

MEMORANDUM



DATE: February 6, 2012
TO: Interested Parties
FROM: William E. Hamilton
RE: Motor Fuel Taxes, Sales Tax on Motor Fuels, and Tax Collection (**Updated**)

There are several separate taxes on gasoline and diesel motor fuels purchased or consumed in Michigan. These taxes are included in the price of fuel purchased "at the pump." This memo provides background information on taxes imposed on motor fuels in Michigan.

Motor Fuel Tax – The state of Michigan imposes a 19-cent per gallon excise tax on gasoline used in motor vehicles. This tax is established in the Motor Fuel Tax Act (2000 PA 403). The tax rate was last changed in 1997 when the rate was increased from 15 cents per gallon to the current 19-cent per gallon rate. The motor fuel tax on gasoline is expected to generate over \$839 million for transportation in FY 2010-11 and represents approximately 45% of the state funds in the state transportation budget.

The state also levies a 15-cent per gallon tax on diesel motor fuel. The tax on diesel motor fuel is established in two different acts: the Motor Fuel Tax Act, and the Motor Carrier Fuel Tax Act (1980 PA 119). The tax under the Motor Fuel Tax Act is effectively a tax on diesel fuel consumed in Michigan *and* purchased in Michigan; it is included in the pump price paid by diesel-powered passenger cars, and commercial diesel-powered trucks that never leave the state of Michigan. Interstate motor carriers are taxed for fuel consumed in Michigan under the Motor Carrier Fuel Tax Act, whether they purchase fuel in Michigan or not. Together the two diesel fuel taxes generated \$125.3 million in fuel tax revenue in FY 2010-11.

Revenue from the motor fuel taxes is dedicated by the 1963 Michigan Constitution for transportation purposes. Revenue from these taxes is first credited to the Michigan Transportation Fund (MTF) and is then distributed to other funds and programs according to a formula established in Public Act 51 of 1951.

Federal Excise Tax – In addition to Michigan's 19-cent per gallon gasoline excise tax, the federal government levies an 18.4 cent per gallon gasoline excise tax, and a 24.4 cent per gallon diesel fuel excise tax. These taxes are earmarked for the Federal Highway Trust Fund which is distributed to the states for highway and public transportation programs.

Michigan Sales Tax – Michigan is one of several states to impose a sales tax on motor fuel sales, in addition to motor fuel excise taxes.¹ Sales of motor fuels are subject to the state's 6% sales tax on retail sales, established in the General Sales Tax Act (1933 PA 167). The tax base for the sales tax on gasoline sales is the motor fuel retail price, including the federal excise tax, but not including the state motor fuel excise tax. **A table showing the calculation of the taxable base for sales tax on gasoline at selected price points is included at the end of this memo.**

¹ Several states also allow for local motor fuel taxes; Michigan does not.

Approximately 4.4 billion taxable gallons of gasoline were consumed in Michigan in 2011. At this level of consumption, and an average pump price of \$3.50 per gallon, the sales tax on gasoline sales would have generated approximately \$818.3 million in sales tax revenue. Assuming the same level of consumption and an average pump price of \$4.00 per gallon, the sales tax would have generated approximately \$941.7 million.

An increase in gasoline-related sales tax does not generate a sales tax "windfall." Because households have budget constraints, increases in consumer gasoline purchases are largely offset by reductions in other taxable purchases.

The Michigan sales tax is subject to earmarking: One hundred percent (100%) of the tax at 2%, and sixty percent (60%) of the tax at 4% is dedicated by the state Constitution to the School Aid Fund. Fifteen percent (15%) of the tax at 4% is constitutionally earmarked for revenue sharing. In addition, a portion of the sales tax on motor fuel and other automotive products is statutorily earmarked, in the General Sales Tax Act, to the Comprehensive Transportation Fund for public transportation programs. This earmark is sometimes described as the "auto-related sales tax." There is also an earmark, effectively \$9.0 million, to the Michigan Health Initiative Fund. The balance of sales tax revenue, i.e. the amount not otherwise constitutionally or statutorily earmarked, is credited to the state General Fund.

Refined Petroleum Fund Regulatory Fee – Most states impose an environmental protection fee on the sale of petroleum products. As provided in Part 215 of the Natural Resources and Environmental Protection Act (1994 PA 451), Michigan imposes a 7/8 cent per gallon regulatory fee on all petroleum products (not just motor fuels). Revenue from this fee is dedicated to the Refined Petroleum Fund for use in state environmental cleanup programs. Refined Petroleum Fund revenue also supports the motor fuel quantity inspection program of the Michigan Department of Agriculture.

How Taxes are Collected – Motor Fuel Taxes

Although the retail price of fuel purchased "at the pump" includes federal and state excise taxes, those taxes are not actually collected from the retailer, (i.e. service station). The state motor fuel excise taxes are actually collected by the Michigan Department of Treasury from fuel suppliers as defined in the Motor Fuel Tax Act.²

In most instances, the point of taxation for the Motor Fuel Tax is the point at which fuel is transferred across a terminal loading rack to a fuel wholesaler.³ The taxpayer, the supplier, is the last owner of motor fuel before it is transferred across the loading rack. Fuel terminals are places where refined fuel is delivered by pipeline or vessel from refineries.⁴

The change in the tax collection point from the retailer to the supplier was effected for the gasoline tax by Public Act 225 of 1992 – this was considered to be one of the reforms of the first *Build Michigan* program. The change for diesel taxes was made in part by PA 225 of 1992, and completed through Public Act 668 of 2002.

² The U.S. Department of Treasury also collects federal motor fuel excise taxes from fuel suppliers, not from retailers.

³ This applies to both sales from in-state terminals and sales from out-of-state terminals where Michigan is the destination state. There are 37 Internal Revenue Service registered refined petroleum product terminals in Michigan.

⁴ Some fuel delivered by pipeline or vessel to Michigan terminals is refined in other states; some fuel is refined at the single operating oil refinery in Michigan, located in Southwest Detroit.

Moving the collection point to the fuel supplier was intended to make the collection of these taxes much more efficient. It is much easier for the Michigan Department of Treasury to collect from and audit a relatively small number of large fuel suppliers than several thousand retail service stations.

Section 14 of the Motor Fuel Tax Act allows suppliers to deduct 1.5% of the gasoline quantity from taxation to allow for "the cost of remitting the tax." This tax expenditure equates to approximately \$12.4 million per year. The deduction had been 2% of the gasoline quantity prior to the enactment of Public Act 83 of 1997 (the amending act that increased the tax from 15 cents per gallon to 19 cents). Prior to 1997 amendment, this deduction had been described in the Motor Fuel Tax Act as an "evaporation and loss allowance."

Section 14 also requires a wholesaler or supplier to pay or credit to the retailer one-third of the deduction on quantities of gasoline sold to the retailer.

How Taxes are Collected – Sales Taxes on Gasoline

With regard to the sales tax, the Michigan Department of Treasury sets a prepaid gasoline sales tax rate. This tax is collected from the gasoline supplier or importer at the time fuel is sold to a wholesaler. As a result, *estimated* sales tax is included in the price paid by the wholesaler and, in turn, the retail service station. The retailer is credited for the amount of prepaid sales tax at the time he or she prepares a monthly sales tax report. If the retailer had effectively prepaid \$10,000 in sales tax, as included in the price charged by the wholesaler, and the retailer's actual total tax liability for the month was \$11,000, the retailer would remit only the \$1,000 balance to the Department of Treasury. Conversely, if the retailer's actual tax liability were less than the amount of pre-payment, the retailer would be entitled to a credit.

The pre-payment provisions of the General Sales Tax Act with regard to the sales tax levied on gasoline sales were first established under 1983 PA 244, which amended the act by adding a new section, Section 6a. The legislative analysis at that time indicated that the amending legislation was intended to make it harder for unscrupulous gasoline retailers to undercut tax-compliant retailers by not charging sales tax.

In 2008, Section 6a of the General Sales Tax Act was amended by 2008 PA 556 (Senate Bill 881). Prior to enactment of Senate Bill 881, the law had required the Department to determine the prepayment rate at least annually, or every six months if the statewide retail price of a gallon of self-serve unleaded regular gasoline had changed by 10.0% or more during the six-month period. Senate Bill 881 required the Department to determine the prepayment rate every *three months* unless it determined that the statewide average retail price for self-serve unleaded regular gasoline had changed less than 10.0% since the establishment of the rate. It is our understanding that the change effected by Senate Bill 881, to increase the frequency of adjustments to the gasoline pre-payment sales tax rate, was intended to help reduce tax overpayments and underpayments.

Components of Gasoline Price at Selected Price Points

Gas at \$4.00 per gallon	
\$3.410	Base retail price
	Federal excise tax
0.184	
\$3.594	Base for sales tax
0.216	Sales tax @ 6%
\$3.810	Subtotal
0.190	State excise tax
\$4.000	Pump price

Gas at \$3.50 per gallon	
\$2.939	Base retail price
	Federal excise tax
0.184	
\$3.123	Base for sales tax
0.187	Sales tax @ 6%
\$3.310	Subtotal
0.190	State excise tax
\$3.500	Pump price

