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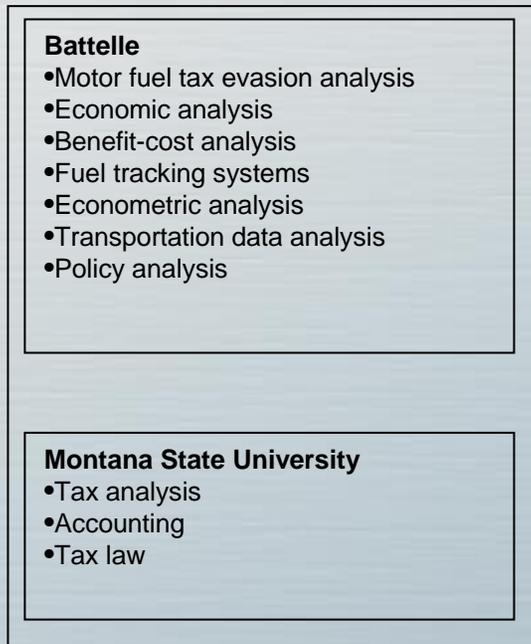
The Business of Innovation

Determining the Current Rates of Motor Fuel Tax Evasion For the State of Montana

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The Battelle Team

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Project Objectives

Objective 1

Assess administrative and enforcement characteristics of state practices, including tax codes

Objective 2

Identify evasion techniques and note strategies used to curtail motor fuel tax evasion

Objective 3

Identify and examine data

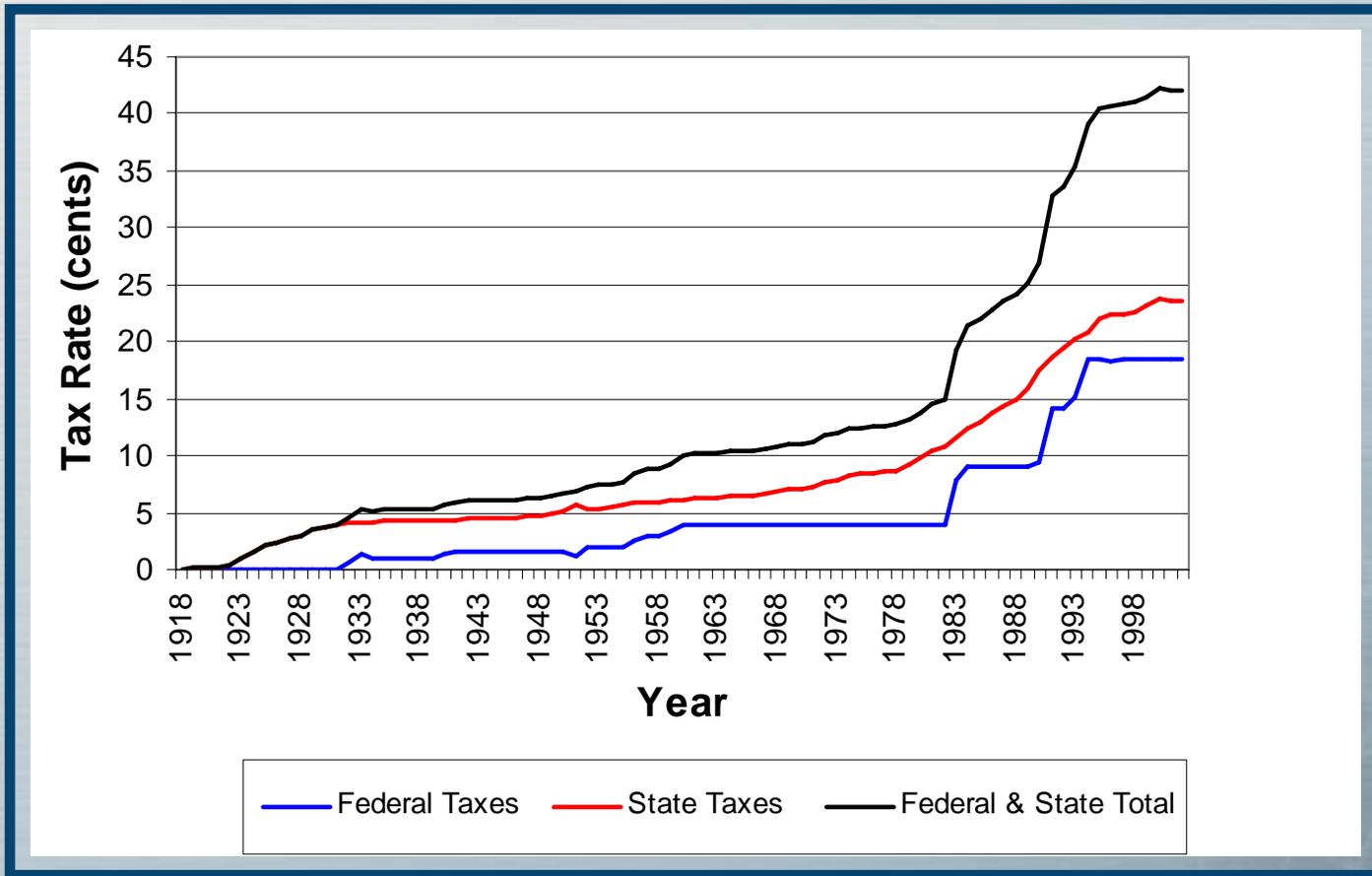
Objective 4

Develop and demonstrate a methodology for reliably estimating state motor fuel tax evasion

Objective 5

Make recommendations for closing gaps in enforcement and reducing evasion.

The Incentive to Evade



Examination of Federal / State Practices

Objective: Scan the literature and conduct interviews in order to identify evasion techniques, methods for measuring evasion, evasion estimates, methods for curtailing evasion and results of efforts to reduce evasion.

■ Literature Review

- Background
- Evasion Studies
- Motor Fuel Tax Administration and Enforcement
- Data Sources
- Motor Fuel Excise Tax Revenue Forecasting
- Tax Codes
- Other Relevant Tax Codes

■ Overview of Efforts to Curtail Motor Fuel Tax Evasion

- Methods Used to Evade Taxes
- Efforts to Curtail Evasion
- Perceived Impact of These Compliance / Enforcement Activities
- Estimated Resources Required to Enhance Compliance and Enforcement Activities

Federal Motor Fuel Tax System

Motor Fuel - Federal Excise Taxation Points

Gasoline

taxation point
moved to rack
Jan 1, 1988



wholesaler



seller at
terminal rack

position holder
pays tax
Jan 1, 1993



position holder at
terminal rack

2004

1984



retailer

Apr 1, 1988
taxation point moved to
licensed wholesaler



wholesaler

Jan 1, 1994
taxation point
moved to rack



position holder at
terminal rack

Jul 1, 1998
undyed kerosene
taxed as diesel fuel

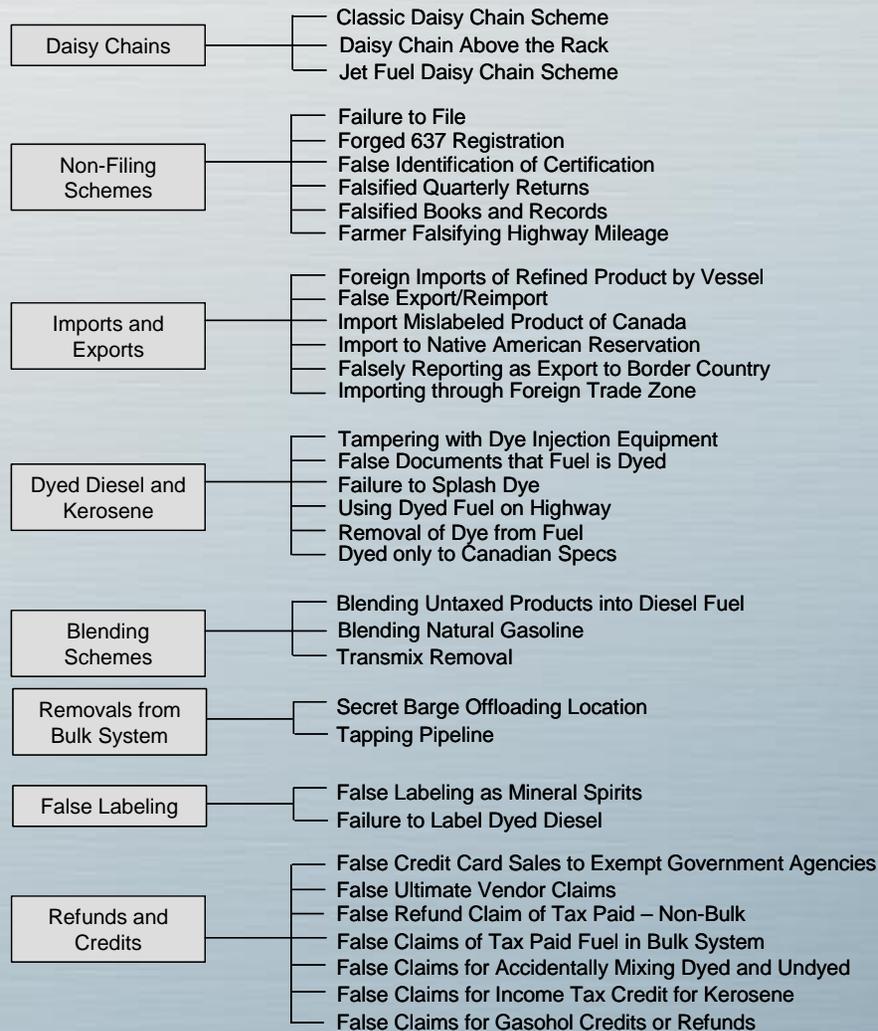


position holder at
terminal rack

Diesel fuel

position holder pays tax

Evasion Techniques



Motor Fuel Tax Compliance and Enforcement Programs

Objective: Examine historical and present administrative, compliance and enforcement activities within Montana and bordering states and provinces to compare the differences between programs and how these differences may impact evasion.

- Conduct Interviews with Representatives of Montana and Border States and Provinces
 - Montana
 - Alberta
 - British Columbia
 - Idaho
 - North Dakota
 - Saskatchewan
 - South Dakota
 - Utah
 - Washington
 - Wyoming

- Compare Program Elements
 - Point of Tax Collection
 - Penalties and Fines
 - Motor Fuel Tracking
 - Enforcement Levels
 - Reporting Procedures

Examine Montana's Tax Codes and Identify Legal Gaps in Enforcement Program

Objective: Summarize current codes and/or proposed legislation to determine if there are gaps in the Montana tax code that exacerbate evasion.

- Review and Examine Montana Tax Codes
- Assess Administrative Rules
- Examine Effective Federal and State Codes and Administrative Rules
- Use Literature Review (e.g., FTA Model Legislation) and Interviews to Generate Concepts / Recommendations for Closing Gaps
- Compare Montana's Tax Codes to Federal Codes and States With Well-Designed Tax Codes

Map the Montana Motor Fuel Distribution System and Examine Industry Enforcement

Objective: Identify entities involved in motor fuel distribution in Montana, examine industry enforcement activities, and map motor fuel distribution system in the region.

- Identify Entities Involved in Motor Fuel Distribution System
 - Bulk Transfer System (e.g., Producers, Distributors, Terminal Operators, Pipeline Operators)
 - Non-Bulk System (e.g., transporters and retailers)
 - Data Obtained from State of Montana, EIA, IRS

- Examine Industry Enforcement Activities
 - Availability and Shortcomings of Data
 - Reporting Requirements
 - Industry Compliance Procedures and Efforts at Reducing Evasion
 - Treatment of Dyed Fuels
 - Perceived Evasion Methods and Recommendations for Curtailing Evasion

- Map Motor Fuel Distribution System in Montana and Neighboring States
 - Graphic Presentations
 - Databases in Geographic Information Systems Framework
 - TransCAD Software to Facilitate Display Information

Motor Fuel Distribution System – Refineries and Terminals



Data Overview and Analysis

Objective: Identify and Examine Transportation, Economic and Tax Data to Support Modeling of Motor Fuel Tax Evasion

■ Data Types

- Motor Fuel Volumes Data (EIA, Customs, Commodity Flow Survey, Waterborne Commerce, Waybill Statistics)
- Tax Enforcement and Compliance Data
- Economic Data (Employment, Gross State Product, Motor Fuel Prices)
- Transportation Data (VMT, MPG)
- Tax Collection Data (Montana Collection Records)

Montana's Motor Fuel Tax Evasion Profile

- Fourth highest diesel tax rate in the nation
- Second highest motor fuel tax rates in the region – Washington motor fuel tax rates are higher
- Geographic proximity to the Canadian border
- Geographic proximity to one of the lowest tax states in the nation – Wyoming
- Relatively low fines and punishments
- Presence of Native American reservations
- Limited field operations

Conclusion: Montana has reason to be concerned about motor fuel tax evasion.

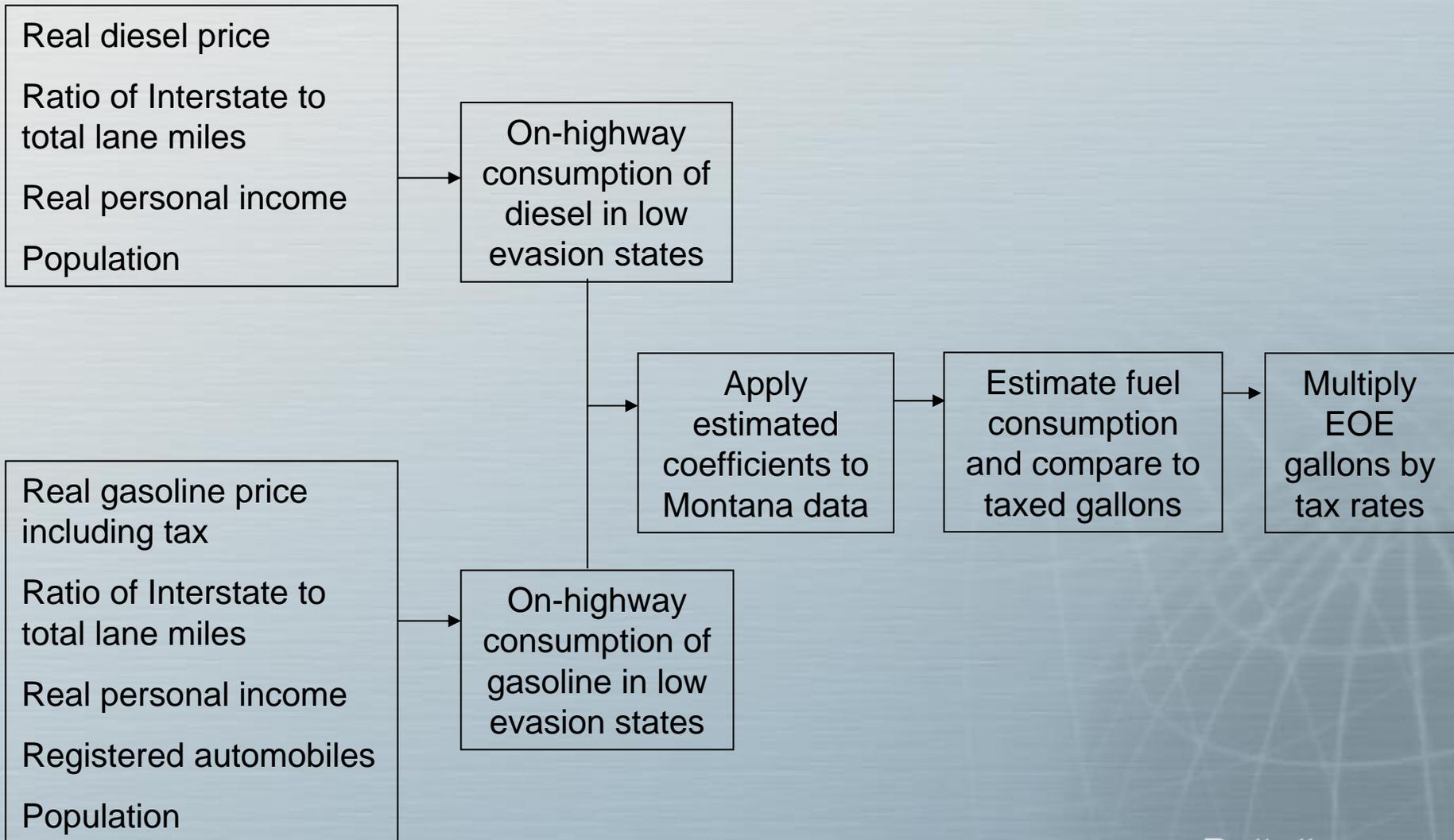
Evidence of Evasion

- Wyoming's per capita diesel consumption is more than 700 gallons
 - Roughly four times the national average
 - More than twice that of any other state in the nation
- Joint border project conducted in 1996 netted \$1.4 million in assessments (\$86,609 per day)
 - 1,188 commercial motor vehicle inspections
 - Broad range of violations
 - Dyed fuel in supply tanks (<1%)
 - Not in compliance with federal highway use tax (43 percent)
 - Dyed fuel violations for tankers (22 of 36 checked or 61 percent)
 - Not in compliance with IFTA (2.2 percent)
- BOLs pulled on-road for Montana-bound Wyoming tankers yield unusually high diversion rates
- Interviews conducted in support of previous field operations demonstrate that drivers are instructed to manipulate BOLs and other tax-related paperwork in order to evade detection
- IFTA audits yielded high initial assessment levels in 2002 and 2003, fewer in 2004

Conclusion: There is evidence to suggest that motor fuel tax evasion is a problem in Montana.

Basic Model Framework - Step 1

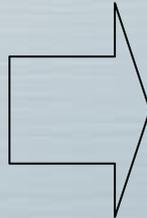
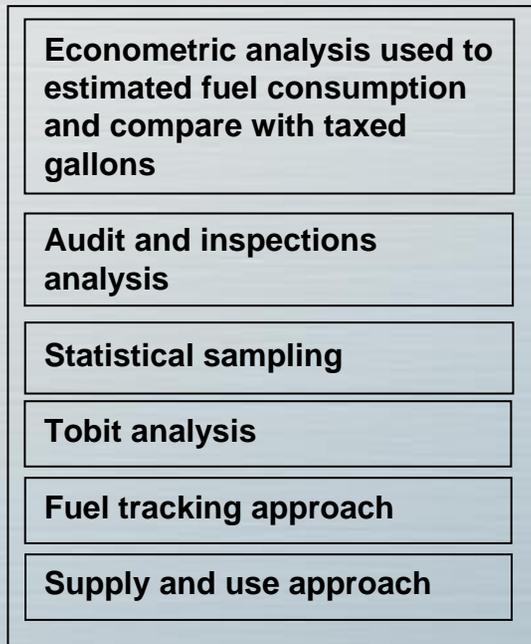
Assessment of Overall Evasion Levels



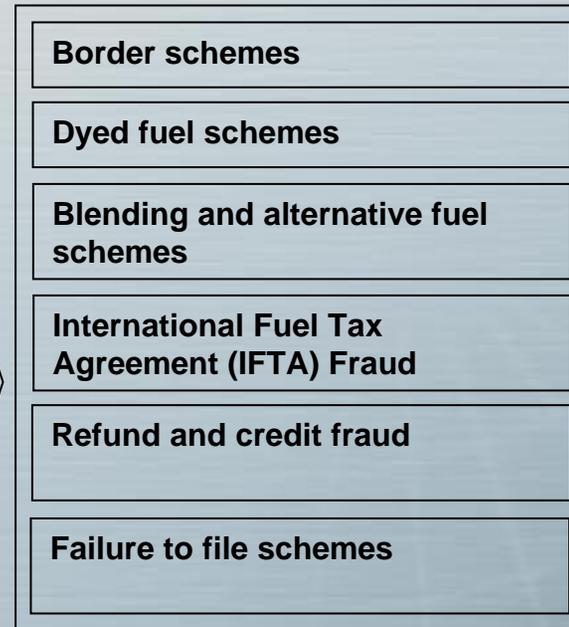
Basic Model Framework - Step 2

Attribute Evasion to Specific Techniques

Estimation Methods



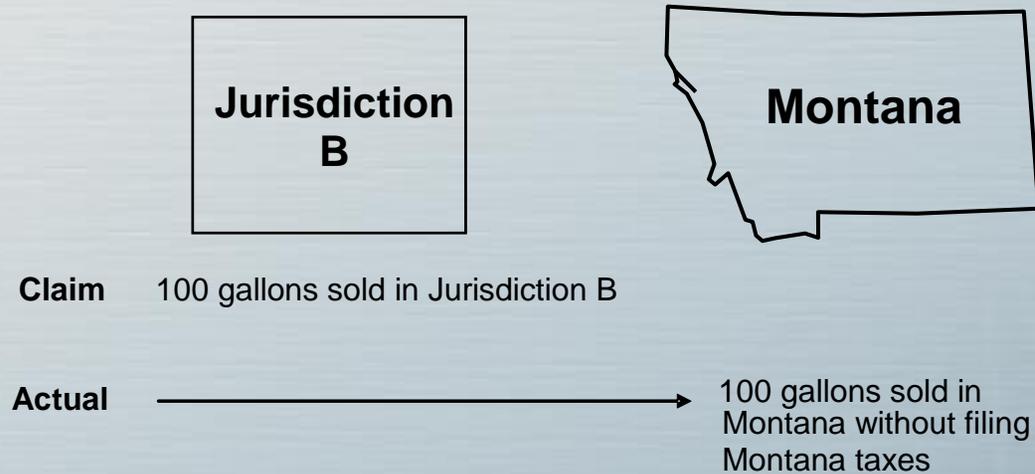
Evasion Techniques



Findings of Evasion Analysis

Evasion Method	Gasoline	Diesel
False Refunds or Credit Schemes (thousand gallons)	2,700	--
Loads Not Reported to MDT and Import Export Schemes (thousand gallons)	1,274	6,995
Evasion using Dyed Fuel (thousand gallons)	--	2,279
Motor Carrier Errors, Omissions and Evasion (thousand gallons)	--	10,511
Other Schemes (thousand gallons)	6,367	23,650
Total EOE (thousand gallons)	10,341	43,435
Total Gallons Taxed (thousand gallons)	493,719	223,636
Annual Lost Revenue (\$ millions)	\$2,792	\$12,053
EOE Rate	2.1%	16.3%

Cross Border Evasion



Recommendations to Modify Montana's Motor Fuel Tax Program

- Audit and inspection programs
 - Perform more distributor audits and modify auditing procedures
 - Expand field operations
 - Distributor audits
 - Border interdictions,
 - Vehicle and tanker inspections
 - Retailer audits
 - Covert operations as necessary
 - Perform random and targeted audits of retail stations
 - Require attendants at weigh stations and Ports of Entry to pull bills of lading from tanker trucks in order to compare with tax records
- Reviews and studies
 - Perform an analysis to determine the correct power take-off rate schedule
 - Further examine the economic and policy implications of moving the point of taxation to the terminal rack

Recommendations to Modify Montana's Motor Fuel Tax Program (ii)

- Administrative practices
 - Attempt to achieve total fuel accountability
 - Obtain and share data (e.g., import/export schedules, lists of convicted tax evaders) on a more consistent basis with neighboring state and provinces
 - Establish an internet website for individuals to report incidents of evasion
 - Maintain a distributor/importer education program
 - Centralize fuel tax administration
 - Perform extensive background checks/investigation of licensee applicants

Recommendations to Modify Montana's Motor Fuel Tax Program (iii)

- Tax codes

- Extend the statute of limitation for motor fuel tax fraud from three to five years
- Hold corporate officers jointly and severally liable for the filing of reports or returns and the payment of tax, penalty, and interest due (i.e., pierce the corporate veil)
- Expand penalties and fines for non-compliance
- Mandate electronic reporting by taxpayers
- Authorize expanded authority to inspect and examine motor fuel and paper work in support of motor fuel tax enforcement