Prepared by the North Dakota Legislative Council
staff for the Taxation Committee
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FUELS TAXES - BACKGROUND MEMORANDUM

House Bill No. 1462 (1999) directs the Legislative Council to study the "application, enforcement, and administration under the fuels tax laws." Fuels taxes are applied under three chapters of the North Dakota Century Code (NDCC). Chapter 57-43.1 imposes taxes on motor vehicle fuels, which includes gasoline and gasohol. Chapter 57-43.2 imposes taxes on special fuels, which includes diesel, kerosene, heating fuel, compressed natural gas, liquefied petroleum gas, and other fuels except gasoline, gasohol, or aviation fuels. Chapter 57-43.3 imposes taxes on aviation fuels.

MOTOR VEHICLE FUEL TAX

North Dakota Century Code Section 57-43.1-02 imposes a tax of 21 cents per gallon on gasoline and gasohol sold or used in this state. The tax is collectible by the dealer from the consumer on all retail sales.

Agricultural users of gasoline or gasohol who paid the tax at the time of purchase may claim a refund of taxes paid. The refund is reduced by seven cents per gallon, of which two cents is deposited in the agricultural fuel tax fund, one cent is retained in the highway tax distribution fund, and four cents is deposited in the agricultural research fund. Effective January 1, 2002, the amount withheld from agricultural use refunds will be reduced to six cents per gallon, with elimination of the one cent per gallon retained in the highway tax distribution fund.

Users of gasoline or gasohol for an industrial purpose are entitled to refund of taxes paid. The refund must be reduced by one-half cent per gallon and that amount is deposited in the agricultural fuel tax fund.

The state and political subdivisions are entitled to a refund of taxes paid on gasoline or gasohol used for construction, reconstruction, and maintenance of a public road or airport.

Under Section 54-27-19.1, one cent per gallon of motor vehicle fuel tax on each gallon of fuel sold in the state is to be allocated to the township highway aid fund for allocation to townships for road purposes. The one cent per gallon for township highway aid is to be withheld from refunds otherwise available to agricultural, industrial, or governmental users.

Except for amounts withheld from refunds or allocated to the township highway aid fund, all motor vehicle fuel tax revenues are allocated to the highway tax distribution fund.

SPECIAL FUELS TAX

A tax of 21 cents per gallon is imposed by NDCC Section 57-43.2-02 on the sale or delivery of special fuels to any consumer. The dealer is required to collect and remit the tax on all retail sales to consumers.

Effective for sales of special fuels after June 30, 1999, a "buy right" provision applies under which special fuels taxes are not refundable for agricultural, railroad, industrial, or governmental users. Such users are eligible for a reduced tax of two percent of purchase price, rather than 21 cents per gallon, for purchases of dyed special fuels used in unlicensed equipment for agricultural, railroad, industrial, or governmental purposes. The owner or operator of a licensed motor vehicle found to contain dyed special fuels in the fuel supply tank of the vehicle is subject to administrative fees from $250 for the first violation to $5,000 for the fourth and subsequent violations within three years. Fees for violations do not apply to a person who purchased dyed special fuels in another state or Canadian province and imported the fuel in the supply tank of a licensed motor vehicle if the state or province where the fuel was purchased does not prohibit its use in the vehicle. The fees also do not apply to a state or local government using dyed special fuels in licensed vehicles for road construction purposes.

Special fuels tax revenues are allocated to the highway tax distribution fund, except for one cent per gallon of the tax which is allocated to the township highway aid fund.

AVIATION FUEL TAX

Tax is imposed on aviation gasoline, kerosene, jet fuel, and any other motor fuel used by aircraft at a rate of eight cents per gallon. The tax is payable by a supplier or distributor on aviation fuel used, wholesale distribution of aviation fuel to a retailer, and direct sales of aviation fuel to a customer. The consumer of aviation fuel is entitled to a refund of the tax paid after deduction of a special excise tax of four percent of the cost of the fuel. A person who has paid the tax on aviation fuel in North Dakota and sells the fuel in another state in which the fuel is taxable is entitled to a full refund of taxes paid in North Dakota. A person who purchased aviation fuel and paid tax in North Dakota and resells the fuel to an agency of the United States government is entitled to a refund of taxes paid.

All aviation fuel tax revenues are deposited in the state Aeronautics Commission's special fund. The moneys in the special fund are provided as a standing appropriation to the Aeronautics Commission for commission administration and for matching funds made available by political subdivisions or airport authorities that do not receive state assistance under

NDCC Section 2-05-06.5. Funds allocated to governmental entities must be used for airport construction or improvement projects.

FUELS TAX - RECENT HISTORY

July 1, 1987 - November 30, 1993 - 17 cents per gallon (aviation fuels eight cents per gallon from 1983 to the present). During this period alcohol-blended fuel was entitled to a tax reduction of four cents per gallon at the pump until June 30, 1989. In 1989 the rate reduction for alcohol-blended fuel was replaced with an ethanol production subsidy funded by one and one-half cents per gallon through June 30, 1991, and two cents per gallon since that date, withheld from farmers' refunds and deposited in the agricultural fuel tax fund. In 1989 legislation was passed to increase the motor vehicle fuel tax rate from 17 cents to 20 cents per gallon and the special fuels tax rate from 17 cents to 19 cents per gallon. In a referral vote on December 5, 1989, the tax rate increases were rejected by the voters in a special election.

December 1, 1993 - December 31, 1995 - 18 cents per gallon. Under 1993 legislation, a "trigger" was added to motor vehicle fuel tax and special fuels tax rates to increase the rates in one cent per gallon increments depending upon the availability of federal highway matching funds. Under this "trigger" provision, the rate increased from 17 cents to 18 cents per gallon.

January 1, 1996 - June 30, 1999 - 20 cents per gallon. In 1995 the Legislative Assembly again provided a "trigger" to increase motor vehicle fuel tax and special fuels tax rates depending upon availability of additional federal highway matching funds. Under the "trigger," the rate increased to 20 cents per gallon for the period January 1, 1996, through December 31, 1997. In 1997 the Legislative Assembly provided statutorily for a 20 cent per gallon motor vehicle and special fuels tax rate, scheduled to sunset on December 31, 1999. Other 1997 legislation provided for withholding an additional four cents per gallon from farmers' fuel tax refunds for deposit into an agricultural research fund and reduced the amount withheld from refunds for ethanol production incentives from two cents to one cent per gallon.

July 1, 1999 - 21 cents per gallon without a "trigger" or sunset provision.

FUEL TAX ALLOCATION

Article X, Section 11, of the Constitution of North Dakota provides:

> Revenue from gasoline and other motor fuel excise and license taxation, motor vehicle registration and license taxes, except revenue from aviation gasoline and unclaimed aviation motor fuel refunds and other aviation motor fuel excise and license taxation used by aircraft, after deduction of cost of administration and collection authorized by legislative appropriation only, and statutory refunds, shall be appropriated and used solely for construction, reconstruction, repair and maintenance of public highways, and the payment of obligations incurred in the construction, reconstruction, repair and maintenance of public highways.

The statutory provisions for deposit and allocation of fuel tax revenues are contained in NDCC Section 54-27-19. That section requires deposit of motor vehicle registration fees and fuel tax revenues in the highway tax distribution fund. Moneys deposited in the highway tax distribution fund are to be allocated monthly by the state treasurer with 63 percent transferred to the state Department of Transportation and placed in the state highway fund and 37 percent allocated to counties in proportion to the number of motor vehicle registrations credited to each county. Before each county receives its allocation, the state treasurer must compute and deduct the incorporated cities' share of revenue allocated to the county. The cities' share of revenues is 27 percent of the amount allocated to the county. However, a weighting factor is included in the formula which provides that in each county having a city with a population of 10,000 or more the allocation is adjusted to increase the share allocated to each city.

1999 LEGISLATION

The 1999 Legislative Assembly enacted the following:

House Bill No. 1019 extended for two years (until December 31, 2001) the additional one cent per gallon withheld from farmers' motor vehicle fuel tax refunds to be retained in the highway tax distribution fund. This additional withholding from refunds was scheduled to expire December 31, 1999.

House Bill No. 1130 eliminated the sunset provision that would have reverted the motor vehicle fuels and special fuels tax rates from 20 cents per gallon to 17 cents per gallon effective January 1, 2000. As compared with the 17 cents per gallon rate that would have been reinstated, this bill is estimated to generate an additional $14.8 million of highway fund revenue during the 1999-2001 biennium and $21.8 million of additional highway fund revenue for the 2001-03 biennium. For cities and counties, the additional revenue is estimated to be $8.7 million for the 1999-2001 biennium and $12.8 million for the 2001-03 biennium.

House Bill No. 1183 increases motor vehicle fuels and special fuels tax rates by one cent per gallon from 20 cents to 21 cents. The 21 cent rate is "permanent" law, meaning it has no sunset provision. This bill also increased motor vehicle registration fees by $1 per year on licensed motor vehicles except pickup trucks 20 years old or older and farm trucks. Estimated revenue increases resulting from this bill total $11.3 million per biennium, $7.1 million of which goes to the state highway fund and $4.2 million of which is distributed to cities and counties. The fiscal note for the bill did not identify the share of increased revenue from the fuel tax rate change but Tax Department estimates are that an additional one cent per gallon motor vehicle and special fuels tax rate generates $10.3 million per biennium, including $6.5 million for the state highway fund and $3.8 million for cities and counties.

Senate Bill No. 2177 is a lengthy bill revising administrative provisions under the fuels tax law. The bill was the product of a three-year study by the office of the state Tax Commissioner and a Petroleum Marketers Association study group. The most significant changes made by the bill are as follows:

1. Allowance of a tax credit or refund for a fuel reseller when the tax has been paid and the fuel is resold to an agency of the federal government. The issue relates to credit card sales. Credit cards issued by major oil companies allowed adjustments to tax returns to cover these transactions but independent credit card company involvement shifted the burden of adjustments to retailers.
2. Requirement of licensing and reporting for fuel terminal operators.
3. Change in deposit of motor vehicle fuel license fees from the state general fund to the highway tax distribution fund to be consistent with the constitutional requirement that fuel tax revenues must be used for highway purposes.
4. Requirement that importers and exporters of fuel for resale be required to supply proof of licensing in the jurisdiction from which the fuel is imported or to which the fuel is exported.
5. Requirement that common or contract carriers hauling fuel be licensed, retain records, be subject to audit, and be required to report diverted loads.
6. Creation of a penalty and interest requirement for aviation fuel tax, which lacked these enforcement provisions.
7. Creation of a collection allowance of one percent, to a maximum of $300 per month, for aviation fuel tax to allow the same collection allowance that is allowed for special fuels taxes.
8. Consolidation of licensing and report requirements for interstate motor carriers to be compatible with the International Fuel Tax Agreement.

House Bill No. 1462 was commonly referred to during the legislative session as the "rack tax bill" although the bill as passed did not change the point of taxation to the "rack." The bill as passed reduced the shrinkage allowance for fuel suppliers, distributors, and retailers from a maximum of one percent to a maximum of .5 percent. The bill created a "buy right" provision, which eliminates refunds of special fuels taxes for nonhighway purposes and requires users of special fuels for nonhighway purposes to buy and use dyed special fuels, which is subject to the reduced rate of two percent, rather than the 21 cents per gallon rate for fuel used in licensed motor vehicles. The bill creates administrative fees for the owner or operator of a licensed motor vehicle found to contain dyed special fuels and which is being used on a highway. The administrative fees range from $250 for the first violation to $5,000 for a fourth and subsequent violation occurring within three years. Citations for unlawful use of dyed fuel in licensed motor vehicles are to be issued by the highway patrol and fees are to be collected by the Tax Commissioner. The Tax Commissioner may waive the administrative fees for good cause.

The most controversial provision of House Bill No. 1462, which was ultimately eliminated from the bill, would have moved the point of taxation for fuels taxes to the "rack," meaning a fuel storage and distribution terminal supplied by a refinery or pipeline. Reasons advanced for changing the point of taxation included decreasing the number of times fuel may change hands without tax being collected and remitted, acceleration of tax collections, and a reduced number of fuel tax returns to improve compliance and auditing. Sixteen states have moved the point of fuel tax collections for diesel fuel to the "rack" since federal fuel tax imposition for diesel fuel was moved to the "rack" effective January 1, 1994. Only red-dyed diesel fuel is exempt from the federal "rack" tax. The primary purpose for the change in federal law was to reduce fuels tax evasion. Opponents of the "rack" tax provision argued that it will not stop fuel tax evasion and would place a substantial financial stress on small- and medium-sized petroleum marketers, possibly causing some of these dealers to go out of business.

Groups expressing support for the "rack" tax change included the Department of Transportation, North Dakota Motor Carriers Association, North Dakota Association of General Contractors, North Dakota Petroleum Council, and North Dakota Association of Counties. Groups opposed to the change included the North Dakota Petroleum Marketers Association, Burlington Northern Railroad, Canadian Pacific Railroad, North Dakota Farmers Union, North Dakota Grain Dealers Association, Froelich Oil, Farmers Union Oil, and Bjornson Oil.

SUGGESTED STUDY APPROACH

The committee should receive regular briefings from the Tax Department to monitor fuel tax reporting and receipts and to determine whether 1999 changes are having the desired effect and whether the "buy right" provisions are having any discernible effect.

The committee may wish to obtain information on the “rack” tax approach including administration of the federal tax, the point of taxation in other states, impact of such a tax on North Dakota dealers and retailers, and other issues the committee may wish to examine.

The committee should monitor highway funding needs of state and local governments and availability of federal highway funds to determine whether there are likely to be changes in demands for motor fuel tax revenues.