



South Dakota Legislative Research Council

Issue Memorandum 95-26

CHANGE IN THE PROCESS OF COLLECTING FUEL TAXES

This past legislative session a bill was approved by the Legislature that revamps the way motor fuel taxes are collected in the state. This bill (Senate Bill 61) was introduced by the Senate Committee on Transportation on behalf of the Department of Revenue and was the result of many months of consideration by the Department of Revenue and a large number of interested groups representing various fuel sellers and purchasers. This comprehensive and complex piece of legislation was fully endorsed by all of these groups during the legislative session. The legislation easily passed the Senate by a vote of 34-0 and the House of Representatives by a vote of 63-3. This legislation goes into effect on January 1, 1996.

The new legislation, despite being lengthy and complex, contains only two major provisions. First, it changes the point at which motor fuel is taxed in this state. Second, it provides for a dyed diesel fuel program. This memorandum will examine the reasons for these changes and will outline what can be expected under the new legislation.

Background

Motor fuel taxes are the taxes on fuel used in motor vehicles driven on the highways in the state and on the aviation fuel used in aircraft in the state. Just over one hundred seven million dollars of state fuel taxes are

collected each year on fuel sold in this state. Over eighty million dollars of these tax revenues are used by the Department of Transportation to construct and to maintain highways and airports in the state. Portions of the motor fuel tax are also used to help finance snowmobile trails, boat facilities, the soil and water conservation fund, and the petroleum release compensation fund. Motor fuel used for off-road use is exempt from taxation.

The last time the motor fuel tax laws were revised was in 1989 when all the laws regarding the taxation of motor fuels were combined into one chapter. The law provided that all motor fuel taxes were to be paid by motor fuel distributors. Those taxes were then passed along to consumers when they paid for the price of gasoline at the retail pump.

Since 1989, difficulties have arisen regarding the way the tax collection on diesel fuel is handled. State law provided that a distributor could only sell diesel fuel, on which no tax had been paid, in bulk to a customer who filed an exemption certificate with the distributor claiming the fuel would not be used for a taxable purpose. State law also provided that if a customer owned a licensed diesel-powered motor vehicle and wished to purchase diesel fuel in bulk, the customer had to license as a bulk fuel user and had to remit fuel taxes on fuel which was utilized on roads and highways. This process of handling untaxed diesel fuel

resulted in a number of persons needing licenses and caused a lot of paper work and confusion for farmers, ranchers, and the sellers of fuel.

In addition, since 1989, changes took place at the federal level which had a great impact on persons who bought and sold diesel fuel in the state. Federal fuel tax laws were changed to make it more difficult to avoid the federal motor fuel tax. The federal tax was imposed at the pipeline “terminal rack” on gasoline and diesel fuel. This means the fuel is taxed at the point the fuel is removed from the dock or platform of a pipeline terminal. The federal government also established a system whereby diesel fuel which was to be used for a nontaxable purpose was dyed at the terminal rack to indicate that the fuel is exempt from federal fuel taxes. This change caused confusion for fuel purchasers and sellers of fuel in the state because some dyed fuel could be subject to state fuel taxes depending on how it would be used.

In June of 1994, the Department of Revenue began meeting with interested parties to review the state motor fuel tax laws to try to address the problems that had arisen. It was determined by those participating in these discussions that new legislation should, as much as possible, mirror current federal legislation pertaining to fuel taxation, should simplify taxation for both the purchasers and sellers, and should try to make any changes in law revenue neutral. Senate Bill 61 was the result of those meetings. A number of interested groups participated in these meetings, including the South Dakota Association of Petroleum Marketers, the South Dakota Petroleum Council, the South Dakota Association of Cooperatives, the South Dakota Trucking Association, the Associated General Contractors of South

Dakota, the South Dakota Farmers Union, the South Dakota Farm Bureau, the Industry and Commerce Association of South Dakota, the Department of Transportation, and the South Dakota Highway Patrol.

Fuel Tax Rates

The tax rates on the various types of fuel have remained unchanged since April 1, 1988. The new legislation that was passed will not change these rates of taxation which are reflected in the following chart:

Fuel Tax Rates	
Gasoline	18 cents per gallon
Diesel Fuel	18 cents per gallon
Ethanol	16 cents per gallon
Aviation gasoline	6 cents per gallon
Jet fuel	4 cents per gallon
E85* and M85**	6 cents per gallon
E85 and M85 used in aircraft	4 cents per gallon
Liquid petroleum gas	16 cents per gallon
Compressed natural gas	6 cents per gallon
* Fuel blends containing 85% or more of ethyl alcohol	
** Fuel blends containing 85% or more of methyl alcohol	

Change in the Point of Taxation

The new legislation moves the point of taxation on fuel to the “terminal rack.” Persons who own the fuel immediately before it is withdrawn from the rack or removed from the bulk cargo tank of a motor

vehicle or a rail car for sale in this state are responsible for paying the motor fuel tax. This means that the major oil companies will now be the ones primarily collecting the motor fuel tax. Previously the distributors of motor fuel, special fuel, and aviation fuel were responsible for collecting the motor fuel tax. South Dakota joins a growing number of states which have adopted this method of collecting motor fuel taxes.

The uses of motor fuel which are subject to the motor fuel tax were not changed by the new legislation. Motor fuel which is used in motor vehicles which use state highways will continue to be subject to the tax and fuel used in off-road vehicles will continue to be exempt from the tax. Only the licensing system used to make sure the motor fuel tax is properly collected has been changed.

Categories of licensees under the new law

The provisions of Senate Bill 61 create the following new categories of licensees:

Supplier--A person who imports motor fuel or special fuel by pipeline into the state must be licensed as a supplier and is responsible for collecting the motor fuel tax. Major oil companies will be primarily licensed as suppliers. It is estimated that thirty suppliers will remit ninety percent of the total tax collections under the new legislation.

Out-of-state supplier--A person who resides outside the state may voluntarily obtain a license as an out-of-state supplier. An out-of-state supplier must remit South Dakota fuel tax on any transaction that indicates a South Dakota destination on a bill of lading.

Exporter--A person who purchases motor fuel or special fuel in this state for the purpose of transporting or delivering the fuel

to another state or country must be licensed as an exporter. If a licensed exporter withdraws fuel from a terminal and the bill of lading indicates the destination to be other than South Dakota, South Dakota tax will not be imposed and need not be collected by the supplier.

Importer--A person who brings fuel into the state by means other than pipeline must be licensed as an importer. An importer, who obtains fuel from an out-of-state supplier who is not licensed in the state, is responsible for remitting the fuel tax.

Blender--A person engaged in the blending of denatured 100 percent ethyl alcohol with gasoline must be licensed as a blender. The ethyl alcohol is not subject to tax until it is blended.

Marketer--A person who purchases fuel from licensed suppliers and subsequently sells it to other customers must be licensed as a marketer. This category will include most of those individuals formerly licensed as distributors and retail dealers. The marketer's license will enable a dealer to obtain any refunds to which the dealer is entitled.

Highway Contractor--A person involved in the construction, reconstruction, repair, or maintenance of public highways must be licensed as a highway contractor. No unit of government in the state may award a public highway or street contract to a contractor who is not licensed as a highway contractor. This license will enable them to purchase all types of fuels and report their usage. If a credit arises, refunds will be automatic.

LPG and CNG Vendors and LPG Users--A person selling liquid petroleum gas (LPG) or compressed natural gas (CNG) and LPG

users that own licensed motor vehicles which run on LPG or that use LPG for both taxable and non-taxable purposes will be licensed as they have been in the past.

Bulk Plant Operator--A person operating a fuel storage facility, other than a terminal, that is primarily used for redistribution of fuel by a transport truck, tank wagon, or rail car must be licensed as a bulk plant operator. These licensees will be required to maintain inventory records; however, they will have minimal or no reporting requirements.

Transporter--A person who transports fuel by truck or rail car must be licensed as a transporter. These licensees will be required to maintain records; however, they will have minimal or no reporting requirements.

Reporting Requirements and Administrative Allowances

LPG users will report and remit taxes on a semiannual basis and highway contractors are going to be required to report quarterly. All remaining licensees who have reporting requirements will report and remit fuel taxes on a monthly basis, on the last day of the month for the preceding month's activity.

Suppliers and out-of-state suppliers will be allowed to retain two and one-fourth percent of the tax required to be paid on each gallon of fuel to the state if the tax is remitted as required by the law. One-third of that amount is to be retained by the supplier to help off-set the administrative expense of timely reporting and remitting of the tax. Two-thirds of that amount shall be

distributed to the customer who purchases the fuel from the terminal location to help off-set the cost of fuel lost due to shrinkage caused by evaporation or temperature change. Importers and exporters will be allowed to retain two-thirds of the two and one-fourth percent allowance for timely reporting and remitting the fuel tax.

The allowance permitted by the new law is similar to the shrinkage allowance under the old law and will amount to about the same amount of revenue for these administrative and shrinkage allowance purposes.

Dyed Diesel Fuel Program

Diesel fuel that is to be used for agricultural and commercial purposes in equipment exempt from fuel taxation will be required to have dye added to it at the terminal rack. This dyeing will make it easier to differentiate taxable and non-taxable fuel, thus ensuring that untaxed fuel is not consumed in licensed vehicles and eliminating the need for exemption certificates and licensing of diesel fuel users. The dye will be as required by the United States Environmental Protection Agency (EPA) or as required by the Internal Revenue Service (IRS). If a person operates a motor vehicle with special fuel that contains a dye and the use of the motor vehicle requires that the fuel tax be collected, that person is subject to a Class 2 misdemeanor and a civil penalty of one thousand dollars. The person is also subject to severe penalties for breaking EPA and IRS laws.

Brief Comparison of Old and New Law				
<i>Licensing under the Old Law</i>			<i>Licensing under the New Law</i>	
Licensees Who Remit Tax Monthly	# of Licensees FY 95	Total Tax Remitted FY 95	Licensees Who Will Remit Tax Monthly	Estimated # of Licensees
Motor Fuel Distributors	560	\$ 70,217,894	Suppliers	30*
Special Fuel Distributors	670	\$ 20,745,319	Importers and Exporters	90
Tank Inspection Fee Licensees	664	\$ 14,241,518	Blenders	145
Aviation Fuel Distributors	132	\$ 459,570	CNG and LPG Vendors	210
Alternative Fuel Distributors	10	\$ 9,267		
Total Taxpayers	2,036	\$ 105,673,568	Total Taxpayers	475
Licensees Who Remit Tax Quarterly & Semiannually	# of Licensees FY 95	Total Tax Remitted FY 95	Licensees Who Will Remit Quarterly & Semiannually	Estimated # of Licensees
Bulk Special Fuel Users	3,429	\$ 175,831	LPG Users	34
Bulk Special Fuel Purchasers	1,089	\$ 1,043,023	Highway Contractors	1,000
Total Users	4,518	\$ 1,218,854	Total Users	1,034
* Estimated that suppliers will remit 90% of tax collections Source: Division of Motor Vehicles				

Refunds

The tax on undyed or clear diesel fuel will be paid at the terminal rack and passed along to consumers. However, several special situations allow consumers of clear diesel fuel to receive a refund.

Persons who use undyed diesel fuel in licensed motor vehicles for agricultural or commercial off-road work will be entitled to a refund of their fuel tax. However, undyed fuel dispensed directly into equipment (such as farm tractors) will not be entitled to a refund. Therefore, a person who has such equipment may want to consider adding an additional storage tank for dyed fuel so dyed

fuel can be dispensed into these types of equipment.

Marketers will be allowed to claim a refund of fuel tax on undyed taxed fuel sold as reefer fuel (fuel used in the refrigerator units on motor vehicle trailers and which is subject to sales tax), on all fuel sold to agencies of the federal government, on all gasoline and gasohol sold to licensed Indian schools in bulk, and all gallons lost.

Any claim for a refund must be submitted within fifteen months of the initial transaction.

Special Cases

The new legislation provides for some special situations. Terrigators and spray coupes which are licensed as motor vehicles will be allowed to operate on dyed (untaxed) diesel since these vehicles are primarily used for off-highway use. Regarding sale of diesel fuel to the state and political subdivisions, the new legislation differs from federal laws. Federal law allows dyed (untaxed) diesel to be used in the licensed vehicles of state and local governments and in school buses. This is not permitted by the new legislation. These vehicles must use undyed (taxed) diesel fuel. In such cases, the government agencies and school districts will have to seek a refund of the federal fuel taxes charged.

Conclusion

Most of the general public will not notice the change in the motor fuel tax laws which will go into effect on January 1, 1996. Over 3,400 persons, primarily farmers and ranchers, who were licensed bulk special fuel users under the old law will no longer

have to be licensed. Farmers and ranchers, however, will continue to apply for refunds on fuel tax paid on gasoline which was used in off-road vehicles, as that process will not change. Fuel distributors in the state will no longer be responsible for collecting the tax because that will now be the responsibility of the major oil companies. Highway contractors will, for the first time, be required to have a fuel tax license before they can be awarded a highway construction contract.

The new method of collecting the motor fuel tax should definitely be simpler for both the purchasers and the sellers of the fuel. The number of taxpayers who will remit fuel tax will be greatly reduced as will be the number of fuel users who have to report to the state. The new method of collecting the motor fuel tax is intended to be revenue neutral and should result in about the same amount of tax to be collected. Legislators can expect attempts in the near future to fine tune any defect which may become apparent when this new law comes into operation.

This issue memorandum was written by David L. Ortbahn, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
