalty for first-time violations from $200 to $1,000. The penalty for second and subsequent violations would remain at $5,000.

Distribution of Motor Fuel Tax Revenue

Section 143 of the Motor Fuel Tax Act currently directs revenue from motor fuel taxes for credit to the Michigan Transportation Fund (MTF) established in Section 10 of 1951 PA 51 (Act 51). Section 10 of Act 51 provides for the formula distribution of MTF revenue to the Comprehensive Transportation Fund (CTF), the State Trunkline Fund (STF), county road commissions, and cities and villages – as well as to certain targeted or categorical programs. House Bill 5477 would amend Section 143 to change the distribution of Motor Fuel Tax revenue for two years:

For the period beginning October 1, 2015, through September 30, 2016, under the bill, "*the first $400.0 million received and collected under this act is appropriated to and shall be deposited in the state treasury to the credit of the Michigan Transportation Fund and allocated as provided in Section 10(1) of 1951 PA 51, and the remainder shall be allocated to indebtedness incurred for projects described in Section 11 of 1951 PA 51*."

The bill provides a similar earmark for the period beginning October 1, 2016, through September 30, 2017. Specifically, the bill would specify that "the first $800.0 million received *and collected under this act is appropriated to and shall be deposited in the state treasury to the credit of the Michigan Transportation Fund and allocated as provided in Section 10(1) of 1951 PA 51, and the remainder shall be allocated to indebtedness incurred for projects described in Section 11 of 1951 PA 51*."

The bill also indicates that "*the money required to be allocated to indebtedness incurred for projects described in Section 11 of 1951 PA 51 shall be expended on that indebtedness no later than September 30, 2017*."

Section 11 of Act 51 establishes and defines the STF. As authorized under Act 51, the Michigan Department of Transportation has sold bonds by pledging future STF revenue. As of September 30, 2014, outstanding STF bonds totaled $1.085 billion, and outstanding grant anticipation bonds (bonds sold by pledging future federal-aid to transportation revenue) totaled $725.0 million.

The language quoted above would appear to govern the distribution of *all* revenue collected under the Motor Fuel Tax Act.

It is our understanding that the bill was intended to change the earmarking of only the *additional* motor fuel tax revenue generated as a result of the bill's enactment, not all revenue generated under the act.

The State Budget Office and Michigan Department of Transportation have indicated that in distributing revenue generated under the bill, they will apply the new provisions of House Bill 5477 only with respect to additional revenue generated as a result of the bill's enactment, not all revenue generated under the act. Our analysis and the distribution of revenue as shown in the attached table reflect this understood intent.

BACKGROUND INFORMATION:

For a detailed discussion of state motor fuel taxes see the November 2014 House Fiscal Agency publication "Motor Fuel Taxes, Sales Tax on Motor Fuels, and Methods of Tax Collection."
http://www.house.mi.gov/hfa/PDF/Transportation/motor_fuel_tax_rates_and_collection_fiscalforum.pdf

FISCAL IMPACT:

House Bill 4539

House Bill 4539 would amend the General Sales Tax Act to exempt gasoline and diesel fuel from the sales tax after October 1, 2015, and provide for a one percentage point increase on the 4% portion of the total rate (increasing the total sales tax rate from 6% to 7%). See the chart at the end of the document for the sales tax impact.

Among other things, House Bill 4539 would impact Comprehensive Transportation Fund (CTF) revenue. Currently, under Section 25 of the General Sales Tax Act, not less than 27.9% of 25% of the sales tax collected at 4% on the sale of motor vehicles, motor vehicle accessories, and motor fuels is dedicated to the CTF. In FY 2014-15 this earmark, sometimes referred to as "auto-related sales tax," is expected to generate $96.5 million for the CTF.

By exempting motor fuel sales from the state general sales tax, House Bill 4539 would reduce revenue for credit to the CTF from the auto-related sales tax earmark. This revenue reduction would be partially offset by provisions of the bill that increase the 4% portion of the total state sales tax to 5%; by increasing the sales tax on motor vehicles and motor vehicle accessories, the bill would increase the CTF auto-related sales tax earmark.

House Bill 5477 & House Bill 5493

Michigan's motor fuel taxes and vehicle registration taxes are dedicated to transportation purposes in Article IX, Section 9 of the 1963 Michigan Constitution. Revenue from these taxes is credited to the MTF created in Section 10 of Public Act 51 of 1951 and distributed to various state and local transportation programs in accordance with Section 10 of Act 51. Specifically, after deductions for certain collection and administrative costs, and for certain categorical or targeted transportation programs, Section 10 of Act 51 distributes 10% of MTF revenue the CTF for public transportation purposes, and then

of net MTF revenue, 39.1% to the STF, 39.1% to county road commissions, and 21.8% to city and villages.

Note that there is a presumption in law that 2% of revenue from the motor fuel tax on gasoline is used for watercraft, snowmobiles, and off-road vehicles. As a result, Article IX, Section 40 of the Michigan Constitution dedicates 2% of all tax revenue derived from the sale of gasoline for consumption in internal combustion engines to the Recreation Improvement Account within the Michigan Conservation and Recreation Legacy Fund. This constitutional dedication is reflected in Part 711 of the Michigan Natural Resources and Environmental Protection Act (1994 PA 451). Our analysis assumes that 2% of the additional gasoline tax revenue from House Bill 5477 would be credited to the Recreation Improvement Account.

The current 19-cent per gallon gasoline tax generated $820.6 million in FY 2013-14, and is expected to generate $820.0 million in FY 2014-15. The current 15-cent per gallon diesel motor fuel tax generated $137.8 million in FY 2013-14, and is expected to generate $135.5 million in FY 2014-15.

As noted earlier, estimates of the impacts of House Bill 5477 and 5493 on motor fuel tax revenue for FY 2014-15 through FY 2022-23 are shown in the table on the last page of the analysis. The estimates are based on current crude oil price projections as well as historical rack and wholesale prices for gasoline and diesel motor fuel. (The table also contains estimates of the revenue impact of related vehicle registration bills that are part of the overall transportation funding proposal that will go before voters.)

Actual revenue generated from motor fuel taxes will depend on both the tax rates established under provisions of the bill and the actual consumption in gallons of gasoline and diesel motor fuel.

As described above, House Bill 5477 would also change the distribution of motor fuel tax revenue for two fiscal years—FYs 2015-16 and 2016-17.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

Summary: Transportation Funding Package Fiscal Impacts
Millions of Dollars

	FY 2015-16							FY 2016-17							FY 2017-18						
Proposed Change	**GF/GP**	**SAF**	**Rev Shar**	**CTF**	**# STF Debt**	**Other MTF**	**TOTAL**	**GF/GP**	**SAF**	**Rev Shar**	**CTF**	**# STF Debt**	**Other MTF**	**TOTAL**	**GF/GP**	**SAF**	**Rev Shar**	**CTF**	**# STF Debt**	**Other MTF**	**TOTAL**
Exempt motor fuel sales from sales tax (HJR UU/HB 4539)	(94.9)	(479.3)	(49.0)	(30.4)			(653.6)	(96.2)	(568.5)	(74.5)	(36.0)			(775.2)	(101.0)	(608.1)	(81.6)	(38.6)			(829.3)
Increase Sales/Use Tax Rate by 1 Percent (HJR UU/HB 4539/HB 5492)	558.0	771.7	138.9	16.7			1,485.3	528.0	789.1	188.3	15.8			1,521.2	543.1	808.1	192.7	15.2			1,559.1
Increase Motor Fuel Taxes (HB 5477/HB 5493)				38.0	865.3	362.0	1,265.3				78.0	467.5	722.0	1,267.5				129.2		1,183.7	1,312.9
Registration taxes: phase out depreciation (HB 4630)*				1.6		14.0	15.5				4.2		37.4	41.5				6.2		56.0	62.2
Increase registration taxes for trucks > 26,000 lbs (HB 4630)**				1.3		11.9	13.2				2.7		23.9	26.5				4.0		35.8	39.8
Impose registration surtax on electric vehicles (HB 4630)***				0.1		0.5	0.6				0.1		0.5	0.6				0.1		0.5	0.6
Expand Earned Income Tax Credit (SB 847)							0.0	(260.0)						(260.0)	(269.1)						(269.1)
TOTAL	**463.1**	**292.4**	**89.9**	**27.3**	**865.3**	**388.3**	**2,126.3**	**171.8**	**220.6**	**113.8**	**64.6**	**467.5**	**783.8**	**1,822.1**	**173.0**	**200.0**	**111.1**	**116.1**	**0.0**	**1,276.0**	**1,876.2**

Estimated distribution of new MTF revenue (other than CTF and STF debt pay-down)																					
Recreation Improvement Account						19.6								20.2						20.9	
Distribution to road agencies						368.7								763.6						1,255.1	
State Trunkline Fund (39.1%)							144.2								298.6						490.8
County Road Commissions (39.1%)							144.2								298.6						490.8
Cities and Villages (21.8%)							80.4								166.5						273.6

Notes:

* Phase out of depreciation of vehicle registration tax rates would be effective January 1, 2016. Estimates are presented on calendar-year basis.

** Increase in truck registration taxes would be phased in over three years beginning March 1, 2016. Estimates are presented on calndar-year basis.

*** Surtax on electric vehicle registrations would be effective beginning January 1, 2016. Estimates are presented on calendar-year basis.

Allocation of motor fuel tax revenue to STF debt service assumes the distribution of only the additional revenue generated as a result of the enactment of House Bill 5477.