

DYED DIESEL FUEL EXCISE TAX EXEMPTION EVALUATION SUMMARY



THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	2000
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	\$50.7 million TAX YEAR 2017
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

The Dyed Diesel Fuel Excise Tax Exemption (Dyed Diesel Exemption) exempts diesel fuel that has been dyed and is used for off-highway or government purposes from the State's excise tax at the time of purchase.

WHAT DID THE EVALUATION FIND?

We determined that the Dyed Diesel Exemption is meeting its purpose because eligible taxpayers are using it.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Dyed Diesel Exemption.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for the exemption. Based on our review of statute and federal laws and regulations, we inferred that the purpose is to prevent taxpayers from having to pay the excise tax when the fuel is not used to propel vehicles on state highways. We also inferred that the exemption prevents government agencies from being taxed on fuel used for government business and ensures that Colorado complies with federal regulations related to the sale and distribution of dyed diesel.

DYED DIESEL FUEL EXCISE TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Dyed Diesel Fuel Excise Tax Exemption (Dyed Diesel Exemption) exempts diesel fuel that has been dyed and is used for off-highway or government purposes from the State's fuel excise tax at the time of purchase [Section 39-27-102.5, C.R.S.]. The federal government allows diesel fuel that will not be used for taxable purposes to be dyed so that it is easily identifiable. This fuel is exempt from both federal and state fuel excise taxes when it is sold in accordance with federal laws and regulations [26 USC 4041 and 4082 and 40 CFR 80.520].

Dyed diesel can be purchased for off-road use, such as for farm equipment or construction equipment when that equipment is being used to construct highways. Dyed diesel can also be used by government agencies, including the State of Colorado and any of its agencies and any town, city, county, school district or any other political subdivision, when conducting government business. Anyone who is caught using dyed diesel for taxable purposes (i.e., anyone outside of government agencies that uses dyed diesel to propel vehicles on public roads) can be fined \$1,000 or \$10 per gallon, whichever is greater, and is responsible for paying the tax due. Violators are reported to the Department of Revenue or the Internal Revenue Service for tax evasion. The Dyed Diesel Exemption was enacted in 2000, and has not had any substantive changes since enactment.

To claim this exemption, entities and individuals can purchase dyed diesel tax-free from a distributor or eligible gas station. If a government agency purchases diesel where the fuel excise tax is imposed, the agency can apply to the Department of Revenue for a refund of the tax, using the Fuel Tax Refund Claim Form (Form DR 7118).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not specifically identify the intended beneficiaries of the Dyed Diesel Exemption. We inferred, based on the statutory language, that the intended beneficiaries are individuals and businesses that use diesel fuel for off-highway purposes, such as farmers and construction companies, and government entities that use diesel fuel to perform government functions.

We also inferred that consumers may indirectly benefit from the expenditure since the individuals or businesses receiving the exemption may pass the savings on to consumers through lower prices on goods and services.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Dyed Diesel Exemption. Based on our review of statute and federal laws and regulations, we inferred that the purpose of the exemption is to prevent individuals and businesses that purchase diesel fuel for off-road use from having to pay the excise tax when the fuel is not used to propel vehicles on state highways. The State's fuel excise tax is intended to place part of the cost of building and maintaining state highways onto highway users when they purchase fuel. Since the fuel purchased for off-road purposes is not used on the State's highways, it is not contributing to their deterioration. In addition, the exemption prevents state and local government agencies from being taxed on diesel fuel used for government business.

We also inferred that the Dyed Diesel Exemption ensures that Colorado complies with federal regulations related to the distribution and sale of dyed diesel. Further, the exemption reduces the administrative burden on the Department of Revenue of processing fuel excise tax refund requests since dyed diesel is exempt from the tax at the time of purchase.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Dyed Diesel Exemption is meeting its purposes because eligible taxpayers are using this exemption. Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created and applied the following performance measure to determine if the Dyed Diesel Exemption is meeting its inferred purposes:

PERFORMANCE MEASURE: *To what extent are individuals, businesses, and government entities that use diesel fuel for non-taxable purposes claiming the Dyed Diesel Exemption by purchasing dyed diesel fuel?*

RESULT: In Tax Year 2017, individuals, businesses, and government agencies purchased over 247 million gallons of dyed diesel fuel in Colorado. These purchases were exempted from about \$50.7 million in fuel excise taxes. We surveyed representatives from the agricultural industry (e.g., farmers and ranchers), construction industry, and government and all indicated that entities in their industries are aware of the exemption and use it.

Furthermore, the Department of Revenue reported that nearly 566 million gallons of taxed highway diesel fuel were purchased during Tax Year 2017 by all taxpayers to propel diesel-powered vehicles on Colorado highways. Adding the amount of taxed diesel fuel purchased with dyed diesel, we were able to estimate that over 813 million gallons of diesel fuel were purchased in Tax Year 2017 and dyed diesel represented 30 percent of the total.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

The Department of Revenue reported that the Dyed Diesel Exemption had a total state revenue impact of \$50.7 million dollars in Tax Year 2017, and has averaged just under \$45 million per year since Tax Year 2011. Eligible taxpayers and government entities saved an equivalent

amount. We were unable to determine how many taxpayers and government entities benefitted from the exemption due to a lack of data.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Dyed Diesel Exemption would increase taxes for individuals, businesses, and government entities that purchase diesel fuel for off-highway or government uses. Without the exemption, eligible taxpayers and government entities would have paid an additional \$50.7 million in fuel excise taxes for Tax Year 2017. However, these taxpayers and government entities would still have been eligible to apply to the Department of Revenue for a partial refund of a percentage of fuel excise taxes paid, which varies based on the industry, under the Off-Road Fuel Use Excise Tax Refunds [Sections 39-27-102(1)(b)(II) and 39-27-103(3)(a)(I), C.R.S.]. Most taxpayers would see an increase in taxes under this scenario because the refund amounts for non-governmental uses under this provision range from 0 to 71 percent of the taxes paid, compared to the Dyed Diesel Exemption which currently exempts 100 percent of the fuel from tax. Also, if all purchasers had to apply for a refund, this could result in an increase in administrative costs to taxpayers for preparing and submitting the claims, as well as to the Department of Revenue for processing refund requests.

These increased tax costs would likely be passed on to consumers to the extent the current beneficiaries are able to do so. However, many agricultural producers may not be able to pass the costs on to consumers because they must often sell at established market prices for agricultural commodities. Thus, agricultural producers would likely have to absorb the additional cost, which could have a significant impact since the agricultural industry already tends to operate on small profit margins.

In addition, if Colorado eliminated the exemption, due to federal laws and regulations [26 USC 4082 and 40 CFR 80.520], the State would no longer be able to sell and distribute dyed diesel fuel. This could have a negative effect on interstate commerce as Colorado distributes dyed

diesel fuel to surrounding states, and surrounding states distribute to organizations in Colorado.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

According to industry stakeholders, dyed diesel is widely used in nearly every state and by the federal government to identify fuel that has not been charged an excise tax as its purpose is for off-highway or government use. Colorado's surrounding states, including Arizona, Kansas, Nebraska, New Mexico, Oklahoma, Utah, and Wyoming all exempt dyed diesel from state fuel excise taxes.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

The Off-Road Fuel Use Refunds [Section 39-27-103(3)(a)(I), C.R.S.] have a similar purpose and reach the same beneficiaries as the Dyed Diesel Exemption. These refunds exempt gasoline and special fuels, which includes diesel, from a portion of the fuel excise tax, based on the industry, if the fuel is used for off-road purposes. However, taxpayers must submit a claim to the Department of Revenue for these refunds, rather than have the fuel excise tax exempted at the time of purchase, as occurs with the Dyed Diesel Exemption. In addition, statute exempts all government agencies from the fuel excise tax when the fuel is used for government business [Section 39-27-102(1)(b)(II), C.R.S.]. All of the diesel fuel purchased under the Dyed Diesel Exemption would also be exempt from the fuel excise tax under one of these other provisions.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue was unable to provide data on the number of taxpayers and government entities that took the Dyed Diesel Exemption. Federal reporting provides the number of gallons of dyed diesel purchased in each state, as distributors are required to report quantities sold on federal tax forms, but not the number of taxpayers applying the exemption. Further, since taxpayers are not required to

submit a filing for the Dyed Diesel Exemption, the Department of Revenue does not have information on the total number of taxpayers who received the exemption at the time of purchase. In addition, although government entities may apply for a refund when the excise tax was imposed upon fuel that is used for an eligible purpose, GenTax, the Department's tax processing and information system, does not capture and compile this information for the Dyed Diesel Exemption. Due to these limitations, we were unable to determine the number of taxpayers who took this exemption, and the average annual exemption per taxpayer.

To address these limitations, the Department of Revenue would have to create a new reporting form and require that those purchasing dyed diesel fuel report these purchases, and then capture and house the data collected in GenTax, which would require additional resources and would place additional tax compliance costs on taxpayers. (See the Tax Expenditures Overview Section of the Office of the State Auditor's *September 2018 Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations)

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Dyed Diesel Exemption.