

Legislative Analysis



Mary Ann Cleary, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

REVISE MOTOR FUEL TAX RATES

House Bill 4539 (Passed by the House as Substitute H-1)
Sponsor: Rep. Wayne Schmidt

House Bill 5477 (Re-transmitted to the Senate as Substitute H-4)
House Bill 5493 (Proposed H-3 Substitute to the Senate-passed Substitute S-1)
Sponsor: Rep. Rob VerHeulen

House Committee: Transportation and Infrastructure
Senate Committee: Infrastructure Modernization

Complete to 12-9-14

A SUMMARY OF HOUSE BILL 4539 (H-1) AS PASSED BY THE HOUSE, HOUSE BILL 5477 (H-4) AS RE-TRANSMITTED TO THE SENATE, AND HOUSE BILL 5493 (PROPOSED H-3) ON HOUSE FLOOR

House Bill 4539 (H-1), as amended, would amend the Sales Tax Act (1933 PA 167) to eliminate the sales tax imposed on purchases of eligible motor fuel (primarily gasoline and diesel) over a six-year period beginning January 1, 2016. The bill contains a provision that if total state appropriations to either the school aid budget or combined revenue sharing and transportation payments to local units of government fall below the prior fiscal year amounts, the sales tax rate will revert back to 6% for that fiscal year. The bill is tie-barred to House Bill 5477.

House Bill 5477 (H-4), as amended, would amend the Motor Fuel Tax Act (2000 PA 403) to change the current fixed tax rates of 19 cents per gallon for gasoline and 15 cents per gallon for diesel motor fuel to tax rates that would change annually through a process defined in the bill. The new tax rates would be based on average wholesale prices. However, there would be a rate floor equivalent to 19 cents per gallon for both gasoline and diesel motor fuel.

The bill would also alter the distribution of any motor fuel tax revenues in excess of the amount collected in the fiscal year ending September 30, 2014. Revenues in excess of the FY 2013-14 baseline year would be directed to the Michigan Transportation Fund (MTF) for distribution to the State Trunkline Fund (STF), to county road commissions, and to cities and villages. The Comprehensive Transportation Fund (CTF), the state restricted fund dedicated for public transportation programs, would not receive a distribution of motor fuel tax revenue in excess of the *base year revenue* distribution. [CTF revenue would also be reduced by the reduction in the sales tax rate applied to sales of motor fuels, as proposed in House Bill 4539 (H-1). See the Fiscal Impact section of this analysis on page 6, below.]

House Bill 5477 (H-8) is tie-barred to House Bill 4539, a bill to amend the General Sales Tax Act, described above. It is also tie-barred to House Bill 5460, which requires certain new warranties on road construction projects.

House Bill 5493 (H-3) would amend the Motor Carrier Fuel Tax Act to make the diesel tax rates in that act consistent with the rates established in House Bill 5477. House Bill 5493 (H-3) is tie-barred to House Bill 5477. (The H-3 substitute for House Bill 5493 was offered during the House session on 12-4-14 but was not adopted or voted on.)

Estimates of the fiscal impacts of the package of bills on motor fuel revenue, the School Aid Fund (SAF), Constitutional Revenue Sharing, the CTF, and state General Fund/General Purpose Revenue (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:

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

[These provisions of the H-4 substitute are different from the S-13 substitute passed by the Senate in that they establish separate motor fuel tax rates for both gasoline and diesel motor fuel. The S-13 substitute had established a single motor fuel tax for both gasoline and diesel motor fuel.]

Provisions regarding motor fuel taxes on gasoline and diesel motor fuel are established in Section 8 of the Motor Fuel Tax Act. The current motor fuel tax rates are 19 cents per gallon for gasoline and 15 cents per gallon for diesel motor fuel. Under the House Bill 5477 (H-4), as amended, these rates would remain in effect through March 31, 2015.

The initial tax rates computed under provisions of the H-4 substitute, as amended, would take effect on April 1, 2015, and would be effective for the nine-month period ending December 31, 2015. The tax rates for gasoline and diesel motor fuel for the period April 1, 2015 through December 31, 2015, would be determined by multiplying the *average wholesale gasoline price* and *the average wholesale diesel fuel price*, respectively, by 7.5%, rounded up to the nearest 1/10 of one cent.

New gasoline and diesel fuel tax rates would be calculated to take effect on January 1, 2016, for the 2016 calendar year. New rates would be calculated to take effect on January 1 of each subsequent year for each applicable calendar year. These rates would be determined by multiplying the *average wholesale gasoline price* and the *average*

wholesale diesel fuel price, respectively, by the applicable percentage, rounded up to the nearest 1/10 of one cent.

The use of *applicable percentage* in the bill does not make the tax an *ad valorem* or sales tax. The tax would still be a specific per-gallon motor fuel tax. The *applicable percentage* is simply a factor used to determine a per-gallon specific motor fuel tax rate.

The *applicable percentages* are fixed in the bill, as follows:

- Beginning April 1, 2015: **7.5%** [9.50% in the S-13] *
- For the year beginning January 1, 2016: **8.5%** [11.50% in the S-13]
- For the year beginning January 1, 2017: **9.5%** [13.50% in the S-13]
- For the year beginning January 1, 2018: **10.5%** [15.50% in the S-13]
- For the year beginning January 1, 2019: **11.5%** [15.50% in the S-13]
- For the year beginning January 1, 2020: **12.5%** [15.50% in the S-13]
- For the year beginning January 1, 2021, and each calendar year thereafter: **13.5%** [15.50% in the S-13]

* Note that this schedule shows the percentage used to establish an initial tax rate, 7.5%; however, 7.5% is not included in the definition of *applicable percentage*.

Note that under Section 8(1)(a) and 8(1)(b) the percentage rate applied to the average wholesale gasoline price and average wholesale diesel fuel price, respectively, as used to determine the motor fuel tax rates for gasoline and diesel fuel, would revert to 7.5% if the rate of sales tax on gasoline and diesel fuel were the rate prescribed under Section 2 of the General Sales Tax Act; i.e. 6%.

While the *applicable percentage* figures would be fixed in the bill as shown above, 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 fuel tax rate, would be variable, within limits established in the bill. As a result, the annual motor fuel tax rate established in the bill would likely change from year to year.

The bill would also amend Section 152, which currently imposes a 15-cent-per-gallon motor fuel tax on liquefied petroleum gas when used as a motor fuel. The bill would change the tax rate for *alternative fuels* to a rate equal to the motor fuel tax on diesel motor fuel. However, the bill would establish a tax on compressed natural gas, hydrogen, and hydrogen compressed natural gas, when used as motor fuels, at the rate established for gasoline.

The S-13 substitute had amended Section 152 to make the tax on liquefied petroleum gas equal to the single motor fuel tax rate. The S-13 substitute did not address alternative fuels.

House Bill 5477 (H-4) would amend Section 8, by adding a new Subsection 10 to require the Department of Treasury, beginning with the rate in effect on January 1, 2016, to publish the notice of the tax rates not later than 30 days prior to their effective date. The H-4 substitute does not require the publication of the initial April 1, 2015 - December 31, 2015 rate.

These provisions are generally the same in the S-13 substitute, except that the S-13 substitute does require publication of the rates beginning with the rate in effect on April 1, 2015.

House Bill 5477 (H-4) would amend Section 8 by adding a new Subsection 11, which states that the department's determination of the average wholesale diesel fuel price, the average wholesale gasoline price, the wholesale diesel fuel price, the wholesale gasoline price, or the tax rate "is 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." These provisions are substantially the same in the S-13 substitute.

House Bill 5477 (H-4) would amend Section 8 by adding a new Subsection 2 that indicates that the motor fuel rates determined as described above cannot be below the *rate floor*, defined in Section 5 to mean, in effect, 19 cents per gallon.

Under current law, specifically Section 143 of the Motor Fuel Tax Act, revenue from motor fuel taxes is credited to the MTF established in Section 10 of 1951 PA 51 (Act 51). House Bill 5477 (H-4) would amend Section 8 by adding a new Subsection 3 regarding the distribution of any motor fuel tax revenue that exceeded *base year revenue* – defined in the bill as the revenue from motor fuel taxes collected during the fiscal year ending September 30, 2014.

Specifically, the bill indicates that beginning January 1, 2016, revenue from the motor fuel taxes on gasoline and diesel motor fuel that exceeded *base year revenue* would be credited to the MTF for distribution as provided in Section 10(1)(j) of Act 51. As a result, revenue in excess of *base additional revenue* would be directed to the STF, to county road commissions, and to cities and villages. The CTF, the state restricted fund dedicated for public transportation programs, would not receive a distribution of motor fuel tax revenue in excess of the *base year revenue* distribution.

This specific distribution provisions in the H-4 substitute are not included in the S-13 substitute.

Definitions (Section 2 from the H-4 substitute)

"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 bill indicates that "for each rate in effect for a particular year under Section 8(1)(b), the 12-month rolling

average period ends on the last day of the month that is 3 months prior to the date in which the rate is determined under Section 8(1)(b) is in effect."

"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 bill indicates that "for each rate in effect for a particular year under Section 8(1)(a), the 12-month rolling average period ends on the last day of the month that is 3 months prior to the date in which the rate is determined under Section 8(1)(a) is in effect."

What these definitions mean in practice is that the initial calculation of the average wholesale gasoline price or wholesale diesel fuel price for the tax rate in effect on April, 1, 2015, would be based on the rolling average of those prices for the 12-month period ending December 31, 2014. The rate in effect beginning January 1, 2016, would be based on the rolling average of wholesale gasoline and the rolling average of diesel motor fuel prices for the 12-month period ending September 30, 2015.

Definitions (Section 6 from the H-4 substitute)

"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.

House Bill 5477 (H-4) – Other Changes

Definitions – Both the H-4 and S-13 substitutes 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 Alternative Fuel Tax Rates – Both the H-4 and S-13 substitutes House Bill 5477 (S-13) would amend Section 8 to strike language that had established differential tax rates for ethanol and biodiesel alternative fuels. These provisions 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 H-4 and S-13 substitutes would reduce this deduction to 1.0%.

Penalties for Using Dyed Diesel Fuel in Motor Vehicles – Diesel fuel has a number of uses, such as for generators and other power equipment, in addition to its use as a motor fuel. 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.

Both the H-4 and S-13 substitutes 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.

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 (H-1)

As written, the bill would result in the loss of sales tax revenue, which would reduce allocations to the School Aid Fund, Constitutional revenue sharing, the Comprehensive Transportation Fund, and the General Fund. By the time motor fuels become completely exempt on January 1, 2021, the FY 2020-21 revenue loss is estimated to exceed \$1.0 billion. (See chart on last page of analysis.)

House Bill 5477 (H-4) & House Bill 5493 (H-3)

The current 19-cent per gallon gasoline tax is estimated to generate \$815.0 million in FY 2014-15; the current 15-cent per gallon diesel motor fuel tax is expected to generate \$131.5 million. Revenue from these motor fuel taxes is constitutionally dedicated for transportation purposes, and is dedicated in statute to the MTF. As noted earlier, estimates of the impacts of House Bills 5477 (H-4) and 5493 (H-3) 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 analysis also assumes the passage of House Bill 5493 (H-3).

By the time motor fuel tax levels are fully phased in, as of January 1, 2021, the FY 2020-21 revenue increase is estimated to exceed \$1.0 billion. (See chart on last page of analysis.)

Initially, as the *applicable percentage* is phased in, the annual change in the corresponding motor fuel tax relies both on the change in the *applicable percentage* as well as the *average wholesale price* of gasoline and diesel motor fuel. By January 1, 2021, when the maximum *applicable percentage* is fully implemented, only the *average wholesale price* of gasoline and diesel motor fuel will affect the motor fuel tax rates. Actual revenue generated from these 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.

Additionally, reducing the deduction allowed for fuel suppliers from 1.5% of the quantity of gasoline subject to the motor fuel tax to 1.0% would increase state restricted transportation revenue by \$4.1 million at the current tax rate of 19-cents per gallon. (This tax expenditure currently equates to \$12.4 million per year.) The amount of increased revenue would increase under the motor fuel tax structure proposed under these bills.

The analysis does not consider how the changes in motor fuel taxes would affect the current 2% earmark of gasoline taxes to the Recreation Improvement Fund.

As described above, House Bill 5477 (H-4) would also change the distribution of any motor fuel tax revenue that exceeded *base year revenue* – defined in the bill as the revenue from motor fuel taxes collected during the fiscal year ending September 30, 2014. Specifically, the bill indicates that beginning January 1, 2016, revenue from the motor fuel taxes on gasoline and diesel motor fuel that exceeded *base year revenue*, would be credited to the MTF for distribution as provided in Section 10(1)(j) of Act 51. In effect, revenue in excess of base additional revenue would be directed to the State Trunkline Fund, to county road commissions, and to cities and villages. The CTF, the state restricted fund dedicated for public transportation programs, would not receive a distribution of motor fuel tax revenue in excess of the *base year revenue* distribution. CTF revenue would also be reduced by the reduction in the sales tax rate applied to sales of motor fuels, as proposed in House Bill 4539 (H-1).

Fiscal Analyst: William E. Hamilton
Senior Economist: Jim Stansell

■ 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.

**Preliminary Estimated Fiscal Impact of HB 4539 (H-1), HB 5477 (H-4), and HB 5493 (H-3) as Passed by the House
(Dollar Amounts in Millions)**

FY2014-15 FY2015-16 FY2016-17 FY2017-18 FY2018-19 FY2019-20 FY2020-21 FY2021-22 FY2022-23

CURRENT LAW ESTIMATES

Gasoline Tax Revenue (at \$0.19 per gallon)	\$815.0	\$811.5	\$808.3	\$805.0	\$801.8	\$798.6	\$795.4	\$792.2	\$789.0
Diesel Tax Revenue (at \$0.15 per gallon)	<u>\$131.5</u>	<u>\$132.5</u>	<u>\$134.8</u>	<u>\$136.4</u>	<u>\$138.2</u>	<u>\$139.7</u>	<u>\$141.3</u>	<u>\$143.0</u>	<u>\$144.8</u>
Total Gasoline and Diesel Tax Revenue	\$946.5	\$944.0	\$943.1	\$941.4	\$940.0	\$938.3	\$936.7	\$935.2	\$933.9
 Sales Tax Collections on Motor Fuels	\$864.7	\$865.4	\$897.7	\$959.8	\$1,023.7	\$1,080.3	\$1,110.7	\$1,172.4	\$1,211.9
Distribution:									
School Aid Fund	\$634.1	\$634.7	\$658.3	\$703.9	\$750.7	\$792.2	\$814.5	\$859.8	\$888.7
Constitutional Revenue Sharing	\$86.5	\$86.5	\$89.8	\$96.0	\$102.4	\$108.0	\$111.1	\$117.2	\$121.2
Comprehensive Transportation Fund	\$40.2	\$40.2	\$41.7	\$44.6	\$47.6	\$50.2	\$51.6	\$54.5	\$56.4
Remainder to GF/GP	\$103.9	\$104.0	\$107.9	\$115.3	\$123.0	\$129.8	\$133.5	\$140.9	\$145.6

ESTIMATES WITH PROPOSED CHANGES

Sales Tax Rate (Calendar Year Basis)	6.0%	5.0%	4.0%	3.0%	2.0%	1.0%	0.0%	0.0%	0.0%
Motor Fuel Tax Rate (Calendar Year Basis)	7.5%	8.5%	9.5%	10.5%	11.5%	12.5%	13.5%	13.5%	13.5%
 Gasoline Tax Revenue	\$862.2	\$824.3	\$923.1	\$1,059.2	\$1,253.3	\$1,462.7	\$1,674.5	\$1,755.4	\$1,856.3
Diesel Tax Revenue	<u>\$166.6</u>	<u>\$181.1</u>	<u>\$206.7</u>	<u>\$242.7</u>	<u>\$292.9</u>	<u>\$349.3</u>	<u>\$407.9</u>	<u>\$434.7</u>	<u>\$470.2</u>
Total Gasoline and Diesel Tax Revenue	\$1,028.8	\$1,005.4	\$1,129.8	\$1,302.0	\$1,546.3	\$1,812.0	\$2,082.4	\$2,190.1	\$2,326.5
 Sales Tax Collections on Motor Fuels	\$864.7	\$757.3	\$635.9	\$519.9	\$383.9	\$225.1	\$46.3	\$0.0	\$0.0
Distribution:									
School Aid Fund	\$634.1	\$569.7	\$501.2	\$439.9	\$366.8	\$171.1	\$27.8	\$0.0	\$0.0
Constitutional Revenue Sharing	\$86.5	\$70.3	\$50.5	\$30.0	\$6.4	\$20.3	\$6.9	\$0.0	\$0.0
Comprehensive Transportation Fund	\$40.2	\$32.7	\$23.5	\$13.9	\$3.0	\$9.4	\$3.2	\$0.0	\$0.0
Remainder to GF/GP	\$103.9	\$84.5	\$60.7	\$36.0	\$7.7	\$24.3	\$8.3	\$0.0	\$0.0

ESTIMATED FISCAL IMPACT

Gasoline Tax Revenue	\$47.2	\$12.8	\$114.9	\$254.2	\$451.5	\$664.1	\$879.1	\$963.2	\$1,067.3
Diesel Tax Revenue	<u>\$35.1</u>	<u>\$48.6</u>	<u>\$71.9</u>	<u>\$106.4</u>	<u>\$154.8</u>	<u>\$209.6</u>	<u>\$266.6</u>	<u>\$291.7</u>	<u>\$325.4</u>
Total Gasoline and Diesel Tax Revenue	\$82.3	\$61.4	\$186.8	\$360.6	\$606.3	\$873.7	\$1,145.7	\$1,254.9	\$1,392.7
 Sales Tax Collections on Motor Fuels	\$0.0	-\$108.2	-\$261.8	-\$439.9	-\$639.8	-\$855.3	-\$1,064.4	-\$1,172.4	-\$1,211.9
Distribution:									
School Aid Fund	\$0.0	-\$64.9	-\$157.1	-\$264.0	-\$383.9	-\$621.2	-\$786.7	-\$859.8	-\$888.7
Constitutional Revenue Sharing	\$0.0	-\$16.2	-\$39.3	-\$66.0	-\$96.0	-\$87.8	-\$104.1	-\$117.2	-\$121.2
Comprehensive Transportation Fund	\$0.0	-\$7.5	-\$18.3	-\$30.7	-\$44.6	-\$40.8	-\$48.4	-\$54.5	-\$56.4