

Model Legislation Checklist

The subcommittee on Model Legislation was established to provide a checklist as a guide for states who are contemplating changing their point of taxation for motor fuel products and implementing the 11 point plan.

- Dyed diesel at each point of taxation.
- Taxation at the rack.
- First receipts method.
- Distributor level.
- Taxation at the retail station.
- Third party reporting.

The intent of this model legislation checklist is to offer a resource to all taxing jurisdictions who are interested in strengthening their motor fuel tax laws to combat motor fuel tax evasion.

Motor fuel tax evasion is recognized as a nationwide problem that results in revenue losses to state and federal governments. Lost motor fuel tax revenues harm both the public and private sectors, limiting the funds available to construct and maintain roads, highways, bridges, and urban transportation systems. Fuel tax evasion also impacts honest businesses trying to compete with evaders selling motor fuel far below legitimate costs.

Once motor fuel tax evasion is recognized as a serious problem within a taxing jurisdiction, preventive measures should be taken before the matter worsens and more and more tax revenues are lost. Tax evasion can be significantly reduced by establishing stronger legislative remedies and improved administrative efforts by proposing legislative and administrative changes that: 1) strengthen enforcement efforts, 2) track all motor fuel sales, 3) reduce the number of taxpayers, 4) minimize the number of tax-free sales, 5) provide consistency between fuel tax and other state tax laws, and 6) rewrite or strengthen existing motor fuel tax laws.

The following are legislative and administrative recommendations that this model legislation checklist addresses:

- Strengthen licensing and bonding requirements.
- Strengthen reporting and record keeping requirements.
- Strengthen criminal and civil penalties.
- Strengthen enforcement and auditing efforts.
- Rewrite or strengthen existing motor fuel tax laws.
- Implement a change in point of taxation legislation

Selected References for the Model Legislation Checklist

1. Taxpayer Options

When proposing changes to existing motor vehicle fuel and/or diesel fuel tax laws, taxing authorities must decide who the taxpayer will be. In other words, how far back up the distribution chain should the incidence of the tax be placed. Following are some taxpayer options and a reference to some recent legislative actions taken by both federal and state taxing authorities.

A. Tax at the Terminal Rack

Generally, all gasoline, undyed diesel fuel and kerosene are taxed as they cross the terminal loading rack. Some states have passed variations of the federal tax at the rack legislation.

Examples of these variations are as follows:

1. Position Holder at the Rack.
Tax is due from the position holder when the product crosses the rack. (the person owning the inventory according to the records of the Terminal Operator).
2. Position Holder or Exchange Receiver at the Rack (Modified Position Holder).
If the position holder delivers on exchange, the exchange receiver remits the tax. Tax is due from the position holder when the product crosses the rack. Exception-Tax is due from the receiver if receiving the product under an exchange agreement
3. First Receiver below the Rack.
The person physically receiving accountable product/motor fuel at the rack remits tax to the taxing jurisdiction, if licensed. If not licensed, then variations 1 or 2 above should be used. Tax is due from the position holder or exchange receiver unless the person physically receiving the product at the rack is a licensed distributor. No subsequent tax-free sales are allowed.

All dyed diesel fuel meeting the United States Environmental Protection Agency (EPA) and Internal Revenue Service (IRS) requirements can be sold tax free and cannot be used on the highways.

B. Tax at the Distributor/Wholesale Level

Sales of gasoline and diesel fuel are taxed at the terminal rack unless the sale is made to another licensed supplier, distributor or wholesaler. It is left up to each taxing jurisdiction to determine and define who qualifies as a license holder for the purpose of purchasing motor fuel tax-free.

Examples:

1. Subsequent sales after the rack are exempt, until the product is sold to an unlicensed party. The last licensed distributor in the chain pays the tax.
2. All licensed distributors are exempt. Tax is due from the last licensed distributor who makes a sale to an unlicensed party.
3. Tax jurisdiction may allow only two (2) exempt sales to licensed distributors. And on the third (3) sale the tax is due to the taxing jurisdiction.

C. Tax at the Retail and/or Use Level

Some taxing jurisdictions license all retail dealers and users of diesel fuel within their state and impose an excise tax on sellers and users who place "special fuel" into the fuel supply tank of a motor vehicle. Usually, every person in the distribution chain is licensed, i.e. distributor, importer, exporter, wholesale, dealer, gasoline jobber, seller-user of special fuel, and retail dealer. Fuel sold to each licensee is sold tax-exempt, and the licensee who places the motor fuel into the supply tank of a motor vehicle becomes the taxpayer. It is left up to each taxing jurisdiction on how and who should be licensed.

D. Tax on First Importation

Another taxpayer option for collecting tax on accountable product/motor fuel is to collect the tax from persons who are responsible for importing, refining, manufacturing, producing, blending, or compounding in a state. If this method is used as an option, consideration must be given to the varying refund provisions that have to be developed.

E. Tax on Importation into State/First Receipt into Storage into a Terminal or Refinery

Tax is paid by the person first receiving product at a terminal or refinery. Tax is also due from the importer when imported directly to the importer's customer or for the importer's use.

2. Collection and Payment of Tax

When considering taxpayer options, the option chosen determines who and how many taxpayers a taxing jurisdiction will have. When the Internal Revenue Service implemented its diesel fuel tax at the terminal rack legislation, it decreased the number of motor fuel taxpayers significantly. When state tax authorities are considering tax at the rack legislation, they must address the problem of former licensed taxpayers losing their cash float because they would be paying their suppliers at the time of removing accountable product/ motor fuel from the terminal rack. Consideration for refunds and supplier bad debt must also be addressed (discussion on these topics is in section 10).

State taxing authorities can decrease their number of state motor fuel taxpayers by moving the point of taxation to the terminal rack. With fewer taxpayers, taxing authorities will provide for greater scrutiny of taxpayers, will have fewer audits but greater coverage of taxable sales, and may be able to sign more manpower and resources to establish stronger on road enforcement policies. Moving the point of taxation to the rack may increase the number of refund claims depending on state statute.

An argument against decreasing taxpayers is that more tax dollars can be stolen because tax liabilities will be greater. To combat this argument, taxing authorities that allow licensed suppliers, distributors, and/or wholesalers or licensed retailers and/or users to be taxpayers increase their number of taxpayers but decrease the chance that one taxpayer can steal large amounts of tax revenue. These taxpayer options will increase the number of taxpayers, but with strong licensing requirements, an aggressive audit department, and strong on road enforcement policies, tax evasion can be curtailed.

Other items that need to be addressed when taxing authorities are deciding who their taxpayers should be are:

- A. Tax payments by importers.
- B. Pre-collection of tax by importers.
- C. Terminal operator liability.
- D. Allowing parties downstream of the taxpayer to defer reimbursement of taxes until the tax is actually remitted to a state.
- E. Tax on cross border movements of motor fuel.
- F. Bad debt allowance.
- G. Back up tax.
- H. Collection allowance/Handling allowance.

Based on the U.S. Supreme Court Case, Chickasaw Indian Nation vs. Oklahoma Tax Commission, it is imperative that states identify that the consumer is the ultimate taxpayer. This case made it clear that immune entities such as Native American Tribes cannot be the taxpayer under state law and are not required to pay tax. However, immune entities can be required to act as the state's agent in collection of tax from customers that are identified as the taxpayer.

A. Electronic Payments

When states are considering requiring or allowing electronic payments of tax liabilities several sources are available to help. States need to adopt the requirements best suited to meet their business needs. The following guidelines provide a checklist of issues/topics to consider prior to writing legislation. States can look to the FTA for information and surveys on what other states have already implemented or review other states' legislation. (Check the FTA or individual state web sites as an alternative).

Electronic payments can take numerous forms. There is the traditional electronic funds transfer (EFT) as well as the use of credit or debit cards.

1. Considerations for legislation.

- a. Set a minimum threshold when EFT payments are required.
- b. Allow sufficient time for taxpayers to register and test your process prior to implementation of the legislation.
- c. Allow voluntary payments for smaller than threshold amounts.
- d. Provide a process to refund or otherwise correct duplicate or erroneous payments which includes the EFT option.
- e. Provide an alternative payment method when a failure in the electronic process occurs.
- f. Determine who will pay the fees, taxpayer or state, if fees are incurred.
- g. Provide taxpayers the ability to "warehouse" ACH debit payments. Warehousing the payment allows the taxpayer to initiate the payment prior to the due date but have the settlement of the funds occur on the due date. Industry considers this a critical component of any EFT program.
- h. Recognize that the taxpayer may lose the "float" on their payment using this method.

2. Electronic Funds Transfer (EFT): An electronic mechanism used in the financial industry to make payments between accounts electronically. ACH is the most popular. It is a nation wide network used by the Federal Reserve to handle direct payments.

- a. ACH Credit: When using ACH credit, the payer tells their bank how much and when to send money to the payee. When sending a tax payment to a revenue agency using this method, a tax addenda record approved by FTA is necessary. Financial institutions typically charge customers for this service.
- b. ACH Debit: When using ACH debit, the payer authorizes the payee to take from the payer's account and send it to the payee. States typically contract through the third party for this service, but it is not required.

3. Credit or Debit Cards:

- a. The state must have the infrastructure in place to handle these payment methods.
- b. Determine what credit/debit cards the state will accept. Credit card companies do business differently.
- c. Determine which payment methods, walk-in, mail-in, telephone (Interactive Voice Recognition), operator assisted or Internet, to offer.
- d. Determine if the state will absorb the merchant fee or if the taxpayer will be charged a convenience fee.
- e. Determine how to market this service.

3. Tax-Exempt Diesel Fuel Must Be Dyed

Diesel fuel can be sold federal excise tax-exempt at a terminal rack, if the fuel meets the dyeing and marking requirements of the Internal Revenue Service under 26 U.S.C. 4082.

Under 4082, certain entities are authorized to operate highway vehicles with untaxed dyed diesel fuel. If new legislation is introduced by state taxing authorities, a section or provision should be made in the law to address this issue.

If a state taxing jurisdiction taxes state and local governments for their own road uses, these entities may want to purchase dyed fuel in order to avoid paying the federal tax. In this instance, the law would need to address some method of taxing dyed diesel fuel sold to state and local governments.

Consideration should also be given about the taxability of kerosene. Currently, under IRS rule, kerosene is taxed when it crosses the terminal rack. In other words, kerosene should be taxed if it is blended into diesel fuel for use as a winter blend highway diesel fuel. If a state decides to tax undyed kerosene and the kerosene is used as a heating fuel or for some other off-highway purposes, then a refund provision should be developed.

A refund section or provision should be developed to address the problem of accidentally contaminating clear taxed diesel fuel with dyed untaxed fuel.

4. Racing Fuel

When considering the taxation or exempt status of racing fuel, the following items should be addressed.

- A. Definition of racing fuel. The definition is typically based on the octane level. Refer to the uniform definition for guidance.
- B. Determine the status of the product, exempt or taxable. If racing fuel is deemed to be exempt, is it exempt based on:
 - 1. The product, regardless of use, or
 - 2. By its use

If racing fuel is deemed to be taxable, are there refund provisions for off-highway use?

- C. Determine if exemptions should be separated by leaded and unleaded product.
- D. Determine if the exemptions are to be valid at the time of purchase or refundable.
- E. Determine if licensing and bonding of persons distributing and/or using racing fuel is necessary. Racing fuel is usually shipped outside the normal fuel distribution chain. The product may be shipped long distances in prepackaged 55-gallon drums.
- F. Enforcement - whether taxable or exempt there are areas for evasion. If taxable, need to address registering a taxpayer that is not a typical fuel dealer in the state and registering carriers that are not typical in the state. Also storage is not common. If exempt, need to address blending racing fuel for highway use or diversion to highway use.
- G. Nexus issues on remote dealers versus registration of users. The state may need a backup tax to enforce a user tax if fuel is otherwise exempt by use or as a result of no nexus on seller.
- H. If exempt from motor fuel tax, is racing fuel then subject to sales or use tax?
- I. If subject to refund, will the taxing authority offset motor fuels refund by sales or use tax due?

5. Clear or Dyed Kerosene

When considering the taxation or exempt status of kerosene, the following items should be addressed:

- A. Definition of Kerosene. The federal government classifies kerosene as diesel and follows the diesel guidelines for taxation (dyed - for off-highway use, undyed – taxable)
- B. Determine the status of the product, exempt or taxable. If kerosene is deemed to be exempt, is it exempt based on:
 1. The product, regardless of use, or
 2. By its use
 If undyed kerosene is deemed to be taxable, are there refund provisions for off-highway use?
- C. Determine if the exemptions are to be valid at the time of purchase, or refundable.
- D. If refundable, determine who files for the refund (i.e. distributor, retail or user), the filing frequency and documentation required.
- E. Determine requirements for invoice markings.
- F. Determine requirements for tank marking and blocking/locking.
- G. Determine the taxability of the prepackaged kerosene sold at locations such as hardware stores, convenience stores, etc.
- H. Enforcement - Regardless of the exempt or taxable status of the product, kerosene can be used in evasion schemes. If taxed at the rack, evasion may stem from refunds. If taxed below the rack, the typical evasion found in other fuels taxed below the rack can occur. Untaxed, untracked kerosene is susceptible to conversion to taxable use. Procedures should be established to address these issues.
- I. Be sure that dyed kerosene is not recognized as nontaxable. If the product is used for a taxable purpose a state would want to tax under backup tax provisions.
- J. If exempt from motor fuels tax, is kerosene then subject to sales or use tax?
- K. If subject to refund will the taxing authority offset motor fuels refund by sales or use taxes due?

6. Exempt Uses and Refunds

When considering exempt use and refund provisions, identify how the following items will be addressed:

- A. Exports
 1. Motor fuel sold to a licensed exporter.
 2. Motor fuel exported by a licensed supplier.
 3. Motor fuel sold to a person for immediate export to a state for which the destination state taxable motor fuel tax has been paid to the supplier and proof of export is available in the form of a destination state shipping paper.
 4. Tax-paid motor fuel which has been placed in storage within this state and is subsequently exported to another state.
 5. Tank wagon deliveries exported to another state from a bulk plant within the state.
- B. K-1 kerosene
- C. Motor fuel sold to the United States or its agencies or instrumentalities.
- D. Diesel fuel used to operate equipment attached to a motor vehicle.
- E. Diesel fuel used as heating oil or in trains, or used for other non-highway purposes.
- F. Motor fuel used on a farm for farming purposes.
- G. Diesel fuel which has been accidentally contaminated by dye.

- H. Motor fuel used in state owned school buses and in state owned administration and service vehicles used in the pupil transportation program.
- I. Motor Fuel sold or dispensed for use in commercial fishing boats.
- J. Diesel fuel sold or dispensed for use by state and local government highway vehicles.
- K. Erroneous payment refunds.
- L. Refund claim procedures, in general.
- M. Destination state diversion procedures.
- N. Federal considerations (always review current laws).
 1. No power take-off exemption (cannot use dyed fuel).
 2. Allows state and local government to use dyed fuel in highway vehicles.
 3. Federal agencies should not use dyed fuel in highway vehicles and are subject to federal tax.
 4. Highway Vehicles are not allowed to use dyed diesel and must pay all federal taxes, even if used off road.
 5. Vessels of all types are exempt from federal diesel fuel taxes and may use dyed diesel.
 6. Federal Ultimate Vendor (Class UV) refunds are limited to state and local governments and (Class UP) retailers selling kerosene from a blocked pump.
 7. Kerosene and kerosene equivalents are considered to be forms of diesel and are treated basically the same for federal tax purposes.
 8. Clear aviation grades of kerosene may be sold tax exempt over the terminal rack. Only qualifying airlines may be exempt from federal aviation tax.

Note: Research and preparation when drafting dyed fuel legislation can lessen conflicts and confusion that may occur. If a state simply adopts a dyed fuel statute without addressing these issues there is likely to be an unintended burden on the taxpayer or the state.

- O. Sales to Third Party Credit Card Companies - Third party credit card companies are defined as card companies not wholly owned by an oil company, which use a credit card for motor fuel transactions.

Considerations for legislation include:

1. Registration or licensing of these companies.
2. Bonding of these companies.
3. Addition of special enforcement and audit processes.
4. Allow exemptions that apply to eligible governmental entities only.
5. Determine if the third party company must hold title to the product to be eligible to file the claim.
6. Establish a retail identification number that is unique to a specific retail location and is used by all credit card companies.
7. Require reporting of the volume and type of fuel by each retail outlet handling the transaction.
8. Determine who is eligible to file the refund claim and to whom it will be paid.
9. Establish a refund process to meet your business need.

7. Licensing and Bonding Requirements.

Effective licensing and bonding of motor fuel taxpayers helps ensure financial responsibility and protects the millions of dollars of tax liability with which licensees are entrusted each month. Taxpayers are likely to become more trustworthy and reliable when the licensing body performs thorough background checks on potential licensees and requires surety for tax liabilities. These measures will help to identify potential tax evaders and places the necessary safeguards on entities that are licensed.

When taxing authorities are considering fuel tax licensing requirements, they should consider licensing every person dealing in motor fuel within their state.

The following licenses should be considered:

- A. Supplier license.
- B. Permissive supplier license.
- C. Terminal operator license.
- D. Exporter license.
- E. Carrier license.
- F. Importer license.
- G. Tank wagon operator importer license.
- H. Fuel vendor or retail dealer license.

Other licensing requirements that should be considered are:

- A. License application forms.
- B. Thorough investigation of a person or persons applying for a license.
- C. License application fees.
- D. License denial hearings.
- E. How long is the license valid (one year; three years; or until suspended, revoked, or cancelled).
- F. License nontransferable notice.
- G. How the license should be displayed.
- H. License surrender upon discontinuance of a business.
- I. Publishing and distribution of a license listing to all licensees within the state.

Surety bonds protect taxing authorities from major tax dollar losses resulting from bankruptcy or tax evasion. The following bonding requirements and issues should be considered when bonding provisions are written.

- A. Dollar amount of the surety bond.
- B. Issued by a surety company approved by the taxing authority.
- C. Bond must name the applicant as the principal and the taxing authority as the obliged.
- D. Be on forms approved by the taxing authority.
- E. New or increase in bond requirements if the liability on the previous bond is discharged or reduced by a judgment rendered, payment made, or if any surety on the previous bond becomes unsatisfactory.
- F. Provision to release an existing surety bond.
- G. Allowance for cash deposits or an irrevocable letter of credit to be used in lieu of a Surety bond.
- H. Taxpayer's prior payment and audit history.

Note: Be cognizant of federal bankruptcy statutes. In almost all instances, the approval of a bankruptcy declaration by a Federal Bankruptcy Court will cause ANY security you may have received (except for a third party surety bond) to revert to the Court. The state will then have no coverage.

8. Fuel Tax Fraud Penalties

Existing penalty provisions in most state taxing jurisdictions have not kept pace with the growing magnitude of state revenue losses. States that have recently passed new motor fuel tax legislation or are in the process of changing existing laws, are strengthening motor fuel tax fraud penalties. Motor fuel tax fraud penalties should be strong enough to provide a sufficient deterrent to prospective tax evaders, but should be flexible enough to allow a waiver of penalties for unintentional errors made by honest taxpayers. If criminal penalties are strong deterrents and the laws are clear and enforceable, cases against fuel tax evaders can be prosecuted more effectively.

The following are some items to consider when a state taxing authority is trying to strengthen criminal and civil penalties:

- A. Allow for the seizure of fuel and property used in illegal operations.
- B. Establish personal liability of individual company/corporate officers for the willful evasion of motor fuel tax.
- C. Designate that collected fuel taxes constitutes a trust fund and make failure to remit a felony.
- D. Establish other offenses as felonies, including:
 - 1. Meter tampering or conspiracy to elude metered output for the purpose of evading taxes.
 - 2. Willful nonpayment of fuel taxes.
 - 3. Illegal collection of fuel taxes.
 - 4. Illegal importation of fuel.
 - 5. Conversion of fuel tax by licensees or their representatives for their own use, or attempting to covert with intent to evade taxes.
 - 6. Importing fuel, or conspiracy to import fuel, with intent to evade taxes.
 - 7. Failure to place dye in fuel intended to be non-taxable.
 - 8. Removal of dye from previously dyed fuel for any purpose.
- E. Other offenses that should be considered are:
 - 1. Willfully remitting or maintaining any false or forged records.
 - 2. Refusing to permit authorized seizures.
 - 3. Transporting motor fuel without a bill of lading, manifest or shipping documents.
- F. Strengthen civil penalties for failure of bulk users, jobbers, distributors, exporters, and resellers to file tax reports.

9. Enforcement

While it is imperative that a state has a comprehensive motor fuel tax audit program backed up by proper laws, those factors alone will not control tax evasion. Effective audit procedures depend on records being kept and motor fuel shipments being reported. Tax evaders, of course, will intentionally distort documents or avoid keeping records. Detection of illegal activity calls for vigorous surveillance and enforcement provisions. For example, a common evasion technique is the shipping of motor fuel from a state with a low tax rate to one with a high tax rate. The bills of lading will show the delivery to the origin state with the lower tax rate being paid in that state. When states do not cross check interstate deliveries, tax is sometimes not paid to either state. States should consider establishing a tax evasion "Hot Line" allowing anyone who suspects a person is evading motor fuel taxes to call a toll free telephone number to report the incident.

Other enforcement provisions that should be considered are:

- A. Establishing a fuel tax investigative unit devoting full time efforts to curb fuel tax evasion.
- B. Providing sworn members of the enforcement or investigative unit with police power to enforce criminal statutes during the performance of their official duties.
- C. Providing the personnel administering the fuel tax and investigating fuel tax evasion with the equipment and resources needed to be effective.
- D. Strengthening shipping document requirements and requiring transporters of motor fuel to carry these documents on board where they can be examined by an investigator.

There are a number of recommendations that may be considered in order to reduce the incidence of motor fuel tax evasion:

- A. Adequate control of licensing.

- B. Increasing audit staff.
- C. Clearly define the point of taxation.
- D. Balanced inventory reporting.
- E. Information sharing between states.
- F. Cross checking between licensed suppliers, distributors, wholesalers, etc.
- G. Adopt Point 6 of the Fuel Tax Evasion 11 Point Plan.

10. Records, Reports, and Payment

Tracking the shipment of fuel from the terminal to its ultimate destination is an important way to intercept and eliminate illegal fuel imports. Bills of lading are issued at the time fuel is pumped from the terminal into tank trucks for delivery, indicating destination state. Driver manifests indicate a more precise destination of the delivery, such as street address and city. Both documents provide solid proof of where the delivery is bound and can be used to verify the intentions of the transporter.

Information on product movements and transactions provide the records necessary to determine the amount of taxes due. Reporting inadequacies and delays provides opportunities for motor fuel tax evasion to go undetected long enough to be successful. The reporting, tax payment and verification process is frequently tested by tax evaders who find weak spots that can be exploited.

Requiring prompt reporting, precise tax payments improves the tracking process and can help identify companies that have not remitted taxes due. Computerization of tax returns and tax payments through electronic filing can further speed up the reporting process and allows for more timely cross-matching of shipments.

Records, reports, and tax payments provisions that should be considered are:

- A. Require the following information on all bills of lading and/or manifests:
 - 1. Address of the terminal or bulk plant from which the motor fuel was removed.
 - 2. Date the motor fuel was removed.
 - 3. Type of motor fuel removed.
 - 4. Number of gallons of motor fuel removed.
 - 5. State of destination as represented to the terminal operator by the purchaser/transporter.
- B. Bills of lading and driver manifests must accompany each delivery.
- C. Require licensees to retain records long enough for audit purposes.
- D. Adopt the uniform forms for reporting the movement and tax of motor fuel.
- E. Allow for uniform electronic reporting systems by adopting the ANSI ASC X12 standards.

11. Import/Export Cross Border Issues

When enacting changes to existing fuel tax statutes, tax authorities should consider how the statutory definitions, reporting requirements and tax status of imports and exports will affect their taxpayers and neighboring state.

Issues to be considered are as follows:

Rack State Issues:

- A. If tax is imposed at the rack will in-state position holders/suppliers be required to collect tax based on out-of-state destinations?
 - 1. This will require supplier/position holders to register and file in bordering states.

2. This will cause the tax-paid purchases in neighboring states to dramatically increase.
 3. Neighboring state laws may prohibit the pre-collection of tax when removed at the rack, possibly causing double taxation problems.
 4. Tax-paid purchases could reduce tracking and matching efforts in the neighboring states.
 5. Neighboring states with additional locally imposed taxes may now need a separate mechanism to collect these taxes.
 6. This may put taxpayers in an over paid position in the neighboring state, forcing the taxpayer and the neighboring state to process refunds.
 7. Exporters may be required to register and file returns, reporting their destination state tax-paid withdrawals.
 8. It will be important to define how you will handle products that may be exempt from tax in the destination state but taxable in your state, example kerosene?
- B. If tax is imposed at the rack, will out-of-state position holders/suppliers be required to collect tax based on in-state destinations.
1. This will require attempting to register out-of-state position holders/suppliers. These businesses may not have nexus in your state and may be willing to voluntarily collect your tax.
 2. If there are non-nexus out-of-state sources of fuel for in-state dealers, a process of registering and reporting imported gallons must be established (license category, returns, bonding, etc.).

General Issues (Applicable to all Levels of Taxation)

- C. Will you provide a mechanism to exchange data with neighboring states?
- D. Will you require specific paper work requirements such as destination state on bill of lading and invoices?
- E. Will you require tax to be separately stated on invoices and the state to be identified?

12. Refunds and Credits for Bad Debts

As taxing jurisdictions implement the tax at the terminal rack option, the marketers of motor fuel who had previously been taxpayers suddenly will lose their cash flow by having to pay the motor fuel tax to their suppliers. Some states have addressed this problem by allowing suppliers to defer collection of motor fuel taxes from their customers until the tax is due the taxing authority. Some supplier customers do not want to defer taxes. This tax deferral program could place a heavy burden on suppliers who find that the taxes become uncollectible from a purchaser. A provision to allow a bad debt credit or refund would protect suppliers from losses due to bankruptcy. Regulations could be written to specify if the supplier could take credit on the tax return or if the supplier has to file a refund claim. The regulations could also adopt rules establishing the evidence the supplier must provide to receive the deduction or refund. The state taxing authority would be covered by the bonding requirements that were established at the time of licensing the distributor/wholesaler. Also, something to consider is handling allowances that should be given to tax collectors to offset increased administrative costs.

13. License Listing

A detailed listing of all licensed suppliers, distributors, wholesalers, importers, exporters, retail dealers, motor fuel carriers, and pipeline terminal operators should be furnished no less than annually to each licensee within the taxing authority. The listing should include the name of the company, street address, city, state, FEIN number, and the license number for each license held within the taxing authority. If the listing is published less than monthly, a monthly update should be furnished,

listing any new licensees, or companies whose licenses have been cancelled, suspended, or revoked since the last published listing. If a monthly listing of changes is furnished, then the monthly listing should be cumulative and should be considered the most recent status. Another item that should be considered is listing all federally approved motor fuel terminals located within a taxing authority. The listing should include the name of the terminal operator, street address, city, state, FEIN number, and the federal terminal code. All listings should clearly indicate additions, deletions, and other changes to assist suppliers in checking against their customer lists. Some taxing jurisdictions consider these listings confidential and, if this is the case, the legislation should address this concern and make it legal to distribute these license listings.

14. Alternative Fuels

As defined in the glossary, alternative fuels are typically products other than gasoline, gasohol, diesel or kerosene. This section provides cross-references to other sections or separate provisions, as necessary, for successful administration.

A. Taxpayer Options

When enacting changes to motor fuel laws, taxing authorities need to consider taxation of alternative fuels and the point of taxation. Sales of alternative fuels are typically exempt at the terminal level. The nature of the fuel is for heating purposes therefore not conducive to taxing at the terminal. There are three common points of taxation for alternative fuels.

1. Tax at the Wholesale Level

A state may license and/or bond an alternative fuels dealer who makes sales to retail dealers or to the end user for highway purposes.

2. Tax at the Retail or User Level

A tax may be imposed on retail dealers or end-users of alternative fuels that deliver or place Alternative fuels into the fuel supply tank or other device of a vehicle for highway purposes. Fuel sold to each licensee is sold tax-free and the licensee who places the alternative fuels into the supply tank or other device of a highway vehicle becomes the taxpayer. Each state determines how and who should be licensed.

3. Registration Fee

In lieu of licensing and reporting sales of alternative fuels, a state may elect to issue a decal and/or license the registration fee of a vehicle when that vehicle is registered for license plate. The state determines the fee.

B. Collection and Payment of Tax/Fee

The point of taxation or fee collection will determine who and how many remitters a jurisdiction will have.

Other items that may need to be addressed are:

1. Collection of monies to be held in trust,
2. Cross border movements,
3. Bad debt allowance,
4. Collection allowance,
5. Exempt entities,
6. Refunds,
7. Conversion rates keeping IFTA requirements in mind.

C. Exempt Uses and Refunds

When considering exempt use and refund provisions, the following are some items to be addressed:

1. US Government
2. State Government and political subdivisions
3. Other states and their political subdivisions
4. Non-profit organizations

5. Farm Use
6. Heating Fuel or other non-highway use
7. School buses
8. Local or Inter-city buses
9. Exports
10. Erroneous payment refund
11. Refund claim procedures, in general
12. Interest on refunds
13. Penalty and/or interest on over-refunded tax

D. Licensing and Bond Requirements

Effective licensing and bonding of alternative fuels taxpayers helps ensure financial responsibilities and protects the tax liability with which licensees are entrusted each month. Taxpayers are likely to become more trustworthy and reliable when the licensing body performs thorough background checks on potential licensees and require surety for tax liabilities.

Licenses should be considered for the following:

1. Alternative Fuels Provider or Dealer.
2. Retailer of Alternative Fuels or Fuel Vendor.
3. Bulk-end User of Alternative Fuels.

Licensing requirements that should be considered are:

1. Application forms and instructions.
2. Background investigation of license applicant.
3. Application fees.
4. License denial hearings.
5. Period of license validity (one year; three years; or until suspended, revoked or cancelled).
6. License nontransferable notice.
7. Display of license.
8. License surrender upon discontinuance of a business.
9. Publication and distribution of license listing to all licensees within the state.

Surety bonds protect the taxing authorities from major tax dollar losses resulting from bankruptcy or tax evasion. The following bonding requirements and issues should be considered when bonding provisions are written:

1. Dollar amount of the bond.
2. Taxing authority approval of issuing Surety Company.
3. Bond must name the applicant as the principal and the taxing authority as the obliged.
4. Taxing authority approved bond forms.
5. New or increase in bond requirements if the liability on the previous bond is discharged or reduced by a judgment rendered, payment made, or any surety on the previous bond becomes unsatisfactory.
6. Provision to release existing surety bonds.
7. Allowance for cash deposits or an irrevocable letter of credit to be used in lieu of a surety bond.
8. Prior filing, payment and audit history of the taxpayer.

E. Fuel Tax Fraud Penalties

See Section 8 of the Model Legislation Checklist

F. Enforcement

See Section 9 of the Model Legislation Checklist.

G. Refunds and Credits for Bad Debts

Each state will determine if a refund or credit will be given to the Provider/Dealer or Retailer/Vendor if it is determined that the tax is uncollectible from the customer. Areas of concern should be:

1. Deferred collection on taxes.
2. Handling allowance.
3. Refund request for bad debts.
4. Credit request for bad debts.
5. Factors used to determine the uncollectible status.
6. Prorating consideration and collection of product and tax.
7. Recapture provision for write-offs.

H. License Listing

Each state will determine if a detailed listing of all alternative fuel licensees will be made available.

The listing should include, but not be limited to:

1. Account Number.
2. Legal Name.
3. Trade Name.
4. Address.
5. License Type.
6. FEIN (if not part of the account number).
7. Effective date.
8. Closed date.
9. Change to license (update listing only).

Some jurisdictions consider these listings confidential and, if this is the case, the legislation should address this concern and make it legal to distribute these license listings both to licensees and on the Internet.

I. Reduced Tax Rates

When considering reduced tax rate provisions for specific alternative fuel blends or fuel uses, the following are some items to be addressed:

- A. There is an increase potential for evasion if:
 1. Fuel may be purchased at a specific blend to receive a reduced tax rate. The reduced rate is remitted, then the fuel may be further blended and sold at the higher rate, or
 2. Fuel may be purchased at a reduced tax rate based on specific use, then later used for a different purpose, which should be taxed at a higher rate.
- B. Consider a credit a credit or refund to allow for ease in fuel taxation This will further ensure accuracy of reduced tax rates/credit situations for specific fuel blends and uses.

15. Two Party Exchanges

Introduction:

Two-party exchange is a transaction in which petroleum product is transferred from one supplier to another supplier pursuant to an exchange agreement.

Exchange Agreement is an agreement between two terminal suppliers whereby a terminal supplier agrees to deliver fuel to the other party or the other party's customer at the loading rack.

Simple example of two-party exchange transaction:

Supplier A is a position holder in Terminal X. Supplier B has a customer taking delivery of product in Terminal X, but Supplier B is not a position holder in Terminal X. Supplier A agrees to exchange product with Supplier B so Supplier B can sell product to the customer. Likewise, Supplier B will exchange product in another terminal where Supplier A is not a position holder.

Items to consider:

- A. Your state's taxation point.
 1. Tax at the terminal rack (including position holder, modified position holder, or first receiver).

Position holder = the one who owns inventory according to the records of the terminal operator.

Modified position holder = The position holder delivers on exchange and the exchange receiver remits the tax; or if no exchange is involved the position holder remits the tax.

First receiver = The person physically receiving accountable product/motor fuel at the rack remits tax to the taxing jurisdiction, if licensed. If not licensed, then variations of position holder and modified position holder should be considered.
 2. Tax below the rack (including distributor/wholesale level, retail level, or upon importation)
 - a. If taxing below the rack, you should consider the number of pass-throughs allowed and whether two-party exchanges will affect the number of pass-throughs on all products, including ethanol blended with gasoline. (An example of a "pass through" is when the distributor could collect and report the tax to the state, but chooses to sell tax-free product to the wholesaler, who then becomes responsible for reporting and paying the tax to the state.) Keep in mind that if you decide to limit the number of pass-throughs, the person in the middle may not know that their the taxable party.
- B. How to handle "stacking" exchange agreements. You might encounter a series of two-party exchanges prior to the product leaving the terminal. States should consider how they want to handle these "stacking" exchange agreements on a single movement of fuel.
- C. Tracking and cross matching issues.
 1. Will you be able to track and cross match transactions involving two-party exchanges?
 2. Does fuel lose identity through a series of two-party exchanges? (This means not being able to identify the fuel type, losing track of the original bill of lading number, or not being able to track the product from the original position holder through the exchange partner to the final recipient.)
 3. Does terminal disbursement information properly match recipient's receipt information? Does the terminal-issued bill of lading reflect the exchange-receiver as the supplier of record as opposed to the position holder? The position holder should not be reported on the bill of lading as the supplier of record.
 4. Does the terminal operator report reflect the exchange receiver as the supplier of record as opposed to the position holder?

- D. Enforcement and auditing issues.
1. Is product transferred via a two-party exchange or is the transaction actually a sale? When does title actually transfer?
 2. Does possession transfer directly from the exchange supplier to the exchange receiver's customer; title passes instantaneously from the exchange supplier to the exchange receiver to the exchange receiver's customer.
 3. Are both parties properly reporting the transaction?
 4. Do participants have proper supporting documentation?
 5. If the fuel is exported to an at-the-rack state, will the proper tax be collected and remitted?