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THE TAXATION OF DIESEL FUEL

The taxation of diesel fuel is an issue of some confusion in Michigan. In the interest of brevity, *CRC Report #321 The Outline of the Michigan Tax System* described the Motor Carrier Fuel Tax in just a few lines. However, these few lines do not fully explain:

- What tax rates are paid?
- Where do the tax revenues go?
- If more trucks purchase diesel fuel than do diesel powered automobiles, why is more tax revenue collected from the Diesel Fuel Tax than from the Motor Carrier Fuel Tax?

This *CRC Memorandum* is offered to explain these issues more fully.

Introduction

In Michigan, the method of taxation paid on purchases of diesel fuel depends on the situation:

- For what type of vehicle is fuel being purchased?
- Is the fuel being purchased for travel in Michigan?
- Is the fuel being purchased for travel in other states?
- Is the fuel being purchased outside Michigan for travel in Michigan?

While the total state tax rates on diesel fuel purchases vary little in each situation, the disposition of the revenues generated by these taxes does vary.

The Basics of Fuel Taxation in Michigan

First, all motor fuel taxes (gasoline, diesel fuel, and liquefied petroleum gas) are collected for the privilege of using public highways. Motor fuel purchased for purposes other than operation of a vehicle on public highways (e.g., on farms, by lumberjacks, or by construction companies) is exempt from motor fuel taxation.

Second, motor fuel purchases are subject to the six percent state Sales Tax in addition to the motor fuel taxes. In the following cases, it is assumed that the price of fuel is \$1.20, 6 cents of this price being Sales Tax. Revenue from the Sales Tax is dedicated to the following purposes:

- School Aid Fund (63.3 percent),
- Unrestricted state revenue sharing (23.6 percent),

- General Fund (1.6 percent), and
- Comprehensive Transportation Fund (1.3 percent).

A Brief History

Michigan is one of only a few states in the nation that levy sales taxes on motor fuel sales and include federal motor fuel taxes with the fuel price as part of the sales tax base. As a result, an additional cost must be paid for fuel purchases in Michigan, creating a potential disincentive for such purchases in Michigan.

To compensate for this, the Diesel Fuel Tax was amended in 1980 to establish a 6-cent-per-gallon discount for fuel delivered into a vehicle bearing a motor carrier permit (for a 5 cent net tax rate). A companion Motor Carrier Fuel Tax Act was enacted at that time. The liability for this tax initially was 5 cents per gallon (equal to the Diesel Fuel Tax rate on motor carriers) multiplied by the gallons of fuel consumed by motor carrier vehicles while traveling in the state. This law also imposed a new \$92 registration fee on Michigan motor carrier trucks and a \$12 fee for out-of-state motor carrier trucks driven in Michigan. These registration fees were structured to replace 4 cents of the 6 cent diesel discount. (In 1986, the out-of-state fee was raised to \$25.)

A 1982 law phased in an increase in the gasoline and diesel tax to 15 cents per gallon. With the 6 cent per gallon diesel discount maintained, motor carrier trucks paid a Diesel Fuel and Motor Carrier Fuel Tax of 9 cents per gallon.

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Gasoline Taxation in Michigan

Gasoline is the fuel most regularly used for propelling motor vehicles on the public highways. The Michigan Gasoline Tax rate is 19 cents per gallon (a July 1997 amendment increased the tax rate from 15 to 19 cents per gallon). Given the assumed price of fuel, the Sales Tax levy adds 6 cents to the price of gasoline. Gasoline Tax revenues are deposited into the Michigan Transportation Fund and used entirely for transportation purposes (mostly for highway construction and maintenance). Therefore, with the example price of fuel, state taxes on a gallon of gasoline total 25 cent per gallon.

Table 1
Taxes Levied on Gasoline Purchases and Their Disposition

| <i>Tax Paid per Gallon of Fuel:</i> | <u>Gasoline Tax</u> | <u>Sales Tax</u> | <u>Total Tax</u> |
|-------------------------------------|---------------------|------------------------|-------------------------|
| | 19 cents/ gallon | + 6 cents/ gallon | = 25 cents/ gallon |

Disposition: 19 cents/ gallon from the Gasoline Tax to the Michigan Transportation Fund; 6 cents/ gallon from the Sales Tax to the School Aid Fund, unrestricted state revenue sharing, General Fund, and Comprehensive Transportation Fund.

The diesel discount was enacted to keep the diesel fuel pump price at Michigan truck stops competitive with out-of-state truck stops. Additionally, the Motor Carrier Fuel Tax effectively changed the tax on motor carriers' diesel fuel from a tax paid on fuel *purchased* in the state to a tax paid on fuel *used* in the state. This change allowed the state to impose for the first time a tax on fuel purchased out-of-state but used on Michigan roads. Truckers driving in Michigan could no longer avoid the state tax by purchasing fuel in another state.

The interaction of these two taxes requires motor carriers to pay the Diesel Fuel Tax "at the pump." Motor fuel taxes in Michigan actually are paid by wholesale distributors, but the additional cost is passed on to the final purchasers, so that the taxes can be considered to be paid at the pump. Motor carriers pay the Motor Carrier Fuel Tax on fuel used in Michigan

but for which no Diesel Fuel Tax has been paid.

If total diesel fuel use exceeds that attributable to Michigan, a refundable credit is due for fuel taxed in Michigan but used outside the state. The Diesel Fuel Tax imposed at the pump is effectively a partial prepayment of the final tax owed. Because the Diesel Fuel Tax is paid and the Motor Carrier Fuel Tax allows a credit for this payment, revenues equal to 9 cents per gallon from motor fuel taxes levied on motor carriers are attributable to Diesel Fuel Taxes.

The Motor Carrier Fuel Tax most recently was amended in 1996 to bring motor carriers' fuel taxes in line with the Gasoline Tax, which at the time was 15 cents per gallon (it was not raised in July 1997 with the Gasoline Tax). While the Diesel Fuel Tax remained unchanged at 15 cents per gallon with a 6 cent diesel discount, the

Motor Carrier Fuel Tax rate was raised to 21 cents per gallon. Motor carriers continue to receive a credit for Diesel Fuel Taxes paid at the pump equal to 9 cents per gallon, and an additional 6 cent per gallon refund was established for Sales Taxes. The 6-cent-per-gallon balance, if due, is collected by mail with the quarterly tax filing. The Motor Carrier Fuel Tax registration fees were repealed in 1996. While a 6 cent refund was enacted to offset Sales Taxes, this refund comes out of the Michigan Transportation Fund, not any of the funds to which Sales Tax revenues are dedicated.

Diesel Fuel Taxation

Case One -- Diesel Fuel Purchases by Other Than a Motor Carrier*: When diesel fuel is purchased for a passenger vehicle, it is subject to the 15-cent-per-gallon Diesel Fuel Tax and the Sales Tax. The Sales Tax levy adds 6 cents to the price of diesel fuel, for a net tax liability

* A "Motor Carrier" is defined as a person who operates or causes to be operated on a public road or highway in this state a motor vehicle used, designed, or maintained for transportation of persons or property that has one of the following: (i) 3 or more axles regardless of weight; (ii) 2 axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds or 12,000 kilograms; or (iii) is used in a combination of vehicles, if the weight of that combination exceeds 26,000 pounds or 12,000 kilograms gross vehicle or registered gross vehicle weight.

Table 2
State Taxes Levied on Diesel Fuel Purchases and Their Disposition

| | <u>Diesel Fuel Tax</u> | <u>Motor Carrier Fuel Tax</u> | <u>6 percent Sales Tax</u> | <u>Total Tax Rate</u> |
|---|--|---|--------------------------------|---------------------------|
| I. Non-Commercial Vehicles | | | | |
| Case 1 -- Passenger Vehicles | 15 cents/gallon | + -- | + 6 cents/gallon | = 21 cents/gallon |
| Disposition: 15 cents/ gallon from the Diesel Fuel Tax to the Michigan Transportation Fund; 6 cents/gallon from the Sales Tax to the School Aid Fund, unrestricted state revenue sharing, the General Fund, and the Comprehensive Transportation Fund. | | | | |
| II. Commercial Vehicles (Motor Carriers) | | | | |
| A. <i>Purchases in Michigan:</i> | | | | |
| Case 2 -- For Travel Entirely in Michigan | 15 cents/gallon - 6 cent credit 9 cents/ gallon net tax rate | 21 cents/ gallon - 15 cent credit 6 cents/gallon net tax rate | + 6 cents/gallon | = 21 cents/ gallon |
| Disposition: | 15 cents/ gallon from the Diesel Fuel and Motor Carrier Fuel taxes to the Michigan Transportation Fund; 6 cents/gallon from the Sales Tax to the School Aid Fund, unrestricted state revenue sharing, the General Fund, and the Comprehensive Transportation Fund. | | | |
| Case 3 -- For Interstate Travel (that includes Michigan) | 15 cents/ gallon - 6 cent credit 9 cents/ gallon net tax rate | 21 cents/ gallon - 15 cent credit 6 cents/gallon net tax rate | + 6 cents/gallon | = 21 cents/gallon |
| Disposition: | 15 cents/ gallon from the Diesel Fuel and Motor Carrier Fuel taxes to the Michigan Transportation Fund in accordance with travel in Michigan; 6 cents/gallon from the Sales Tax to the School Aid Fund, unrestricted state revenue sharing, the General Fund, and the Comprehensive Transportation Fund. | | | |
| B. <i>Purchases Outside Michigan:</i> | | | | |
| Case 4 -- For Interstate Travel (that includes Michigan) | --- | + 21 cent/ gallon (no credits given) | + -- | = 21 cents/ gallon |
| Disposition: | 21 cents per gallon of Motor Carrier Fuel Tax revenues are deposited into the Michigan Transportation Fund in accordance with travel in Michigan. | | | |

of 21 cents per gallon (See **Case 1 in Table 2**). Diesel Fuel Tax revenues are deposited in the Michigan Transportation Fund and used solely for transportation purposes.

Case Two -- Diesel Fuel Purchases by Motor Carriers for Use Entirely in Michigan: When diesel fuel is purchased by a motor carrier, the purchase is subject to the Diesel Fuel Tax, the Motor Carrier Fuel Tax, and the Sales Tax. Motor carriers pay the 9 cents per gallon Diesel Fuel Tax at the point of purchase (at the pump). The Sales Tax adds 6 cents to the purchase price. Finally, the Motor Carrier Fuel Tax is levied at a 21 cent per gallon tax rate with a 15 cent per gallon credit for fuel purchased in Michigan (9 cents for the effective amount of Diesel Fuel Tax plus 6 cents for the Sales Tax), resulting in a net tax rate of 6 cents per gallon. The total tax liability is 21 cents per gallon (See **Case 2 in Table 2**).

Case Three -- Diesel Fuel Purchases by Motor Carriers in Michigan for Interstate Travel: When diesel fuel is purchased in Michigan by a motor carrier for interstate travel, the taxes levied are the same as Case Two. Diesel Fuel Taxes are paid at the pump, and at the end of each quarter, motor carriers reconcile the Michigan taxes paid at the pump with the fuel used for travel in Michigan. If more fuel is used in the state than the amount on which taxes have been paid, an additional liability is owed to the state. If less fuel is used in Michigan than the amount on which taxes have been paid, a refundable Motor Carrier Fuel Tax credit is received equal to the amount of tax that has been paid.

Case Four -- Diesel Fuel Purchases by Motor Carriers Outside of Michigan With Travel in Michigan: When a motor carrier purchases diesel fuel in another state and travels into Michigan,

the miles traveled inside Michigan are subject to the 21 cent per gallon Motor Carrier Fuel Tax (See **Case 4 in Table 2**). No credits or refunds are given for fuel purchased in other states. (The Sales Tax is levied only on purchases occurring within Michigan.)

The differences among Cases Two, Three, and Four are not felt by the taxpayer, either at the pump or after reconciliation, but by the state fund to which the motor fuel taxes are dedicated. Under Case 4, all 21 cents per gallon is paid into the Michigan Transportation fund, while under Case 2, only 15 cents per gallon is paid into the Michigan Transportation Fund (and an additional 0.26 cents is paid into the Comprehensive Transportation Fund). Under Case 3, all refunds for tax paid on fuel used outside Michigan reduce Fund revenues, even though 6 cents of the 15 cents per gallon refund are for Sales Taxes that have been paid.