Fuel Excise Tax Expenditures

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OFFICE OF THE STATE AUDITOR
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Colorado levies an excise tax on fuel at a rate of 20.5 cents per gallon for special fuel, 22 cents per gallon for gasoline and gasoline/ethanol fuel blends, 6 cents per gallon for aviation gasoline, and 4 cents per gallon for jet fuel. This evaluation covers three tax expenditures—Two Percent Loss Allowance, Bad Debts and Administration Allowance, and Lost or Destroyed Fuel Credit, referred to collectively in this report as the Fuel Excise Tax Expenditures. These expenditures compensate taxpayers for taxes paid on fuel that does not reach the final consumer, fuel the taxpayer is not paid for after paying the excise tax, and for the cost of calculating and remitting fuel excise taxes.

We found that all of the evaluated expenditures are meeting their purposes. Specifically:

- The Two Percent Loss and Bad Debt and Administrative Allowances are automatically applied by the Department of Revenue so taxpayers consistently receive them.
- The 2 percent rate for the Two Percent Loss Allowance was in line with current tax policies in similarly situated states. We found that 10 of the 15 states that we reviewed that border Colorado and/or have similar winter climates have a transfer loss allowance similar to Colorado.
- Despite the infrequency of its use, beneficiaries are aware of the Lost and Destroyed Fuel Credit and appear to claim it when they are eligible.

Policy Considerations

We did not identify any new policy considerations for these tax expenditures.

	Two Percent Loss Allowance	Bad Debt & Admin Allowance	Lost and Destroyed Fuel Credit
Tax Type:	**Excise - Fuel**	**Excise - Fuel**	**Excise - Fuel**
Expenditure Type:	**Allowance**	**Allowance**	**Credit**
Statutory Citation:	**Section 39-27-102(1)(b)(I), C.R.S.**	**Section 39-27-105(2)(b), C.R.S.**	**Section 39-27-103(1), C.R.S.**
Year Enacted:	**1929**	**1969**	**1929**
Repeal/Expiration Date:	**None**	**None**	**None**
Revenue Impact:	**$13.1 million (2021)**	**$3.2 million (2021)**	**$0 (2021)**
Purpose given in statute or enacting legislation? **Yes**			

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Background

Colorado levies an excise tax on fuel at a rate of 20.5 cents per gallon for special fuel, 22 cents per gallon for gasoline and gasoline/ethanol fuel blends, 6 cents per gallon for aviation gasoline, and 4 cents per gallon for jet fuel. Statute requires the first entity that removes the fuel from the "terminal," defined as a fuel storage and distribution facility, to pay the excise tax. This is most often a distributor, but could also be a supplier or retailer depending on the situation. While a distributor typically pays the excise tax, the cost of the tax is intended to be passed on through the distribution chain in the form of higher prices, so that the final consumer of the fuel bears the cost of the tax. Fuel excise taxes are remitted to the State monthly. The revenue generated by motor vehicle gasoline and special fuel excise taxes are used for the management of Colorado's public highways and the costs of administration of the taxes. Excise taxes collected on aviation fuel are used exclusively for aviation purposes.

This evaluation covers three structural tax expenditures that define the tax base for the State's fuel excise tax, referred to collectively in this report as the Fuel Excise Tax Expenditures.

The Two Percent Loss Allowance [Section 39-27-102(1)(b)(I), C.R.S.] was established in 1929 and its purpose is to allow taxpayers to deduct two percent of the taxable gallons removed from the terminal in order to account for fuel that is lost in transit, typically due to volumetric shift (see technical note), evaporation, or other losses in the transfer process. The Department of Revenue (Department) automatically applies the allowance each month when the distributor reports and pays their excise taxes. House Bill 21-1322 removed the requirement that taxpayers allot half of this allowance to retailers, which was done through a one percent reduction in price.

The Washington Joint Legislative Audit and Review Committee released a review of the State of Washington's fuel loss allowance which found, in conjunction with EPA research, that the combined loss of fuel in transfer, evaporation, and volumetric shift was less than one percent of total fuel. We looked at tax policies in 15 states that either border Colorado and/or have similar winter climates. Of those, 10 states had some form of transfer loss allowance ranging from 0.5 to 2.5 percent with the average being 1.5 percent.

Technical Note

Volumetric shift is the industry term for the increase or decrease in volume of a fluid that occurs due to temperature changes. As the fluid gets cooler, the volume decreases; inversely, as the fluid gets warmer, the volume increases. This means that 100 gallons of gasoline put into a tanker truck at 60 degrees would reduce in volume as the temperature decreases during winter transport. If the weather was at 0 degrees, the amount of volume would decrease 4 percent leaving the tanker only containing about 96 gallons of a more viscous gasoline. However, once the fuel has warmed back up to 60 degrees, the volume will return to its original viscosity and volume of 100 gallons.

The Bad Debts and Administrative Allowance [Section 39-27-105(2)(b), C.R.S.] was established in 1969 and provides taxpayers with a 0.5 percent reduction in net fuel excise taxes owed (calculated after the two percent deduction has been applied). Its purpose is two-fold. First, it covers taxes that taxpayers paid on fuel that customers requested be removed from the terminal but were later unable to pay for (i.e. bad debts). The purpose of this part of the allowance appears to be to allow taxpayers to recoup taxes paid on bad debt fuel since the cost of the tax was not passed on to the customer. The second purpose of the allowance is to compensate taxpayers for expenses associated with the calcuation and payment of fuel taxes. The Department automatically applies the allowance when the taxpayer reports and pays their excise taxes. Taxpayers are not extended this allowance for any filing period in which their report and/or payment are posted after the defined due date; therefore, the allowance also provides an incentive to encourage timely filing and payment.

Of the 15 states we looked at, seven have some form of refund or credit for fuel excise taxes paid in bad debt situations and nine have some form of allowance intended to assist or cover administrative costs associated with paying the excise taxes. Of those nine administrative allowances, seven are stand-alone provisions, rather than being combined with another allowance, such as an allowance for bad debts. On average, the seven states we reviewed with stand-alone adminstrative allowances allowed taxpayers to retain 1.2 percent of the taxes owed.

The Lost or Destroyed Fuel Credit [Section 39-27-103(1), C.R.S.] was established in 1929 and allows a distributor, transporter, or retailer to receive a credit in the amount of the excise taxes paid for fuel that was lost or destroyed and never reaches the consumer. The credit can only be taken when the loss or destruction of 100 gallons or more of fuel occurred under circumstances that were outside the control of distributors, transporters, and retailers—i.e. "fire, lightning, flood, windstorm, explosion, accident, or other cause beyond the control of the distributor or transporter of such gasoline or special fuel." House Bill 21-1322 clarified that the person in control of the fuel at the time of the incident is the party entitled to receive this credit regardless if they were the one to pay the excise tax because, assumedly, the tax was already passed on to them in the form of higher prices. The purpose of the credit is to offset taxpayers' tax liability on fuel for which the excise tax cannot be passed on to the final consumer.

To claim the Lost and Destroyed Credit, eligible distributors, transporters, and retailers must submit the Excise, Fee and Fuel Claim for Refund form (DR137E) to the Department within 30 days of the incident occuring, along with supporting evidence, such as a police report. In addition, a qualified taxpayer claiming the credit must have a fuel tax refund permit from the Department, which they acquired by submitting the Gasoline/Special Fuel Tax Refund Permit Application (DR 7189). Of the 15 states we looked at, thirteen have either a refund or a credit for taxes paid on fuel that was lost or destroyed and have similar restrictions on when it can be claimed to those in Colorado.

There are no performance measures for any of the Fuel Excise Tax Expenditures included in statute. In order to determine if these expenditures are meeting their purposes, we assessed whether the intended beneficiaries were aware of and taking the allowances and credit when eligible.

Evaluation Results

We found that the Two Percent Loss and Bad Debt and Administrative Allowances are meeting their purposes because they are regularly received by the intended beneficiaries. The Department automatically applies these two allowances when the taxpayers file their excise tax return. Therefore, all eligible taxpayers should be receiving these allowances. The revenue impact for these expenditures totalled $16.3 million for Calendar Year 2021, the most recent year with information available, with the Two Percent Loss Allowance accounting for 80 percent (about $13.1 million) and the Bad Debt and Administrative Allowance accounting for the other 20 percent (about $3.2 million). An industry representative we spoke with said that eligible taxpayers are aware of the allowances and receive them regularly as calculated by RevenueOnline, the online tax-payment platform operated by the Department. They also explained that although bad debts are not common outside of a recession, the Bad Debt and Administrative Allowance does assist greatly in the administrative burdens associated with paying the excise tax. They noted that paying the excise tax can be complex and time-consuming because tracking and applying the many tax exemptions related to fuel, such as fuel for governmental entities, aviation fuel used in commercial aircraft, and dyed special fuels, requires substantial documentation from customers prior to calculating and submitting their monthly returns.

Additionally the Department confirmed that the current design of the allowance is administratively convienient for both the Department and the taxpayers because it does not require any documentation or review; it is simply calculated as a percentage of the tax.

We found that, despite the infrequency of its use, beneficiaries are aware of the Lost and Destroyed Fuel Credit and appear to claim it when they are eligible. In our previous evaluation, published in July 2019, we found that between Tax Years 2011 and 2017 the credit had been claimed by 8 taxpayers for a total of $12,000. According to Department staff, there have been no claims for the Lost and Destroyed Fuel Credit in 2017, 2019, and 2021, which are the only recent years for which data is available. It should be noted, however, that while the types of situtations that would make a taxpayer eligible for this credit—wildfire, electrical storm, accident outside the control of the operator, etc.—are fairly common occurances, fuel loss or destruction resulting from such an event is far more rare. Although this credit is not used very often, it still serves an important structural purpose in ensuring that fuel which does not reach the consumer and is not used on public roads is not taxed in the event that a qualifying incident does occur. We spoke with a representative from a fuel distributors trade organization and they reported being aware of the credit, and stated that taxpayers are also aware of the credit, but that they are not aware of any qualifying events in recent years.

To determine whether there were any potentially-eligible taxpayers who lost fuel in the state but did not claim the credit, we researched fuel spills that occurred in the state between 2015 and 2021. We used the Environmental Protection Agency's On-Scene Coordinator Response Sites database to identify three potentially-eligible fuel spills in Colorado; however, upon further review, in all cases the drivers were responsible in some way for the accidents that resulted in fuel loss and, thus, the taxpayers were not eligible for the credit.

Policy Considerations

We did not identify any new policy considerations for these tax expenditures. Our previous evaluation did not identify any policy considerations for these tax expenditures either.

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