

# GASOLINE AND SPECIAL FUEL & DYED DIESEL SALES TAX EXEMPTIONS



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2020-TE8

## EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

	SALES TAX EXEMPTION FOR GASOLINE AND SPECIAL FUEL	SALES TAX EXEMPTION FOR DYED DIESEL
YEAR ENACTED	1935	2015
REPEAL/ EXPIRATION DATE	none	none
REVENUE IMPACT (CALENDAR YEAR 2017)	\$223 million	\$18 million
NUMBER OF TAXPAYERS	NA	NA
AVERAGE TAXPAYER BENEFIT	NA	NA
IS IT MEETING ITS PURPOSE?	Yes	Yes

### WHAT DO THESE TAX EXPENDITURES DO?

The Sales Tax Exemption for Gasoline and Special Fuel exempts from sales tax fuel products that are already subject to the State's motor fuel excise tax.

The Sales Tax Exemption for Dyed Diesel exempts all sales of dyed diesel from sales tax.

### WHAT DID THE EVALUATION FIND?

We determined that these expenditures are meeting their purposes.

### WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

The Sales Tax Exemption for Gasoline and Special Fuel prevents taxpayers from having to pay the sales tax on products for which an excise tax has already been paid.

The Sales Tax Exemption for Dyed Diesel eliminates the administrative burden on retailers to determine if individual sales of dyed diesel are exempt from sales tax.

### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations regarding these tax expenditures.

# GASOLINE AND SPECIAL FUEL & DYED DIESEL SALES TAX EXEMPTIONS

## EVALUATION RESULTS

### WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers two similar sales tax exemptions for sales of fuels. The Gasoline and Special Fuel Sales Tax Exemption (Fuel Exemption) [Section 39-26-715(1)(a)(I), C.R.S.] exempts all fuel products subject to the State's gasoline and special fuel excise tax from also being subject to the State's sales and use tax. Similarly, the Dyed Diesel Sales Tax Exemption (Dyed Diesel Exemption) [Section 39-26-715(1)(a)(III), C.R.S.] exempts diesel fuel that has been dyed and is used for off-highway or government purposes from sales tax. This fuel is dyed to make it easily identifiable, which aids the enforcement of laws prohibiting it being used on highways. Dyed diesel is also 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].

In addition, sales of gasoline, special fuel, and dyed diesel are exempt from local sales taxes for purchases made in statutory cities and counties, which have their local sales taxes collected by the State on their behalf, because statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Fuel Exemption and Dyed Diesel Exemption.

Colorado first imposed a general sales tax in 1935, which is currently set at 2.9 percent of sales of tangible personal property. When the sales tax was passed, it included a provision with the same effect as the Fuel Exemption, providing a sales tax exemption for all commodities already subject to some form of excise tax, which included most fuels. Though the general sales tax exemption for commodities was subsequently replaced with provisions to clarify the specific types of tangible personal

property excluded, which included the Fuel Exemption, the State has exempted sales of most types of fuel from sales tax since this time.

The Dyed Diesel Exemption was established in 2015 under House Bill 15-1012. When the exemption was established, most dyed diesel sales were already exempt from sales tax because the primary purchasers of dyed diesel are government agencies and farmers, who are exempt from sales tax for such purchases under other provisions of statute. The Dyed Diesel Exemption extended this exemption to include all other uses that were not covered under these other provisions, such as in building power generators or auxiliary power units in semitrailers.

Both the Fuel Exemption and the Dyed Diesel Exemption are typically applied by retailers at the point of sale. Retailers report exempted sales on the Colorado Retail Tax Return (Form DR 0100). If a retailer does not apply the exemption at the time of purchase, the taxpayer may apply to the Department of Revenue for a refund using the Claim for Refund (Form DR 0137).

#### WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not specifically identify the intended beneficiaries of the Fuel Exemption. We inferred, based on the statutory language, that the intended beneficiaries are individuals who purchase fuel in Colorado, because the exemption lowers the after-tax cost of these products.

For the Dyed Diesel Exemption, the legislative declaration for House Bill 15-1012 indicates that the intended beneficiaries are individuals who purchase dyed diesel fuel for off road use since most other purchases of dyed diesel were already exempt from sales tax under other provisions. The legislative declaration also indicated that retailers were intended to benefit from the exemption because it reduces their administrative burden of determining which purchases should be exempt.

#### WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute does not explicitly state a purpose for the Fuel Exemption. Based

on our review of statute, we inferred that the purpose is to prevent individuals and businesses that purchase fuel from having to pay the sales tax on products for which an excise tax has already been paid. This is a common structural provision in most states with an excise tax on fuel and prevents double taxation of the same purchases.

According to the legislative declaration for House Bill 15-1012, the purpose of the Dyed Diesel Exemption “is to streamline the collection of sales and use taxes by treating all dyed diesel the same.” The legislative declaration indicates that most sales of dyed diesel fuel were already exempt from sales tax under other provisions, and while there were some uses of dyed diesel that were not exempt, they constituted an insignificant amount of revenue and compliance created an administrative burden for retailers, who were responsible for determining which sales were exempt.

#### ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Fuel Exemption and the Dyed Diesel Exemption are meeting their purposes because retailers are using them to exempt eligible fuel products from sales and use tax. Statute does not provide quantifiable performance measures for these expenditures. Therefore, we created and applied the following performance measure to determine if the exemptions are meeting their purposes:

**PERFORMANCE MEASURE:** *To what extent are retailers applying the Fuel and Dyed Diesel Exemptions at point of sale to avoid taxing eligible fuel products?*

**RESULT:** We found that the exemptions are applied to nearly all eligible sales of fuel. Specifically, based on Department of Revenue data on the amount of fuel sales retailers reported exempting, we estimated that the tax expenditures were applied to about \$8 billion in fuel sales during Calendar Year 2017. Based on our analysis of data from the U.S. Energy Information Office on fuels sales and prices in Colorado, we estimate

that about \$8 billion in eligible fuel sales occurred in Calendar Year 2017, indicating that nearly all of the sales were exempt from sales tax. Further, in our conversations with stakeholders, which included industry groups, distributors, retailers, and purchasers of a variety of fuel products including gasoline, special fuel, aviation fuel, and dyed diesel, they indicated that retailers in the industry are well aware of both tax expenditures and apply them to all eligible transactions.

### WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

According to the Department of Revenue's 2018 *Tax Profile & Expenditure Report*, the Fuel Exemption and Dyed Diesel Exemption resulted in a combined total of \$241 million of forgone revenue for the State in Calendar Year 2017. That revenue impact is based only on data collected from the State Sales Tax Return (Form DR 0100); it does not include exemptions claimed using the Retailer's Use Return (Form DR 0173), which is used less frequently and for which the Department of Revenue cannot provide data.

While the Department of Revenue does not separately track the revenue impact of the two expenditures, we were able to use its estimate for the Dyed Diesel Excise Tax Exemption and diesel price data from the U.S. Energy Information Office to estimate that the Dyed Diesel Exemption constitutes roughly \$18 million (7 percent) of that total, leaving \$223 million of forgone revenue attributable to the Fuel Exemption.

While the State collects less sales tax revenue as a result of the Fuel Exemption, those products are instead taxed under the gasoline and special fuel excise tax. According to the Department of Revenue, the excise tax resulted in collections of \$640 million in Calendar Year 2017. This means that the net effect to the State of substituting the excise tax for the regular sales tax is a revenue gain of more than \$400 million; however, the State could apply both taxes if it desired to do so.

In addition, the exemptions apply to local sales taxes for purchases made in local taxing jurisdictions, such as statutory cities and counties,

which have their local sales taxes collected by the State on their behalf under Section 29-2-105(1)(d)(I), C.R.S. We estimated the revenue impact to local jurisdictions to be roughly \$141 million. We calculated this using an average statewide population, weighted local tax rate for state-collected local governments of 1.7 percent, and multiplied by the \$8.3 billion in exempted statewide fuel sales that we estimated based on Department of Revenue data.

#### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If these expenditures were eliminated, retailers that sell fuel would be required to collect sales taxes on these sales, which would increase the after tax cost to consumers by 2.9 percent. In addition, fuel retailers would experience increased administrative costs since they would be required to collect and remit sales taxes on their sales of fuel, though this additional cost may be limited since many fuel retailers sell other products that are subject to sales tax and they are already required to collect and remit sales taxes for those sales.

However, for the Dyed Diesel Exemption specifically, repeal of this expenditure may have a more significant impact on retailers. Specifically, at the time this expenditure was created, the bill indicated that it was administratively difficult to apply the exemption because although most sales of dyed diesel were already exempt under other statutory provisions, some sales of dyed diesel did not fall under the exemptions and were subject to sales tax, which required retailers to determine on a case-by-case basis whether purchasers were tax exempt. If the Dyed Diesel Exemption was eliminated, retailers would again have this same administrative requirement.

#### ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 other states with a sales tax, 34 states (excluding Colorado) and the District of Columbia apply a sales tax exemption for fuel products similar to the Fuel Exemption. The other 10 states do not have an exemption and apply both a sales tax and an excise tax to sales of fuel.

The Dyed Diesel Exemption is less common. In total, six additional states and the District of Columbia have a similar blanket exemption from sales tax for dyed diesel. An additional six states exempt dyed diesel from sales tax when used for certain purposes.

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

We did not identify other tax expenditures or programs with a similar purpose to the Fuel or Dyed Diesel Exemptions.

#### WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

The Department of Revenue was unable to provide disaggregated data for the two expenditures. Specifically, the Fuel Exemption and the Dyed Diesel Exemption are both claimed on line 10 of Form DR 0100, for “Other Exemptions,” and the data for each expenditure cannot be disaggregated. Although we were able to estimate the revenue impact of these exemptions based on federal Energy Information Office data on fuel sales in Colorado, we could base our reported revenue impact for each expenditure on data directly reported by taxpayers if the Department of Revenue collected data for each exemption separately.

To collect this data, the Department of Revenue would have to create new reporting lines on Form DR 0100 to allow for each exemption to be reported separately and then capture and house the data collected on those lines in GenTax, the Department of Revenue’s tax processing system, which would require additional resources (see the Tax Expenditures Overview Section of the Office of the State Auditor’s *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 regarding these tax expenditures.