DETERMINING THE CURRENT RATES OF MOTOR FUEL TAX EVASION FOR THE STATE OF MONTANA

FHWA/MT-06-007/8180

Final Report

prepared for
THE STATE OF MONTANA
DEPARTMENT OF TRANSPORTATION

in cooperation with
THE U.S. DEPARTMENT OF TRANSPORTATION
FEDERAL HIGHWAY ADMINISTRATION

November 2006

prepared by
Battelle
Columbus, Ohio 43201

in cooperation with
Montana State University - Billings
Billings, Montana 59101

RESEARCH PROGRAMS

Montana Department of Transportation
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16. Abstract

The report uses data collected through interviews with neighboring states and provincial tax administrators as well as audit, enforcement and collections data provided by the Montana Department of Transportation (MDT) to determine the extent and underlying reasons of motor fuel tax evasion in Montana. The report outlines numerous techniques that could be used to evade Montana motor fuel taxes, including border schemes, dyed fuel schemes, refund and credit fraud, daisy chains and blending schemes. Based on the analyses presented within this report, it is estimated that errors, omissions and evasion (EOE) associated with diesel taxes totals roughly 16.3 percent of total tax liability, an amount equal to 43.4 million gallons or $12.1 million in 2004. The data collected for this study suggest that gasoline tax EOE is not as significant, totaling roughly 2.1 percent of total tax liability: an amount equal to $2.8 million or 10.3 million gallons in 2004. This report also critically assesses Montana's motor fuel tax program and recommends approaches to close current enforcement gaps.

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ACRONYMS

ACS	Affiliated Computer Services, Inc.
ARM	Administrative Rules of Montana
ATV	All-terrain Vehicle
AUFES	Automated Upfront Fuel Exemption System
BC	British Columbia
BEA	Bureau of Economic Analysis
BLS	Bureau of Labor Statistics
BOL	Bill of Lading
BTRIS	Below the Rack Information System
CBPP	Center for Balanced Public Policy
CGPA	Council of Governor's Policy Advisors
CNG	Compressed Natural Gas
CSG	Council of State Governments
CVEO	Commercial Vehicle Enforcement Office
DOR	Department of Revenue
DOT	Department of Transportation
EDI	Electronic Data Interchange
EFT	Electronic Funds Transfer
EIA	Energy Information Administration
EOE	Error, Omission, and Evasion
EPA	Environmental Protection Agency
ExACT	Excise Automated Claims Tracking
ExCAT	Excise Customs Activity Tracking
ExCIS	Excise Classification Information System
ExFIRS	Excise Files Information Retrieval System
ExFON	Excise Fuel Online Network
ExSTARS	Excise Summary Terminal Activity Reporting System
ExTOLE	Excise Tax Online Exchange
ExTRAS	Excise Tax Registration Authorization System
FBI	Federal Bureau of Investigation
FEIN	Federal Employer Identification Number

FHWA	Federal Highway Administration
FTA	Federation of Tax Administrators
FTE	Full-time Equivalent
FTMA	Fuel Tax Management and Analysis
GAO	General Accounting Office
GDP	Gross Domestic Product
GIS	Geographic Information System
HRFM	Highway Revenue Forecasting Model
HTF	Highway Trust Fund
IAU	Internal Audit Unit
IFTA	International Fuel Tax Agreement
IRP	International Registration Plan
IRS	Internal Revenue Service
ISTEA	Intermodal Surface Transportation Efficiency Act
JCT	Joint Committee of Taxation
JFSMFTCP	Joint Federal/State Motor Fuel Tax Compliance Project
LPG	Liquefied Petroleum Gas
MCA	Montana Codes Annotated
MCSO	Motor Carrier Safety Officer
MDT	Montana Department of Transportation
MF	Motor Fuel
MFT	Motor Fuel Tax
MPG	Miles Per Gallon
MPR	Ministry of Provincial Revenue
NCHRP	National Cooperative Highway Research Program
NCSL	National Conference of State Legislatures
NEMS	National Energy Modeling System
NERA	National Economic Research Association
NGA	National Governor's Association
OAR	Oregon Administrative Rule
OBRA	Omnibus Budget Reconciliation Act
OMB	Office of Management and Budget

ORNL	Oak Ridge National Laboratory
ORS	Oregon Revised Statute
OTA	US Treasury Office of Tax Analysis
PAD	Petroleum Administration for Defense
PTO	Power Take-Off
RA	Revenue Act
RCW	Revised Code of Washington
RFG	Reformulated Gasoline
RRA	Revenue Reconciliation Act
SB	Senate Bill
SSN	Social Security Number
TEA-21	Transportation Equity Act for the 21st Century
TRA	Tax Reform Act
TRAN	Transportation Demand Module
USDOE	United States Department of Energy
USDOT	United States Department of Transportation
VMT	Vehicles Miles Traveled
WSLTC	Washington State Legislative Transportation Committee
WSP	Washington State Patrol

ABSTRACT

The report uses data collected through interviews with neighboring state and provincial tax administrators as well as audit, enforcement and collections data provided by the Montana Department of Transportation (MDT) to determine the extent and underlying reasons of motor fuel tax evasion in Montana. The report outlines numerous techniques that could be used to evade Montana motor fuel taxes, including border schemes, dyed fuel schemes, refund and credit fraud, daisy chains and blending schemes. Based on the analyses presented within this report, it is estimated that errors, omissions and evasion (EOE) associated with diesel taxes totals roughly 16.3 percent of total tax liability, an amount equal to 43.4 million gallons or $12.1 million in 2004. The data collected for this study suggest that gasoline tax EOE is not as significant, totaling roughly 2.1 percent of total tax liability: an amount equal to $2.8 million or 10.3 million gallons in 2004. This report also critically assesses Montana's motor fuel tax program and recommends approaches to close current enforcement gaps.

EXECUTIVE SUMMARY

There are incentives to evade motor fuel taxes in the State of Montana. Montana has among the highest motor fuel tax rates as compared to all bordering states, nearly twice those imposed in the State of Wyoming. Montana's gasoline excise tax rate, at 27 cents per gallon, is 7 cents per gallon more than the nationwide mean tax rate of 20.3 cents per gallon. Indeed, as of 2004 Montana imposed the fourth highest gasoline tax rate in the nation, notwithstanding any additional state sales taxes imposed on the sale of motor fuels. Montana's diesel tax rate is 27.75 cents per gallon.

Historic changes in legislation and increased enforcement and audit efforts have increased revenues deposited in Montana's Highway Special Revenue Account, yet fuel tax evasion is still considered to be a significant and persistent problem. The nature of the problem and the extent of the resulting revenue losses have been considered by the Montana Department of Transportation (MDT) but not in a quantitative and systematic manner as they have within this report.

Montana is not alone in its interest in curbing motor fuel tax evasion. State concern over motor fuel excise tax evasion has generated a concerted research effort over the past two decades, resulting in the detection of numerous evasion methods and the development of new approaches for measuring evasion and techniques for curtailing evasion. This study outlines numerous techniques that could be used to evade Montana motor fuel taxes, including:

- Border Schemes,
- Dyed Fuel Schemes,
- Alternative Fuels Schemes,
- International Fuel Tax Agreement (IFTA) Fraud,
- Refund and Credit Fraud,
- Daisy Chains, and
- Failure to File Schemes.

To compute motor fuel tax errors, omissions, and evasion (EOE) in the State of Montana, a model was used to estimate the amount of fuel consumed in the State of Montana and compare that amount to reported gallons in 2002, 2003, and 2004. The results for 2004 are presented in Table ES-1 and a discussion of the model used is provided in Section 8.1. To disaggregate the total amounts of evasion to specific evasion techniques (e.g., illegal use of dyed fuel), several estimation methods were used. For this study, an "evasion technique" is defined as an approach intentionally used to defraud jurisdictions of motor fuel taxes. For example, bootlegging would be considered an evasion technique. For this study, an "estimation method" is defined as a method used to estimate levels of EOE. Thus, estimation methods are used to estimate EOE levels resulting from evasion techniques. For example, analysis of on-road inspection data (an estimation method) may be used to estimate EOE resulting from abuse of tax-exempt dyed fuel (an evasion technique).

Table ES-1 presents the results of the EOE analysis. Based on the results of the analyses presented later in this report, it is estimated that EOE of diesel taxes totals roughly 16.3 percent of total tax liability, an amount equal to 43.4 million gallons. This level of EOE represented a loss in revenue to Montana of approximately $12.1 million in 2004. Fraud perpetrated by distributors using cross-border evasion techniques and various forms of motor carrier EOE as detected through IFTA audits represent the most significant evasion techniques, collectively accounting for $4.9 million in lost diesel tax revenue in 2004. The data collected for this study suggest that gasoline tax EOE is not as significant, totaling roughly 2.1 percent of total tax liability: an amount equal to $2.8 million or 10.3 million gallons in 2004. Note that the consumption model estimated overall EOE levels and the other models prepared for this study attempted to attribute the overall EOE level to numerous evasion techniques. In both the gasoline and diesel tax EOE modeling process, the research team was unable to attribute 100 percent of the total EOE estimates to the evasion techniques. This result was expected due to the lack of available data to estimate EOE for certain evasion techniques (e.g., retailer fraud, illegal importation of dyed fuel reported as clear from Canada, illegal use of dyed fuel in pickup trucks, illegal blending schemes) and the inability to imagine every evasion technique deployed. Thus, the difference between the total estimated EOE levels and the EOE attributed to the major evasion techniques is identified in Table ES-1 as EOE attributed to *other schemes*.

Table ES-1. Gasoline and Diesel Tax EOE in the State of Montana

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%

Based on the information on enforcement and compliance activities undertaken by MDT and other agencies examined in this report, as well as the results of the evasion analysis, numerous recommendations have been designed to close current enforcement gaps:

- Perform More Distributor Audits and Modify Auditing Procedures;
- Expand Field Operations;
- Extend the Statute of Limitations for Motor Fuel Tax Fraud;

- Conduct Analysis to Determine Correct Power Take-Off Rate Schedule;
- Further Examine the Economic and Policy Implications of Moving the Point of Taxation to Terminal Rack;
- Attempt to Achieve Total Fuel Accountability at All Levels in the Distribution Chain;
- Perform Random and Targeted Retailer Audits;
- Require Attendants at Weigh Stations and Ports of Entry to Pull Bills of Lading from Tanker Trucks;
- Establish an Internet Website for Individuals to Report Incidents of Evasion;
- Obtain and Share Data with Neighboring Jurisdictions on a More Consistent Basis;
- Maintain Distributor/Importer Education Program;
- Centralize Fuel Tax Administration;
- Pierce the Corporate Veil;
- Authorize the Examination of Records, Fuels, and Equipment;
- Perform Background Checks/Investigation of Licensee Applicants;
- Expand Penalties and Fines for Non-compliance; and
- Mandate Electronic Tax Reporting.

These recommendations are presented in more detail in Chapter 9 of this report.

CHAPTER 1.0 INTRODUCTION

Revenues from motor fuel taxes are the primary funding source used to support Montana's transportation system. This important source of transportation funding, however, can be jeopardized by the presence of motor fuel excise tax evasion. Historic changes in legislation and increased enforcement and audit efforts have increased revenues deposited in Montana's Highway Special Revenue Account, yet fuel tax evasion is still considered to be a significant and persistent problem. The nature of the problem and the extent of the resulting revenue losses have been considered by the Montana Department of Transportation (MDT) but not in a quantitative and systematic manner as they have within this report. The determination of the origin and magnitude of fuel tax evasion will enable MDT to productively address the problem and allocate resources more efficiently.

This report presents the findings of a research project designed to determine the extent and underlying reasons for motor fuel tax evasion, and is further designed to generate recommendations concerning where best to focus enforcement efforts and make changes to tax code to close the gap between total tax liability and actual tax collections in Montana. The specific objectives of this project were to:

- Critically assess administrative and enforcement characteristics of border state practices, identify how these characteristics have traditionally correlated with certain types of evasion, and compare these programs to those practiced in Montana;
- Identify evasion techniques and note administrative, enforcement, and legislative strategies used to curtail motor fuel tax evasion;
- Identify and examine data that could be used to assist Montana in measuring motor fuel tax evasion;
- Develop and demonstrate a methodology for estimating state motor fuel tax evasion; and
- Develop recommendations for making changes to the current administrative, enforcement, and legislative framework established for the motor fuel tax program in Montana.

This report is divided into nine chapters as follows:

- Chapter 1.0 – Introduction;
- Chapter 2.0 – Literature Review – documents relevant literature;
- Chapter 3.0 – Fuel Tax Evasion and Current Compliance and Enforcement Activities – documents current enforcement and compliance activities at the state and federal level;
- Chapter 4.0 – Regional Motor Fuel Distribution System – includes visual representations and geographic information system (GIS) maps created using data characterizing regional fuel production, fuel distribution, geographic relationships, and motor fuel tax program features;

- Chapter 5.0 – Regional Fuel Tax Administration Characteristics and Opportunities for Evasion – analyzes fuel tax policy, administration, and enforcement practices in Montana and surrounding jurisdictions in order to assess Montana's fuel tax evasion vulnerabilities;
- Chapter 6.0 – Analysis of Tax Codes and Opportunities for Evasion – summarizes Montana's fuel tax code and compares it with other states, provinces, and the federal government, where applicable, to aid in the identification of gaps in the tax code that may be exploited by tax evaders;
- Chapter 7.0 – Industry Perspectives on Fuel Tax Compliance and Evasion – documents the results of interviews with entities involved in distributing motor fuel within Montana to understand industry-level enforcement activities targeted at fuel tax evasion;
- Chapter 8.0 – Estimation of Revenue Lost – estimates fuel tax error, omissions, and evasion (EOE) rates in Montana; and
- Chapter 9.0 – Montana Motor Fuel Tax Program Recommendations – provides recommendations for closing current enforcement gaps.

CHAPTER 2.0 LITERATURE REVIEW

In 1993, the evasion rate for the federal gasoline tax was estimated to be between three and seven percent, and the diesel tax evasion rate was estimated at 15 to 25 percent (FHWA 1992). That level of evasion translated at the time to roughly $1 billion in lost revenue annually. These estimates were largely based on Congressional subcommittee testimony of state and federal representatives as well as that of convicted tax evaders. At the state level, estimates have varied significantly, from as low as $600 million to as high as $2 billion (Weimar et al. 2002). At these rates of evasion, the State of Montana would experience roughly 7.0 million and 15.5 million in annual lost revenue from gasoline and diesel tax evasion, respectively.[1]

From 1993 onward, changes in legislation and increased enforcement and audit efforts, primarily directed toward diesel, kerosene, and aviation fuels, have increased revenue to both Federal and State Highway Trust Funds (HTFs). Simple, unscientific estimates that take into consideration traditional factors for growth of revenue (i.e., vehicle miles traveled [VMT]) compared to actual revenue growth indicate that the evasion rates are not as great as the levels estimated prior to 1993 (Baluch 1996). However, results of post-1993 joint audits performed under the Federal Highway Administration's (FHWA) Joint Federal/State Motor Fuel Tax Compliance Project suggest that evasion persists.

There are incentives to evade motor fuel taxes in the State of Montana. Table 2-1 shows that Montana has the highest motor fuel tax rates as compared to all bordering states, nearly twice those imposed in the State of Wyoming. Montana's gasoline excise tax rate, at 27 cents per gallon, is 7 cents per gallon more than the nationwide mean tax rate of 20.3 cents per gallon. Indeed, as of 2004, Montana imposed the fourth highest gasoline tax rate in the nation, notwithstanding any additional state sales taxes imposed on the sale of motor fuels.

Montana is not alone in its interest in curbing motor fuel tax evasion. State concern over motor fuel excise tax evasion has generated a concerted research effort over the past two decades, resulting in new methods for measuring evasion and techniques for curtailing evasion. This research has focused predominantly on measuring the extent of evasion and finding methods to increase compliance at both the state and federal levels. Relevant literature and information examined for this literature review fit into the following categories:

- Studies measuring extent of evasion;
- Sources of motor fuel consumption and revenue forecasting models; and
- Literature relating to tax administration, enforcement, and methods of curtailing evasion.

[1] Evasion estimates represent the product of the mid-point of the FHWA-generated percentage rate evasion estimates (5 percent for gasoline and 20 percent for diesel), net motor volumes taxed as reported to FHWA and presented in Table MF-2 in Federal Highway Statistics, and the tax rates shown in Table 2-1 of this report.

Table 2-1. State Tax Rates on Motor Fuel (cents per gallon)

STATE	GASOLINE		DIESEL		LIQUEFIED PETROLEUM GAS		GASOHOL		
	RATE	EFFECTIVE DATE	RATE	EFFECTIVE DATE	RATE	EFFECTIVE DATE	RATE	EFFECTIVE DATE	EXEMPTION
Alabama	18.0	06/01/95	19.0	06/01/95	17.0	06/01/95	18.0	06/01/95	-
Alaska	8.0	07/01/70	8.0	07/01/70	-	-	8.0	07/01/97	-
Arizona	18.0	07/01/90	26.0	07/01/00	18.0	07/01/90	18.0	07/01/90	-
Arkansas	21.7	09/01/01	22.7	09/01/01	16.5	01/01/02	21.7	09/01/01	-
California	18.0	01/01/94	18.0	01/01/94	6.0	01/01/76	18.0	01/01/94	-
Colorado	22.0	01/01/91	20.5	01/01/92	20.5	01/01/92	22.0	01/01/91	-
Connecticut	25.0	07/01/00	26.0	08/01/02	-	07/01/96	24.0	07/01/00	1
Delaware	23.0	01/01/95	22.0	01/01/95	22.0	01/01/95	23.0	01/01/95	-
Dist. of Col.	20.0	10/01/94	20.0	10/01/94	20.0	10/01/94	20.0	10/01/94	-
Florida	13.9	01/01/02	26.4	01/01/02	26.4	01/01/02	13.9	01/01/02	-
Georgia	7.5	07/01/71	7.5	07/01/71	7.5	07/01/71	7.5	07/01/71	-
Hawaii	16.0	07/01/91	16.0	07/01/91	5.3	03/01/02	16.0	07/01/91	-
Idaho	**25.0**	**04/01/96**	**25.0**	**04/01/96**	**18.1**	**04/01/96**	**22.5**	**07/01/94**	**2.5**
Illinois	19.0	01/01/90	21.5	01/01/90	19.0	01/01/90	19.0	01/01/90	-
Indiana	18.0	04/01/03	16.0	04/01/93	-	-	15.0	04/01/90	-
Iowa	20.3	07/01/03	22.5	01/01/89	20.0	01/01/89	19.0	01/01/89	1
Kansas	24.0	07/01/03	26.0	07/01/03	22.0	07/01/02	24.0	07/01/03	-
Kentucky	16.4	07/15/94	13.4	07/15/94	16.4	07/01/86	16.4	07/15/94	-
Louisiana	20.0	01/01/90	20.0	01/01/90	16.0	07/01/93	20.0	01/01/90	-
Maine	22.0	08/01/99	23.0	08/01/99	21.0	08/01/99	22.0	08/01/99	-
Maryland	23.5	05/01/92	24.3	07/01/93	23.5	07/01/93	23.5	05/01/92	-
Massachusetts	21.0	01/01/91	21.0	01/01/91	15.0	10/01/03	21.0	01/01/91	-
Michigan	19.0	08/01/97	15.0	01/01/84	15.0	01/01/84	19.0	08/01/97	-
Minnesota	20.0	06/01/88	20.0	06/01/88	15.0	07/01/95	20.0	06/01/88	-
Mississippi	18.4	07/01/93	18.4	07/01/93	17.0	01/01/89	18.4	07/01/93	-
Missouri	17.0	04/01/96	17.0	04/01/96	17.0	04/01/96	17.0	04/01/96	-
Montana	**27.0**	**07/01/94**	**27.75**	**07/01/94**	**-**	**-**	**27.0**	**07/01/94**	**-**
Nebraska	**24.6**	**07/01/03**	**24.6**	**07/01/03**	**24.6**	**07/01/03**	**24.6**	**07/01/03**	**-**
Nevada	25.7	01/01/03	27.7	01/01/97	22.0	07/01/97	24.7	01/01/97	-
New Hampshire	19.5	07/01/95	19.5	07/01/95	18.0	06/16/91	19.5	07/01/95	-
New Jersey	10.5	07/01/88	13.5	07/01/88	5.3	07/01/88	10.5	01/01/92	-
New Mexico	18.5	10/01/00	19.5	10/01/00	6.0	01/01/98	18.5	10/01/98	-
New York	22.7	01/01/02	20.9	01/01/02	8.1	01/01/01	22.7	01/01/02	-
North Carolina	24.2	06/01/03	24.2	06/01/03	22.1	06/01/03	24.2	06/01/03	
North Dakota	**21.0**	**07/01/99**	**21.0**	**07/01/99**	**21.0**	**07/01/99**	**21.0**	**07/01/99**	**-**
Ohio	24.0	07/01/03	24.0	07/01/03	24.0	07/01/03	24.0	07/01/03	
Oklahoma	17.0	07/01/89	14.0	07/01/89	17.0	07/01/89	17.0	07/01/89	-
Oregon	24.0	01/01/00	24.0	01/01/00	18.5	09/09/95	24.0	01/01/00	-
Pennsylvania	25.9	01/01/03	30.8	01/01/03	19.2	01/01/03	25.9	01/01/03	-
Rhode Island	30.0	07/01/02	30.0	07/01/02	30.0	07/01/02	30.0	07/01/02	-
South Carolina	16.0	01/01/89	16.0	01/01/89	16.0	01/01/89	16.0	01/01/91	-
South Dakota	**22.0**	**04/01/99**	**22.0**	**04/01/99**	**20.0**	**04/01/99**	**20.0**	**04/01/99**	**2**
Tennessee	21.4	04/01/03	18.4	04/01/03	14.0	04/01/89	20.0	04/01/89	-
Texas	20.0	10/01/91	20.0	10/01/91	15.0	01/01/87	20.0	10/01/91	-
Utah	**24.5**	**07/01/97**	**24.5**	**07/01/97**	**24.5**	**07/01/97**	**24.5**	**07/01/97**	-
Vermont	20.0	08/01/97	26.0	07/01/00	-	-	20.0	08/01/97	-
Virginia	17.5	07/01/92	16.0	07/01/92	16.0	01/01/98	17.5	07/01/92	-
Washington	28.0	07/01/03	28.0	07/01/03	-	-	28.0	07/01/03	-
West Virginia	25.4	01/01/02	25.4	01/01/02	25.4	01/01/02	25.4	01/01/02	-
Wisconsin	28.5	04/01/03	28.5	04/01/03	28.5	04/01/03	28.5	04/01/03	-
Wyoming	**14.0**	**07/01/98**	**14.0**	**07/01/98**	**-**	**-**	**14.0**	**07/01/98**	-
Mean	20.3		20.5		17.2		20.4		
Weighted Avg.	19.1		19.4		11.9		20.6		
Federal Tax	18.4	10/01/97	24.4	10/01/97	13.6	10/01/97	13.2	01/01/01	

Source: (FHWA 2004)

2.1 Methods of Quantifying Motor Fuel Tax Evasion

Many studies have been conducted to examine and quantify the extent of fuel tax non-compliance at both the state and federal levels. Following an extensive literature review, however, it is apparent that there is no consensus among the evasion studies and that there exist a number of techniques that have been employed to quantify evasion levels including: (a) the literature review method, (b) audit review, (c) border interdiction method, (d) survey of tax administrators method, (e) comparison of fuel consumption with taxed volumes method, (f) comparison of fuel sale volumes with taxed volumes method, and (g) the econometric analysis method.

2.1.1 Literature Review Method

The literature review method can involve the use of previous evasion studies, interviews with tax administrators, anecdotes, and testimony. It was estimated in 1996 that the State of Washington could recover $15-$30 million in tax revenue through legislation aimed at increasing fuel tax compliance (WSLTC 1996). The FHWA also used this method in 1992 and 1994 to estimate motor fuel tax evasion at the federal level (FHWA 1992). This approach may yield inaccurate results because estimates are often based on other flawed studies or on unverified testimony by government officials, industry representatives, tax evaders, and other concerned parties.

2.1.2 Audit Review Method

Some studies have based their findings on petroleum operations' audits. The theory underlying this method is that audits represent a sample of taxpayer behavior and to the extent that audits uncover 10 percent in underpayments, when applied to the universe of taxpayers it translates to 10 percent evasion. This method was used by the WSLTC in 1996 at the state level and FHWA in 1992 at the federal level (WSLTC 1996 and FHWA 1992). One problem with this approach is that the results can be biased if audits are not randomly conducted. That is, audits are often triggered by suspicious and high-risk returns. Thus, audit data must either represent a random selection of taxpayers or bias inherent in the data must be addressed through statistical measures. Further, the audit samples are often small and are indiscriminately aggregated to the universe of taxpayers. Finally, audit data fail to account for evasion schemes occurring external to the legitimate fuel supply system such as fuel smuggling and daisy chains. Thus, audit data can best be used to examine evasion for specific methods such as failure to remit or International Fuel Tax Agreement (IFTA) fraud.

2.1.3 Border Interdictions Method

The border interdictions method is used to identify cross-border smuggling. It involves the examination of petroleum import records and the establishment of onsite inspections of vehicles and vessels crossing state and international borders. WSLTC used this method in a 1996 study (WSLTC 1996). The border interdictions method is limited due to time and cost constraints. Further, it fails to capture virtually all forms of fuel tax evasion, focusing only on smuggling. Finally, the high visibility of such an operation may deter petroleum shipments where the border

checks are in place. The Washington State Patrol (WSP) encountered this problem. WSLTC used United States Custom Service agents to monitor petroleum trucks crossing the border for seven days and established a 1.6 trucks per hour benchmark (not a reliable statistical representation for a baseline establishment). Washington State Patrol commercial vehicle enforcement officers encountered a marked decrease in the number of petroleum tankers crossing the border during the three-day operation. Observed petroleum tankers averaged one per hour on Day 1 of the border check, 0.4 trucks per hour for Day 2 and remained low (at 0.5 trucks per hour) on Day 3.

2.1.4 Survey of Tax Administrators Method

Surveying tax administrators has been used by the Council of State Governments & the Council of Governors' Policy Advisors (CSG & CGPA) in 1996 for each state and Denison and Hackbart in 1996 for Kentucky (CSG & CGPA 1996 and Denison and Hackbart 1996). This method is used to determine the perceived nature and magnitude of motor fuel tax evasion. One problem with using this approach when comparing or aggregating states is that methods to estimate evasion vary widely between states. Further, this method relies on a gathering of random and unsubstantiated individual estimates.

2.1.5 Comparison of Fuel Consumption with Taxed Volumes Method

Evasion can be estimated by comparing estimated consumption of fuel (demand) with taxed volumes. This approach was used to estimate evasion of diesel fuel taxes through blending aviation fuels in vehicles performing taxable on-road travel in the State of Florida (KPMG 2001). While this method may have theoretical appeal, differences between how the supply and consumption data are collected and treated may have damaging impacts on the reliability of the evasion analysis. For example, FHWA estimates of taxed gasoline volumes were consistently less than the U.S. Department of Energy, Energy Information Administration's (EIA) estimates of gasoline gallons supplied prior to 1994, as shown in Figure 2-1 (Hallquist 1999). At the same time, FHWA-taxed gallons exceeded EIA estimates of gallons supplied to the market.

2.1.6 Comparison of Fuel Sales Volumes with Taxed Gallons Method

This method, which compares independently derived estimates of motor fuel sales volumes with taxed volumes, has been used by the National Association of Truck Stop Operators (Mitstifer 1992) and Revenue Canada (Revenue Canada 1996). Similar to the previous method, this method is based on the assumption that the difference between demand for motor fuel, as expressed in this case as gallons sold rather than gallons consumed, and taxed gallons is attributable to tax evasion. However, sales volumes and taxed gallons may differ for a number of reasons unrelated to evasion including treatment of blending fuels data, treatment of refunds data, differing levels of accuracy of survey responses, and varying sources of data. Further, this method does not adequately capture other forms of evasion (e.g., smuggled fuel and fuel identified for export but subsequently sold in the United States).

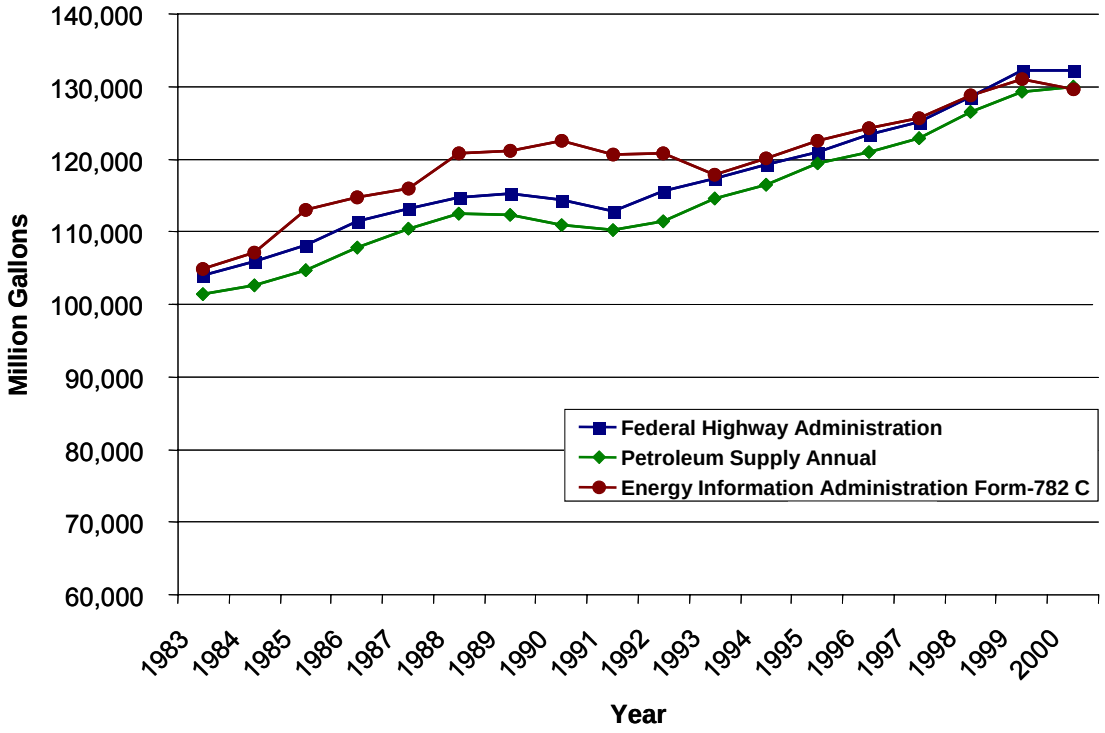


Figure 2-1. Gasoline Supply and Consumption Estimates

2.1.7 Econometric Analysis

The econometric method of estimating tax evasion applies statistical techniques correlating evasion with economic activity. By examining historical structural relationships between economic factors (e.g., non-farm employment, national income, Gross Domestic Product [GDP]) and fuel consumption, this method can predict fuel tax liability. The difference between predicted fuel tax liability and actual fuel tax collections can be used as a measure of evasion.

This method, in conjunction with literature review, has been the most frequently utilized method for estimating fuel tax evasion. That is, econometric models examine historical structural relationships between economic indicators (e.g., non-farm employment, national income and GDP) and motor gasoline consumption to predict total excise tax liability. The downside to the econometric method is that the difference between predicted and actual gallons consumed will likely be a combination of evasion and model error. An econometric model will only measure evasion to the extent that it models fuel consumption accurately. Studies that use this method to estimate tax evasion at the state level include Mingo et al. (1996); Denison and Hackbart (1996); and at the federal level, Addanki et al. (1987).

2.2 Motor Fuel Excise Tax Revenue Forecasting

The federal government and many state governments have developed models that forecast motor fuel consumption and motor fuel excise tax revenue. These models can forecast and detect trends in fuel tax revenue and fuel consumption by identifying and examining factors that are strongly correlated with these variables. These models vary in parameters, scope, and data used. The fuel tax and consumption models examined in this section of the literature review have not been developed to address tax evasion directly. However, they can provide information about other factors that impact fuel tax collections and present variables that could be used in any econometric examination designed to detect evasion.

The modeling needs of states and the federal government are similar, yet distinct. Figure 2-2 shows that both state and federal models are used for budgeting purposes; however, federal models are also designed with revenue attribution and the revenue aligned budget authority mandate in mind. State models are primarily concerned with forecasting revenues to support highway construction, rehabilitation and maintenance programs, as well as administrative and staffing overhead levels.

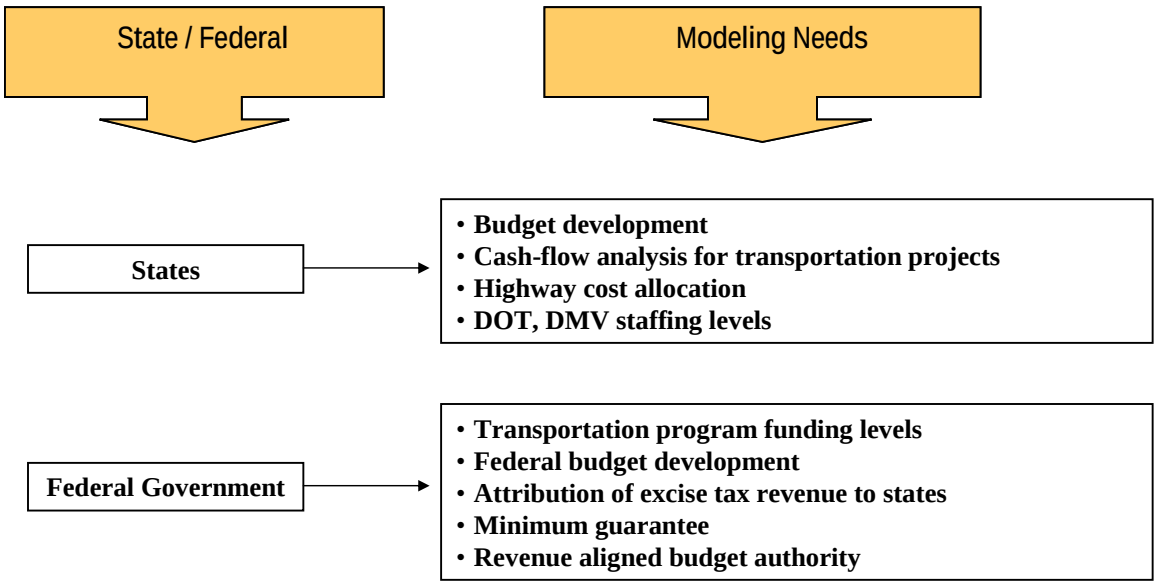


Figure 2-2. Federal and State Revenue Forecasting Modeling Needs

2.2.1 Federal Revenue Forecasting Models

The federal models use valuable data relating to travel and fuel efficiency (e.g., fuel consumption; imports and exports; fleet composition; and national economic variables) to forecast revenue and satisfy federal budgeting regulations (e.g., minimum guarantee and revenue aligned budget authority). Federal models examined in this section include:

(a) National Energy Modeling System,
(b) Highway Revenue Forecasting Model,
(c) Joint Committee on Taxation Revenue Estimating Model,
(d) US Treasury Office of Tax Analysis Fuel Tax Revenue Forecasting Model,
(e) FHWA Fuel Consumption Forecasting Model, and
(f) FHWA Gasohol Consumption Estimation Model.

National Energy Modeling System (NEMS)

At the federal level, the EIA implemented NEMS, an expansive energy forecasting model for the mid-term period through 2025. NEMS is a computer-based model that forecasts the production, conversion, consumption, and import of petroleum products, as well as energy prices conditional on correlations with "macroeconomic and financial factors, world energy markets, resource availability and costs, behavioral and technological choice criteria, cost and performance characteristics of energy technologies, and demographics" (USDOE 2003).

NEMS is designed as a modular system. The Transportation Demand Module (TRAN) is one of seven modules and is of particular interest for this study because it provides mid-term forecasts of fuel consumption and explores the factors that correlate with motor fuel consumption. The TRAN itself is composed of several semi-independent models, which address different aspects of the transportation sector. Combined, these models predict transportation fuel demand by transportation mode including gasoline, diesel fuel, aviation fuel and other alternative fuels. These forecasts are developed and then published in the EIA's *Annual Energy Outlook*.

Highway Revenue Forecasting Model (HRFM)

HRFM is another federal model that estimates federal fuel consumption. Further, it gives both short- and long-term estimates of federal fuel tax revenue. HRFM was developed by the FHWA in 1981 but has since been updated. FHWA used this model in the 1997 Federal Highway Cost Allocation Study to attribute federal highway user revenues by tax type to vehicle classes and weight category (FHWA 1997). HRFM estimates fuel consumption by multiplying miles per gallon (MPG) and vehicle miles traveled (VMT) for each vehicle class and operating weight. Estimation of fuel tax collection is then based on fuel consumption and the tax rate.

Joint Committee on Taxation (JCT) Revenue Estimation

The Joint Committee of Taxation (JCT), established under the Revenue Act of 1926, is another source of a tax revenue forecasting model. The JCT utilizes a variety of econometric models to estimate the impacts on revenue from changes in tax legislation. A description of the JCT methodology is provided in the 1995 US Congress Report, *Written Testimony of the Staff of the Joint Committee of Taxation Regarding the Revenue Estimating Process* (JCT 1995). Most of the revenue estimates by the JCT follow the same basic methodology. It is first determined what the revenue yield is under a current legislation. Then, an estimate is made on the revenue yield if the proposed change in legislation passed. An overview specifically relating to highway excise taxes, highway motor fuels tax rates, and highway fuels tax exemptions is presented in the 1998 amendment, *The Chairman's Amendment Relating to Extension of Highway Trust Fuel Excise Taxes and Related Trust Fund Provisions* (US Congress 1998).

US Treasury Office of Tax Analysis (OTA) Fuel Tax Revenue Forecasting

OTA has also created federal revenue forecasts for fuel tax revenue. Seven different OTA models forecast highway user tax sources such as gasoline, gasohol, and diesel. These forecasting models are greatly reliant on data from the Office of Management and Budget (OMB), the Council of Economic Advisors and the Treasury Department (Weimar et al. 2002).

FHWA Fuel Consumption Forecasting Model

The Oak Ridge National Laboratory (ORNL) developed both a model to estimate national highway travel by vehicle type in 1995 and a model to estimate off-highway recreational fuel consumption by vehicle type at the state level in 1994 and updated in 1999 for the FHWA (Hwang 2000). The national model is composed of a short-term module and a long-term module. While the short-term module is primarily driven by economic variables, the long-term module is more reliant on demographic factors and trends in key factors such as the dematerialization of GNP (Hwang 2000).

FHWA Gasohol Consumption Estimation Model

As a part of the allocation of HTF funds for each state, a rule-based model estimating gasohol consumption was developed by ORNL for the FHWA in 2003. This model is implemented as a spreadsheet application and is made up of three sub-modules: one to compute a control total of gasohol and ethanol gallons collected by the treasury; another to estimate gasohol usage for states that have reliable data; and another to calculate gasohol for all other states (Hwang et al 2003a). The model used HTF revenue data from Treasury, state fuel usage from *Highway Statistics*, reformulated gasoline (RFG) data from the Environmental Protection Agency (EPA) and data from the Petroleum Marketing Annual.

2.2.2 State Revenue Forecasting Models

Several U.S. states have their own fuel tax revenue forecasting models. The main objective of these models is to accurately forecast tax revenues that are apportioned to the states' transportation system. These estimates strongly influence transportation budgets and the decision process for new transportation projects. Battelle reviewed several state fuel tax revenue models, focusing on states that use regression analysis to forecast revenue (Weimar et al. 2002). Battelle reviewed models from the following states:

- Oregon,
- Indiana,
- Maryland,
- Virginia,
- Washington, and
- Wisconsin.

The majority of the tax revenue forecasting models are transfer function models, meaning they combine causal relationship models with time series models.

Oregon's Revenue Forecasting Model is representative of most of the models encountered, where;

> MV Fuel Consumption = F (Fuel economy, price of gas_{t-1}/price index $_{t-1}$ Oregon employment participation rate, Oregon population $_{t-1}$, % change in real personal income) (Malik 2002)

There are a number of commonalities between the state models reviewed including:

- They were mostly influenced by fuel prices and macroeconomic factors,
- Gasoline and diesel were typically modeled separately, and
- State models provided relatively accurate forecasts (generally within 3 percent of actual collections).

2.3 Motor Fuel Tax Administration and Enforcement Practices

The way the federal government and many state governments handle the administration and enforcement of motor fuel taxes has comprehensively transformed over the past two decades. Motor fuel tax administration law has, and continues to be, changed to lessen the opportunities and incentives to evade. Further, many collection agencies have increased efforts to investigate and reconcile unlawful activity. This section will discuss past and present efforts at both the state and federal levels to curtail fuel tax evasion.

2.3.1 Point of Taxation

Since the discovery of the multi-million dollar fuel tax evasion schemes of the 1980's, one of the central modifications to fuel tax administrative procedures has been at the point of taxation. In general, fuel tax is collected and reported at one of three points in the distribution chain: (1) at the terminal rack/import, (2) at wholesale levels or (3) at retail levels (Figures 2-3 and 2-4).

At the federal level, the point of taxation for gasoline was moved to the terminal rack by the Tax Reform Act (TRA) of 1986. In 1990, the Revenue Reconciliation Act (RRA) tightened up administrative regulations by requiring that the imposition of gasoline tax take place at the point of import, the removal from the terminal or refinery, or the point of sale of any unregistered entity (KPMG 2001). The point of taxation for diesel was moved to the terminal rack in 1994 by the Omnibus Budget Reconciliation Act (OBRA) of 1993.

The administrative conditions facing states vary widely; consequently, so do the points of taxation. In some states there are many refineries while others have none. A few states have a small number or no terminals and import their fuel from other states and foreign locations (CSG & CGPA 1996). Many states now collect fuel taxes at the terminal level. In general, the position holder or importer is responsible for remitting the tax. States that tax at the wholesale level generally hold license distributors accountable for the tax when fuel is sold to an unlicensed entity. A system that taxes at the retail level can either require that the tax be paid when the retailer purchases the fuel, or when the fuel is placed in a highway transportation tank.

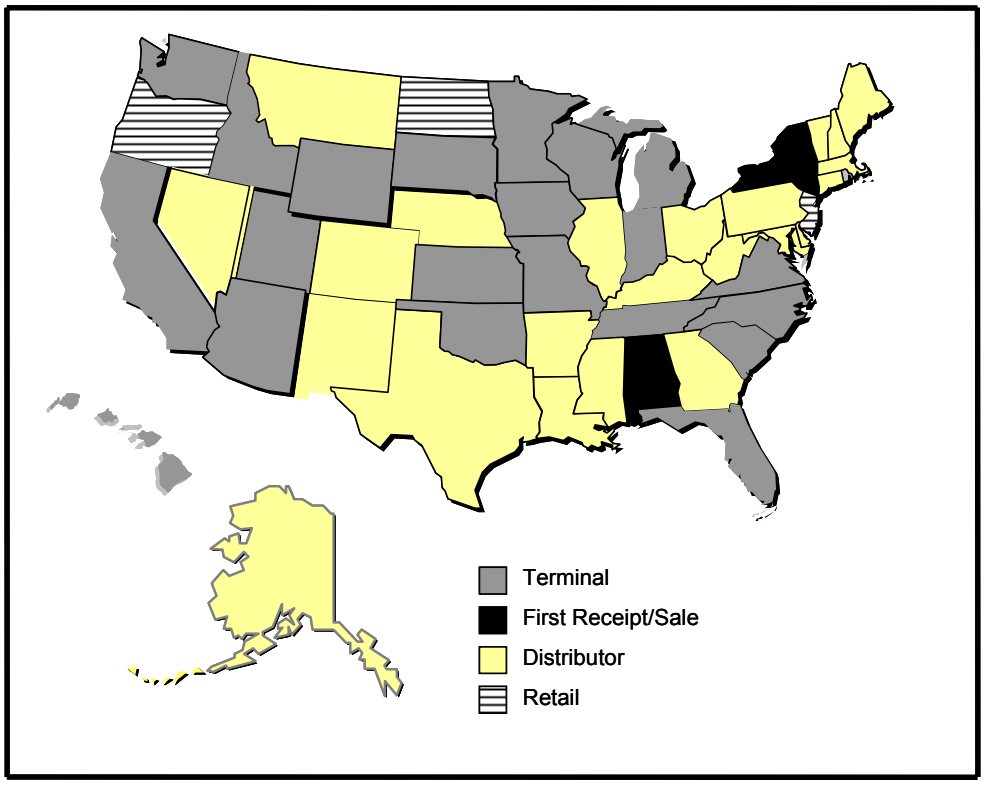


Figure 2-3. State Points of Taxation for Diesel Fuel

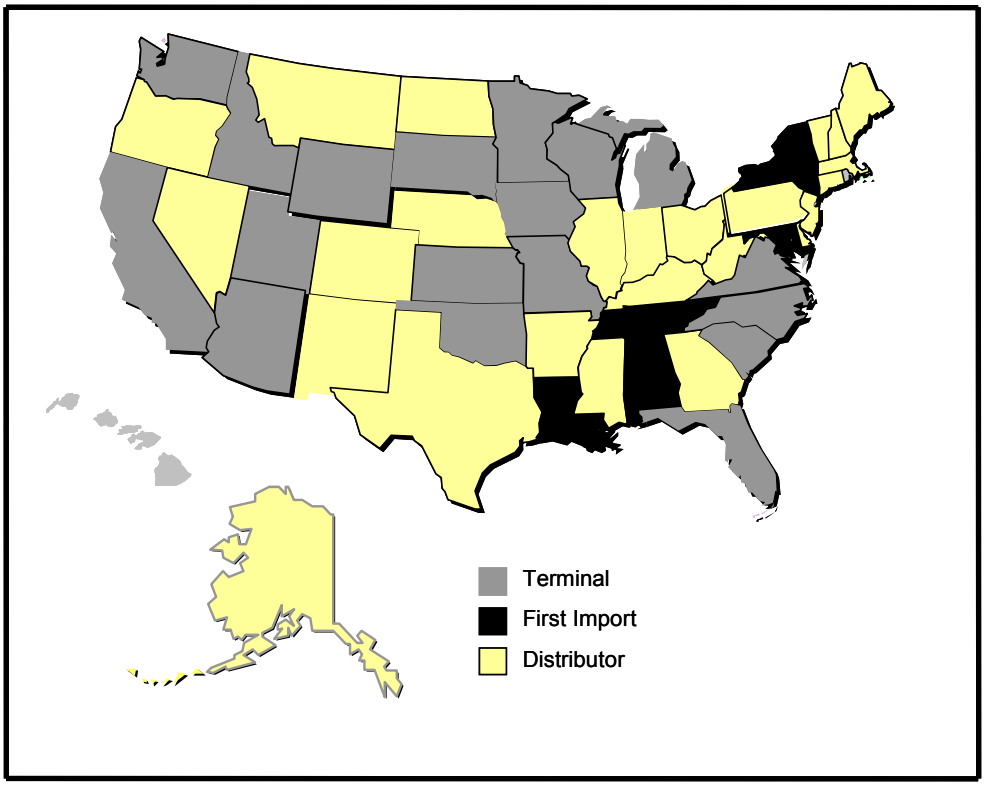


Figure 2-4. State Points of Taxation for Gasoline

Each point of tax collection throughout the fuel supply chain has the effect of encouraging certain evasion methods while discouraging others. Both Federation of Tax Administrators (FTA) and the Center for Balanced Public Policy (CBPP) have defined and categorized many different evasion techniques (CBPP 2004). Figure 2-5 depicts the categories of evasion methods that FTA has identified as primarily being associated with different points of taxation (FTA 2004a). Note that although these evasion techniques may be most closely associated with specific points of taxation, other points may be vulnerable as well. For example, refund fraud could exist at both the terminal rack and wholesale points of taxation.

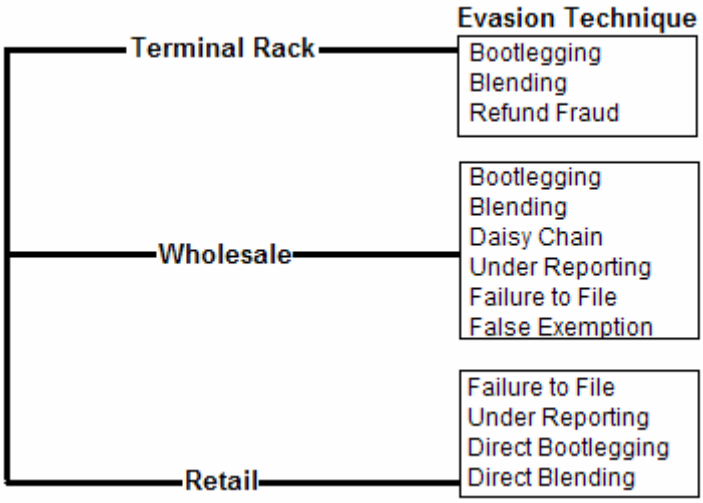


Figure 2-5. Evasion Schemes Associated with Particular Points of Taxation

Moving the point of taxation down the distribution chain may actually decrease the incentive to evade because the amount of tax stolen is based on the volume of fuel sold. Since the quantity of fuel sold at the retail level on a taxpayer basis is a small amount, so are the gains from evading taxes. For this reason, the retail point of taxation may actually, in limited circumstances, present fewer enforcement problems (FTA 2004a). One disadvantage to taxing at the retail level is the enormity of the resources required for processing a high volume of returns and delinquencies.

Establishing the point of taxation for all taxable fuels at the terminal rack is widely thought to be one of the most critical steps in reducing fuel tax evasion. Shifting the point of taxation to the terminal rack both greatly reduces the number of taxpayers, decreases the administrative and enforcement burden on collection agencies, and reduces the opportunities of downstream tax evasion. However, there are trade-offs associated with fewer taxpayers. First, since there is no paper trail for unlicensed distributors, it is unlikely that a transaction where a dealer purchases fuel from a source other than a terminal and pays no tax will be discovered. Second, taxation at the rack increases the number of refund requests from sales of fuel for tax exempt purposes (FTA 2004a). This can make administration increasingly complex for fuels for which a high percentage of total consumption is used for non-taxable purposes. Further, enforcement is made more difficult by the introduction of refund fraud. For instance, less than 50 percent of diesel fuel is consumed for on-road, taxable purposes. Some argue that the best strategy for fuels with

a large number of tax exempt uses is tax collection at the retail level since it is closest to the end user (CSG & CGPA 1996).

Shifting the point of taxation to the terminal rack may increase administrative issues around refunds for some fuel types; however, many states have experienced positive returns from moving the point of taxation up the supply chain. New York experienced a reduction in fuel tax revenues in the seven years preceding the move up the distribution chain, experienced a 19 percent increase in the first year after the point of taxation for motor fuel was moved up the distribution chain to first import, and an average growth of two percent in the four years following the shift in the point of taxation (FHWA 1992). Maryland also experienced an increase in revenue of about 20 percent in 1985 after moving the point of taxation for diesel fuel from the end user to the wholesale level (CSG & CGPA 1996). After moving aviation fuel taxation to the rack in 1996, Florida's aviation fuel tax collections increased by 21.4 percent that year (KPMG 2001).

2.3.2 Diesel Fuel Dyeing

The Omnibus Budget Reconciliation Act (OBRA) of 1993 was perhaps the most significant piece of legislation designed to curtail motor fuel tax evasion at the federal level. Besides moving the point of taxation for diesel to the terminal rack, it also mandated a federal fuel dyeing program. Beginning in 1994, all diesel fuel sold tax-free for exempt purposes – e.g., farm equipment and other off road vehicles – was required to be dyed red. The objective of dyeing fuel is to provide a quick and visible way of determining compliance. A federal penalty of $1,000 or $10 per gallon of fuel was also prescribed for motor carriers using dyed fuel for a taxable use (Baluch 1996). The first year after the law took effect, federal diesel fuel revenues increased by $1 billion. It was estimated that $600 to $700 million of that was attributed to increased compliance (GAO 1996).

The federal dyeing regulations benefited state enforcement programs since the same undyed fuel for highway use was generally also taxed for state transportation programs. Many states have adopted Internal Revenue Service (IRS) definitions of taxable uses of diesel fuel for ease of enforcement, and are enforcing the law by monitoring highways. By 1995, almost half of the states had adopted penalty provisions for improper use of dyed fuel (Baluch 1996). States that have conformed to OBRA have seen substantial increases – double digit annual percentage increases in some cases – in diesel fuel tax revenue (Peters 2002).

2.3.3 Joint Federal/State Motor Fuel Tax Compliance Project

In addition to legislative changes in the administration of fuel taxes, state and federal enforcement efforts have also been intensified during the early 1990's when combined state and federal revenue losses due to evasion were estimated at $3 million (FHWA 1999b). One feature of this continued enforcement effort was the formation of the Joint Federal/State Motor Fuel Tax Compliance Project (Joint Project or JFSMFTCP), a product of a long standing cooperative effort between the IRS and the FHWA. The Joint Project's steering committee is chaired by the IRS and the FHWA and is composed of representatives from nine lead states that head regional

task forces. Among the activities by the task forces to improve fuel tax compliance were training, joint criminal and audit investigations, and information exchange (Baluch 1996).

In 1991, Congress passed the Intermodal Surface Transportation Efficiency Act (ISTEA), which allocated funds to the Joint Project to organize cooperative efforts on fuel tax enforcement (FHWA 1992). This act provided $5 million annually in HTF funds through 1997 to the Joint Project. Of that $5 million, the Joint Project allocated $2 million to the IRS to enhance its fuel tax enforcement efforts. The other $3 million was given to states for participation in regional motor fuel tax evasion task forces. By FY 1995, most of the states, including the District of Columbia, had taken part in one or more of the nine regional task forces.

2.3.4 Auditing Efforts

Desk and field audits are recognized by many studies as being one of the most fundamental components of any program for reducing evasion (FHWA 1992, CSG & CGPA 1996, and WSLTC 1996). A highly visible and vigilant revenue agency decreases the incentives to cheat the system. Rigorous and frequent auditing efforts will be most effective at deterring evasion from businesses that are well-established and expect to stay in the fuel supply business for the long term. However, daisy chain evasion methods, and other criminal activities involving organized crime, will not be easily deterred by increased audits because the entire operation is geared to produce erroneous paperwork that is intended to lead auditors to a dead end (FHWA 1992). The creation of a special unit for evasion investigation was recommended by one study (WSLTC 1996). Arizona and Georgia have such units.

It is often difficult for state revenue and highway agencies to obtain the resources to expand enforcement operations. However, increases in state and federal audit operations have seen positive returns on investment. Out of 38 states, gasoline tax revenues averaged $443 per staff hour during the period of October 1992 through March 1993. For the same period and within the same states, diesel revenues were enhanced at the rate of $321 per hour (CSG & CGPA 1996). Further, FHWA reports that each dollar spent from HTF on compliance projects (i.e. audits and criminal prosecutions) has been estimated to produce $10 to $20 in extra revenue from state and federal fuel tax violations (FHWA 1999c).

2.3.5 Fuel Tracking

The ability to track fuel through the distribution system is a key component of ensuring fuel tax compliance. Acknowledging that such a system could become an effective enforcement tool, Congress allocated HTF funds under ISTEA for the development of what is now known as the Excise Files Information Retrieval System (ExFIRS). ExFIRS – developed and implemented by the IRS to aid identification and prevention of fuel noncompliance – is composed of 10 subsystems which support the collection and analysis of motor fuel industry operational information.

Perhaps the most significant of these subsystems is the Excise Summary Terminal Activity Reporting System (ExSTARS). ExSTARS is designed to track all movements of petroleum through state-designated fuel sales terminals. Since all federal excise taxes on fuels are imposed at the terminal rack, the IRS can balance all terminal disbursements with tax returns. It should be noted that while ExSTARS provides data on destination states for fuel leaving terminals, it does not supply exact destination location within states.

At the state level, the usefulness of ExSTARS will vary as a result of disconformities in the point of taxation between states. Some states tax at the rack while others tax at the first import, wholesale, or retail levels. If the point of taxation for an individual state is at the terminal rack – similar to the federal government – the state may be able to make direct comparisons between ExSTARS data and state tax returns. On the other hand, if a state's point of taxation is below the rack, data on how much fuel enters the state may prove to be useful (FTA 2004b). At the time of writing this report, ExSTARS is in full operation but the data are not yet comprehensive, with the vast majority of the data reported electronically but with a small share of the total data (roughly 10-20 percent) submitted on paper forms and entered into the database in a summarized version (Anders-Robb 2004).

For states, the other notable subsystem of ExFIRS is the Excise Tax Online Exchange (ExTOLE). This system provides a convenient way for states to share information that could help in enforcement, compliance, and investigation efforts. ExTOLE allows states to do more significant background checks before issuing registrations, determine where the taxpayers are in operation and view fuel distribution activity in other states.

Some states are opting to implement their own fuel tracking systems, choosing automated systems over manual accounting. Other states have adopted fuel tracking systems developed by Lockheed-Martin and ZyTax (FHWA 1999a). Table 2-2 presents an overview of state tracking systems present in place.

2.3.6 Uniform Administrative Forms and Procedures

Unscrupulous marketers can take advantage of the disparities in reporting requirements and information exchange across state and international borders. This is why cooperation between state agencies can be extremely advantageous in the struggle against fuel tax evasion. However, the ability to cooperate and exchange information is made problematic when states have their own unique tax laws, report forms, definitions, exemptions, and compliance methods.

Table 2-2. State Tracking Systems

State	Tracking System
Virginia	ACS
Nevada	ACS
Mississippi	ACS
Arkansas	ACS
Michigan	ACS
Georgia	ACS
Colorado	Explorer
Wisconsin	Synergy
South Carolina	ZyTax
Tennessee	ZyTax
North Dakota	ZyTax
California	In-house
Illinois	In-house
Missouri	In-house
Nebraska	In-house
Montana	In-house

Source: Anders-Robb 2004, FHWA 2003b, FHWA 2002, FHWA 2001, FHWA 1999a.

One of the first efforts toward uniformity was the International Fuel Tax Agreement (IFTA) created as a component of ISTEA in 1991. IFTA is an agreement between states that simplifies the reporting of fuel taxes by Interstate haulers by establishing a uniform system for administering and collecting taxes. Congress ordered all states to participate in this program by 1996 or be faced with a decrease in federal highway funds (Raven 1999). Before IFTA, motor carriers were obliged to register, obtain permits, and file tax returns with each state in which they operated. Now, motor carriers choose a base jurisdiction to register with and file a single return with a single payment to their base jurisdiction. The base jurisdiction processes the IFTA tax return for net fuel taxes and forwards funds to, or requests funds from, each jurisdiction (MPR 2004). By 1996, all 50 states and 9 Canadian provinces were IFTA members (CSG & CGPA 1996).

Another key cooperative effort is the FTA Uniformity Committee. The Uniformity Committee created and is encouraging states to adopt an 11-point plan. The major points in this plan include:

- Uniform definitions for imports and exports,
- Federal identification codes that distinguish entities for reporting and information exchange,
- Total accountability of fuel by licensing of all resellers,
- Requiring third-party reporting on the movement of fuel,

- Uniform electronic reporting systems, and
- Training for auditors and investigators.

Further, the Uniformity Committee has created a model legislation checklist for states that wish to change their point of taxation for fuels and implement the 11-point plan (FTA 2003).

2.3.7 Screening, Licensing, and Bonding

Not all states thoroughly investigate applicants for taxpayer or distributor licenses. For states that tax at the distributor level, proper screening of applicants can stop daisy chain-type operations from forming. The FTA recommended in 1995 that applications include financial statements of past operations, personal contact with the applicant, and physical inspection of the operation site (CSG & CGPA 1996). Further, ExTOLE can be a resource for conducting background checks by providing information about taxpayers in other states.

As a part of the Uniformity Committee 11-point plan, it is recommended that every person or business dealing in tax-free motor fuel in the state be licensed, not just the taxpayers (FTA 2003). This allows for total accountability of motor fuel throughout the distribution system and provides information that can be used for enforcement purposes.

Requiring bonds or property liens is another way of ensuring financial trustworthiness for fuel tax liability. Security bonds protect states from major losses in tax revenues resulting from bankruptcy or tax evasion; but only if they are established at a proper level for the anticipated tax liability. Bonding requirements can be thwarted when entities file fraudulent documentation, allow bonds to expire, or when the amount of the bond is calculated based on a lower volume of revenues than actually experienced. For instance, Florida found that even a $100,000 bond did not deter some evaders who could recover such amounts from stolen fuel taxes in a short enough time as not to be detected (FHWA 1992). Montana requires a maximum $100,000 bond for distributors and a minimum $25,000 bond for importers.

2.3.8 Adopting Electronic Reporting

Many states have required that all fuel taxpayers file their returns electronically. This system doesn't take the time and space that a traditional paper system would, freeing up resources for both industry and state collection agencies by reducing tax administration and compliance costs. Further, information becomes easily accessible for enforcement efforts within states. The FTA Uniformity Committee encourages states to not only adopt an electronic reporting system, but also adopt uniform methods and standards for their systems so that states can share detailed information with each other in an efficient manner (FTA 2003).

2.3.9 Fines and Punishments

States have also stepped up their punishments and penalties – with the intention of deterring evasion – for actions such as failure to fill out mandatory documents, pay compulsory taxes, or knowingly providing false information on documents. In a study of Southern states, it was found

that great diversity exists between states on the nature and severity of penalties for fuel tax evasion (Denison and Eger 2000). Some states consider fuel tax evasion a felony while others deem it a misdemeanor. For instance, fuel tax evasion in Delaware is a Class E felony and is punished by a fine of not more than $11,500 or by imprisonment of up to 5 years. Mississippi considers fuel tax evasion a misdemeanor and levies fines of between $50 and $100, a mild punishment by comparison to Delaware. Further, in all but two of the 16 Southern states reviewed liability for fuel taxes are ultimately placed on the officers of a corporation. It is worth noting that the effectiveness of penalties for deterring tax fraud is still under considerable dispute (Denison and Eger 2000).

2.3.10 Education

Some states have sought to curb fuel tax evasion by establishing education programs. The expectation is that the public knowledge and awareness regarding the nature and extent of fuel tax evasion will generate public, government, and industry support for programs aimed at curtailing fuel evasion (WSLTC 1996). Arizona embarked on such a campaign that included development of a web page,[2] brochures, and posters alerting the public to tax evasion and a telephone hotline for reporting evasion activities (FHWA 2003b).

2.4 Prevalent and Persistent Fuel Tax Evasion Schemes

As noted earlier, each point of taxation in the distribution system will have its own unique vulnerabilities to certain evasion schemes. One scheme that is common to all points of taxation and is a continual problem is bootlegging. In a survey of revenue officials for each state, bootlegging across borders was perceived to be the most common gasoline tax evasion scheme by a bulk of respondent states (CSG & CGPA 1996). Bootlegging can be particularly prevalent where the disparities in motor fuel tax rates between states are significant. For instance, Montana shares borders with five other states and has a higher rate – nearly twice the gasoline and diesel tax rates relative to Wyoming – compared with its neighbors. To address the potential bootlegging problem, Montana increased reporting requirements and mandated licensing for all fuel distributors (CSG & CGPA 1996). Other methods of deterring bootlegging found in the literature and outlined in this report are fuel tracking, interstate and intergovernmental information sharing, intensive auditing that tracks fuel from the terminal to the retail level, and efforts toward uniformity in tax administration.

Another prevalent evasion scheme is refund fraud. For example, a farmer may collect on a tax refund from fuel that was used for highway travel. One study found that diesel fuel tax evasion is likely occurring in Wisconsin because refund claims for agricultural rebates far exceed any other Midwestern state, controlling for factors such as the number of farms and total state acreage (Eger 2002). Suggested policy options made by the report include: enact a permit process for all refund filer or an income tax credit for exempted users, increased quantity and efficiency of inspection, collection and enforcement and enhanced criminal penalties. Also,

[2] http://www.dot.state.az.us/mvd/FuelTaxEvasion/ConsumerInformation.htm.

there have been unsuccessful legislative efforts to revoke the right of farmers to obtain tax exempt fuel in Mississippi (FHWA 2003b).

In a report for FHWA, the Center for Balanced Public Policy (CBPP) performed a comprehensive analysis of motor fuel tax evasion schemes (CBPP 2004). The CBPP report outlines eight (8) broad evasion methods including:

1) Refunds and credits schemes,
2) Non-filing schemes,
3) Removals from bulk systems,
4) Imports and exports,
5) Daisy chains,
6) Dyed diesel and kerosene,
7) False labeling, and
8) Blending schemes.

Within these categories, 35 actual or potential evasion techniques are described in depth. The description includes effected fuels, distribution sector involved, scheme contributing factors, and actual documented cases. It should be noted that while categorization of techniques is useful in order to identify elements of an evasion scheme when it is encountered, it is not always the case that evasion schemes fit into neat categorical groups. In reality, evasion practices are usually very complex and involve elements of several evasion methods.

The evasion techniques as categorized by CBPP are summarized in Figure 2-6. One of the more publicized evasion schemes is the daisy chain. This scheme often involves a series of legitimate or illegitimate companies creating a paper trail of fuel sales leading to a "burn" company that would fold if and when discovered by the IRS. Non-filing, nonpayment, and forged document schemes are perhaps the most unsophisticated evasion methods and simply rely on the failure of auditors and investigators to detect wrongdoing. Removal from bulk transfer system schemes can either entail offloading fuel at an unregistered site or tapping a pipeline at a pumping station, dock, or a remote location. Import or export schemes typically entail forging import and export documents. For instance, tax evaders can falsely report an export to a border country or fail to report imports from out-of-state terminals. Dyed diesel and kerosene schemes generally involve misrepresenting fuels in paperwork or sabotaging a physical aspect of the fuel dye injection process. Some examples of dyed fuel schemes are tampering with dye injection equipment, falsifying documents claiming dye has been injected into a fuel, or using dyed fuel on highways.

False product labeling schemes take advantage of the existence of fuel products that are non-taxable (i.e. mineral spirits) and involve mislabeling taxable products as nontaxable products. Blending schemes involve blending taxable fuels with non-taxable fuels. Evaders can under-report actual volumes of taxable fuels sold or can blend untaxed natural gasoline with octane enhancing additives. Finally, refund and credit schemes take advantage of the refund process related with the terminal rack point of taxation. They can entail claiming a refund for fuel that was actually used for a taxable purpose or claiming a tax refund when no tax or less tax was actually collected (CBPP 2004).

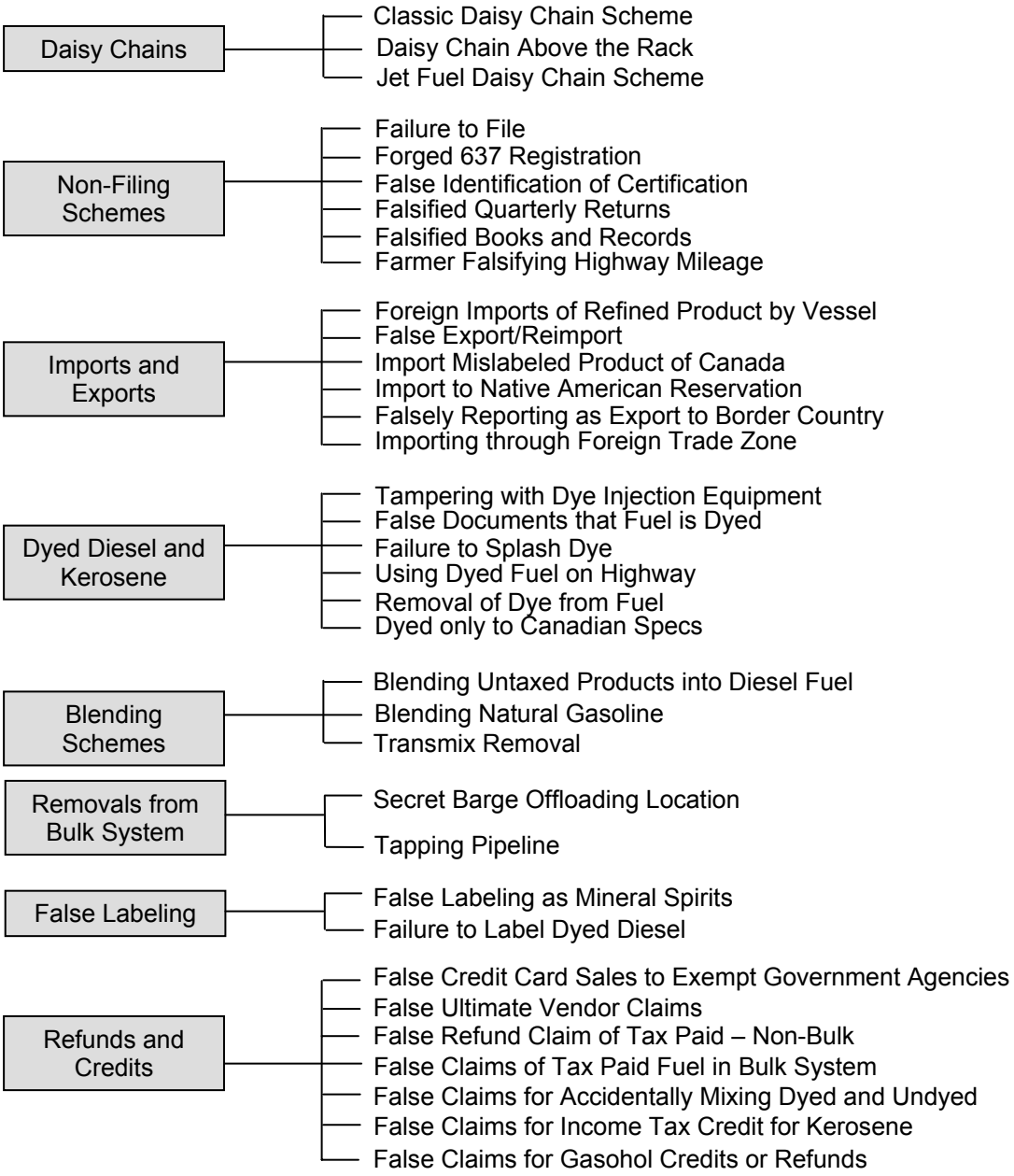


Figure 2-6. Evasion Schemes as Categorized by CBPP

2.5 Current and Historical Federal Fuel Tax Administration and Enforcement Activities

Federal receipts for gasoline and diesel alone grossed over $29 billion in 2002.[3] These and other fuel taxes provide the greater portion of revenue for the Highway Trust Fund (HTF). Indeed, the primary purpose of fuel taxes is to provide for mass transportation and highway maintenance/ improvement programs. These taxes have also provided funds for additional purposes in recent

[3] Calculated from Table 21 from Statistics of Income (IRS 1993-2002).

times (e.g., servicing the national debt). At its inception, however, the federal fuel excise tax was not intended to be the mainstay of transportation funding that it is now. The first federal tax on a fuel was initiated in 1932, and was intended to provide a temporary fix to the federal budget. The Revenue Act of 1932 mandated a $.01 per gallon excise tax to be placed on gasoline and a $.04 per gallon tax on lubricating oil. The first year after the tax had passed, receipts from gasoline excise taxes alone far exceeded receipts for all other excise taxes. As a result and despite its original objective, the federal fuel excise tax has persisted and broadened in scope.

The list of federally-taxed fuels has expanded since the original gasoline excise tax. The Revenue Act of 1951 introduced a tax on diesel and other special fuels (e.g., propane, butane, benzol, benzene and naphtha) at 2 cents per gallon (FHWA 2000). In 1983, gasohol was added to the list of taxable fuels while the tax on lubricating oil was repealed. As shown in Table 2-3, federal tax rates on fuels have increased considerably over the past 30 years.

Revenues from fuel excise taxes have also steadily increased. Gradual growth in these revenues could be explained by growth in vehicle miles traveled due to increasing number of vehicles or increases in average number of miles traveled per vehicle. Large jumps in collections can be attributed to tax rate increases.

It is not surprising that the initial concern over fuel tax evasion came shortly after the first major increase in federal fuel taxes – more than doubling the tax rate on gasoline and diesel – in 1983. This substantial increase in the tax rate also significantly increased the incentive to cheat on taxes. For an 8,000 gallon truck load of gasoline or diesel, a distributor could make $720 in profits from evading the federal diesel tax at the $.09 per gallon rate and $320 in profits at the previous tax rate. As one fuel tax evasion defendant explained to the IRS, “every time you raise taxes, we get a raise” (Hallquist 1999).

After fuel tax revenues fell short of expectations from the 1983 tax rate increases and tax fraud operations in the New York metropolitan area were uncovered and highly publicized, concern over motor fuel tax evasion became a widespread concern. This concern was substantiated by the testimony before the Oversight Committee of the House Ways and Means Committee on July 15, 1986. The hearing marked the beginning of a significant effort to reduce motor fuel tax evasion. Spokesmen from the IRS and state revenue agencies testified on the extent of the motor fuel tax evasion problem, and gave estimates of federal tax evasion of as much as $1.2 billion a year (FHWA 1992). The testimony that generated the most interest was that of Larry Iorizzo – convicted tax evader with organized crime connections. He approximated that the federal government was losing $1 billion annually from fuel tax fraud. It was the observations and recommendations from this hearing that launched the federal fuel tax reform efforts into motion. These efforts – discussed in the following sections – were focused around the point of tax collection, diesel fuel dyeing, increased funding for auditing, tracking systems, electronic reporting, IFTA, the Joint Federal/State Motor Fuel Tax Compliance Project, and the changing tax treatment on other fuels.

Table 2-3. Federal Tax Rates on Motor Fuel and Lubricating Oil (1932-2003)

Effective Date of New Tax or Revision to Existing Tax	Gasoline (cents per gallon)	Diesel (cents per gallon)	Special Fuels (cents per gallon)[4]	Lubricating Oil (cents per gallon)
June 21, 1932	1¢	⇓	⇓	4¢
June 17, 1933	1.5¢	⇓	⇓	⇓
January 1, 1934	1¢	⇓	⇓	⇓
July 1, 1940	1.5¢	⇓	⇓	4.5¢
November 1, 1942	⇓	⇓	⇓	6¢
November 1, 1951	2¢	2¢	2¢	⇓
September 1, 1955	⇓	⇓	⇓	Cutting oil is 3¢ other is 6¢
July 1, 1956	3¢	3¢	3¢	⇓
October 1, 1959	4¢	4¢	4¢	⇓
January 1, 1966	⇓	⇓	⇓	6¢
November 10, 1978	4¢	4¢	4¢	6¢
January 1, 1979	4¢	⇓	4¢	6¢
January 7, 1983	⇓	⇓	⇓	Repealed
April 1, 1983	9¢	9¢	4¢	⇓
August 1, 1984	⇓	15¢	⇓	⇓
January 1, 1987	9.1¢	15.1¢	⇓	⇓
December 1, 1990	14.1¢	20.1¢	14¢	⇓
October 1, 1993	18.4¢	24.4¢	18.3¢	⇓
January 1, 1996	18.3¢	24.3¢	18.3¢	⇓
October 1, 1997	18.4¢	24.4¢	13.6¢	⇓

Source: Adapted from *Highway Statistics 2003*, Table FE-101A (FHWA 2003a)

2.5.1 Federal Point of Taxation

The history of gasoline and diesel fuel tax legislation is one of changing mandates with respect to the point of taxation and treatment of exemptions. From the inception of the fuel tax in 1932 to the late 1950's, the IRS collected gasoline taxes from refiners and importers. However, this system was deemed unfair because wholesalers purchased their gasoline already taxed while refiners and importers that were vertically integrated could pay their taxes further down the supply chain. In some cases, these companies would not have to pay tax until fuel was sold at retail outlets to consumers (GAO 1992). In the late 1950's, Congress gave compounders, blenders, and chain operators with 10 or more retail outlets the right to purchase tax-free gasoline. Gasoline tax was generally imposed when a registered wholesaler sold gasoline:

[4] Tax rates shown for special fuels are propane rates.

(1) to a retailer; (2) to an unregistered wholesaler; or (3) at the wholesaler's retail pumps (CBPP 2004). This change in policy essentially moved the point of taxation to the pump. Tax exempt sales were allowed for export to government agencies, schools, or commercial fishing operations.

When diesel was first taxed in 1951, the tax was generally imposed at the retail level. Diesel was taxed when it was sold by a retailer and transferred into a highway vehicle fuel supply tank or when the fuel was used for highway travel and was not taxed in a previous transaction. This system allowed direct non-taxable transactions to tax-exempt users – no registration required.

After the discovery of the multi-million dollar fuel tax evasion schemes of the 1980's, the IRS and the FHWA began working together to combat fuel tax evasion by promoting changes in tax collection processes and encouraging enforcement activities. Legislative efforts to reduce evasion were soon focused on moving the point of federal motor fuel taxation up the supply chain. It was believed that this modification would reduce evasion for a few reasons. First, the tax would be imposed on fewer taxpayers, reducing the number of firms that the IRS would need to oversee. Second, since fuel would change hands fewer times between production and taxation, there would be fewer opportunities for evasion. Third, it was thought that companies farther upstream such as refineries and terminal operators were more trustworthy because they have more sophisticated record keeping and financial stability (GAO 1992).

The Tax Reform Act (TRA) of 1986 was the first major federal legislative change to address the fuel tax evasion problem. Effective in 1988, the tax collection point for gasoline was moved upstream from the wholesale level to the terminal rack when (1) diesel fuel was transferred to tanker trucks or to rail road cars for further distribution or (2) it was sold to an unregistered person within the terminal system. In 1989, the Technical Miscellaneous Act set up a credit/refund system and allowed wholesalers to sell fuel on a tax exempt basis for export, use by government agencies, use in aircraft, or for certain non-profit educational organizations (KPMG 2001).

For diesel, TRA of 1986 allowed retailers to elect to buy diesel on a tax paid basis, thereby moving the tax liability up to the wholesale level in such cases. However, the Revenue Act (RA) of 1987 annulled the choice given to retailers by mandating diesel taxation at the wholesale level. This Act also ordered tax-exempt users beyond the wholesale level to buy their fuel on a tax-paid basis and then apply for a refund. This new requirement was meant to reduce the opportunities for evasion. However, mandates wavered again with respect to exemptions in 1988 when the Technical Miscellaneous Act reversed RA of 1987 by allowing users such as farmers, off-road users, and boaters to buy tax-free fuel.

Opinions were mixed as to what effect these federal legislative changes had on evasion. Officials from the IRS, the American Petroleum Institute, and the Petroleum Marketers Association of America believed that these changes significantly reduced evasion. However, officials from FHWA and the Justice Department and operators of Northeastern state terminals believed that daisy chain operations may have been curtailed but significant fuel tax leakage was still occurring from alternative evasion schemes (GAO 1992). Despite the beliefs of fuel tax officials across the nation, there was no solid evidence that changing the point in taxation had

positively or negatively impacted revenues. As Table 2-4 shows, it is unclear what impact the aforementioned legislative acts had on tax revenues.

Table 2-4. Deposits to the Highway Account of the Federal Highway Trust Fund

Fiscal Year	Diesel (thousands)	Gasoline (thousands)
1986	$2,452,924	$7,801,112
1987	$2,621,399	$7,536,973
1988	$2,557,282	$8,086,417
1989	$4,045,919	$8,145,081
1990	$2,896,263	$7,618,486

Source: GAO 1992

Although there was a bump in diesel and gasoline collections in 1989, collections in 1990 dropped at around or below pre-1986 levels. The variation in revenue collections could be explained by any number of factors, (e.g., economic fluctuations, earlier tax collections, decreased fuel evasion, unprocessed or delayed refunds, or credits). Even though there was no concrete proof of increased compliance resulting from the upward shift in the taxation points for gasoline and diesel, there was a general agreement that the measures taken did close many evasion opportunities that existed under the previous system. Due to this agreement, the new upstream tax collection system was kept and fine-tuned.

The Revenue Reconciliation Act (RRA) of 1990 was a legislative effort to fine-tune the gasoline excise tax collection system. It further tightened the rules with regard to where and how the excise tax on gasoline could be collected in an attempt to prevent daisy chain-type operations by discouraging the reselling of previously taxed fuel. The new rules imposed a tax upon (1) imports, (2) removal from any refinery or terminal, or (3) sale to unregistered persons except for situations in which there had been a previous taxable removal or entry from the terminal (KPMG 2001). The person who owned the fuel prior to sale was deemed responsible for remitting the tax. In case of any removal or sale of gasoline by non-registered persons, the terminal operator was deemed responsible for the tax (CBPP 2004).

The new tax at the rack system was adopted for diesel excise taxes in 1994, mandated by OBRA. The law changed diesel tax collection processes to emulate those of gasoline.

2.5.2 Federal Diesel Fuel Dyeing

Prior to OBRA and the establishment of the federal diesel dyeing program, FHWA estimated the magnitude of diesel excise tax evasion to be between 15-25 percent of all taxable gallons (Baluch 1996). At these rates, federal revenue losses for 1990 through 1993 would have averaged between $687 and $973 million annually. To improve enforcement, provisions in OBRA of 1993 required that red dye be added to all diesel sold for tax exempt purposes.

Effective in 1994, only dyed diesel could be removed from the terminal without remitting a tax. The federal dyed diesel program provides an easy way to determine if untaxed fuel is used illegally for taxable purposes. In conjunction with mandatory fuel dyeing, IRS enforcement efforts included training 150 dyed diesel compliance officers and distributing $6 million to states for roadside sampling of highway diesel fuel using vehicles (Baluch 1996).

The federal dyed fuel program provides a compelling deterrent against the use of tax-exempt fuel for taxable purposes. Since dyed fuel is apparent even with considerable dilution, fuel compliance investigators can determine if dyed fuel had been previously used within a few tank refills earlier. Provisions in OBRA prescribed a fine of $1,000 or $10 per gallon of misused fuel, whichever is greater. If an inspector discovers diluted fuel, the fine is prescribed for a whole tank full of dyed fuel. Moreover, these fines are imposed on the driver of the vehicle and not the company for which the driver works. A long-distance truck with a 300 gallon fuel tank using dyed fuel could save $73.20 in federal fuel taxes but could be fined $3,000 in addition to state and local penalties. In 1995, the IRS conducted spot checks around the country (i.e. Operation Red Alert and Operation Blue Flame) in which 5 to 12 percent of all trucks surveyed had dyed diesel in their tanks (Mingo et al 1996).

The GAO reported that collections increased by $1.2 billion from 1993-1994 (GAO 1996). However, provisions in OBRA also increased the tax rate and shifted the tax collection to the rack in addition to the dyed diesel fuel program. Controlling for macroeconomic fluctuations and the tax rate increase, the GAO estimated that $600-$700 million of the 1994 increase was solely due to increased diesel fuel excise tax compliance. However, this estimate does not separate the effects of the diesel fuel dye program from the effects of the simultaneous upstream shift in the point of diesel taxation.

2.5.3 Federal Tax Treatment of Aviation Fuel

Prior to 1988, the tax on jet fuel was collected at the retail level and was only applicable to non-commercial aviation. The Revenue Act of 1987 moved the taxation point for non-commercial aviation fuel up the distribution chain to the wholesale level effective April 1, 1988. OBRA of 1993 imposed a fuel tax on commercial aviation fuel that took effect in 1995. The American Jobs Creation Act of 2004 moved the point of taxation up the distribution chain to the terminal rack.

The point of taxation for both commercial and non-commercial aviation was recently shifted to the terminal rack. The current tax rate on commercial jet fuel is $.044 cents per gallon and $.219 cents per gallon for non-commercial jet fuel. Since diesel is taxed at $0.244 cents per gallon, incentives exist to use tax paid aviation fuel as a substitute for diesel for highway use. A 2001 study estimated that the shortfall in federal revenues from diversion of commercial jet fuel to be in the range of $1.7 - $9.2 billion for the period of 2001-2011 (KPMG 2001).

2.5.4 Federal Tax Treatment of Gasohol

Although gasohol (i.e. gasoline blended with ethanol or methanol) had been sold as engine fuel since the mid 1930's, it wasn't officially recognized until the Energy Tax Act of 1978. Effective in 1979, gasohol was defined as a blend of 90 percent gasoline and 10 percent alcohol – excluding alcohol made from coal, natural gas, or petroleum. Gasohol was first taxed at the federal level – at a much lower rate compared to gasoline – in 1983. Because the alcohol component is much more expensive than the gasoline component of gasohol and was taxed at a significantly lower rate as compared to gasoline, incentives existed to decrease the alcohol content below the minimum 10 percent. To address this issue, the Energy Policy Act of 1992 expanded the definition of gasohol to include blends with 5.7 and 7.7 percent alcohol. Table 2-5 outlines the evolution of tax rates on gasohol blends.

Table 2-5. Historical Federal Tax Rates on Gasohol

Effective Date of New Tax or Revision to Existing Tax	Gasohol (cents per gallon)
April 1, 1983	4¢
January 1, 1985	3¢
January 1, 1987	3.1¢
December 1, 1990	ethanol at 10% is 8.7¢ and methanol at 10% is 8.1¢
January 1, 1993	ethanol ≥ 7.7% is 9.942¢ and ≥ 5.7% is 11.022¢ methanol ≥ at 7.7% is 9.48¢ and ≥ at 5.7% is 10.68¢
October 1, 1993	ethanol ≥ 7.7% is 14.242¢ and ≥ 5.7% is 15.322¢ methanol ≥ at 7.7% is 13.78¢ and ≥ at 5.7% is 14.98¢
January 1, 1996	ethanol ≥ 7.7% is 14.142¢ and ≥ 5.7% is 15.222¢ methanol ≥ at 7.7% is 13.68¢ and ≥ at 5.7% is 14.88¢
October 1, 1997	ethanol ≥ 7.7% is 14.242¢ and ≥ 5.7% is 15.322¢ methanol ≥ at 7.7% is 13.78¢ and ≥ at 5.7% is 14.98¢
January 1, 2001	ethanol ≥ 7.7% is 14.319¢ and ≥ 5.7% is 15.379¢ methanol ≥ at 7.7% is 13.78¢ and ≥ at 5.7% is 14.98¢
October 1, 2003	ethanol ≥ 7.7% is 14.396¢ and ≥ 5.7% is 15.436¢ methanol ≥ at 7.7% is 13.78¢ and ≥ at 5.7% is 14.98¢

Source: Adapted from *Highway Statistics 2003*, Table FE-101A (FHWA 2003a).

2.5.5 Federal Tax Treatment of Kerosene

After the federal diesel fuel dye program took effect in 1994, there was some indication that excise tax evasion may have shifted from diesel to kerosene as there had been some discoveries that kerosene was being sold at service stations as diesel fuel. Kerosene is used as a home heating fuel but can also be used as, or blended with, diesel. To address this issue, the Congress included a provision in the Taxpayer Relief Act in 1997 that expanded the statutory definition of

taxable fuel to include kerosene. Soon after, the IRS implemented a tax or dye program for kerosene that emulated the one for diesel fuel.

2.5.6 Joint Federal/State Motor Fuel Tax Compliance Project

The IRS and FHWA began working together subsequent to the discovery that fuel tax evasion was a significant problem by supporting enforcement activities and changes in the taxation process. Moreover, the IRS and many states began collaborative exchange in the late 1980's by intensifying investigations, identifying tax evaders, and conducting highly publicized prosecutions in the hopes of deterring evasion (GAO 1992). The Joint Federal/State Motor Fuel Tax Compliance Project (Joint Project) is a product of these interagency efforts.

To address the continuing evasion problem, Congress authorized $1.2 million in HTF funds in 1990 for the Joint Project to organize cooperative efforts on fuel tax enforcement (FHWA 1992). These initial funds were used by the IRS for the development of training courses and to organize three regional pilot task forces headed by New Jersey, Texas, and Indiana to improve tax compliance by combining enforcement efforts and exchanging information (GAO 1992).

However, it was the funding provided by the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 which allowed for the expansion of the nationwide fuel tax evasion program. This act provided $5 million annually in HTF funds through 1997 to the Joint Project. Of that $5 million, the Joint Project allocated $2 million to the IRS to enhance its fuel tax enforcement efforts. The other $3 million was given to states for participation in regional motor fuel tax evasion task forces (FHWA 1999b). These regional task forces have focused on improving fuel tax compliance through training, joint criminal and audit investigations, and information exchange (Baluch 1996).

The Joint Project currently has nine (9) regional task forces headed by California, Indiana, Florida, Massachusetts, Nebraska, New Jersey, North Carolina, Oregon, and Texas. The Joint Project's steering committee is chaired by the IRS and the FHWA and is composed of representatives from nine lead states that head regional task forces. Other committee participants include representatives from the Department of Justice, Defense Criminal Investigative Service, Department of Transportation (DOT) Office of Inspector General, Federation of Tax Administrators, American Association of State Highway and Transportation Officials, and several petroleum industry organizations (Baluch 1996).

2.5.7 Federal Auditing Efforts

The auditing and prosecution of tax evaders has been a primary component of the effort to increase fuel tax compliance. IRS staff supporting motor fuel tax collections increased substantially in the early 1990's as shown in Table 2-6. Specifically, the diesel tax examination effort more than doubled between FY 1989 and FY 1991.

Table 2-6. IRS Motor Fuel Tax Audits FY 1989-1993

Item Description	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993
Registration Staff Years	68	66	88	87	97
Gasoline Tax Staff Years	17	15	21	16	12
Diesel Tax Staff Years	46	72	122	100	106
Additional Fuel Tax Assessed (millions)	53.2	68.3	93.1	79.9	108.6

Source: (Baluch 1996)

Significant additional funding for these efforts came through the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991. ISTEA provided $2 million annually to the IRS from 1991 through 1997 to enhance its fuel tax enforcement efforts. These revenues also helped to boost fuel tax criminal investigations, most of which were in cooperation with state investigators (see Table 2-7). IRS criminal investigations since the early 1990's have significantly decreased, averaging only 18 initiated investigations for FY 1997 through FY 2003 for all excise taxes.

Table 2-7. IRS Motor Fuel Tax Investigations and Convictions FY 1989-1994

Item Description	FY 1989	FY 1990	FY 1991	FY 1992	FY 1993	FY 1994
Criminal Investigations Initiated	19	47	40	108	144	69
Convictions	6	16	16	23	77	79
Staff Years for Motor Fuel Cases	27	31	45	61	76	81

Source: (Baluch 1996)

One measure of the effectiveness of IRS enforcement efforts is assessments of tax loss from audits and criminal prosecutions. Every dollar spent in joint auditing efforts by the IRS and states from ISTEA funds between 1991 and 1994 yielded an average of almost $20 in tax assessments (Baluch 1996). These assessments, however, are rarely converted into recovered revenue since many assessments cannot be collected and fines are not often attributed to unpaid tax liabilities. The effectiveness of auditing and prosecution efforts can also be measured by the level of deterred evasion, but these benefits are virtually impossible to quantify.

2.5.8 Federal Electronic Reporting

Filing tax returns electronically provides many advantages above and beyond the traditional paper system. No postage expenses, less storage space consumed, and reduction in paper

consumption are a few of the benefits of electronic filing. Further, filing taxes removes much of the human element in the reviewing and processing of returns. Recognizing the benefits of paperless filing, Congress included a provision in the IRS Restructuring and Reform Act of 1998 that states "it is the policy of Congress that paperless filing should be the preferred and most convenient means of filing federal tax and information returns, and it should be the goal of the IRS to have at least 80 percent of all such returns filed electronically by the year 2007." An additional benefit of electronically filed motor fuel excise tax returns is that electronic return information can easily be transferred, compiled, compared, and analyzed with respect to fuel tracking data, aiding in enforcement efforts.

The IRS began using electronic reporting in 1986 starting with the filing of individual tax returns. The system has expanded to perform many functions and handle many different tax types including motor fuel excise taxes. Terminal operators, carriers, and transmitters can use the electronic system to file 720-TO and 730-CS in the Electronic Data Interchange (EDI) format. The system validates the return, sends acknowledgement to the information provider, and prepares the data for IRS processing.

2.5.9 Federal Fuel Tracking

The congressional hearings on motor fuel tax evasion in the mid 1980's spawned a myriad of strategies to increase fuel tax compliance; one of these strategies was the use of technology. With a multitude of jurisdictions, each with their own complex taxation structure, unscrupulous marketers have easy opportunities to cheat the system. Possessing information on the motor fuel industry and distribution process can close many of the gaps that exist within and between taxation systems and make evasion more risky. Recognizing this, Congress directed the IRS to investigate the prospect of an automated fuel tracking system. By 1995, a working concept of a system that would monitor motor fuel through the distribution chain was developed. With the passage of the TEA-21 in 1998, Congress provided significant funding ($31 million) to the IRS for the development and implementation of a fuel tracking system (Peters 2002).

ExFIRS – the fuel tracking system still under development by the IRS – aids in the collection and analysis of information about motor fuel industry operations. ExFIRS is composed of a number of subsystems including:

- ExSTARS – collects and analyzes motor fuel distribution data,
- Excise Classification Information System (ExCIS) – gathers information on tax returns,
- Excise Automated Claims Tracking System (ExACT) – analyzes claims,
- Excise Customs Activity Tracking (ExCAT) – gathers information on imports and exports,
- Excise Fuel Online Network (ExFON) – integrates fuel tracking with case processing,
- Excise Tax Registration Authorization System (ExTRAS) – manages 637 registration data,
- Below the Rack Information System (BTRIS) – holds below the rack motor fuel activity information such as finger-printing, and
- ExTOLE – allows states to exchange information.

2.5.10 Federal Involvement with the International Fuel Tax Agreement (IFTA)

IFTA is an arrangement between jurisdictions that simplifies motor fuel excise tax reporting for inter-jurisdictional motor carriers. Prior to IFTA, carriers were required to file a fuel use tax report for each state or province in which they traveled. Each of these tax reports had its own unique format, timeline, and requirements. This non-conformity between state fuel tax requirements became incredibly burdensome for motor carriers that did business in many jurisdictions.

Under IFTA, a motor carrier registers with and pays taxes to a base jurisdiction and receives authorization to travel in other IFTA member jurisdictions. The base jurisdiction then distributes the taxes owed to other states and provinces based on the tax rate and miles traveled in each state and province. The base jurisdiction is also responsible for auditing its carriers for all other IFTA members. Also, IFTA provides uniform fuel tax reporting with standardized forms, due dates, and other administrative processes.

The first IFTA agreement was formed in 1983 between Arizona, Iowa, and Washington. In 1985, the United States Department of Transportation (USDOT) funded a 3-year project that examined the encumbrances faced by interstate motor carriers from the heterogeneous administration of motor fuel taxes and produced a model draft of IFTA to be adopted by states. The National Governors' Association (NGA), the National Conference of State Legislatures (NCSL) and several state and industry representatives were involved with this study. However, by 1990, many states resisted joining IFTA and only 14 states had become members.

Due to pressure by the motor carrier industry, Congress included provisions in the Intermodal Surface Transportation Efficiency Act (ISTEA) that compelled states to adopt IFTA. Congress never explicitly mandated states to adopt IFTA, but the consequence was the same as if they had. Section 4008 of ISTEA had declared that states that had not complied with IFTA by September 30, 1996 would not be permitted to impose reporting and payment of motor fuel taxes. The same section of ISTEA also granted significant funds for any state that joins IFTA. As of 1996, all 50 states and nine Canadian provinces had become members of IFTA.

2.6 Tax Codes

Changes in administrative and enforcement efforts have also been accompanied by efforts towards reducing fuel tax evasion by closing gaps in tax code through legislation and rulemaking. Fuel tax law has also been shaped by legal disputes primarily between Native American Tribes and states. This section presents recent legislation and court cases related to motor fuel excise taxes.

2.6.1 Federal Legislation

The most recent legislation impacting motor fuel excise taxes at the federal level was the American Jobs Creation Act of 2004 (Public Law No. 108-357 on October 22, 2004). Several modifications and additions to the tax code were passed to reduce opportunities for evasion and strengthen penalties in order to reduce the incentives for evasion. The following sections of this report represent changes and modifications to federal fuel tax legislation included in Subtitle C – Reduction of Fuel Tax Evasion:

- *Section 853. Taxation of Aviation-Grade Kerosene.*
  This modification of the section changes the incidence of taxation of aviation fuel from the sale of the aviation fuel by a producer or importer to the removal of the aviation fuel from the refinery or terminal. In addition, the sale of not-previously-taxed aviation fuel would be subject to tax if the aviation fuel is sold to an unregistered person.

- *Section 854. Dye Injection Equipment.*
  The modification of this section requires the Secretary of the Treasury to issue regulations regarding standards for tamper-resistant mechanical dye injection systems and penalties for tampering with or failing to maintain security requirements for mechanical dye injection systems.

- *Section 6715A. Tampering with or Failing to Maintain Security Requirements for Mechanical Dye Injection Systems.*
  The modification of this section imposes a penalty on tampering with mechanical dye injection systems; the greater of $25,000 or $10 for each gallon of fuel involved, and a $1,000 penalty for each day it is not corrected. The liability for failure to maintain security requirement are imposed if such person should have reasonably known of such violation. This section also imposes joint and several liabilities on any business entity, each officer, employee, or agent of such entity or other contracting party who willfully participates in any act involving the penalties.

- *Section 855. Elimination of Administrative Review for Taxable Use of Dyed Fuel.*
  This section was modified so that there will be no administrative appeal for third and subsequent violations related to the penalties outlined in Section 6715. The modification includes an exception in the case of fraud, mistake, or mathematical calculation of the amount of the penalty.

- *Section 856. Penalty on Untaxed Chemically-Altered Dyed Fuel Mixtures.*
  This section was modified to include a forth paragraph which states that the penalties in section 6715 will apply also to: "any person who has knowledge that a dyed fuel which has been altered as described in paragraph (3) [of section 856] sells or holds for sale such fuel for any use which the person knows or has reason to know is not a nontaxable use of such fuel."

- *Section 858. Authority to Inspect On-Site Records.*
  This section, which previously limited on-site record inspections to include the examination of the equipment used to determine the amount or composition of taxable fuel and of the equipment used to store the fuel and further allowed the removal of samples of taxable fuel, was modified to include the inspection of any books, records, or shipping papers pertaining to taxable fuel.

- *Section 6717. Refusal of Entry.*
  This is a new section added to impose a penalty of $1,000 for refusal of entry for inspection and joint and several liability on any business entity, each officer, employee, or agent or other contracting party who willfully participated in any act giving rise to the penalty (i.e., refusal to admit entry).

- *Section 860. Registration of Pipeline or Vessel Operators Required for Exemption of Bulk Transfers to Registered Terminals or Refineries.*
  An addition of a paragraph (c) was added which states that the Secretary of the Treasury shall publish periodically a current list of persons registered. These registered persons are any pipeline or vessel operator that is a party to a bulk transfer.

- *Section 861. Display of Registration.*
  This section is modified to require that each operator of a vessel that is required to be registered must display proof of registration on each vessel that transfers taxable fuel.

- *Section 6781. Failure to Display Tax Registration on Vessels.*
  This is a new section that imposes a penalty of $500 for each failure to display the proof of registration required in section 861. Multiple violations are increased by the multiplication of the number of incidents and the penalty is only imposed once per month per vessel. There are exceptions to imposing the penalty for "reasonable cause."

- *Section 6719. Failure to Register.*
  This new section imposes a penalty of $10,000 for each initial failure to register and $1,000 for each day thereafter that such person fails to register. This pertains to every person who is required to register under section 4101 (motor fuel tax act). There is an exception for "reasonable cause" from the penalty.

- *Section 6725. Failure to Report Information Under Section 4101.*
  This new section imposes a penalty on any person with respect to a vessel or facility of $10,000 for any failure to make a report required under section 4101(d) on the due date or any failure to include all of the information required or including incorrect information.

- *Section 864. Electronic Filing of Required Information Reports.*
  Modification of this section requires that any person that is required to report under this subsection and who has 25 or more reportable transactions in a month will be required to report in electronic format.

- *Section 870. Transmix and Diesel Fuel Blend Stocks Treated as Taxable Fuel.*
  This section was modified so that the definition of diesel fuel would be expanded to any liquid which is sold as or offered for sale as a fuel in a diesel-powered highway vehicle or a diesel-powered train. Transmix is defined to mean a by-product of a refined products pipeline operations created by the mixing of different specification products during pipeline transportation.

- *Section 871. Study Regarding Fuel Tax Compliance.*
  This section was added and states that the Secretary of the Treasury must submit to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives a report regarding compliance of motor fuel tax which would include a list of blended fuel stocks, waste products added to taxable fuels, IRS findings of erroneous certifications of tax exempt status and information, and analysis and recommendations for correction of these issues.

2.6.2 Legislation, Court Cases, and Motor Fuel Taxation on Native American Reservations

As discussed in subsequent sections of this report, the presence of Native American reservations has provided a distinctive and complex compliance issue for state agencies due to the particular opportunities for fuel tax evasion. Two recent examples of state legislative efforts and court cases in Kansas and Idaho highlight current issues and the status of state fuel taxation on Native American reservations.

Idaho House Bill 732

The State of Idaho had been imposing a 25 cent motor fuel tax on all motor fuel delivered to the Indian tribes within the State of Idaho. In 1999, the Idaho District Court (a federal court) held that the Idaho Tax Commission did not have the legal right to collect the tax from the distributors of motor fuel purchased by the Indian tribe of Idaho. In *Goodman Oil Co. v Idaho State Tax Commission*, the Idaho Supreme Court affirmed the Idaho District Courts decision. The two issues of the case were: 1) whether the Hayden-Cartwright Act, 4 USC §104, gave the Idaho Tax Commission the right to tax distributors of motor fuel to Indian tribes within Idaho and 2) whether the Idaho Code §§63-2401 et seq. and 41-4901 et seq. (regarding motor fuels tax) placed the legal incidence of tax on the Indian tribes.

The Idaho Tax Commissioner's position in regard to the Hayden-Cartwright Act was that the Act gave the Commissioner the right to tax the Indian reservations within Idaho. This position was based on paragraph (a) of section104 – Tax on motor fuel sold on military or other reservation; reports to state taxing authority – which stated the following:

> All taxes levied by any State, Territory, or the District of Columbia upon, with respect to, or measured by, sales, purchase, storage, or use of gasoline or other motor vehicle fuels may be levied, in the same manner and to the same extent, with respect to such fuels when sold by or through post exchanges, ship stores, ship service stores, commissaries, filling stations, licensed traders, and other similar agencies, located on United States military or *other reservations*, when

> such fuels are not for the exclusive use of the United States. Such taxes, so levied, shall be paid to the proper taxing authorities of the State, Territory, or the District of Columbia, within whose borders the reservation affected may be located.

The Idaho Supreme Court held that the Hayden-Cartwright Act, 4 U.S.C. §104, did not confer authority to the state for imposing a gasoline tax on gasoline sold to Indian tribes because the Act was referring to military reservations and not Indian reservations. Secondly, it was also decided that the incidence of the state's motor fuels tax, Idaho Code §§63-2401 et seq. and 41-4901 et seq., fell on the Indian tribes.

In 2002, Idaho passed House Bill 732 in reaction to the Idaho Supreme Court decision. The intent of the Act was to clearly state that the legal incidence of motor fuel tax was to be borne by the distributor. Immediately following when the amendments of House Bill 732 took effect, the Coeur d'Alene Tribe challenged the state in Federal District Court. Other Idaho tribes also filed similar lawsuits. That same year, the Federal District Court invalidated the tax, concluding that the amendments had not shifted the tax's legal incidence to the non-Indian distributors, rejecting the Hayden-Cartwright Act's applicability to Indian reservations again.

The Idaho state tax commissioners appealed the Federal District Court's decision to the Ninth Circuit Court of Appeals. The Ninth Circuit Court of Appeals affirmed the district court's decision in August of 2004. A petition for certiorari was then filed in November of 2004 by the Attorney General of Idaho, which asked the Supreme Court to review the case of Coeur d'Alene Tribe v. Hammond. The Supreme Court was asked whether "a federal court may deem the legal incidence of a motor fuel tax to be borne by retailers, where a state legislature has expressly allocated the incidence to the distributor and whether the Hayden-Cartwright Act encompasses Indian reservations." The Supreme Court rejected to hear the case, therefore upholding the Ninth Circuit Court of Appeals decision.

The implications of these cases are that Idaho is not able to collect taxes for fuels headed for Indian reservations. Further, the implications impact other states because of the rejection that the Hayden-Cartwright Act is applicable to Native American reservations.

Kansas Motor Fuel Tax Act. (Kan. Stat. Ann. §§ 79-3401 to 79-3464f)

In 1995, Kansas amended the Kansas Motor Fuel Tax Act. This amendment placed the legal incidence of the motor fuel tax on the distributor. Kan. Stat. Ann. §79-3409 allows the distributors to pass the tax to the fuel retailers. After these changes in the statutes, the Kansas Department of Revenue began collecting tax on motor fuel distributed to Indian reservations.

The Prairie Band Potawatomi Nation brought suit against the Kansas Department of Revenue in U.S. District Court for the District of Kansas. The Prairie Band Potawatomi Nation owned gas station was taxing the fuel sold to consumers through the station. The Prairie Band Potawatomi Nation kept the tax and used the revenue tax to maintain and construct roads on the reservation.

At issue was whether the Kansas Department of Revenue had the authority to tax motor fuel distributed to the Prairie Band Potawatomi Nation owned gas station (*Prairie Band Potawatomi*

Nation v Richards, Secretary of the Kansas Department of Revenue, 241 F. Supp. 2d 1295, 2003 U.S. Dist.).

There were numerous laws listed in support of each party's argument in the suit regarding the issue of whether the Kansas Department of Revenue or the Prairie Band Potawatomi Nation had authority to tax the fuel sold on the Indian reservation. The Kansas Department of Revenue argued that the Hayden-Cartwright Act 4 USC §104 allowed the State of Kansas to tax motor fuel sold on the Indian reservation within the state and that the state's fuel tax was not preempted by federal law. The Prairie Band Potawatomi Nation argued that the following laws barred the Kansas Department of Revenue from taxing the Prairie Band Potawatomi Nation:

1) U.S. Constitution Article I, §8 Clause 3, also known as the "Indian Commerce Clause;"
2) Act for Admission of Kansas into the Union, Chapter XX, §1, 12 Statute 126 (1861) also known as "The Act for Admission of Kansas;" and
3) The Prairie Band Potawatomi Nation's right to self-government and self-determination.

The court held that the Hayden-Cartwright Act did not allow the State of Kansas the right to tax the Indian reservation. The court also held that the Indian Commerce Clause and the Act for Admission of Kansas did not prohibit the State of Kansas from taxing the Prairie Band Potawatomi Nation. The court granted the Kansas Department of Revenue a summary judgment in their favor. The court supported their decision in the case by stating that the legal incidence of the Kansas motor fuel tax falls on non-Indians. The court weighed the balancing of the federal, state, and tribal interest. The court cited *Washington v Confederated Tribes of the Colville Indian Reservation,* 447 U.S. 134 (1980), a Supreme Court decision that held "that while federal policy seeks to foster tribal self-government and economic development, it does not preclude state taxation of sales by Indians to nonmembers of the tribe."

The Prairie Band Potawatomi Nation appealed to the United States Appellate Court, Tenth Circuit. The court reversed the U.S. District Court's holding. The appellate court supported its decision by stating that the motor fuel tax is on value being created on the reservation through the casino and that Kansas does not maintain the road to the casino. The casino's patrons are the main patrons of the gas station in question in which the debate centers on the motor fuel tax generated from this gas station. Therefore, in balancing the federal, state, and tribal interest, the tribal interests outweigh the Kansas state's interest (*Prairie Band Potawatomi Nation v Richards, Secretary of the Kansas Department of Revenue,* (CA-10, 2004)).

The State of Kansas petitioned for certiorari asking the Supreme Court on November 5, 2004 to hear the case. The Kansas Department of Revenue has asked the Court whether:

1) The interest-balancing test in *White Mountain Apache Tribe v Bracker,* 448 U.S. 136 (1980), applies when a state taxes the off-reservation receipt of fuel by non-tribal entities because the fuel is later sold by a tribe to final consumers;
2) The interest-balancing test should be abandoned in favor of a preemption analysis based on the principle that Indian immunities are dependant on congressional intent; and

3) The Court of Appeals erred by placing dispositive weight on the fact that the tribally-owned gas station derived income from largely non-tribal patrons of the tribe's nearby casino.

On December 6, 2005, the U.S. Supreme Court upheld the legality of the Kansas fuel tax by a 7-2 vote. The U.S. Supreme Court found that Kansas law made it clear that the tax fell on the distributor, not the retailer. Thus, the distributor, regardless of where the tax is ultimately sold, is responsible for remitting taxes to the State of Kansas.

2.6.3 Model Legislation Checklist

As noted previously, the Motor Fuel Tax Section Uniformity Project's objective is to reduce motor fuel tax evasion by enabling better cooperation between jurisdictions through uniformity.

Part of this effort has produced a checklist of model legislation, which is a reference that governments can look to when making statutory changes. Below is a summary of the Uniformity Project suggestions regarding analysis, planning, and development before implementation of legislative changes.

The first consideration suggested in the Model Legislation Checklist is to "determine who the taxpayer will be" (FTA 2003). The four "taxpayer" options or points of taxation listed in the checklist are:

1) Taxation at the Terminal Rack,
2) Tax at the Distributor/Wholesale Level,
3) Tax at the Retail and/or Use Level, and
4) Tax on First Importation.

Jurisdictions considering a change in the point of taxation need to be taking into account a number of legal considerations including where the legal incidence of taxation falls. Are there federal laws that will preempt the fuel tax? For issues related to taxation and Native American reservations, courts may hold that the state's rights are preempted by federal law. The analysis must include an evaluation of the state law to ensure it does not conflict with the federal laws or constitutional laws. Further considerations need to be given to how imports and exports will be handled so they are not in conflict with other states' or countries' statutes.

Another significant issue that jurisdictions must address is the method of tax reporting and collection. For instance, recently passed under the American Jobs Creation Act of 2004 were electronic filing requirements that mandated that all individuals with 25 or more reportable transactions monthly are required to report in electronic format. Electronic transmission of reports has benefits such as increased processing speed and enforcement benefits; however, ensuring security in all transactions and privacy of information is a priority and also needs to be considered and appropriately handled. Further, the question of who would bear the cost of fees of electronic reporting and payments must also be addressed. The Model Legislation Checklist suggests the following items when considering legislation for electronic payments:

1) Provide a minimum threshold when electronic funds transfer (EFT) payments are required;
2) Allow sufficient time for taxpayers to register and test the process prior to implementation of the legislation;
3) Allow voluntary payments for smaller than threshold amounts;
4) Provide a process to refund or otherwise correct duplicate or erroneous payments, which includes the EFT option;
5) Provide an alternative payment method when a failure in the electronic process occurs;
6) Determine who will pay the fees, taxpayers or state, if fees are incurred ;
7) Provide taxpayers the ability to "warehouse" Automated Clearinghouse debit payments as warehousing the payment allows the taxpayers to initiate the payment prior to the due date but have the settlement of the funds occur on the due date. Industry considers this a critical component of any EFT program; and
8) Recognize that the taxpayer may lose the "float" on their payment using this method.

Another major consideration is how refunds should be dealt with. For instance, in what situations and by what entities would refunds be allowable are necessary questions to address. The model legislative check list suggests analyzing the following criteria when making the determination of exempt uses and refunds:

1) Exports;
2) K-1 kerosene;
3) Taxable motor fuel sold to the United States or its agencies or instrumentalities;
4) Diesel fuel used to operate equipment attached to a motor vehicle;
5) Diesel fuel used as heating oil or in trains, or used for other non-highway purposes;
6) Taxable motor fuel used on a farm for farming purposes;
7) Taxable diesel fuel, which has been accidentally contaminated by dye;
8) Taxable motor fuel used in state-owned school buses and in state-owned administration and service vehicles used in the pupil transportation program;
9) Gasoline sold or dispensed for use in commercial fishing boats;
10) Taxable diesel fuel sold or dispensed for use by state and local government highway vehicles;
11) Erroneous payment refunds;
12) Refund claim procedures, in general;
13) Interest on refunds;
14) Destination state diversion procedures;
15) Federal considerations (always review current laws); and
16) Sales to third-party credit card companies – third-party credit card companies are defined as card companies not wholly owned by an oil company, which use a credit card for motor fuel transactions.

A good example of the determination of tax treatment of diesel fuel used in the operation of equipment attached to highway vehicles is in federal legislation (American Jobs Creation Act of 2004 – Public Law No. 108-357, October 22, 2004 Subtitle C – Reduction of Fuel Tax Evasion. Section 851. Exemption from Certain Excise Taxes for Mobile Machinery). In some cases, federal statutes can be analyzed and used to model state legislation.

Other considerations recommended by the Model Legislation checklist are licensing and bonding requirements, fraud penalties, how records and reports should be maintained, and treatment of alternative fuels.

CHAPTER 3.0 FUEL TAX EVASION AND CURRENT COMPLIANCE AND ENFORCEMENT ACTIVITIES

Over the past 30 years, a multitude of schemes have been invented to evade state and federal motor fuel taxes. These schemes take advantage of the characteristics and processes of the motor fuel tax system in and between jurisdictions (e.g., borders, alternative fuels, the IFTA process, the presence of Native American reservations, fuel dyeing, refund and credit processes, etc.). States and the federal government have devised a multitude of tools, strategies, and methods for dealing with, and estimating the magnitude of motor fuel tax evasion. This section of the document reports on the magnitude of fuel tax evasion found through studies in a number of jurisdictions and describes the various schemes used to evade motor fuel taxes.

This chapter is organized in the following three sections. First, a range of evasion estimates and rates will be presented as found through evasion studies at the federal and state level. Second, an overview of the methods used to evade taxes will be described in terms of the motor fuel tax administration and jurisdictional characteristics they exploit. Finally, a checklist of best practices will be highlighted and the compliance impacts of these practices will be reported based on how they are perceived to impact motor fuel tax evasion. Further, to the extent possible, revenue and cost impacts of these practices will be documented wherever analyses within the jurisdictions employing these practices have been identified.

3.1 Rates of Motor Fuel Tax Evasion

The first significant attempt at deciphering federal fuel tax evasion was completed in 1987 by the National Economic Research Associates (Addanki et al 1987). This study employed econometric analysis and a comparison between fuel consumption and taxed gallons to estimate federal gasoline tax evasion. The study found little evidence of evasion between the years 1979 and 1982 using the fuel consumption and taxed gallons comparison method. However, after the federal gasoline tax rate increased in 1983, a distinct increase in the gap between taxed gallons and estimated consumption was apparent, equaling $500 million in lost collections per year during the period of 1984 to 1986. Using the econometric approach, consumption data was trended for the period of 1974 to 1982 and then used to predict the number of gallons of gasoline that should have been taxed during 1984 to 1986. The divergence between actual and predicted gallons of taxed fuel for this two-year period was 5.6 billion gallons annually. In dollar terms, this amounted to $510 million dollars in lost revenue.

Using a similar comparison, Mitstifer of the National Association of Truck Stop Operators estimated diesel tax evasion in 1992 (Mitstifer 1992). In this study, a comparison was made between gallons of diesel taxed and volumes consumed as reported by truck stops. Based on the difference between taxed and consumed volumes, it was estimated that federal diesel tax evasion totaled roughly $3 billion annually.

In a study sponsored by the FHWA and prepared by the Joint Federal/State Motor Fuel Tax Compliance Project, estimates of motor fuel tax evasion were based on testimony, prior studies, and information documented by fuel tax fraud investigations (FHWA 1992). This study estimated the diesel fuel tax evasion rate to be between 15 and 25 percent of gallons consumed,

but it was concluded that the evasion rate was probably close to 20 percent. This would have meant that evasion was costing the federal government $860.2 million in taxes at the time. The gasoline tax evasion rate was also estimated at a range between 3 percent and 7 percent of gallons consumed, but it was stated that the authors believed the actual evasion rate to be at the lower end of the range due to changes in administration of fuel taxes such as the movement of the point in taxation for gasoline to the terminal rack in 1988. Based on 3 percent tax evasion, it was estimated that gasoline tax evasion was costing $466.1 million in lost revenue at the time.

Table 3-1 describes various estimates of federal fuel tax evasion.

Table 3-1. Federal Fuel Tax Evasion Studies Summary

Author(s)	Date	Evasion Estimate
Addanki, National Economic Research Associates, Inc. (NERA)	1987	More than $500 million up to the point study was completed in federal gasoline taxes
Federal Highway Administration	1992	3% on gallons of gasoline; 20% on gallons of diesel
Mitstifer, National Association of Truck Stop Operators	1992	$3 billion in Federal diesel taxes
KPMG	2001	$1.7 - $9.2 billion in federal diesel taxes over the next 10 years due to jet fuel diversion

At the state level, the first study to consider motor fuel tax evasion at the federal level (Addanki et al. 1987) also made an effort to quantify fuel tax evasion in New York. Employing econometric analysis, pre-1982 gasoline sales, and traffic counts, gasoline prices in New York were correlated and used to predict post-1982 gasoline consumption trends. Then, as with the federal study, the divergence between predicted gasoline consumption and taxed gallons was used to estimate evasion, which was $168.4 million in 1984 and $254.5 in 1985.

After an almost 10-year lull in efforts to estimate state-level fuel tax evasion, several studies were published on this subject in 1996. One study published was by the Council of State Governments and the Council of Governors Policy Advisors and focused on fuel tax evasion for all states (CSG & CGPA 1996). Two methods were used to estimate rates of fuel tax evasion; surveying fuel tax administrators and econometric analysis. Based on the perceptions of fuel tax administrators, diesel and gasoline tax evasion was costing states approximately 6.53 percent in revenues. At that time, this equaled a total of $1.2 billion in extra revenues for all states combined. The second method entailed estimating demand for motor fuels using a step-wise regression model and then comparing these estimates to fuel tax collections. This method produced an estimate of $952 million for all states.

Another study published in 1996 also explored state-level fuel tax evasion for all states (Mingo et al. 1996). Based on a comparison of reported diesel fuel consumption with consumption

based on state truck travel, it was estimated that tax evasion occurs on 21 percent of all diesel fuel consumed.

Fuel tax evasion has been explored for individual states as well. One study published in 1996 used a survey of Southern fuel tax administrators estimating fuel tax evasion in Kentucky (Denison and Hackbart 1996). Fuel tax administrators were asked to estimate the increase in fuel tax revenues given the elimination of fuel tax evasion. Based on their answers, it was reported that the average loss in revenue due to gasoline tax evasion was approximately 4.64 percent and the average loss in diesel revenue due to evasion was 10.05 percent. This would have meant a loss of $26 to $34 million yearly at the time in Kentucky.

A study focusing on Washington used a combination of several methods to produce an estimate of motor fuel tax evasion including: literature review, border interdictions, and analysis of audit data. The study, published in 1996, reported that fuel tax evasion for all fuels was likely costing the State of Washington $15 to $30 million in revenue annually.

Wisconsin fuel tax evasion was explored in another study, published in 2002, specifically due to refund fraud and misuse of dyed fuel (Eger 2002). Using regression analysis and controlling for factors such as total farm acreage, number of farms, and tax rates, Wisconsin's consumption of tax-exempt fuel exceeded other states in the region by approximately $4 million. Figure 3-1 describes fuel tax evasion studies that focus on the state-level.

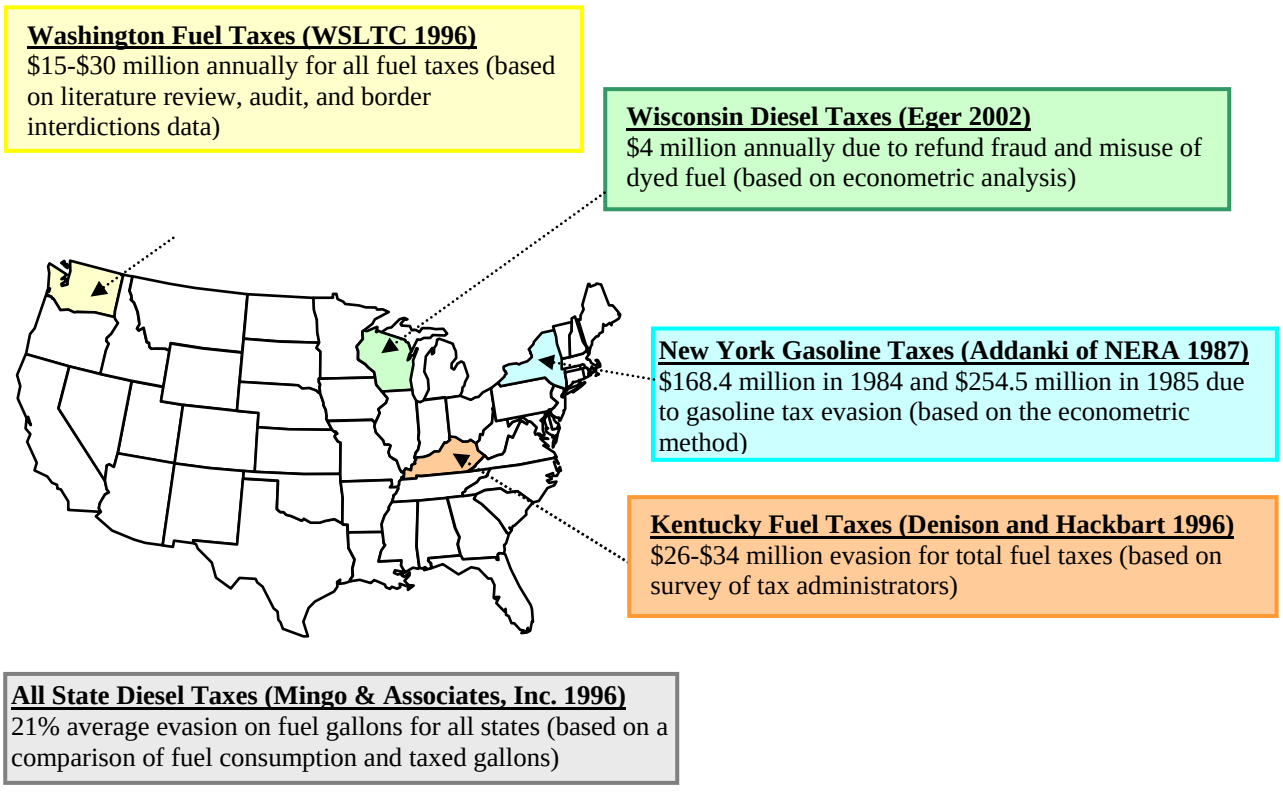


Figure 3-1. Summary of State Fuel Tax Evasion Studies

3.2 Motor Fuel Tax Evasion Schemes

The following is a synopsis of the major known schemes used to evade motor fuel taxes. For the sake of simplicity, these schemes are classified into the following categories: border schemes, dyed fuel schemes, alternative fuels schemes, IFTA fraud, false refund and credit schemes, daisy chain schemes, and failure to remit schemes.

3.2.1 Border Schemes

Perpetrators of motor fuel tax evasion can exploit differences between jurisdiction tax programs through border schemes. The gap in the information, administrative, and enforcement processes between states make importing and exporting an easy target through which evasion can be accomplished.

Bootlegging across state lines
The difference in tax rates between bordering states makes this scheme lucrative. Perpetrators profit by paying lower state taxes and selling fuel in a higher tax rate state at the higher tax rate state's prices. Terminal or distributor reports will falsely declare that the fuel was delivered to an instate retail location. Since the tax is paid in the low tax state, it is unlikely that the scheme will fall onto the radar of the low tax state. However, if either state requires retailer reports and cross checks these reports with terminal and distributor reports, it is likely that this scheme could be discovered. Perpetrators can get around this by owning retail stations in whichever state requires these reports and falsifying information on retailer reports. States may also catch this scheme by being mindful of potential locations in which it can occur. For instance, it will only happen between states with differentials between tax rates. Further, the diverted gallons will likely be delivered to retail stations within a certain distance from the border due to transport costs. Increased monitoring at border sites and audits that track fuel from the terminal to retail outlet may help to deter this form of evasion.

False export schemes, to state, province, or Native American reservation
Fuel is sold within a state but false paperwork is filed claiming that these gallons were exported to another jurisdiction. Thus, the tax due on these gallons is avoided altogether. This scheme can occur between states and across international borders. Fuel gallons can also be falsely claimed to be exported to a Native American reservation for the use of its residents. Like the scheme above, and unless the perpetrators' operations extend to all of the points in the distribution chain that fuel accountability reports are required, this scheme can be discovered and deterred through requiring retailer reporting as a part of a total fuel accountability system.

Illegal importation schemes, import directly to native reservation
After purchasing fuel from a foreign source, this fuel can be smuggled into the United States by barge or truck. In both cases, steps are taken to hide gallons from any documentation by customs agent or businesses within the fuel distribution system. By truck, the fuel can be shipped across unmanned points at the border or a false bill of lading can be presented if requested by customs agents at manned border crossings. By ocean vessel, the proper importation paperwork can be filed with falsified information or simply not filed. The

shipment could be offloaded at a secret location directly to tanker trucks which could drive the fuel directly to retail stations. Alternately, the customs officer(s) charged with inspecting bulk loads could be part of the conspiracy or the tax evaded gallons could be offloaded after the offloading of legitimate tax paid fuel has been unloaded and the officer gauging the shipment has left. The gallons are not reported on any further terminal, distributor, or retail report and the tax is avoided.

3.2.2 Dyed Fuel Schemes

The dyeing of tax exempt fuel (e.g. diesel and home heating oil) has created an easy way to detect whether tax exempt fuel is being misused for taxable purposes. However, there are many ways to subvert the intentions of the dyed fuel system.

Delivering dyed fuel to retail outlets
Delivery of dyed fuel to retail stations is possibly the easiest way to undermine the dyed fuel rules but is also possibly the most risky. A fuel distributor can pick up a load of dyed fuel using falsified or stolen federal and state registration and then sell it as tax paid fuel at a retail station, pocketing the tax as profit. Customers would be filling their tanks with dyed diesel unknowingly. This scheme is risky because station attendants, drivers, or on-road enforcement may spot the fuels color and it could be easily tracked back to the deliverer. However, the perpetrator could set up a sham company and can operate under phony names to guard against being discovered.

Tapering with fuel dye equipment
Terminal card lock stations at night and retail card lock stations in general are commonly unmanned. This allows a perpetrator to pull up to the loading rack and tamper with the equipment, circumventing injection of the dye into the fuel load. The way in which the injection of dye is avoided will vary depending on the type of injection equipment. In a case discovered and prosecuted in Indiana, a driver was seen on surveillance tape closing the injection valve and opening the test valve on a three valve system (i.e., injection, intake, and test valves) (CBPP 2004). While the truck was loaded with diesel, the dye was poured into a bucket.

Failure to splash dye
For terminals that do not have special dye injection equipment, many states allow splash dyeing (i.e., pouring the dye directly into a fuel tank) although the IRS no longer allows it for tax exempt status. A driver can purchase tax-free fuel and fail or pretend to splash dye. An elaborate way to avoid mixing the dye with fuel involves modified tanker trucks with internal and separate bladders that a trucker can pour the dye into. Montana does not allow splash dyeing.

Illegal dye removal schemes
After apparent red color from tax exempt fuel is removed, perpetrators of this scheme sell it as taxable fuel at taxed prices. There are several possible ways to remove the red color. One way is to set up an elaborate filtration process and run fuel through several tanks containing charcoal until the fuel is clear. It is also possible that a perpetrator can own a plant for re-refining mixed fuels such as transmix and can remove the red dye there. Solvents such as bleach or sulfuric acid may also be added to fuel to remove visible red color. Finally, one method discovered in Ontario, Canada involved a driver pouring green dye into the tanker to mask the apparent red color (Taylor 2005).

Use of dyed fuel on road
This type of evasion scheme doesn't take the creativity and planning that most other evasion schemes require, but instead is simple and fairly common. Dyed diesel violation rates, as reported by several states from inspections in 2004 and 2005, ranged from approximately 0.5 percent to 1.8 percent (Morris 2005). Dyed diesel is accessible to businesses that operate off-road vehicles for logging, construction, and farming. These businesses or individuals associated with these businesses can fill up the gas tanks of on-road vehicles at unmanned card lock stations or at fuel tanks owned and placed at the business site.

3.2.3 Alternative Fuels Schemes

Perpetrators of these fuel tax evasion schemes take advantage of the fact that there are many products that are usable for motor fuel but not taxable or not tracked by taxing agencies.

False product labeling
Perpetrators label a taxable product as non-taxable but then later sell it for a taxable use. For instance, kerosene is not taxable or is taxed at a reduced rate in many states but since it is substitutable for diesel, it can eventually be sold as diesel fuel for on-road use at taxed fuel prices.

Blending
There exist many products that can be blended with motor fuel (e.g., used motor fuel, transmix, dyed fuel, natural gasoline, alcohol, aviation fuel, biodiesel, and solvents). These products can be used to extend fuel volumes, depending on the blend ratio, without noticeably impacting short-term engine performance. However, some products when mixed in large enough quantities will cause long-term engine damage. Certain products will also cause the resulting fuel to be visibly darker, which can serve as an indication that a fuel has been blended.

3.2.4 IFTA Fraud

This type of fuel tax fraud is perpetrated solely by motor carriers through the IFTA return process. Motor carriers purchase tax paid fuel and file IFTA returns in their base jurisdiction. The incentive to cheat on IFTA returns comes directly from differentials in state tax rates. The taxes can be refunded, remitted to other jurisdictions, or kept by the base jurisdiction depending

on the amount of miles driven in each jurisdiction and where fuel was originally purchased. There are several ways to defraud the IFTA process, but any of these schemes generally mean that a state with a higher tax rate relative to neighboring states is cheated out of tax revenue. For example, a carrier can falsely claim that more miles were driven in a lower tax state than actually were thereby wrongly entitling the carrier to a refund if the fuel was bought in a high tax state or making it so that the carrier does not have to remit extra taxes if the fuel was bought in the low tax state. Another violation would occur if the carrier simply did not register and file IFTA returns or illegally obtained IFTA decals.

3.2.5 Refund and Credit Fraud

Perpetrators of this scheme file for refunds falsely claiming that taxed fuel was used for a non-taxable purpose. The types of non-taxable uses will vary from jurisdiction to jurisdiction but can include the following: fuel was sold to a government agency; fuel was used in off-road equipment (e.g., farming, construction, or logging vehicles); fuel was contaminated or destroyed; allowance for loss of fuel due to evaporation and handling; fuel used in marine vehicles; and fuel used for home heating. Refund fraud may be more prevalent in tax at the rack jurisdictions because fuel is determined taxable earlier in the distribution chain as compared with other points of taxation. Some states have considered doing away with refund programs all together and completely relying on their tax or dye programs to suit the needs of off-highway travel. One state, Texas, does not allow any refunds or credits for diesel.

3.2.6 Daisy Chains

Daisy chains appeared to be the most dominant and costly type of fuel tax evasion scheme known in the 1980s but have since almost disappeared from the radar of fuel tax administrators; likely due to the changes in fuel tax policy adopted in the past 20 years which lessened the opportunities for this type of evasion scheme. In this scheme, a chain of dummy corporations are set up and transact several false purchases existing only on paper. The fuel is eventually sold to a legal retail operation at taxed rates without remitting the tax. If and when these operations are investigated, one of the dummy companies is allowed to fold and the liability for the tax terminates.

3.2.7 Failure to File Schemes

In this scheme, perpetrators purchase tax-free fuel and sell it as tax paid to distributors or retailers. There are two known possible ways perpetrators can purchase tax-free fuel. One way would be to apply for state and federal registrations allowing businesses to purchase tax-free fuel and simply not make tax payments when they are due. When enforcement finally catches up to the perpetrators, which may be enough time for the perpetrators to make a great deal of money on this scheme, the business is allowed to fold. Another way would be to create false registration documentation to present at the time of purchase. Once again, the business may be shut down if and when enforcement pursues the tax evaders.

3.3 Best Practices

Over the years, certain legislative actions and administrative processes have been devised and instituted to combat fuel tax evasion and simplify fuel tax administration. Conclusions regarding what practices are the most effective at ensuring motor fuel tax compliance can be drawn through the experiences of taxing jurisdictions, the perceived benefits of such practices by the staff instituting such policies, and the recommendations made by the Model Legislation Subcommittee of the FTA Uniformity Project. The following section describes a set of model fuel tax administrative practices and legislative actions. These practices will be further examined through a discussion of the costs and compliance impacts experienced by jurisdictions wherever adequate examples exist.

3.3.1 Point of Taxation

Taxation at the terminal rack is widely thought to be the most efficient and effective method with respect to motor fuel points of taxation. Through the interviews conducted for this project, it became apparent that many states and provinces have recently moved the point of taxation to the terminal rack or are in the process of considering doing so out of expectation of improved compliance. However, although a significant number of jurisdictions have moved to this point in taxation, there is no absolute consensus regarding this issue.

Some contend that each point of taxation has certain benefits and fosters particular compliance problems and the decision of what is best may vary from jurisdiction to jurisdiction. Further, the Model Legislation checklist provided by the Model Legislation Subcommittee does not claim that any particular taxation point is best. The document explains that while a point of taxation higher in the fuel distribution process will decrease the number of taxpayers thereby concentrating audit efforts allowing greater scrutiny on fewer accounts and freeing resources for other aspects of motor fuel taxation, it also opens up the possibility that a single entity can steal a greater sum of tax dollars because the tax liabilities are larger when there are fewer taxpayers.

There are many examples of revenue gains after jurisdictions move the point of taxation up the distribution chain, indicating that the new method of taxation had caught many gallons of fuel that had previously gone untaxed. Table 3-2 provides a summary of revenue impacts experienced by some states after moving their point of taxation up the supply chain. It should be noted that these estimates may be gross revenue increases and may not control for normal growth or changes in other administrative processes.

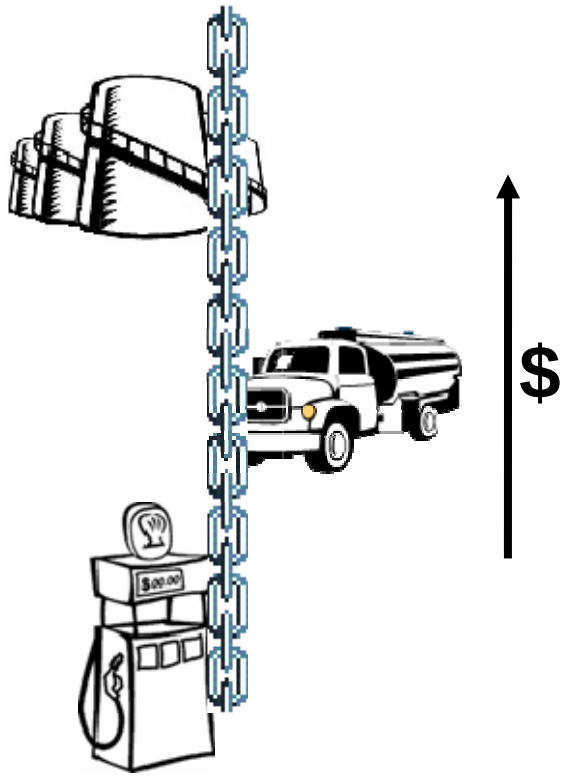
Table 3-2. Impacts of Moving the Point of Taxation Up the Distribution Chain[5]

State or Province	Change	Data of Change	Revenue Impact
Wyoming	Gasoline and diesel taxes moved to the terminal rack	1997	$5.6 million increase the following year
Washington	Gasoline and diesel taxes moved to the terminal rack	1999	$15 million increase the following year
South Dakota	Gasoline and diesel taxes moved to the terminal rack	1996	10% overall increase
North Carolina	Gasoline and diesel taxes moved to the terminal rack	1996	2% overall increase
California	Diesel moved to the terminal rack	1995	10%-15% increase
Michigan	Diesel moved to the terminal rack	1993	21.3 percent increase within first 6 months (FHWA 1993)
Idaho	Gasoline and diesel point of taxation moved to first receiver	1996	19% overall increase

It could be argued that the revenue increases experienced by jurisdictions due to moving the point of taxation for motor fuels up the distribution chain does not prove that taxing up the supply chain is better than taxing down the supply chain. It could be the case that it simply takes tax evaders a little time before new ways of stealing motor fuel taxes are devised under a fresh system. If this reasoning is correct, it might be that a jurisdiction could experience revenue increases by moving the point of taxation down the distribution chain, from the terminal rack to the wholesale level. This was indeed the case for New Jersey in 1992 after changing the point of taxation for diesel fuel from the wholesale level to the retail level in which a $30 million revenue increase occurred the first period that the change took effect. Figure 3-2 shows the benefits and costs of moving the point of taxation up the supply chain.

While significant time and resources may be required to change the point of fuel taxation, these factors have not been recorded and studied by jurisdictions that have legislated and instituted this change. Further, the costs and benefits of such a change will depend on the size of the jurisdiction and nature of the fuel taxing system being instituted. For instance, many states move their point of taxation up the distribution chain because collecting taxes from fewer taxpayers is easier and less costly to administrate. However, the consequence of moving the point in taxation up the distribution chain is the expansion of the refund program and the overhead costs associated with this expansion and potential for refund fraud. The size of the refund program will depend on the complexity of the exemptions and non-taxable uses of fuel.

[5] The estimates of the impacts of moving the point of taxation in each state are from Task 2 interviews conducted for this report, unless otherwise noted.



Primary Benefits:

- Fewer tax entities involved in collecting and remitting tax.
- Reduced opportunities for down stream evasion.
- Alleviation of the administrative burden on industry and tax administrators.

Primary Costs:

- Increased refund requests since fuel use is determined earlier in the distribution process.
- Greater incentive to evade taxes since tax liabilities would be greater.

Figure 3-2. Benefits and Costs of Moving the Point of Taxation Up the Supply Chain

3.3.2 Dyeing of All Tax-Exempt Fuel

All fuel that can be sold tax-free should be dyed. The existence of motor fuel products that are non-taxable but are not dyed leaves a significant opportunity to evade fuel taxes by using untaxed fuel for taxable purposes. The IRS requires that all tax-exempt diesel and kerosene be dyed and many states have adopted IRS definitions of these products so that the benefits of the tax or dye program can be generated at the state level. The costs of such a system are primarily absorbed by industry as the injector equipment must be purchased and installed at terminals and card lock stations. The inclusion of an invisible chemical marker with fuel dye is also an advantageous practice as many schemes attempt to subvert the apparent red color in tax exempt fuel that can be detected through fuel sample analysis.

3.3.3 Total Fuel Accountability

The ability to track motor fuel though the distribution system and have multiple party confirmation regarding the position of fuel gallons has been recognized as a significant step towards ensuring fuel tax compliance and is part of the 11-point plan authored by the Uniformity Committee. There are two main components of fuel accountability. The first step towards this capability is instituting reporting requirements for entities dealing in motor fuel, including: terminals, suppliers, common or contract carriers, distributors, retailers, and bulk dealers. The second is using these reports to cross-reference information regarding the transactions and movement of motor fuel gallons in order to account for all the motor fuel.

Cross-checking is either done electronically, manually, or through a mixed system. For efficiency sake, many jurisdictions have chosen to track motor fuel though electronic systems. Instituting an electronic system requires a significant initial investment. Some jurisdictions have chosen to develop their own tracking system while others have purchased tracking systems from outside vendors. Because each jurisdiction has unique circumstances and policies, each system must be tailored to meet these individual needs. Therefore, there is a wide variation in the costs to develop or purchase a state motor fuel tracking system.

Montana developed a system in-house that tracks fuel at the refinery, terminal, and distributor levels with the additional capability to include carrier reports though the department does not require it at this time. The total cost of this system was estimated at $200,000 (Beagles 2005). California developed an in-house electronic motor fuel tracking system that cost $3 million just in money spent paying outside contractors, which didn't include resources and time spent in-house on the system development (Frank 2005). Wisconsin's electronic motor fuel tracking system tracks terminal and supplier reports and was built in-house. This system cost was estimated between $1.5 to 1.75 million just in outside contracts; it is unknown how much was spent on in-house resources and time (Zwettler 2005).

Colorado contracted with Explorer to provide a motor fuel tracking service. This system is different from many other state fuel tracking systems in that Explorer provides a service of supplying reports and performing cross checking functions. The initial system development cost was $400,000 and monthly fees are $35,000 (Zion 2005). Manual systems are less costly initially, however, they require more labor time on an ongoing basis.

3.3.4 Uniformity

Just as a motor fuel tracking system helps to keep track of gallons within a jurisdiction, uniformity allows motor fuels to be tracked between jurisdictions. The lack of uniformity between states lends to the development of import/export schemes (e.g., bootlegging, false exports, illegal importing) because states cannot effectively compare import and export information. Uniform definitions, forms, and administrative practices allow jurisdictions to effectively and efficiently communicate interstate reported fuel distribution activity to identify unreported taxes and fraudulent activities.

Table 3-3 shows a plan developed by the FTA Uniformity Committee that lists 11 goals for reaching uniformity across states.

Table 3-3. FTA Uniformity Committee 11-Point Plan

11-Point Plan	
Point One	State adoption/implementation of the uniform reporting guidelines. Mechanism for the states to share information with other states. Identification by fuel type.
Point Two	State adoption/implementation of the uniform definitions for imports and exports. Require licensing of and reporting by importers and exporters.
Point Three	Incorporate the Federal Employer Identification Number (FEIN), Social Security Number (SSN), or Canadian Social Insurance Number as a reference for reporting and exchange of information between jurisdictions.
Point Four	Require licensing of all resellers or entities who obtain tax-free inventory for ultimate resale.
Point Five	State adoption/implementation of procedures to achieve total accountability of fuel to include: types of fuel that all states wish to account for or tax. Schedules of accountability for fuels, which may be subject to the tax. Total accountability should be both on audit and on the required schedules filed with the states. Reporting gallons as required by the uniform reporting guidelines. Reporting of commingled inventories held by multiple owners in a common terminal facility to be reported by the terminal operator. Review uniform cut-off time alternatives for declaring receipts and sales.
Point Six	Allow for uniform electronic reporting systems by adopting the ANSI ASC X12 standard for all EDI applications.
Point Seven	Regional workshops for auditing and investigative techniques to identify tax evasion schemes.
Point Eight	Review states' confidentiality laws; implement steps necessary, at a minimum, for states to provide licensing number information to industry and to provide licensing and tax information to other government jurisdictions.
Point Nine	Require third-party reporting on the movement of fuel. Transporter reports should include the movement of fuel by common or contract carriers. Adoption of uniform report forms for third-party reporting.
Point Ten	Establishment of a fuel tax advisory group in each state to be comprised of state and industry representatives. The purpose of this group will be the implementation of the 11-point plan and to address new issues as they occur.
Point Eleven	Encourage states to establish and adequately maintain a compliance staff dedicated to fuel tax enforcement.

Source: (FTA 2003)

The costs and benefits of uniformity are not easily quantifiable for a number of reasons. First, there are many levels of uniformity as evident in the FTA 11-Point Plan above. For instance, a jurisdiction may adopt only certain points of the plan above or may only partially adopt a particular point in the plan (i.e., some of the definitions may be in uniformity while other definitions remain heterogeneous). Second, adoption of uniform standards may occur incrementally over time instead of all at once. Third, different processes and varying levels of work and resources may be required to adopt certain aspects of uniformity due to each jurisdiction's unique circumstance. Fourth, the benefits of one jurisdiction adopting uniformity may accrue to other jurisdictions. For instance, if State A adopts uniform import schedules, State B (who has already implemented these uniform schedules) will now be able to easily access import information from State A. Lastly, the marginal benefits of uniformity to each jurisdiction may vary depending on the number of jurisdictions that have adopted uniform standards and to what level each jurisdictions' forms, definitions, and administrative tools and processes are uniform. Therefore, while implementing uniform standards does impose costs and does theoretically offer benefits, tracking and quantifying these costs and benefits may be significantly difficult. It is no wonder that no attempts have been made (to the knowledge of the authors) to quantify the resources needed to implement uniformity and the benefits accrued from such actions.

3.3.5 Effective Auditing and Enforcement

Effective auditing and enforcement of motor fuel taxes are considered critical for ensuring fuel tax compliance; first, because of the greater chance of discovering any schemes to evade fuel taxes and second, because the perception of a rigorous auditing program may ward off attempts to evade taxes. The following items can be considered to be attributes of effective auditing and enforcement programs.

Centralization of fuel tax administration

The structure of fuel tax program administration varies widely from jurisdiction to jurisdiction. Some jurisdictions collect fuel taxes in one department while fulfilling audit and enforcement functions in another department. Other jurisdictions split fuel taxes between departments based on the type of tax [i.e., general fuel tax collections occur in a Department of Revenue (DOR) while IFTA is administered by the DOT]. Many jurisdictions, however, have sought the centralization of all fuel tax programs in recent years as a method of increasing the efficiency of fuel tax administration. Efficiency, for example, might be gained through this structure because it allows cost items such as overhead and administrative staff to be shared, possibly resulting in lower costs for overall fuel tax administration. Further, this structure can cater to a more rapid response to potential fraud cases as compared to a fuel tax administration structure where collections, auditing, and investigations are separated into separate departments. While these arguments have provided the basis for organizational change, no formal analysis has been done to examine and quantify all of the costs and the benefits of such a measure. The costs of a reorganization measure such as this would vary depending on a state's prior fuel tax administration structure and law. Logically, the primary cost of such a change would be the initial cost of time spent planning and resources used to adopt the structural change.

Dedicated fuel tax investigation unit
Establishing such a unit was recommended by the Uniformity Subcommittee on Model Legislation. The costs of establishing such a unit will be the wages paid to the investigators and the time needed to establish the unit. These costs will vary mostly depending on differences in average wage rates in each state. The benefit of a unit such as this is the increased likelihood that illegal activity will be detected or deterred. It is also recommended by the Model Legislation Committee that members of this unit be allowed to have police powers to enforce criminal laws.

Fuel tax prosecutors
Having prosecutors that are both knowledgeable and dedicated to motor fuel taxes increases the strength of enforcement and the likelihood that tax evaders will be put on trial. Possibly the most effective way of accomplishing this is to have public prosecutors within the motor fuel tax unit. However, some states have sought to improve this element of enforcement by working with and training prosecutors external to the fuel tax department.

Sufficient auditing staff
While no exact figure can be tied to what would be a sufficient amount of auditing staff for any particular jurisdiction, it is rational to believe that a lack of auditors means that illegal activities will most likely go unidentified and unscrupulous marketers will see overburdened auditors as an opportunity to expand evasion schemes. In a 2001 study on the impact of auditors on assessments, it was found that an additional state motor fuel tax auditor increased assessments by an average of $415,219 (Eger 2001). This does not necessarily mean that for every fuel tax auditor a state employs, assessments will grow by an additional $415 thousand because: 1) it is likely that there is a diminishing marginal productivity relationship between the number of auditors and the amount of assessments, and 2) the total amount that could possibly be assessed is a finite sum. Rather, this number expresses an average increase in assessments with the addition of one auditor given the concentrations of auditors in state fuel tax programs at this time.

However, the marginal benefit of additional auditors cannot only be judged based on the extra amounts that are assessed. Strengthening an audit program may deter potential acts of evasion, which would contribute to overall collections. Therefore, it would be incorrect to determine that an additional auditor is not of value because they bring in less assessments on the margin compared to the last additional auditor. It could be the case that the increased compliance plus assessments brings in the same if not a greater amount of revenue on the margin. Unfortunately, the marginal compliance benefits of an additional auditor on overall collections (collections plus assessments) is much more difficult to decipher than the marginal assessment impacts because of the many other factors affecting total assessments (e.g., seasonal variation, other enforcement and administration program changes, activities in surrounding states etc.).

Training
While the number of audit staff is important to motor fuel tax compliance, it is also essential that existing staff be experienced and competent at their jobs. To ensure this, regular training and staff development can be a way of increasing the proficiency of auditing and

enforcement personnel. Quantifiable benefits of motor fuel tax audit staff training have not been previously explored. It is expected that with training, audit staff would become more skilled and efficient at identifying wrongdoing. The training can either be performed externally or provided in-house. The FTA has provided such training courses in the past that have lasted approximately three days and were priced in the range of $300 to $450 dollars per registrant depending on the level of the course.

On-road enforcement officers

Designated officers conducting fuel dipping can help to deter misuse of dyed fuel. Dipping can occur on-road at checkpoints, weigh stations, and when officers pull over vehicles. These officers can be a part of a special motor fuel tax unit or can be part of the responsibilities of state police officers. The legal ability for officers to dip into smaller diesel vehicles as well as large trucks and do this without the legal need for probable cause will also help to deter dyed fuel misuse. The costs of such a program would depend on the type of personnel used and what proportion of their time is spent performing the inspections. Table 3-4 provides dyed fuel sampling statistics from selected states and the assessments that were made as a result of violations.

Table 3-4. On-road Enforcement Sample Statistics 1995-2004

States with On-road Dyed Fuel Enforcement	Total Samples	Total Violations	Violation Rate	Total Assessments
ALABAMA [1]	84,823	824	0.97%	$874,000
CALIFORNIA[2]	161,690	752	0.47%	$612,248
MINNESOTA	31,840	587	1.84%	$670,260
MONTANA[3]	42,855	273	0.64%	$34,125
NEBRASKA	44,570	506	1.14%	$409,375
NEVADA	43,303	326	0.75%	$170,070
NORTH CAROLINA	12,107	125	1.03%	$90,000
PENNSYLVANIA[4]	162,341	788	0.49%	$1,198,092
TEXAS	3,175	29	0.91%	$63,050
VIRGINIA	21,239	280	1.32%	$606,346
WEST VIRGINIA[5]	23,901	231	0.97%	$198,271

[1] Alabama - Total average percent is slightly high due to missing numbers for samples taken in 1995 and 1996.

[2] California - Total penalties assessed are from years 99-04 only.

[3] Montana - Data cover the 2002-2004 time period only and were supplied by MDT.

[4] Pennsylvania - 164 kerosene inspections were conducted resulting in 46 violations for illegal use of the untaxed fuel.

[5] West Virginia - No samples taken in first quarter of 2003 due to weather.

Source: (Morris 2005)

Evasion hotline

The Subcommittee on Model Legislation suggests that states consider instituting an anonymous toll free telephone number for individuals to call on suspected incidents of evasion. The costs of establishing and monitoring a dedicated phone line are likely minor. The hotline will only be useful, however, if some resources are expended to publicize and make industry aware of it. Montana has established a hotline and places informational decals on dyed fuel pumps. Figure 3-3 shows a poster that the State of Washington places on or near any fuel pumps dispensing red dyed diesel (Beach 2004).

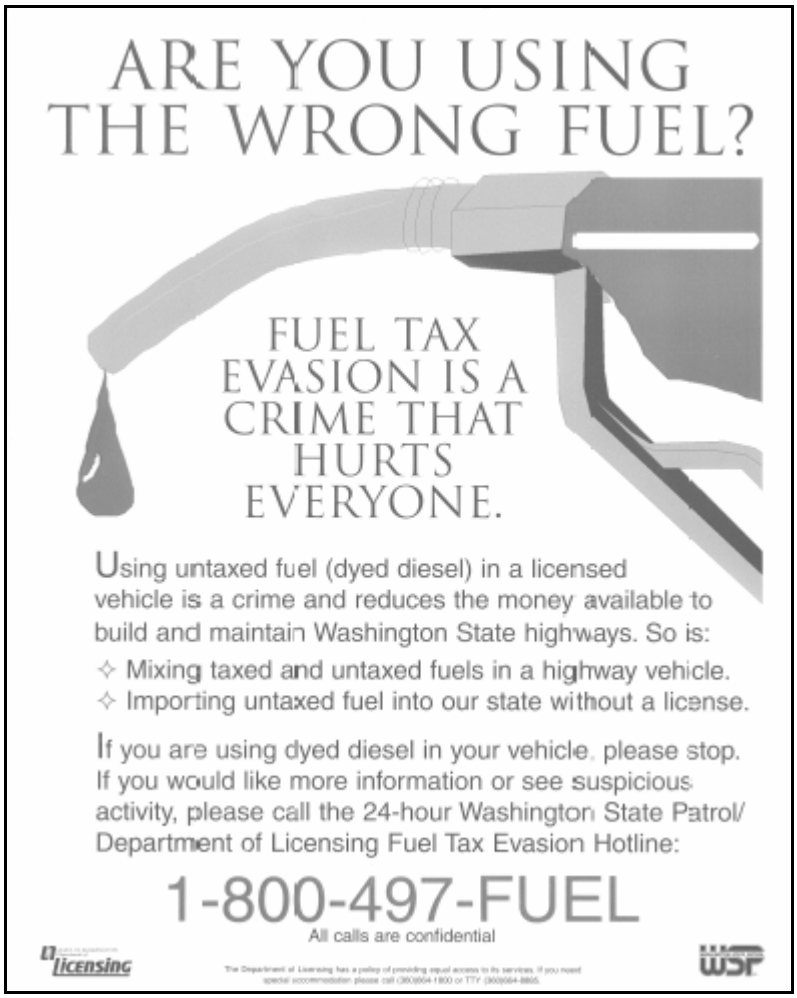


Figure 3-3. Washington State Dyed Fuel Hotline Poster

3.3.6 Minimize Exempt Uses and Refunds

A jurisdiction can take legislative action to minimize the opportunities to evade fuel taxes through exemptions by restricting the number of exemptions and opportunities for refunds. Since dyed diesel is so prevalent and accessible in many places, one option is for states to allow operations with exempt uses and exempt entities to rely on dyed fuel for all of their tax-free fuel

needs. Not only does restricting refunds potentially increase revenues because of the reduction in fraudulent returns, but this also lessens the administrative burden by decreasing the overall level of returns that need to be processed. For instance, as of 2005, Texas changed its tax laws so as not to allow refunds of taxes paid on undyed diesel used for off-highway equipment, stationary engines, and for other non-highway purposes.

3.3.7 Licensing and Bonding

The Model Legislation Subcommittee of the Uniformity Committee recommends that jurisdictions consider licensing all entities involved in motor fuel commerce, from producers and importers to retailers. Further, bonds must be adequate and keep pace with the fuel tax rates in order to cover fuel tax liabilities. The actual costs and benefits of licensing and bonding have not been analyzed. However, there would likely be costs associated with setting up and administering license processes. On the benefit side, licensing and bonding measures help to make certain that motor fuel dealers are legitimate and tax liabilities are paid. Further, they can provide a channel to deny known non-payers and evasion perpetrators from operating in the fuel industry.

3.3.8 Fines and Penalties

Penalties must be sufficiently robust to deter fuel tax evasion and ensure that noncompliance is not profitable when perpetrators are caught. In addition to making civil monetary fines for unlawful activities, there are three major measures that can be taken by any state to strengthen retribution against those who engage in unlawful activity. First, fuel tax evasion activities (e.g., illegal importation or exportation, willful nonpayment, or tampering with meter equipment or fuel dye) could be brought to felony status within the state fuel tax code. Secondly, another helpful legal provision is the ability to seize assets for non-payment or once unlawful activities are detected. Lastly, the ability to pierce the corporate shield (i.e., hold officers personally liable for willful evasion) is also a significant deterrent to committing fuel tax evasion.

CHAPTER 4.0 REGIONAL MOTOR FUEL DISTRIBUTION SYSTEM

The opportunities for motor fuel evasion within a state are impacted by a number of factors such as the regional geography, fuel production and distribution, and the nature and extent of the applicable tax codes, administrative procedures, and enforcement efforts internal to a jurisdiction and of those surrounding jurisdictions. This section illustrates Montana's regional characteristics in terms of the fuel distribution system and geographic features.

Montana is bordered by four U.S. states and three Canadian provinces. Figure 4-1 shows the states and provinces surrounding Montana and the road and rail networks that connect these jurisdictions to Montana. Further, U.S./Canadian border highway and rail crossings are also depicted for the Montana study region. Montana has 15 highway border crossings that are either manned or controlled electronically (i.e., card controlled and remote monitored crossings). One rail crossing connects Alberta (who is a net exporter of motor fuels) to Montana.

Figures 4-2 and 4-3 depict crude oil production and refinery production for the Montana region jurisdictions. Alberta is the largest producer of crude oil, producing approximately 3½ times more crude oil than the second largest producer in the study region, South Dakota. Figure 4-3 shows the Petroleum Administration of Defense (PAD) refinery production.

Figure 4-4 depicts refinery and terminal capacities in Montana and the bordering region. Montana has four refineries and 11 terminals.

Figure 4-1. Montana Region Transportation Characteristics

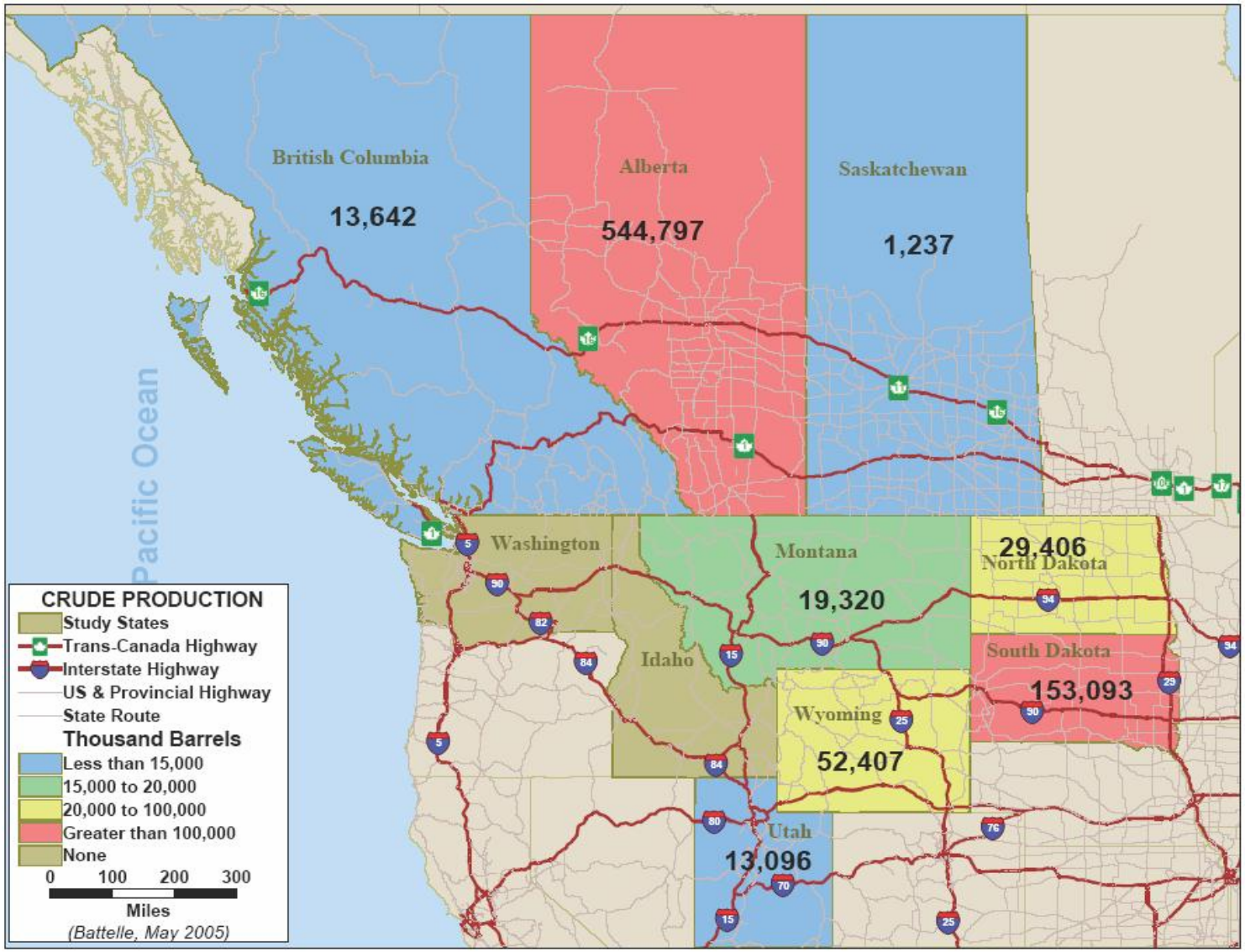


Figure 4-2. Montana Region Crude Oil Production

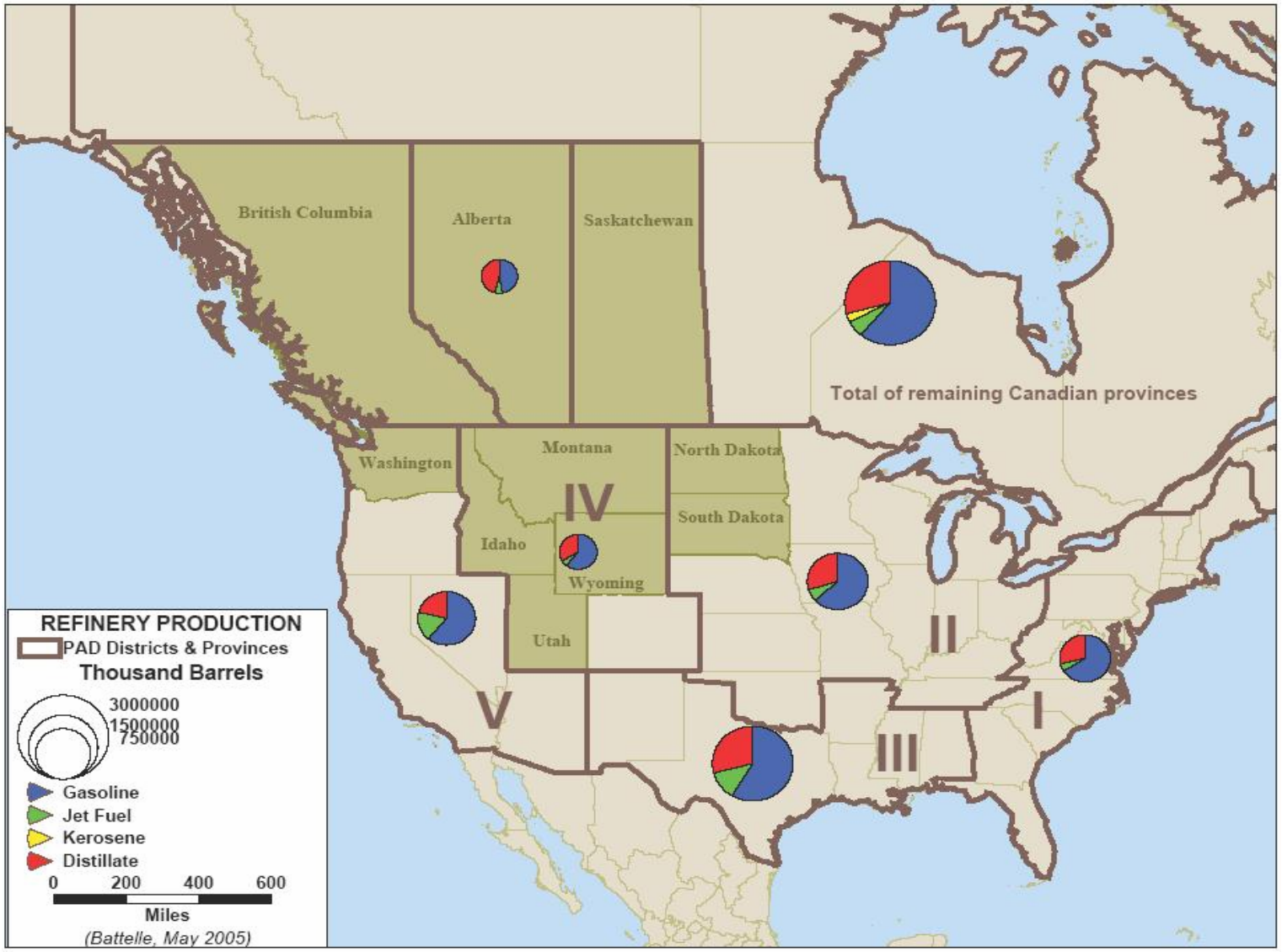


Figure 4-3. PAD Refinery Production

Figure 4-4. Montana Region Refineries and Terminals

CHAPTER 5.0 REGIONAL FUEL TAX ADMINISTRATION CHARACTERISTICS AND OPPORTUNITIES FOR EVASION

Many motor fuel tax evasion schemes take advantage of state and international borders. Differences in fuel tax law, administration, and enforcement drive the incentives and opportunities to evade the fuel tax system. Evasion schemes such as misreporting miles on IFTA reports, bootlegging, and other border schemes exploit the dissimilarities (e.g., fuel tax rates, treatment of alternative fuels, and fuel dyeing) and the lack of cooperation between jurisdictions. The purpose of this section is to identify those factors that conspire against the road fund for the State of Montana by analyzing the motor fuel tax laws and programs in Montana and the surrounding jurisdictions. The following jurisdictional programs were analyzed:

- Montana,
- Alberta,
- British Columbia,
- Idaho,
- North Dakota,
- Saskatchewan,
- South Dakota,
- Utah,
- Washington, and
- Wyoming.

Information for this analysis was compiled from interviews and other sources into motor fuel tax program profiles for each state and province listed above. These tables were then sent to the fuel tax administrators previously interviewed to be approved and completed in the case of missing information. Appendix A contains the motor fuel tax administrator survey.

Analysis of the Montana and bordering jurisdiction's fuel tax programs and opportunities for evasion due to these characteristics will proceed in three sections. First, a profile for the above states and provinces will describe the primary characteristics of each motor fuel tax program (e.g., structure, tax rates, points of taxation, and exemptions). Second, these fuel tax programs will be compared in relation to major categories that characterize motor fuel tax programs. Finally, based on the aforementioned profiles and comparisons, a list of major motor fuel tax administration and enforcement characteristics for the above jurisdictions creating potential opportunities for fuel tax evasion and compliance issues in Montana will be identified and described.

5.1 Profiles of the Montana Region Motor Fuel Tax Programs

The following profiles will summarize the major characteristics in the fuel tax programs for the Montana region states and provinces. The primary motor fuel tax administrative and enforcement categories that will describe each program are the following:

- program structure;
- point of taxation;
- fuel tax rates, dyeing, and treatment of alternative fuels;
- exemptions and refunds;
- licenses and bonds;
- tax collection and motor fuel tracking;
- motor fuel taxation and Native American tribes;
- on-road enforcement;
- auditing; and
- fines and penalties.

5.1.1 Montana Motor Fuel Program Profile

Program Structure: All motor fuel tax collection and enforcement activities in Montana are organized by MDT. The collection staff are in a separate section from the auditing staff section and collect all monies due MDT. MDT auditors have responsibilities for auditing all MDT internal and external activities. Motor fuel tax is a small part of the auditor's responsibilities.

Point of Taxation: Montana collects gasoline and diesel taxes at the distributor level.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Montana taxes gasoline and gasohol at $0.27 per gallon, gasohol mechanically blended at the terminal at $0.24 per gallon, diesel, kerosene and biodiesel at $0.2775 per gallon, and aviation and jet fuel at $0.04 per gallon (federally-certified commercial carriers can attain a refund of $0.02 on aviation fuel). Table 5-1 shows the Montana fuel tax rates and dyeing practices.

Table 5-1. Montana Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-Free	Dyed when Tax-Free
Gasoline	$0.27/gallon		
Diesel	$0.2775/gallon	✓	✓
Aviation Fuel	$0.04/gallon (with $0.02 refund)		
Kerosene	$0.2775/gallon	✓	✓
Gasohol[6]	$0.27/gallon		
Biodiesel	$0.2775/gallon		

[6] Gasohol is subject to a 3 cents per gallon refund, thus reducing the effective tax rate down to $.24 per gallon when it is mechanically blended at the rack.

Exemptions and Refunds: Any diesel or gasoline used off-road is subject to refund with supporting records from qualified applicants. Diesel fuel used by governmental agencies, including tribal governments and school districts that own their own buses may use dyed diesel in their vehicles. Jet fuel sold to the military is exempt from taxation.

Licenses and Bonds: Distributors (i.e., anyone engaged in producing, refining, manufacturing, compounding gasoline or special fuels and importing) are required to be licensed in Montana. The maximum bond for importers/exporters is $100,000 and the minimum bond is $25,000 or twice the monthly estimated tax liability, whichever is greater. For other types of distributors, the bond is twice the monthly estimated tax liability, up to $100,000.

Tax Collection and Motor Fuel Tracking: In general, fuel taxes are remitted on a monthly basis. Reports can be filed electronically or by paper. Out of 138 distributor taxpayers in Montana, 85 percent file electronically. Montana has a motor fuel tracking system, developed in-house, which tracks motor fuel at the refinery, terminal, and distributor levels.

Motor Fuel Taxation and Native American Tribes: Montana has gasoline revenue sharing agreements with six of seven tribal governments within its borders. Five of the six agreements are driven by tribal enrollment, which is agreed upon between the state and each tribe. The sixth agreement is based on the number of gallons sold on the reservation.

On-road Enforcement: Montana conducts on-road enforcement with approximately 90 Motor Carrier Safety Officers (MCSO) who have a quota for the number of tanks they must dip each month. Montana MCSOs have the ability to pull over both light and heavy diesel vehicles; however, probable cause is needed to pull over vehicles weighing less than 10,000 pounds.

Auditing: Montana has 11 staff that audit motor fuel taxes, IFTA, and International Registration Plan (IRP) fees. However, the 11 members of the auditing staff do much more than just motor fuel tax audits. The audit staff is also responsible for compliance reviews and contract auditing for MDT.

Fines and Penalties: Fuel tax evasion in Montana is a civil penalty. There are no penalties for underpayment on IFTA returns. The penalty for underpayment by distributors is 10 percent of total tax liability. The penalty for fraudulent activity related to diesel taxation is 25 percent of the taxes due plus one percent interest per month of underpayment.

5.1.2 Alberta Motor Fuel Program Profile

Program Structure: Motor fuel tax collection and enforcement activities in Alberta are organized by Alberta Finance. The personnel that administer fuel taxes also deal with tobacco and hotel taxes. For fraud investigations, Alberta Finance contracts with the Alberta Gaming and Liquor Commission. Fuel taxes are separated into programs: the Farm Fuel Program, Indian Tax Exempt Program, IFTA, and Manufacture and Bulk returns.

Point of Taxation: Alberta collects gasoline and diesel taxes at both the manufacturer level and the bulk dealer level. The actual legal incidence of the tax is on the consumer of motor fuels;

however, manufacturing companies and bulk dealers are appointed as agents and turn in monthly returns. The tax is generally collected from motor fuel manufacturers, but is also collected from bulk dealers when it is imported.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Alberta taxes gasoline, diesel, biodiesel, and kerosene at $0.28 per gallon ($0.09 CA per liter). Aviation fuel is taxed at $0.06 per gallon ($0.02 CA per liter) and only the non-ethanol portion of gasohol is taxable. Table 5-2 shows Alberta fuel tax rates and dyeing practices.

Table 5-2. Alberta Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-Free	Dyed when Tax-Free
Gasoline	$0.09/liter or $0.28/US gallon	✓	✓
Diesel	$0.09/liter or $0.28/US gallon	✓	✓
Aviation Fuel	$0.02/liter or $0.06/US gallon		
Kerosene	$0.09/liter or $0.28/US gallon		
Gasohol	Only non-ethanol portion		
Biodiesel	$0.09/liter or $0.28/US gallon		

Exemptions and Refunds: The following uses of fuel are nontaxable: fuel used by federal agencies, foreign diplomatic corporations, and military; fuel used within the Indian tax exemption program; use of fuel off-road; and non-motive use of fuel (e.g., heating and power generation). Alberta has a farm fuel program where industries using fuel off-road can obtain permits to purchase motor fuel tax-free. Normally, dyed fuel is relied on for the needs of these industries. However, if a particular industry has mixed on-road and off-road operations, they are made to purchase clear fuel and apply for refunds. Because of this fact, Alberta has a significant refund program; approximately 4,000 refunds are filed each fiscal year.

Licenses and Bonds: The following activities require a license in Alberta: reselling fuel oil or liquefied petroleum gas (LPG); selling marked fuel to consumers; selling fuel oil or aviation fuel exempt from tax; importing fuel oil, LPG, or aviation fuel into Alberta for sale to consumers; exporting fuel oil, LPG, or aviation gas from Alberta; purchasing fuel oil for consumption by a locomotive of which the person is the owner; and purchasing LPG for consumption in Alberta by the purchaser directly from a producer of LPG. Also, consumers who qualify for tax exempt fuel are required to obtain a license. A bond of up to 3 times the maximum amount expected to be remitted by the agent-collector during a single reporting period can be required.

Tax Collection and Motor Fuel Tracking: Fuel taxes remitted by the agent collectors are remitted on a monthly basis. There is no electronic filing requirement; however filing electronically is an option. Retailers in the Indian Tax Exempt Program that sell fuel tax-free to status Indians have the option to file electronically via a Point-of-Sale System and daily FTP file transfers. They may also use a paper system if they do not want to pay the cost of the electronic

system. Alberta does not employ an electronic motor fuel tracking system nor does it track fuel manually.

Motor Fuel Taxation and Native Tribes: The Indian Tax Exemption Program allows reservation motor fuel resellers to sell motor fuel tax-free to Indians on the reservation. When individuals present their valid Certificate of Indian Status Identification Card at a retail outlet on a reservation, the product is sold tax-free and the retailer receives a refund for the tax.

On-road Enforcement: Alberta does not have an on-road dyed fuel enforcement program. Further, there are legal restrictions on pulling over vehicles or doing stop checks. There must be reasonable grounds for suspecting illegal possession of marked fuel in order for officers to dip tanks. However, dipping does occur randomly at weigh and safety stations.

Auditing: Alberta has 26 audit staff that work on motor fuel program auditing, but their time is split up among auditing other types of taxes. There are three full time equivalent (FTE) auditors that are dedicated solely to IFTA taxes.

Fines and Penalties: The severity of fuel tax fraud is summary in nature, which is the equivalent of a misdemeanor in the United States. Fines imposed on consumers failing to pay taxes can be up to $1,000 for a first offense and up to $5,000 for subsequent offenses. For falsifying documents, the fine is a maximum of 300 percent of the tax evaded or sought to evade and/or up to two years in jail. A penalty of 25 percent of the assessment may be assessed for neglect, carelessness, willful default, fraud, or evasion.

5.1.3 British Columbia Motor Fuel Program Profile

Program Structure: British Columbia's (BC) Ministry of Provincial Revenue organizes collection and enforcement activities for motor fuel taxes. The staff that collect and audit motor fuels taxes also audit other taxes including, but not limited to, the social service tax, hotel room tax, logging tax, mining tax, and the insurance premium tax.

Point of Taxation: The legal incidence of the motor fuel tax is at the retail level; however, for administrative simplification, distributor collectors are appointed to collect and remit the tax.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: BC taxes gasoline at $0.44 per gallon ($0.145 CA per liter) and diesel at $0.46 per gallon ($0.15 CA per liter). Aviation fuel is taxed at $0.06 per gallon ($0.02 CA per liter). Kerosene is exempt from tax and gasohol is only tax exempt if the ethanol portion is between 5 and 25 percent of the volume. Biodiesel is only taxable when the biodiesel portion is not less than 5 percent or more than 50 percent. Table 5-3 displays the BC fuel tax rates and dyeing practices.

Exemptions and Refunds: Exempt sales may be made to natives, farmers, and diplomats. All-terrain vehicles (ATVs), snowmobiles, and unlicensed vehicles, which are operated on farms for farm purposes are also exempt from taxation. Farmers must be certified to purchase tax exempt fuel.

Licenses and Bonds: Any person or entity involved in the sale or coloring of motor fuel is required to be licensed.

Table 5-3. British Columbia Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be sold Tax-free	Dyed when Tax-free
Gasoline	$0.145/litres $0.44 US/gallon	✓	✓
Diesel	$0.15/litres $0.46 US/gallon	✓	✓
Aviation Fuel	$0.02/litre $0.06 US/gallon		
Kerosene	Exempt	✓	
Gasohol	Exempt if ethanol portion is 5% - 25%	✓	
Biodiesel	Exempt if biodiesel portion is 5% - 50%	✓	

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly, quarterly, semi-annual, and annual basis depending on the amount of tax liability. There is no electronic filing requirement and only summary reports can be filed electronically. A mixed electronic and manual system is used for motor fuel tracking. An electronic system provided by Gentax captures summary level information such as terminal and refinery production; imports and export; rebrands; exempt sales; and taxable sales. Desk audits are used to identify discrepancies in load-by-load information.

Motor Fuel Taxation and Native Tribes: BC has agreements in place with Indian Tribes such that fuel is generally taxed on Indian reservations except when sold to status Indians (i.e., registered with the state). Retailers then file for refunds based on total sales exempt sales.

On-road Enforcement: There is no on-road enforcement program in BC at this time.

Auditing: There are five auditors; 30 percent of their total audit time is devoted to IFTA and motor fuels.

Fines and Penalties: There is a range of 10 to 100 percent penalty for fraudulent activity. BC is able to immediately revoke licenses once fraud is detected and able to seize the assets of non-paying entities. Further, corporate officers can be held responsible for a corporation's debt in BC.

5.1.4 Idaho Motor Fuel Program Profile

Program Structure: All motor fuel tax collection and enforcement activities in Idaho are organized by the Fuel Tax Section of the Idaho State Tax Commission. Motor fuel tax auditors are solely responsible for fuel taxes and IRP fees.

Point of Taxation: Idaho is a first receiver state (i.e., fuel taxes are collected when fuel is sold to a supplier). There are 240 distributors who report taxes to the tax commission. Revenues increased by 19 percent when the point of taxation was moved up to first receiver in 1996.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Idaho taxes gasoline, diesel, biodiesel, and kerosene at $0.25 per gallon. Aviation gasoline is taxed at $0.055 per gallon and jet fuel is taxed at $0.045 per gallon. Gasohol is taxed at $0.225 per gallon. Table 5-4 shows the Idaho fuel tax rates and dyeing practices.

Table 5-4. Idaho Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.25/gallon		
Diesel	$0.25/gallon	✓	✓
Aviation Gasoline	$0.055/gallon		
Jet Fuel	$0.045/gallon		
Kerosene	$0.25/gallon	✓	✓
Gasohol	$0.225/gallon		
Biodiesel	$0.25/gallon	✓	✓

Exemptions and Refunds: The National Guard and Native American Tribes can buy fuel untaxed and undyed. Otherwise, dyed untaxed fuel or refunds are available for all exempt purposes (e.g., fuel used in stationary engines, off-highway equipment, commercial motor boats, and home heating). Any entity eligible for dyed fuel fills out and presents a standardized form to the seller to purchase fuel. Once that entity has submitted that form to the seller, that form is valid for all future purchases.

Licenses and Bonds: Any motor fuel distributor who does not pay tax to their supplier is required to be licensed. A bond is required in order to attain a license of $1,000 (minimum) to $200,000 (maximum). The information provided on license application is cross-checked and licenses are denied on the basis of a record of delinquency or criminal offenses in other states.

Tax Collection and Motor Fuel Tracking: In general, fuel taxes are remitted on a monthly basis. Reports can be filed electronically or by paper. Idaho has a mixed paper and electronic system for cross-checking fuel tax reports. The electronic system was developed in-house. These

systems keep track of gallons being distributed through pipelines, terminals, position holders, and licensed distributors.

Motor Fuel Taxation and Native American Tribes: Fuel is not taxed on Native American reservations in Idaho. Idaho does not have agreements with Native American tribes. Further, in a recent case, Hammond v. Coeur d'Alene Tribe, the Supreme Court declined to review a Ninth Circuit Court ruling that nullified Idaho's right to tax fuel on Indian reservations.

On-road Enforcement: Idaho does not perform on-road inspections but rather relies on the IRS inspection program. Dipping into tanks is performed at random by state police and at weigh stations but is not done regularly or as a part of regular safety inspections. Idaho has estimated, informally, that its dyed diesel violation rate is six percent based on IRS inspections, referrals from citizens, and tests from State Police Officers.

Auditing: Idaho has 14 permanent auditors. These auditors spend 100 percent of their time on motor fuel and registration fee audits. These 14 auditors conduct five types of audits: 1) distributor motor fuel audits, 2) IFTA audits, 3) IRP audits, 4) audits of motor fuel refunds, and 5) registration audits of all intrastate operators. In addition, Idaho employs four staff who collect terminal records, import/export schedules, and distributor reports in order to detect discrepancies and deter evasion.

Fines and Penalties: The majority of non-compliance actions are considered misdemeanors in Idaho; however, collection of fuel tax and intentional non-remittance is a felony crime. A penalty of 5 percent of assessment is applied for negligence and anywhere between a 10 and 25 percent penalty is applied for serious reporting issues such as under-reporting of tax liability. A penalty of 50 percent is imposed in the case of fraudulent activity. For dyed fuel violations, as revealed through IRS inspections, an assessment is made assuming dyed fuel misuse dating back seven years. The burden of proof is placed on the person fined that the dyed fuel was used for exempt purposes.

5.1.5 North Dakota Motor Fuel Program Profile

Program Structure: General motor fuel tax collection, auditing, and enforcement are organized by the North Dakota Office of State Tax Commissioner. IFTA taxes, however, are administrated by the Department of Transportation. The staff conducting motor fuel audits also have responsibility for other taxes including wholesale alcohol taxes and sales/use taxes.

Point of Taxation: North Dakota collects gasoline taxes at the distributor level and diesel taxes at both the distributor and retail level.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: North Dakota taxes gasoline, diesel, gasohol, and biodiesel at $0.21 per gallon. Aviation fuel is taxed at $0.08 per gallon. Dyed diesel and kerosene are taxed at 2 percent of the consumer purchase price. Table 5-5 shows the North Dakota fuel tax rates and dyeing practices.

Exemptions and Refunds: The only entities exempt from tax are agencies of the U.S. government and agencies located on North Dakota Indian reservations. Consumers, such as agriculture or industry, may obtain refunds of tax on fuel used in non-licensed, off-road equipment.

Table 5-5. North Dakota Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.21/gallon		
Diesel	$0.21/gallon (2% for dyed diesel)		✓
Aviation Fuel	$0.08/gallon		
Kerosene	$0.21/gallon (2% of purchase price for dyed)		✓
Gasohol	$0.21/gallon		
Biodiesel	$0.21/gallon		

Licenses and Bonds: Entities required to be licensed in North Dakota are motor fuel refiners, terminal operators, suppliers, distributors, importers, exporters, and also special fuel or liquefied petroleum retailers. Information on license applications is cross-checked to ensure the legitimacy of the company.

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly basis. All returns and schedules can be filed electronically or by paper; there is no requirement electronic reporting requirement. North Dakota does not have an electronic motor fuel tracking system; however, movements of fuel between motor fuel distribution entities (i.e. terminal rack to supplier, supplier to distributor, distributor to retailer and imports) are tracked manually by cross-checking schedules and returns.

Motor Fuel Taxation and Native American Tribes: Fuel is generally taxed on Native American reservations with the exception of fuel used by tribal governments. North Dakota does have an agreement with one tribe to share revenue; the Tax Commissioner collects the tax and distributes 75 percent to the tribe and retains 25 percent for the state.

On-road Enforcement: North Dakota does not have an on-road fuel inspection program, nor are fuel checks included in safety and weigh station inspections. For the misuse of dyed fuel, an assessment of $0.21 per gallon times the gallons in the fuel tank is made and additional fines include: $250 for the first violation; $500 for a second violation occurring within three years of a previous violation; $1,000 for a third violation occurring within three years of two previous violations; and $5,000 for the fourth and subsequent violations occurring within three years of three or more previous violations.

Auditing: North Dakota has 18 auditors that have responsibilities for auditing sales and cigarette taxes as well as motor fuel taxes.

Fines and Penalties: Fuel tax evasion is considered a misdemeanor in North Dakota. The tax commissioner is not able to immediately revoke fuel tax licenses once unlawful activities are suspected and is further unable to seize assets for evasion or nonpayment. Late reporting results in a 5 percent penalty and late tax payments result in a 5 percent penalty plus one percent per month interest on any balance.

5.1.6 Saskatchewan Motor Fuel Program Profile

Program Structure: Motor fuel tax collection and enforcement activities in Saskatchewan are organized by the Fuel, Tobacco, and Pro Rate Taxes Branch of the Revenue Department within Saskatchewan Finance. Besides collecting and auditing fuel taxes, this branch administrates the IFTA program and three additional programs unique to Saskatchewan and discussed further in this profile: Farm Fuel Program, Gasoline Competition Assistance Program, and the First Nations Tax Refund Program. In addition to fuel taxes, this department also administrates other consumption taxes such as sales, tobacco, and liquor taxes.

Point of Taxation: Saskatchewan collects both gasoline and diesel taxes at the terminal rack. This tax at the rack policy was implemented in 2001. The movement of the point of taxation up to the terminal rack reduced the number of taxpayers from approximately 40 distributors to six terminals and importers. While the policy was implemented to simplify tax administration and to prevent motor fuel tax evasion, no significant impact on revenues from the change has been measured.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Saskatchewan taxes gasoline, diesel, biodiesel, and gasohol at $0.46 per gallon ($0.15 CA per liter). Aviation fuel is taxed at $0.05 per gallon ($0.02 CA per liter). Any alternative fuels that are blended such as ethanol and methanol are taxed when blended at the rack. Tax exempt diesel is dyed. Gasoline can be tax exempt under the Farm Fuel Program; however, it is not dyed. Kerosene is neither taxed nor dyed. Table 5-6 displays the Saskatchewan fuel tax rates and dyeing practices.

Exemptions and Refunds: The following uses of fuel are nontaxable: fuel used by federal agencies; first nations people when purchased on a reservation; farming, logging, trapping, mineral exploration, and commercial fishing. Operations within the industries mentioned can apply for a permit to purchase motor fuel. This permit entitles them to purchase diesel, propane, and 80 percent of their gasoline tax-free from bulk dealers. Since gasoline is ordinarily taxed by the time it reaches this level, bulk dealers, card lock, and key lock operators receive a refund or credit of $0.12 CA per liter for gasoline (not dyed) and are allowed to apply a $.03 CA tax for administrative purposes.

Table 5-6. Saskatchewan Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.15/liter $0.46/US gallon	✓	
Diesel	$0.15/liter $0.46/US gallon	✓	✓
Aviation fuel	$0.02/liter $0.05/US gallon		
Kerosene	$0.00	✓	
Gasohol	$0.15/liter $0.46/US gallon		
Biodiesel	$0.15/liter $0.46/US gallon		

Saskatchewan also gives partial refunds to retail stations on provincial borders to allow these outlets to compete with stations on the other side of borders in lower tax rate provinces. This program, called the Gasoline Competition Assistance Program, allows service stations and bulk fuel dealers located along certain border sections of Alberta and Manitoba to receive a commission of a certain percentage of the tax rate (depending on the border zone) for the differential between the tax rates between Saskatchewan and its bordering provinces.

Licenses and Bonds: Entities required to be licensed in Saskatchewan include: terminal operators, exemption permit holders (e.g., farmers, commercial fishers, trappers and loggers), bulk dealers, card lock dealers, exporters, importers, and companies doing mineral excavation. A surety bond or guaranteed letter of credit is required with all license applications, the amounts of which are up to the discretion of the finance agency depending on assessment of risk. Licenses can be denied based on any history of non-compliance.

Tax Collection and Motor Fuel Tracking: In general, fuel taxes are remitted on a monthly basis with the exception of motor carriers who are required to remit semi-monthly because they pay more than $10,000 monthly. Reports and schedules are filed either electronically or by paper as there is no electronic reporting requirement for reports and schedules filed regarding taxable fuel.

Saskatchewan does employ a motor fuel tracking system; however, it is used to record sales of exempt fuel only and not taxable fuels as they move through the distribution process. As part of the Farm Fuel Program, Saskatchewan has implemented a system that records sales of tax exempt diesel, propane, and gasoline to fuel tax exemption permit holders (i.e., farmers, loggers, commercial trappers, and commercial fishers) called the Automated Upfront Fuel Exemption System (AUFES). This system was created in-house. Whenever a sale of tax exempt fuel is made by a bulk dealer to a permit holder, the sale is recorded by the system. This data is compared to known size and scope of the permit holders operations to ensure that significant volumes of motor fuel are not leaked to taxable purposes.

Motor Fuel Taxation and Native American Tribes: Fuel sold on Native lands is, by default, taxed (i.e., fuel is taxed prior to reaching retailers on reservations due to the tax at the rack policy). However, Saskatchewan has a program, the First Nations Tax Refund Program, which allows Native reservations to enter into agreements with Saskatchewan to remove the tax for fuel purchases made by reservation residents. When individuals present their valid Certificate of Indian Status Identification Card at a retail station on a reservation, the product is sold tax-free and the retailer receives a refund for the tax.

On-road Enforcement: Saskatchewan does have a dyed fuel enforcement program. There are six revenue officers that devote 40 percent of their time to fuel testing. These officers inspect vehicles, facilities, injector sites, refineries, borders, bulk dealer, and terminals. Approximately 1,200 fuel tax inspections are made per year with a violation rate of approximately 5 percent.

Auditing: Saskatchewan has seven auditors that are responsible for general fuel tax audits; however, these auditors are also responsible for auditing other sales and corporate taxes. There are three FTE auditors that are dedicated solely to IFTA taxes.

Fines and Penalties: The maximum penalty for the misuse of marked fuel is $1 million and three years in prison. For assessments, the penalty is 10 percent of the owed taxes up to a maximum of $25,000 and interest on late payments is 3 percent. There are no special penalties for assessments made due to fraudulent activities.

5.1.7 South Dakota Motor Fuel Program Profile

Program Structure: Motor fuel tax collection and auditing in South Dakota are organized by the Department of Revenue and Regulation. Motor Carrier Enforcement officers under the direction of the Highway Patrol perform on-road enforcement. The personnel responsible for administrating and auditing motor fuel taxes are also responsible for other taxes such as sales and other excise taxes.

Point of Taxation: South Dakota collects both gasoline and diesel taxes at the terminal rack. This tax at the rack policy was implemented in 1996. The impact of this change was an overall 10 percent increase in motor fuel tax collections.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: South Dakota taxes gasoline, diesel, kerosene, and biodiesel at $0.22 per gallon. Gasohol is taxed at $0.20, aviation gasoline is taxed at $0.06, and jet fuel taxed at $0.04. Table 5-7 shows the South Dakota fuel tax rates and dyeing practices.

Exemptions and Refunds: South Dakota allows exemption on sales of fuel to the federal government, licensed Indian schools, fuel used as reefer fuel, and tax paid fuel used off-road for commercial and agricultural purposes.

Table 5-7. South Dakota Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.22/gallon		
Diesel	$0.22/gallon	✓	✓
Aviation Fuel	$0.06/gallon aviation gasoline $0.04/gallon jet fuel		
Kerosene	$0.22/gallon	✓	✓
Gasohol	$0.20/gallon		
Biodiesel	$0.22/gallon		

Licenses and Bonds: The following entities are required to be licensed: supplier, exporter, importer, blender, marketer, LPG vendor, compressed natural gas (CNG) vendor, ethanol producer, transporter, terminal operator, bulk plant operator, LPG user, highway contractor, and motor carriers for IFTA.

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly, quarterly and semi-annual basis depending on the amount of tax liability. All returns and schedules are filed by paper and fuel is not tracked electronically or manually.

Motor Fuel Taxation and Native American Tribes: There are fuel tax agreements between the State of South Dakota and particular tribes that allow fuel taxes to be collected on reservation land and remitted back to the tribe based on total sales less exempt sales. There are four such agreements in place presently. Otherwise, motor fuel is not generally taxed on Native American reservations in South Dakota.

On-road Enforcement: There are 27 officers charged with motor carrier issues that conduct on-road enforcement of dyed fuel laws. They do have the ability to pull over and dip tanks of both small and large trucks but need probable cause. Dipping is included in safety and weigh station checks.

Auditing: South Dakota has six auditors who work on motor fuel tax and IFTA returns as well as taxes such as sales and other excise taxes.

Fines and Penalties: Fuel tax evasion, depending on the infraction, can be a misdemeanor or a felony in South Dakota. The penalty for filing a late return is 10 percent of tax due, or a $10 minimum and 1.5 percent monthly interest is applied for late payments. Late IFTA returns is punishable by a 10 percent penalty of tax due or $50, whichever is greater, and one percent monthly interest for late payments. Revocation of licenses requires due process. Further, it is possible for South Dakota to seize assets of non-paying filers, but this is rarely done since the department has trouble getting the legal and enforcement cooperation required.

5.1.8 Utah Motor Fuel Program Profile

Program Structure: Motor fuel tax collection and enforcement is organized through Utah's State tax commission. The staff charged with motor fuel tax administration and enforcement are also responsible for other taxes.

Point of Taxation: Utah collects gasoline taxes at the distributor level and diesel taxes at the terminal rack. The point of taxation for diesel was moved to the rack in 1997.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Utah taxes gasoline, diesel, gasohol, and biodiesel at $0.25 per gallon. Aviation fuel used by Federally-certificated air carriers is taxed at 4 cents per gallon. Aviation fuel used for other purposes is taxed at 9 cents per gallon. Kerosene is only taxed when it is blended with other taxable products and is taxed at $0.245 per gallon. Table 5-8 shows the Utah fuel tax rates and dyeing practices.

Table 5-8. Utah Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.25/gallon		
Diesel	$0.25/gallon	✓	✓
Aviation Fuel	$0.04/gallon by air carriers $0.04/gallon for other purposes		
Kerosene	$0.245/gallon	✓	✓
Gasohol	$0.25/gallon		
Biodiesel	$0.25/gallon		

Exemptions and Refunds: Diesel used off-road and in power units in garbage trucks is exempt from taxation. Gasoline used in agriculture is not taxed.

Licenses and Bonds: Any entity that imports, produces, blends, or wholesales motor fuel and anyone who imports, produces, or blends special fuel is required to be licensed in Utah.

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly basis. All returns and schedules are filed by paper; there is no option for electronic reporting. Utah does have an electronic system which fuel data is entered into; however, only summary level data are keyed in. Therefore, no load by load tracking is currently being performed. Summary level data entered into the system are from terminal and distributor reports.

Motor Fuel Taxation and Native American Tribes: Fuel is taxed at retail stations on tribal land in Utah but tribes can file for refunds for fuel used on reservation. There are revenue sharing agreements in place between the state and tribes to purchase fuel tax paid and then file for

refunds. The Navajo tax is 24 cents/gallon total; 18 cents/gallon goes to the Navajo and Utah receives 6 cents.

On-road Enforcement: Utah does not have an on-road fuel inspection program, nor are fuel checks included in safety and weigh station inspections.

Auditing: Utah has eight auditors and one technician that have responsibilities for auditing cigarette and tobacco taxes as well as motor fuel taxes, IFTA, and IRP.

Fines and Penalties: Operating without a license in Utah is a third-degree felony. Intent to evade taxes is a second-degree felony and willful attempt to evade is a Class B misdemeanor. There is a 10 percent penalty for late and non-payment, 10 percent penalty for negligence, 15 percent penalty for intentional disregard, and a 50 to 100 percent penalty for fraud. As of May of 2005, Utah is no longer able to revoke licenses once fraud is detected; due notice and a hearing are now required for license revocation. Further, Utah cannot seize assets from non-paying entities.

5.1.9 Washington Motor Fuel Program Profile

Program Structure: All motor fuel tax collection and enforcement activities in the State of Washington are organized by the Department of Licensing. The personnel responsible for administrating and auditing motor fuel taxes are solely responsible for motor fuel taxes and IFTA and IRP administration and auditing.

Point of Taxation: Washington collects both gasoline and diesel taxes at the terminal rack. This tax at the rack policy was implemented in 1999. The impact of this change was an increase of $15 million in combined diesel and gasoline taxes annually.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Washington taxes gasoline, diesel, gasohol, and kerosene at $0.28 per gallon. Aviation fuel is taxed at $0.10 per gallon. Table 5-9 displays the Washington fuel tax rates and dyeing practices.

Table 5-9. Washington Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.28/gallon		
Diesel	$0.28/gallon	✓	✓
Aviation Fuel	$0.10/gallon		
Kerosene	$0.28/gallon	✓	✓
Gasohol	$0.28/gallon		
Biodiesel	$0.28/gallon		

Exemptions and Refunds: Diesel and kerosene are sold tax-free for designated non-taxable purposes. Refunds can be sought for any off-road use of fuel.

Licenses and Bonds: Any motor fuel importer, producer, blender, or supplier is required to be licensed in the State of Washington. Significant measures are taken to ensure the legitimacy of the businesses licensed and to attain information about the primary officers responsible for reporting and remitting taxes. For instance, Washington cross-checks information about the officers to ensure they have no unpaid taxes from other operations within Washington or in other states or provinces. Further, application documentation must include finger prints of the primary officers of the company. A bond of up to $100,000, depending on the volume of motor fuel moved, is also required for a license. Licenses can be revoked for several reasons, including: false information on the application, a fuel license has been revoked in another jurisdiction, or conviction for fraud and money owed for taxes in any jurisdiction.

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly basis. All returns and schedules are filed by paper. The only electronic reporting requirement is that taxes must be remitted via electronic funds transfer (EFT) for taxpayers that owe more than $50,000 monthly. Terminal reports are keyed into an in-house tracking system from paper reports. All movements of tax-free fuel above the rack are tracked.

Motor Fuel Taxation and Native American Tribe: Washington has 13 State/Tribal Fuel Tax Agreements. Fuel is taxed on tribal land and refunds are provided back to the tribe based on calculations of tribal consumption. There are three tribal lawsuits currently in federal court over fuel taxes in Washington.

On-road Enforcement: Washington does not have any dedicated staff for on-road dyed fuel enforcement; however, there are over 100 Commercial Vehicle Enforcement Officers (CVEO) and two Washington State Patrol (WSP) detectives that provide assistance as needed. CVEO's and WSP detectives have the authority to stop vehicles for testing. On suspected large-scale evasion, WSP uses search warrants. Dipping inspections for compliance occurs at weigh stations, safety checks, vehicle storage yards, and bulk storage tanks. The fine for a dyed fuel violation is $1,000 or $10 per gallon, whichever is greater.

Auditing: Auditing staff in Washington are fully dedicated to motor fuel taxes, IFTA, and IRP fees. In Washington State, there are 18 auditors dedicated entirely to conducting audits of IRP and IFTA returns and accounts, distributors, refund claims, and heating oil licenses.

Fines and Penalties: Fuel tax evasion is a felony in Washington, punishable by a 100 percent penalty on the gallons evaded. The fines for underpayment are 2 percent for motor fuels and 10 percent for special fuels, although fines can reach up to 25 percent for significant negligence. Washington is both able to immediately revoke licenses once fraud has been detected, and seize assets once fraud has been proved. Further, the officers can be held personally responsible for fraud.

5.1.10 Wyoming Motor Fuel Program Profile

Program Structure: Motor fuel tax collection and enforcement activities are organized by Wyoming's Department of Transportation. The audit program, however, is administered through the Department of Audit, Excise Tax Division. There are two full-time auditors dedicated to motor fuel taxes and a number of other officers that audit fuel taxes as well as other taxes.

Point of Taxation: Wyoming collects motor fuel taxes at the terminal rack. The point of taxation was moved in 1997 and total revenues increased by $6 million annually after the change.

Fuel Tax Rates, Dyeing, and Treatment of Alternative Fuels: Wyoming taxes gasoline, diesel, gasohol, and biodiesel at $0.14 per gallon making it the lowest tax state in the region. Aviation fuel is taxed at $0.05 per gallon. Table 5-10 shows the Wyoming fuel tax rates and dyeing practices.

Table 5-10. Wyoming Fuel Tax Rates and Dyeing Practices

Fuel	Tax Rate	Can be Sold Tax-free	Dyed when Tax-free
Gasoline	$0.14/gallon		
Diesel	$0.14/gallon $0.01 on dyed		✓
Aviation Fuel	$0.05/gallon		
Kerosene	$0.14/gallon $0.01 on dyed		✓
Gasohol	$0.14/gallon		
Biodiesel	$0.14/gallon	✓	✓

Exemptions and Refunds: Motor fuel for off-road purposes is exempt from taxation.

Licenses and Bonds: Entities required to be licensed in Wyoming are motor fuel refiners, terminal operators, suppliers, distributors, importers, exporters, and also special fuel or liquefied petroleum retailers. Information on license applications is cross-checked to ensure the legitimacy of the company.

Tax Collection and Motor Fuel Tracking: Fuel taxes are remitted on a monthly basis. All returns and schedules can be filed electronically or by paper; there is no requirement electronic reporting requirement. Wyoming has an electronic mainframe system that can cross-check schedules.

Motor Fuel Taxation and Native American Tribes: Fuel is taxed on Native American reservations in Wyoming and refund assessments are made based on reservation population estimates.

On-road Enforcement: Wyoming does not have an on-road fuel inspection program, nor are fuel checks included in safety and weigh station inspections. The fines for the misuse of dyed fuel are $300 or $3 per gallon, whichever is greater.

Auditing: There are two full-time auditors dedicated to motor fuel taxes and a number of other officers that audit fuel taxes as well as other taxes.

Fines and Penalties: Fuel tax evasion is considered a misdemeanor in Wyoming. A 10 percent penalty and one percent per month interest can be applied for significant negligence. Fraudulent activity can be punished by a 10 percent penalty, a fine of $750, and up to six months in prison. Wyoming is unable to seize assets of non-paying entities.

5.2 Comparison of the Montana Region Motor Fuel Tax Programs

The following section presents the motor fuel tax programs for each jurisdiction in comparison to one another. The primary categories of comparison are: points of taxation; tax rates and fuel dyeing; penalties and fines for non-compliance; motor fuel reporting and tracking; auditing and enforcement; motor fuel taxation; and treatment of Indian tribes.

5.2.1 Points of Taxation

There is a range of motor fuel tax collection points in the region surrounding Montana. While some jurisdictions have maintained the point of tax collection at the same level for 20 or more years, the majority of the jurisdictions in the region have moved their point of taxation up the supply chain to either the terminal or distributor level in recent years. Some of these jurisdictions have experienced positive revenue impacts due to this change as expressed in Tables 5-11 and 5-12.

Table 5-11. Montana Region Jurisdictions Points of Taxation for Gasoline

Jurisdiction	Point of Taxation for Gasoline	Last Changed	Impact of Change
Montana	Distributor (moved from dealer level to distributor)	1969	Motor fuel tax collections grew by 10.4% in 1969 and 12.0% in 1970[7]
Alberta	Manufacturers and bulk dealers (legal incidence on consumer)	N/A	N/A
British Colombia	Taxed at the first sale in BC, appointed 13 full collectors and 40 restricted collectors (i.e., importers)	N/A	N/A
Idaho	First receiver	1996	19% increase in overall tax collections
North Dakota	Distributor	N/A	N/A
Saskatchewan	Rack	2001	No significant impact measured
South Dakota	Rack	1996	10% overall revenue increase
Utah	Distributor	Unchanged	N/A
Washington	Rack	1999	$15 million per year total for both gasoline and diesel
Wyoming	Rack	1997	$6 million increase in motor fuel taxes annually

[7] Revenue impact associated with moving Montana's point of taxation up the distribution chain calculated using historical data published in FHWA (1996).

Table 5-12. Montana Region Jurisdictions Points of Taxation for Diesel

Jurisdiction	Point of Taxation for Diesel	Last Changed	Impact of Change
Montana	Distributor	1993	Taxed diesel volumes grew by 12.4% in 1994 (FHWA 1996)
Alberta	Manufacturers and bulk dealers (legal incidence on consumer)	N/A	N/A
British Colombia	Taxed at the first sales in BC, appointed 13 full collectors and 40 restricted collectors (i.e., importers)	N/A	N/A
Idaho	First receiver	1996	19% increase in overall tax collections
North Dakota	Distributor or retail	N/A	N/A
Saskatchewan	Rack	2001	No significant impact measured.
South Dakota	Rack	1996	10% overall revenue increase
Utah	Rack	1997	Higher rate of compliance by retail stations. Fewer accounts to manage and audit.
Washington	Rack	1999	$15 million total for both gasoline and diesel
Wyoming	Rack	1997	$6 million increase in motor fuel taxes annually

5.2.2 Tax Rates and Fuel Dyeing

Montana fuel tax rates are among the highest in the region. Washington's motor fuel tax rates are one cent higher for gasoline, kerosene, and gasohol. Kerosene is not taxed by BC and Saskatchewan. Fuel tax rates in BC and Saskatchewan are significantly higher than the rates in Montana. Table 5-13 summarizes fuel tax rates for the jurisdictions examined in this study.

Table 5-13. Montana Region Jurisdictions Motor Fuel Tax Rates

Jurisdiction	Gasoline	Diesel	Aviation Fuel	Kerosene	Gasohol	Biodiesel
Montana	$0.27	$0.2775	$0.04 (commercial carriers can request a refund of $0.02 per gallon)	$0.2775	$0.27 (3 cents per gallons refund when mechanically blended at rack)	$0.2775
Alberta	$0.275	$0.275	$0.06	$0.275	Only the non-ethanol portion is taxable	$0.275
British Colombia	$0.443	$0.459	$0.06	0	Exempt if the ethanol portion is not less than 5% or more than 25%	Exempt if the biodiesel portion is not less than 5% or more than 50%
Idaho	$0.25	$0.25	$0.055 aviation gasoline $.045 jet fuel	$0.25	$0.23	$0.25
North Dakota	$0.21	$0.21[1]	$0.08 (certain consumers qualify for refund, if so, it becomes 4% of purchase price)	$0.21 (2% of the price paid by the customer for dyed)	$0.21	$0.21 or 2% depending upon which product it is mixed with (i.e., clear or dyed diesel)
Saskatchewan	$0.459	$0.459	$0.05	0	$0.459	$0.459
South Dakota	$0.22	$0.22	Aviation gasoline is $0.06 Jet fuel is $0.04	$0.22	$0.20	$0.22
Utah	$0.25	$0.25	$0.04 cents for federally-certificated air carriers $0.09 for other purposes	$0.245 only taxed when blended	$0.25	$0.25
Washington	$0.28	$0.28	$0.10	$0.28	$0.28	$0.28
Wyoming	$0.14	$0.14 $0.01 on dyed	$0.05	$0.14 $0.01 on dyed	$0.14	$0.14

[1] North Dakota taxes dyed diesel at 2% of the price paid by the customer.

All of the Montana region jurisdictions have a dyed fuel program and diesel is either taxed or dyed in these jurisdictions. The types of fuels that are dyed in these jurisdictions do vary, however, as shown in Table 5-14.

Table 5-14. Summary of Montana Region Jurisdictions Dyed Fuel Programs

Jurisdiction	Tax or dye program?	Fuels included	Do you allow splash dyeing?
Montana	Yes	Diesel Kerosene	No
Alberta	Yes	Diesel Gasoline	Yes
British Colombia	Yes	Diesel Gasoline	Yes
Idaho	Yes	Diesel Biodiesel Kerosene	No
North Dakota	Yes	Diesel	No
Saskatchewan	Yes	Diesel	No
South Dakota	Yes	Diesel Kerosene Biodiesel Blend	Yes (however not recognized by IRS)
Utah	Yes	Diesel Kerosene	No
Washington	Yes	Diesel Kerosene Home Heating Oil	No
Wyoming	Yes	Diesel Kerosene Biodiesel	No

5.2.3 Penalties and Fines for Non-Compliance

There exists a significant variation in severity of penalties and fines for non-compliance between the jurisdictions in the Montana region. Four of the seven U.S. states in the region explored for this study deem fuel tax evasion a felony. Three states (Montana, North Dakota and Wyoming) deem tax evasion a misdemeanor, though Montana deems it so only after a third offense. Severity of offenses in Canada are composed of summary offenses (less serious) and indictable offenses (more serious), similar to the misdemeanor and felony categorizations in the United States. None of the three Provinces (i.e., Alberta, British Columbia, or Saskatchewan) criminal code considers fuel tax fraud as indictable at this time. Eight of the ten (excluding Montana and

North Dakota) jurisdictions bordering Montana are able to hold corporate officers responsible for any unpaid tax liability.

Table 5-15 summarizes the penalty and fine regulations as provided by the jurisdictions included in this study. It is worth noting that while a jurisdiction may have legal authority to pursue certain penalties, these laws may not be applied stringently in practice.

Table 5-15. Summary of Penalties and Fines for Montana Region Jurisdictions

Jurisdiction	Summary of Penalties	Able to immediately revoke or suspend licenses once fraud is detected?	Able to seize assets?
Montana	• 10% for underpayment for distributors • 25% for diesel tax fraud • 1% per month interest • $1,000 and a civil penalty for first offense with regard to misuse of dyed fuel; the second offense is a penalty up to $5,000 • Third or subsequent offense could include a criminal penalty resulting in not less than 30 days or more than 6 months imprisonment	Fraud can result in the revocation of the distributor's license	Yes
Alberta	• $1,000 for a first offense and up to $5,000 for subsequent offenses imposed on consumers for failing to pay taxes • Up to 300% penalty and/or up to 2 years in jail for falsifying documents • 25% for neglect, carelessness, willful default, fraud, or evasion • Up to 10 years in jail for fraud over $5,000; up to 2 years for fraud under $5,000 • $25 for each day of default for failing to submit a return • 5% for each month or part of a month in which the amount is overdue • $50 or 10% of assessed late taxes for late IFTA • $50 a day for failing to provide information • 6.5% interest applied on late payments • $150 for first offense, up to $5000 for subsequent offenses for the misuse of dyed fuel	Can revoke IFTA license and can cancel registrations or certificates	Yes
British Colombia	• 10%, 25%, or 100% penalty for fraudulent activity • Interest applied on late payments • $200 to $2,000 for misuse of dyed fuel	Yes	Yes
Idaho	• 10% penalty for underpayment • 50% penalty for fraud (dyed diesel and proved intent) • 5% negligence penalty • 10% if it is a serious reporting problem (e.g., 10-25% under reporting) • Interest is applied on an amended return and all late payments.	No	Yes
North Dakota	• 5% penalty for late report • Late tax payment results in a 5% penalty + 1% per month on any balance.	No	No
Saskatchewan	• Max audit is $25,000 • Max $10,000 on first offense for individuals • Max $50,000 on first offense for corporations • Fraud penalty not exceeding $1 million or 3 years imprisonment.	Must provide an opportunity to be heard prior to revoking or suspending a license	Yes

Table 5-15. Summary of Penalties and Fines for Montana Region Jurisdictions (Continued)

Jurisdiction	Summary of Penalties	Able to immediately revoke or suspend licenses once fraud is detected?	Able to seize assets?
South Dakota	• 10% penalty for late return or $10 minimum for motor fuel (MF) • 10% penalty for late return or $50 (whichever is greater) for IFTA • 1.5% monthly interest for MF • 1% monthly interest for IFTA • Misuse of dyed diesel in large trucks; $500 for the first violation and $1,000 for each subsequent violation • Misuse of dyed diesel in small trucks or cars; $250 for the first violation, $500 for each subsequent violation	All revocations require due process	Yes
Utah	• 15% intentional disregard • 50% to 100% fraud penalties • 10% for late payments and non-payment • 10% negligence	Through 5/1/2005: yes After 5/1/2005: due notice and hearing required prior to revocation	No
Washington	• 10% penalty for underpayment of special fuels • 2% penalty for underpayment of motor fuels • Up to 25 % for significant negligence • 100% for fraud • 1% monthly cumulative interest on late payments • $1,000 or $10 per gallon, whichever is greater, for the misuse of dyed fuel	Yes	Yes
Wyoming	• 10% penalty for underpayment • 10% penalty plus $750 and up to 6 months prison for fraud • 1%/month interest for late payments • $300 or $3 per gallon for the misuse of dyed fuel	Yes	No

5.2.4 Motor Fuel Reporting and Tracking

The majority of the Montana region jurisdictions require tax reports to be filed on a monthly basis; both BC and South Dakota accept returns on a monthly, quarterly, or annual basis depending on the filer and amount of tax liability. Only one state in this region requires EFT. Washington requires that taxpayers remitting greater than $50,000 monthly remit via EFT. All but one of the jurisdictions (Alberta) in the Montana region track motor fuel in some way and eight of the nine motor fuel tracking jurisdictions have electronic systems to aid with this effort. Further, six jurisdictions in this region have the capability of accepting electronic reporting but only North Dakota places a requirement of electronic reporting for a portion of its taxpayers. Data sharing is exchanged via paper reports between the jurisdictions at this time. Tracking efforts vary considerably as shown in Table 5-16.

Table 5-16. Summary of Motor Fuel Tracking for Montana Region Jurisdictions

Jurisdiction	Paper, Electronic, or None	Type	Places in Distribution Process Captured by Tracking
Montana	Electronic	In-house	Refinery, terminal, and distributor
Alberta	None	----	----
British Colombia	Electronic and paper - use desk audits to identify discrepancies	Gentax	Refinery, terminal, import/export, rebrands exempt, and taxable sales
Idaho	A combination of electronic and paper cross-checking systems	In-house	Pipeline, terminal, position holders, and licensed distributors
North Dakota	Manual	In-house	Rack to supplier – supplier to distributor – distributor to retailer, imports
Saskatchewan	Paper and electronic	In house	Exempt sales made by bulk fuel dealers
South Dakota	Electronic	Sesam	Terminal
Utah	Electronic system (only summary level information is keyed in)	Manual	Terminal and distributor
Washington	Paper and electronic (schedules are keyed in)	In-house electronic tracking system	Above the terminal rack tax-free fuel
Wyoming	Paper and electronic (schedules are keyed into main frame that can cross-check)	In-house	Origin and destinations for buyers and sellers via the tax return schedules

5.2.5 Auditing and Enforcement

Table 5-17 shows the number of audit staff for each jurisdiction. This data may provide a general sketch of the efforts expended by jurisdictions; however, it is unclear as to the portion of time spent by the auditing staff on motor fuels and IFTA in most jurisdictions.

Because, under the IFTA agreement, jurisdictions are required to complete audits of an average of 3 percent of their carriers over a period of five years, excellent records are kept with regard to IFTA auditing efforts. As shown in Table 5-18, only three of the jurisdictions in this region have, on average, fulfilled the 3 percent IFTA auditing requirement. Table 5-18 also shows which jurisdictions participate in the IFTA clearinghouse.

Table 5-17. Audit Staff for Montana Region Jurisdictions

Jurisdiction	Paper, Electronic, or None
Montana	11, not entirely dedicated to motor fuel taxes
Alberta	26
British Colombia	5 auditors – 30% of their total audit time devoted for IFTA and motor fuel tax (MFT)
Idaho	14
North Dakota	18
Saskatchewan	10
South Dakota	6
Utah	8 auditors and one technician
Washington	18
Wyoming	Unknown

Table 5-18. Percentage of Motor Carriers Audited for IFTA

Jurisdiction	2000	2001	2002	2003	2004	Average	Participate in IFTA Clearing House?
Montana	2.9%	2.8%	2.7%	3.6%	3.1%	**3.0%**	Yes
Alberta	1.3%	0.4%	0.8%	2.5%	1.9%	**1.4%**	No
British Columbia	0.9%	1.6%	2.7%	2.2%	1.2%	**1.7%**	Yes
Idaho	3.2%	3.6%	3.9%	3.5%	2.1%	**3.3%**	Yes
North Dakota	1.6%	3.4%	2.9%	3.3%	3.2%	**2.9%**	Yes
Saskatchewan	1.6%	0.7%	1.6%	0.6%	1.4%	**1.2%**	No
South Dakota	1.0%	0.3%	0.4%	0.5%	1.9%	**0.8%**	Yes
Utah	3.6%	3.7%	3.4%	3.6%	3.7%	**3.6%**	Yes
Washington	3.7%	2.1%	1.3%	1.4%	1.7%	**2.0%**	Yes
Wyoming	3.8%	3.8%	2.7%	2.7%	1.9%	**3.0%**	No

Source: International Fuel Tax Agreement (2005)

The extent of on-road enforcement efforts and the authority that is possessed to enforce dyed fuel laws, like other motor fuel program characteristics, varies significantly from jurisdiction to jurisdiction. Six jurisdictions of the ten jurisdictions in this region (e.g., Alberta, British Columbia, Idaho, North Dakota, Utah, and Wyoming) do not have a designated on-road enforcement program or rely on IRS inspection officers for on-road fuel inspections. Montana, Washington, and South Dakota provide for fuel inspections through commercial vehicle safety officers. Saskatchewan has on-road officers within the tax department that devote part of their

time to fuel tax issues such as fuel inspections. Table 5-19 provides a summary of on-road enforcement programs and the fines for fuel violations.

Table 5-19. Enforcement Program Overview for Montana Region Jurisdictions

Jurisdiction	Number of dedicated officers or dedicated staff hours to on-road enforcement	Have the ability to pull over and dip tanks, light and heavy vehicles?	Is dipping included in weight and safety checks at weigh stations?	Fines for violations
Montana	90 motor carrier safety officers total (not primary function but included in responsibilities), including 16 patrol officers	Yes for vehicles weighing over 10,000 (need probable cause for vehicles less than 10,000); vehicles over 14,000 are required to pull into weigh stations	Yes	• $1,000 for first offense (civil penalty) • Up to $5,000 for second offense • Fine of between $535 and $1,000 and criminal penalty resulting in imprisonment of at least 30 days but not more than 6 months for third offense
Alberta	None	Only for reasonable cause	Yes	• $150 for first offense, up to $5,000 for subsequent offenses
British Colombia	None	No	No	• $200 to $2,000
Idaho	None. Rely on two IRS dyed diesel inspectors	Yes Idaho State Police have ability	Yes Random; not part of every safety inspection	• Left up to the local judge
North Dakota	None. North Dakota Highway Patrol has legal authority to do this, but does not in practice.	Only for reasonable cause	No	• $250 for first violation; $500 for a second violation; $1,000 for a third violation; and $5,000 for the fourth and subsequent violations • Assess $.21 per gallon fuel tax on total gallons in vehicle's tank
Saskatchewan	6 officers at 40% time devoted to fuel tax (60%devoted to sales tax)	Yes	No	• $250 CA ($198 US)
South Dakota	24 motor carrier officers (not primary function but included in responsibilities)	Yes, both small and large vehicles, but must have another reason to pull over truck.	Yes	• Assessment if 1% dyed or greater. • Misuse of dyed diesel in large trucks; $500 for the first violation and $1,000 for each subsequent violation • Misuse of dyed diesel in small trucks or cars; $250 for the first violation $500 for each subsequent violation
Utah	None	N/A	No	N/A
Washington	100 plus (not primary function but included in responsibilities) Commercial Vehicle Enforcement Officers and 2 Washington State Patrol	Yes	Yes	• $1,000 or $10 per gallon, whichever is greater
Wyoming	None	No	No	• $300 or $3 per gallon

5.2.6 Motor Fuel Taxes and Native American Tribes

Figure 5-1 depicts areas of Native American land for the states and provinces analyzed in this study.

Idaho is the only state that does not tax – and in fact cannot tax due to a recent decision by the 9th circuit court of appeals – fuel sold at retail outlets on Native American reservations.

South Dakota, Washington, and Wyoming have similar agreements with Native tribes so that fuel taxed at retail stations on Native American reservations is refunded to the tribes based on tribal consumption calculations. However, South Dakota only taxes fuel on the four reservations where agreements are established. The three Canadian jurisdictions bordering Montana all treat issues of fuel tax and Native tribes in a similar manner. Fuel is sold to reservation retailers on a taxed basis. These retailers can sell fuel to individuals presenting their Indian Status Identification Card and receive a refund back from the province. North Dakota and Utah tax motor fuel on Native reservations but have revenue sharing agreements with tribes either based on tax percentages, resident enrollment, or quantity of fuel sold. In Montana, six of seven tribes tax their own tribal members and Montana shares that revenue with the tribes through revenue sharing agreements. One tribe does not have an agreement with the state. Table 5-20 summarizes treatment of fuel taxation on Native reservations within the Montana region.

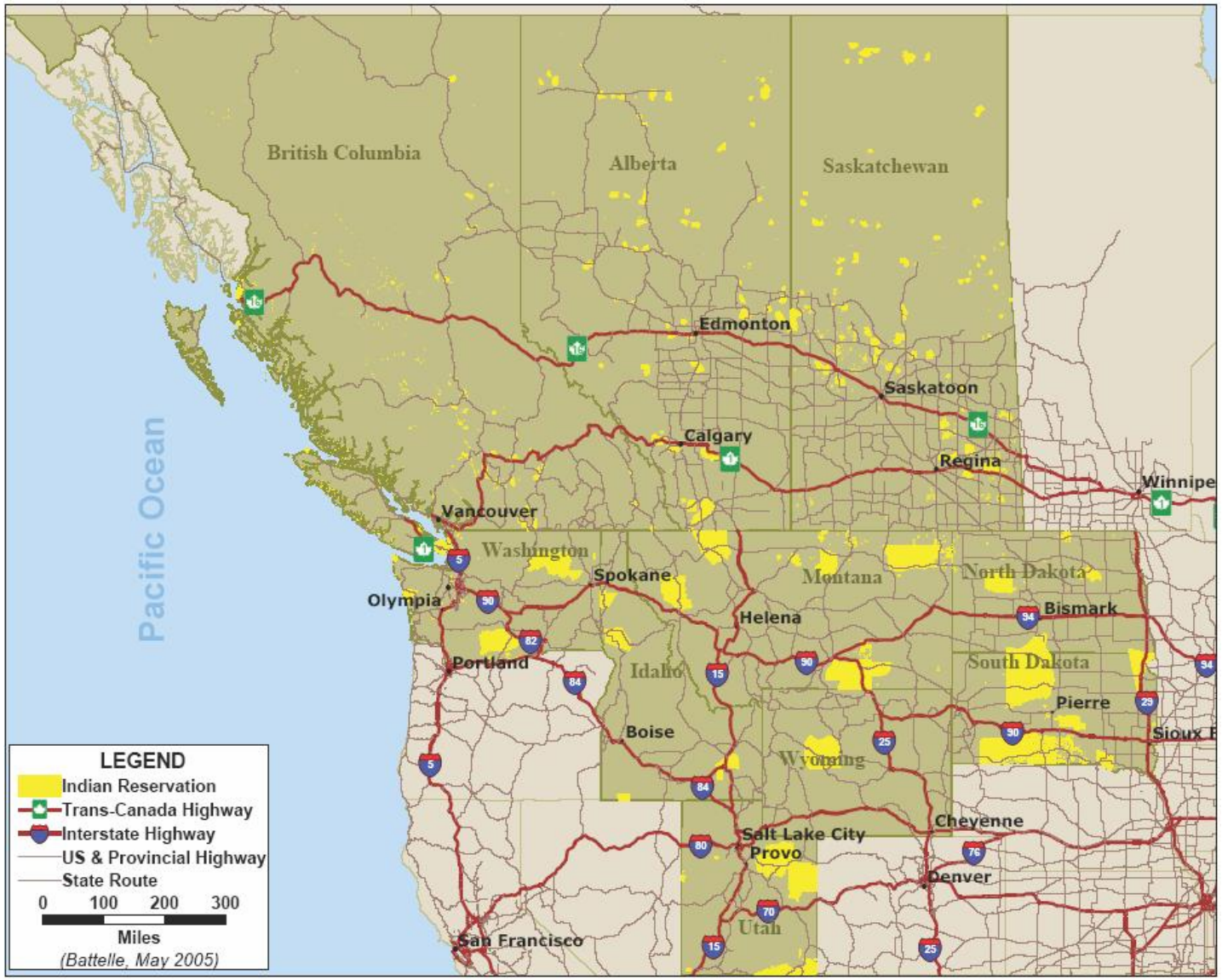


Figure 5-1. Indian Reservation Land

Table 5-20. Summary of Fuel Taxation on Native Reservations for Montana Region Jurisdictions

Jurisdiction	Is fuel taxed on reservations?	Agreements in place with Native American tribes?	Nature of agreements	Litigation currently pending?	Fuel tracked on reservations?
Montana	Yes	Yes	Six of seven tribes tax their tribal members and the gas tax is shared with the tribes through revenue sharing agreements. One tribe does not have an agreement with the state.	No	Only a few retail stations report to the Department due to one agreement
Alberta	Yes	Yes (Federal Treaty)	Fuel is sold on a taxed basis unless an Indian Status Identification Card is presented. Retail stations file a refund for fuel sold to status Indians.	No	No
British Colombia	Yes	Yes (Federal Treaty)	Fuel is sold on a taxed basis unless an Indian Status Identification Card is presented. Retail stations file a refund for fuel sold to status Indians.	No	Yes
Idaho	No	No	N/A	No	Yes
North Dakota	Yes	Yes, with one tribe	Standing Rock Sioux Tribe imposed its own fuel tax which is the same as the state's tax. Tax Commissioner collects the tax and distributes 75% to the tribe and retains 25% for the state	Yes	No
Saskatchewan	Yes	Yes	Fuel is sold on a taxed basis unless an Indian Status Identification Card is presented. Retail stations file a refund for fuel sold to status Indians.	Yes	Only exempt sales made by on-reservation retailers are recorded.
South Dakota	No unless there is an agreement	Yes 4 tribes	Required to report total sales less exempt sales.	Yes	Stations located on reservations with tax agreements report monthly.
Utah	Yes	Yes	Tribes purchase fuel tax paid and then file for refunds. The Navajo tax is 24 cents/gallon total, 18 cents/gallon goes to the Navajo and Utah receives 6 cents.	No	Yes
Washington	Yes	Yes 13 State/Tribal Agreements and 1 Federal Consent Decree	Calculations of tribal consumption are made and refunds are provided back to the tribe.	Yes	Yes
Wyoming	Yes	Yes	The amount of motor fuel use on the reservation by its people is estimated by the population on the reservation. A refund is based on this calculation.	No	Unknown

CHAPTER 6.0 ANALYSIS OF TAX CODES AND OPPORTUNITIES FOR EVASION

Just as the strength and degree of administrative and enforcement procedures has implications for the opportunities and extent of fuel tax evasion, so too does the nature of laws that govern motor fuel taxation. Current sections related to fuel taxation in the Montana codes do protect the road fund tax base; however, the code could be further strengthened to reduce opportunities and incentives for fuel tax evasion.

This analysis summarizes current motor fuel excise tax code, identifies recent and proposed legislation in Montana aimed at addressing motor fuel tax codes, and identifies gaps in the tax code that can be exploited by fuel tax evaders. Recommendations for closing these gaps are provided in Chapter 9.

This analysis focuses on the 2003 Montana Codes Annotated (MCA) and the Administrative Rules of Montana (ARM) and specifically, the following sections of the MCA:

1. MCA Title 15, Chapter 70 Gasoline and Vehicle Fuel Taxes;
2. MCA Title 18, Chapter 11 State – Tribal Cooperative Agreement;
3. ARM Title 18, Chapter 9 Motor Rules – Gasoline Tax;
4. ARM Title 18, Chapter 10 Motor Fuels Tax Division – Other Fuels; and
5. ARM Title 18, Chapter 11 Motor Fuels – Seizure and other related code.

Examples of federal tax code and tax code of states and jurisdictions in the region surrounding Montana will provide a basis of comparison for analysis of Montana code. It is important to note that the tax code in jurisdictions surrounding Montana has implications for the incentives to evade fuel taxes in the State of Montana. For example, if the tax code of those jurisdictions bordering Montana is generally tighter and more stringent, then Montana becomes a more accessible and advantageous place to conduct fraudulent activities.

6.1 License Suspension

Revised Code of Washington 82.36.080 states if any person acts as a licensee without first securing the license required within the motor fuel statutes that the motor fuel tax shall be immediately due and payable by the person. The director of transportation shall determine the amount of tax from the best available sources and immediately assess the tax determined due and 100 percent penalty.

Revised Code of Washington (RCW) 82.38.130 regarding special fuel, authorizes the department to revoke the license for cause. The department must notify the licensee of the reasons for the revocation. The licensee has 20 days to respond why the license should not be revoked. Prior to and pending a hearing the department may suspend the license at the discretion of the department. RCW section 82.36.190 regarding motor vehicle fuel (gasoline), authorizes the department to suspend or revoke the license of any licensee refusing or neglecting to comply with any provision of chapter 36 (motor fuel tax). The department is required to notify the licensee by registered mail notice of cancellation and the reason for the cancellation. The

cancellation will become effective without further notification if the licensee does not rectify the violation within 10 days.

Oregon Revised Statute (ORS) 319.096 authorizes the department to suspend the dealer's license for any violations of the Oregon motor fuel tax statutes. The department is required to give immediate notification to the licensee of the suspension, of the cause for the suspension, and the dealer's rights to a hearing. Oregon Revised Statute 319.100 then allows for the revocation of the suspended license if the licensee is unable or unwilling to comply with the motor fuel tax statutes. This revocation becomes automatic within 10 days of mailing and without further notice if the dealer does not comply with the motor fuel statutes. Oregon Administrative Rule (OAR) 735-170-0120 instructs each dealer to provide the department with contact information for notification of suspension of license. The dealer is responsible to notify the department of any changes in the contact information. The department is responsible for notifying all other dealers of the suspension or revocation of the licensee's license.

6.2 Joint and Several Liability/Piercing the Corporate Veil

Montana statutes do not contain section(s) within the motor fuel code or administrative rules on joint and several liabilities or piercing the corporate veil of corporations or limited liability companies. Fuel tax evaders can hide behind the corporate shield because their assets are exempt from the reach of the jurisdiction. In some cases, even though the corporation is prosecuted and convicted, the directors, officers, and employees are not held to be culpable as there is no statute to prosecute these individuals as is the case currently in Montana. Imposing joint and several liabilities on both the corporation and limited liability companies would act as a deterrent to potential evaders. Doing so would increase security measures to protect against any individuals within the company committing fuel tax evasion. It will also clarify to the courts that the legislative intent is to hold the specific perpetrators of the evasion financially and criminally liable.

Alberta Fuel Tax Act, R.S.A. 2000, c. F-28-25(1) states that where a corporation has failed to remit tax collected by that corporation, the directors of the corporation at the time the corporation was required to remit the tax collected are jointly and severally liable, together with the corporation, to pay that tax collected and any interest or penalties relating to it. This code section states that if a corporation defaults on payment of motor fuel taxes during the process of collection and prosecution the department can continue to pursue both the corporation and the directors. This code section imposes individual liability on the director (as well as the corporation), including the personal assets of the directors.

BC's motor fuel tax act contains a section imposing joint and severally liability on a board member of a corporation that has failed to collect or remit the authorized motor fuel tax. The liability is for taxes, penalty, and interest defaulted during the term of the board member. The section details that the board member may use only the following defense: the board member exercised the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances to prevent the corporation's failure to collect or remit taxes or to pay security as required under this Act. See RSBC 317-7-45.1. This defense of the director is already contained within Montana's common law Business Judgment Rule. BC's Motor Fuel

Tax Act Chapter 317, Part 4, Section 45.2 states that if the DOT believes that a person who was not a member of the board of directors of a corporation performed some or all of the functions of a member of the board of directors that the person may be deemed a member of the board of directors. The BC motor fuel act contains a section stating that an officer, director, employee, or agent of a corporation who directs, authorizes, assents to, acquiesces in, or participates in the commission of an offense is a party to and guilty of the offense and liable to the punishment provided for the offense. See RSBC 317-1-68.

North Dakota Century Code on motor fuel tax has sections for imposing liability on corporate officers, managers, or members of corporations or limited liability companies. If a corporation fails to file the required returns or pay the tax due, the president, vice president, secretary, or treasurer are personally, jointly, or severally liable for the failure. If a limited liability company fails for any reason to file the required returns or to pay the taxes due the managers, or members of a limited liability company, they are personally, jointly, or severally liable for the failure. The dissolution of a corporation or limited liability company does not discharge a manager's or member's liability for a prior failure of the corporation or limited liability company to file a return or remit the tax due. The taxes, penalty, and interest may be assessed and collected from the officers, managers, or members of the corporation or limited liability company. If the corporate officers, managers, or members wish not to be held personally liable, the corporation or limited liability company may deposit or bond in an amount equal to the estimated annual motor vehicle fuel tax liability of the corporation or limited liability company with the department to avoid personal liability. See NDCC 57-43.1-17.2, 57-43.1-17.3, 57-43.2-16.1 and 57-43.2-16.2.

South Dakota has a specific code section imposing joint and severally liability for the filing of reports or returns and the payment of tax, penalty, and interest due on the corporate officers. The corporate officer is not discharged of this liability by leaving his position as an officer of the corporation. Also, the dissolution of the corporation does not discharge the officer of his liability. See SDCL 10-47B-41.

Revised Code of Washington 82.36.045 states that if a licensee converts motor fuel tax collected to any use other than the payment of the tax, that person is guilty of a felony or gross misdemeanor. A person, partnership, corporation, or corporate officer who fails to collect the motor fuel tax imposed or collects and fails to pay the tax to the department in the manner required, is personally liable to the state for the amount of the tax.

6.3 Burden of Proof

MCA Title 15; Chapter 70 Gasoline and Vehicle Fuel Taxes or Administrative Rule of Montana title 18; Chapters 9, 10 and 11 Motor Fuels does not have a section addressing which party has the burden of proof nor the standard of proof when penalties may be contested.

Washington has two code sections that state that if the validity of an assessment of penalty is challenged that the burden of proof is on the person who challenges the assessment to establish by a fair preponderance of evidence that the assessment is erroneous or excessive. See RCW 82.36.045 and 82.38.170.

North Dakota Century Code 57-43.2-14.1 states that if a person fails, neglects, or refuses to file a special fuel tax report when due, the commissioner shall, on the basis of available information, determine the tax liability for the period during which no report was filed, and to the tax thus determined the commissioner shall add the penalty and interest. An assessment made by the commissioner under this section is presumed to be correct, and in any case when the validity of the assessment is in question, the burden is on the person who challenges the assessment to establish by fair preponderance of evidence that it is erroneous or excessive.

BC Motor Fuel Tax Act 317-65 states that in a prosecution for failure to collect, remit, or pay money under the Act, the onus is on the accused to prove that the money was collected by the accused or was paid or remitted, as the case may be, to the BC government.

To strengthen Montana code, a section could be added to the MCA Title 15; Chapter 70 Gasoline and Vehicle Fuel Taxes. The code section could state that in any case where the validity of the assessment is drawn in question, the burden shall be on the person who challenges the assessment to establish by a fair preponderance of the evidence that it is erroneous or excessive. This code section would be in addition to all other Montana code section regarding penalties.

6.4 Examination of Records, Fuels, and Equipment

MCA 15-70-208 authorizes the department to examine the books, records, and equipment of any gasoline distributor. MCA 15-70-208 also outlines the documents that are required to be kept by the distributor. The statute is worded so that the distributor must keep all documents that would be necessary for the DOT to ascertain and determine whether all license taxes due are being properly reported and paid. The code section does not authorize the department to examine or sample the gasoline itself, nor does it lay out the penalty or consequences of not making available the books, records, equipment, or fuel for examination or inspection.

MCA 15-70-324 and 15-70-349 authorizes the department to examine the books, papers, records, and equipment of any special fuel user or distributor respectively. These code sections also authorize the implementation of penalties. A person who purposely or knowingly refuses to permit an inspection is guilty of a misdemeanor and fines not to exceed $500, $1,000, and $2,000 for the first, second, and subsequent offenses, respectively. MCA code sections 15-70-324 and 15-70-349 also state that the special fuel user or any person dealing in, transporting, or storing special fuel must keep all documents that would be necessary for the DOT to investigate the character of the disposition that any person makes of special fuel in order to ascertain and determine whether all excise taxes (special fuel user) or license tax (special fuel distributor) due are being properly reported and paid.

Administrative Rules Montana 18-10-324 authorizes the department to revoke the special fuel user's permit if the special fuel user does not maintain the records specified in MCA 15-70-323.

MCA 15-70-713 authorizes the examination of the records, receipts, invoices, documents, and equipment of any compressed natural gas dealer, any liquefied petroleum gas dealer, or any person importing, manufacturing, refining, dealing in, transporting, or storing compressed

natural gas or liquefied petroleum gas. MCA 15-70-713 requires that records, receipts, invoices, documents, and equipment of any compressed natural gas dealer, any liquefied petroleum gas dealer, or any person importing, manufacturing, refining, dealing in, transporting, or storing compressed natural gas or liquefied petroleum gas must be kept so that the department may investigate the character of the disposition that any person makes of compressed natural gas or liquefied petroleum gas in order to determine whether all taxes due under this part are being properly reported and paid. The code section does not authorize the department to examine or sample the liquefied petroleum gas itself. The code section also does not detail the penalty or consequences of not making available the books, records, equipment, or fuel for examination or inspection.

Montana could consider instituting code sections that would authorize the inspection and examination of motor fuel and paper work of any persons engaged in storing, selling, transporting, or distributing motor vehicle fuel, other petroleum product, or related products within Montana, and such other investigations as it considers necessary in carrying out the provisions of the statutes regarding motor fuel. This would allow for the inspection and examination of fuel contents of all fuel containers whether stationary or mobile to ensure that they contain the fuel stated on the related documents or paperwork. The documents and paperwork would include, but not be limited to records, receipts, invoices, shipping papers, and any other pertinent papers supporting sales or movement of each distributor or any person dealing in, transporting, or storing motor fuel. These code sections would also allow for inspections and examination of motor fuel and paper work of all persons in the motor fuel supply chain. This potential solution is very similar to the solution for the section Importation and Exportation – Investigation and Examination. It is more efficient to have one statute that solves multiple issues.

6.5 Seizure of Fuel without a Warrant

MCA 15-70-233 and 15-70-357 allows for the seizure of fuel without a warrant with approval of the director of the DOT. The peace officer may stop and search a conveyance in the state if the peace officer has reasonable cause to believe that the fuel has been improperly imported and is intentionally avoiding fuel tax responsibility. These code sections are superior to other state's code sections regarding seizure of fuel for suspected evasion. The majority of states bordering Montana (e.g., Idaho, Wyoming, Oregon, Utah, North Dakota, and South Dakota) do not address this issue of whether a warrant is needed or not needed within their statutes or regulations. By not addressing the issue within the statutes, the enforcement officers would need to obtain a search warrant before seizing motor fuel of a taxpayer.

MCA 15-70-233 and 15-70-357 Seizure of Fuel without a Warrant statutes are superior to the surrounding states as it does not require a warrant if the enforcement officer has "reasonable cause" to believe that the motor fuel has been improperly imported and if the enforcement officer obtains authorization from the director of the DOT to seize the fuel. Obtaining a search warrant can take a considerable amount of time. During the period of time of obtaining a warrant to seize the motor fuel, the fuel could leave the state or be disposed of or concealed in such a way that it would be difficult to identify the specific motor fuel in question. There are judicial recognized exceptions to the United States Constitution Fourth Amendment and Montana

Constitution prohibition against unreasonable searches and seizures or in other words, the requirements of a warrant. However, Montana's statutes clearly lay out both the procedure, obtaining authorization from the director of the DOT and the "reasonable cause" requirement for seizing motor fuel. Therefore, the enforcement officer would have clear authority to seize the motor fuel and the DOT would have clear authority to possession of the motor fuel.

Washington requires either a warrant or exigent circumstances to exist to seize fuel without a warrant (WCA 82.36.470 or 82.38.60). Revised Code of Washington, Title 82 Excise Taxes, Chapter 36 Motor Vehicle Fuel Tax section 470 and 490 require a warrant with the following exceptions: seizure is incident to an arrest, or exigent circumstances (emergency circumstances where there is a high probability that the evidence would disappear or locating the evidence again may become impossible) exist making procurement of a search warrant impracticable.

Saskatchewan, Fuel Tax Act, 2000, Chapter F-23.21, Part IV, Division 1, Section 36 addresses warrants and requires a warrant for search and seizure of any place, motor vehicle or any evidence that is obtained pursuant to any violations of the Fuel Tax Act.

MCA 1570-233 and 15-70-357 could be expanded not only to cover improperly imported fuel but also to include any type of taxed fuel or non-taxed fuel if there is reasonable cause to believe that there is intent to avoid fuel tax responsibility. This would eliminate the requirement of proving that the fuel was improperly imported. The only element that would have to be proved would be intent to avoid fuel tax responsibility. This change in the code section would allow the code section to be expanded for use in more situations. This code section change would also prevent the issue of an evader that is being prosecuted from raising the defense that the fuel was not improperly imported and assert that the fuel was illegally seized by the DOT.

6.6 Security/Bond

Montana gasoline and special fuel distributors are required to have a minimum security of $25,000 and a maximum of two months estimated fuel taxes. The security or bond is to protect the government against evasion schemes or distributors that go out of business for various reasons. In either case the result is that the government does not collect the fuel tax due. The security is to reduce or eliminate the government's risk of uncollected fuel tax. The security will also deter potential perpetrators from setting up a sham company as the cost of the security will reduce the intended benefits of motor fuel tax evasion. Washington's license application procedure requires that the bond be a minimum of three times the estimated monthly fuel tax (see RCW 82.38.110(10)). Utah's bond requirements for a licensee is determined by the Department of Transportation Commission and may not be less than $50,000 or exceed $500,000 (see UCA 59-13-203.1). Wyoming's bond requirement for a licensee is the greater of 6 months estimated tax liability or $50,000 (see WS 39-17-106(e)(i)). Oregon recently amended their statutes regarding bonding requirements in 2003. Oregon is a good example in the area of bonding within the motor fuel tax codes and regulations. Oregon's bonding requires the lesser of twice the dealers estimated monthly license tax or $250,000 (see ORS 319.050). Oregon's code section is also unique in that it has provisions for both increasing and decreasing the bond. Oregon Revised Statute 319.051 reduces the bond to $100,000 or two months estimated fuel tax, whichever is less. This reduction is implemented if the dealer/licensee has held the license since

October 23, 1999 and had no indications of fuel tax evasion, complied with the motor fuel tax statutes, and met all requirements of taxes, penalties, and other obligations. Oregon Revised Statue 319.052 increases the bond requirements to the lesser of $1 million or two months estimated taxes if the dealer/licensee: 1) was late filing, 2) submitted a check or electronic funds that were dishonored, 3) failed to maintain or make available records, 4) motor fuel license was revoked in Oregon or another jurisdiction. Oregon does reserve the right to waive this requirement based on a determination regarding intent to avoid the fuel tax.

Montana could increase the minimum amount of security required by the licensee/registrant. The amount should be large enough to cover the time frame for detection of fuel tax evasion. Montana could adopt Oregon's approach of increasing the minimum amount of security to the lesser of $250,000 or two months estimated fuel tax liability. This would be a revision to the Montana Code Annotated 15-70-202(1)(b) and 15-70-341(1)(b). It should also include a revision to any administrative rules affected – ARM 18.9.102. An additional code section could also be included which would allow for the security amount to be increased to the lesser of $1 million or two months estimated fuel tax for any non-compliance of the motor fuel tax statutes. This will reduce the risk to the DOT by having more security to cover the time it takes to detect fuel tax evaders. To allow the department discretion, a code section could be added to allow the department to waive an increase in the bond amount if the department determines that the distributor did not intend to avoid payment of the motor fuel tax. A code section could be added to reduce the security back down to its original amount of the lesser of $250,000 or estimated two months of fuel tax if after a state period of time that the distributor/licensee has been compliant with all the motor fuel tax statutes.

6.7 Background Checks/Investigation of Applicant Licensees

Montana statutes and most of the surrounding states and provinces do not detail the investigation that is performed before granting an applicant a license. A thorough investigation will prevent fuel tax evasion. Time spent before granting a license by performing an investigation of the applicant, fingerprint investigation, and site and facility examination will save significant potential time in evasion detection and audit. Upfront prevention is always more cost efficient than detection and conviction. Audit, enforcement, and detection of fuel tax evasion is difficult, time-consuming, and expensive. Washington code section 82.36.070 details the license requirements for motor vehicle fuel (gasoline). The license does require investigation and inspection of records of the State of Washington, any other state and the federal government to verify the information contained on the application for license. Washington code section RCW 82.38.110 details the application process for special fuel tax (all other fuel other than gasoline). Subsection (6) requires that the director conduct an investigation to determine whether the information contained in the license application is true. It further requires a fingerprint record check of the applicant through the WSP criminal identification system and the Federal Bureau of Investigation (FBI) before issuance of a license.

A code section or regulation could be adopted by Montana detailing the registration requirements. These requirements should include increased background checks including finger printing to avoid licensing previous or habitual fuel tax evaders or other types of undesirable previous behavior that would indicate an increase risk of fuel evasion. The fingerprint check

should include the state of Montana records and the FBI. The application for a license should include the names of the officers of the company. The officer's names should be checked to ensure that they do not owe motor fuel tax from other companies that they are an officer of or a related party. All other state, provinces, and the federal government records should be checked to ensure that the applicant's license is in good standing in the respective jurisdiction. An enforcement officer should be sent to examine the site and facilities of all licensee applicants. The increased cost of the background check, fingerprint check, and site/facilities examination should be included in the cost of the application fee of the applicant to mitigate the increased costs associated with the investigation, fingerprint check, and site and facility examination.

6.8 Method of Reporting and Remittance of Tax

In Montana, electronic filing of returns and information and electronic payment is voluntary (see MCA 15-70-112, MCA 15-70-113, MCA 15-70-114 and MCA 15-70-115 Rules). At present, approximately 87 percent of all taxpayers, representing 99 percent of tax payments, are filed electronically. Advantages of switching from manual/paper to electronic include the reduction in cost to the department for manually imputing information into the motor fuel distributor processing system and reduction of errors. EDI and EFT result in faster receipt of reports, information, and revenue. Faster receipt of information will speed up the process for detection of evasion and facilitate automated cross-matching by the fuel distributor processing system. Most surrounding states and provinces have EDI and EFT capabilities; however, submitting reporting by EDI and remitting tax funds by EFT is voluntary. Washington, however, requires that when monthly taxes are $50,000 or more, EFT is required (see RCW 82.36.035 and 82.38.160).

MDT could make both report filing and tax payment electronically mandatory when the motor fuel tax meets or exceeds $50,000 monthly. Advantages of switching from manual/paper to electronic are reduction in cost to the department for manually imputing information into the motor fuel distributor processing system and reduction of errors. EDI and EFT result in faster receipt of reports, information, and revenue. Faster receipt of information will speed up the process for detection of evasion and facilitate automated cross-matching by the fuel distributor processing system. The $50,000 tax cutoff will protect smaller distributors that do not have access or the resources to implement electronic access and will allow them to continue reporting and remittance of tax manually. MDT has the capability to receive reporting by paper, EDI, or through the web. However, distributors without electronic access should be a very small percentage of distributors, as most distributors at a minimum should have access to the web.

6.9 Importation and Exportation – Investigation and Examination

MCA 15-70-357 allows for an enforcement officer to stop and search a conveyance if he has "reasonable cause" to believe that motor fuel has been improperly imported. However, this may be too restrictive given the diverse ways in which fuel tax liability is intentionally avoided. For instance, one scheme used to evade fuel taxes occurs when a motor fuel carrier schedules the export of a load of fuel but instead deposits the fuel at a storage facility or delivers it to a dealer

within Montana and then fills the carrier with water and proceeds through a weigh station so that the documentation states that the fuel was exported out of Montana to avoid detection.

This particular fuel tax evasion scheme and other variations of it can be detected by inspecting both the contents and the records of motor fuel carriers; however, there are significant hurdles in the code that keep enforcement officers from detecting such schemes. First, reasonable cause means that the facts have to be such that an ordinary and prudent person would have an honest and strong suspicion that the facts are such that a crime has been committed. Second, the suspicion of the crime has to be limited to illegal importation of motor fuel.

To combat these types of schemes, enforcement officers would have to dip or examine the contents of conveyances (tank car, vehicle, or vessel that is used to transport fuel) on a regular basis (abet random or periodic basis). At this point in time, MCA 15-70-357 Improperly Imported Fuel – Seizures, could be used by a person that the DOT is trying to prosecute as a defense, stating that the officer did not have probable cause to believe that the fuel was illegally imported.

In North Dakota, the department or its authorized representative may examine fuel of any transport, refiner, supplier, distributor, importer, exporter, terminal operator, retailer, or common or contract carrier. See NDCC 57-43.1-17 and 57-43.2-14. Saskatchewan has a code section that allows for the enforcement officer to stop and inspect a motor carrier carrying bulk fuel to determine if the contents of the carrier match the paper work of the carrier (see Saskatchewan Fuel Tax Act F-23.21-34-38). Revised Code of Washington sections 82.36.200 and 82.38.140 authorize the DOT or authorized agents at any time during normal business hours to examine the stocks of any person engaged in the transportation of motor vehicle fuel within the State of Washington for the purpose of checking shipments or use of motor vehicle fuel.

Montana could consider instituting code sections that authorize the inspection and examination of motor fuel and paper work of any persons engaged in storing, selling, transporting, or distributing of motor vehicle fuel or other petroleum products within Montana, and such other investigations as it considers necessary in carrying out the provisions of the statutes regarding motor fuel. This would allow for the inspection and examination of fuel contents of all fuel carriers leaving or entering the state to ensure that they contain the fuel stated on the importation or export document/shipping papers. These code sections would also allow for inspections and examination of motor fuel and paper work of all persons in the motor fuel supply chain.

6.10 Refunds or Credits and Required Records

There is a potential for evasion of taxes in the refund/credit area. Taxpayers can create false documentation of nontaxable use or not documenting/claiming highway use of untaxed fuel. All applications for refunds currently must be filed with the department within 36 months after the date on which the gasoline or aviation fuel was purchased as shown by invoices on or after the date on which the tax was paid. Generally, refunds requests are initially granted by the State of Montana but are later audited. During the audits, MDT determines whether all supporting documentation was provided and the refund request was valid. The filing time could be reduced to 12 months as it is easy to falsify documents and old invoices that can no longer be verified.

Currently, if a claim is rejected, the department may suspend the claimant's right to refund for a period not to exceed one year.

Oregon Revised Statute 319.290 limits the time that a claim for refund of motor fuel tax may be filed to a maximum of 15 months from the date of purchase, invoice, or exportation. Washington special fuel and motor fuel tax statutes contain sections on limiting the time claims must be filed with the DOT to 13 months from the time of purchase for a tax refund. (See RWC 82.38.190 and 82.36.330). North Dakota Century Code 57-43.1-06 and 57-43.2-04.2 limits the time that a claim for refund must be made to a maximum of one year for a refund of tax paid in multiple jurisdictions for both motor fuel or special fuel tax. The one year tolling starts from the time the fuel is removed from the state.

6.11 Recent Legislation

There were a number of bills (proposed statutes) both introduced and un-introduced from the Montana Legislative Branch and both the House and the Senate during the recent 2005 Montana Legislative session. The following is a summary of the bills related to motor fuel tax evasion.

House Bill No. 296
This was an Act allowing a municipality to impose a local option motor fuel excise tax upon approval of the voters of the municipality; allowing the revenue to be used for property tax relief and multimodal transportation as well as road maintenance and construction; prohibiting double taxation; and amending sections MCA 7-14-301, 7-14-302 and 7-14-303. This bill missed the deadline for revenue bill transmittal and was not enacted. This bill would appear to increase the complexity of the administration of the motor fuel tax in Montana and expand the use of the motor fuel tax funds.

Senate Bill No. 45
This was an Act establishing a uniform statute of limitations on assessment of taxes, penalties, and interest for gasoline, special fuels, and compressed natural gas; providing conditions under which the statue of limitations does not apply; amending sections MCA 15-70-212, 15-70-355 and 15-70-720; and providing an effective date. This bill died in standing committee and is now a dead bill. This bill does not change the current statute of limitation of three years. The tolling, however, starts after the return is filed. The change is to clarify language and to have consistent language in the three different code sections listed above.

Senate Bill No. 123
Senate Bill (SB) 123 revised requirements governing special fuel permit holders and special fuel users; requiring that special fuel permit holders use fuel on which state tax has been paid; requiring that material used for construction, reconstruction, or improvement in connection with work performed under a public contract be produced using special fuel on which state fuel tax has been paid; exempting special fuel permit holders from certain recordkeeping requirements; increasing the penalties for using dyed special fuel on the public roads and highways; and amending sections MCA 15-70-302, 15-70-321, 15-70-323, 15-70-325, 15-70-330, 15-70-356 and 15-70-372. This bill was passed and signed into law. The change outlined in the bill requires all special fuel users who contract with any state, city, county, or federal agency to do

public road projects to obtain a special fuel user permit and requires that it be displayed at all times. Another change is to collect tax on special fuel that is used for construction, reconstruction, or improvements of any highway or street on public agency contracts. The bill also contained a change that eliminated special fuel users' ability to request to file annual reports. The last change contained in the bill is an increase in the maximum amount of the civil penalties from $100 to $1,000 and $5,000 for the first and second offenses, respectively of MCA 15-70-330(3), using dyed special fuel to operate a motor vehicle upon the public roads and highways of Montana.

Senate Bill No. 277

SB 277 was signed by the Speaker on April 15, 2005 and sent to the Governor on April 16, 2005. SB 277 modified MCA 15-70-311 to include the following: that any person operating a special fuel-powered vehicle over 26,000 pounds gross vehicle weight upon the public roads and highways of this state who is using the vehicle for the movement of that person's agricultural products is required to purchase a special fuel user's agricultural product temporary trip permit.

CHAPTER 7.0 INDUSTRY PERSPECTIVES ON FUEL TAX COMPLIANCE AND EVASION

Fuel tax evasion doesn't just threaten funding for the Montana road system, it also threatens those legitimate companies in the fuel distribution process that are undercut or are affected by the unfair competitive advantage that unscrupulous marketers gain from fraudulent activity.

It is therefore in the fuel distribution industry's interest to both protect their organizations from potential fraudulent activities within their organizations and for the state to have efficient but non-burdensome enforcement and compliance measures in place. Given the significant stakes that the legitimate fuel industry has in the problem of fuel tax evasion, an industry perspective is an important one in order to assess and address the problem of fuel tax evasion in Montana.

The following section reports on enforcement activities within the organizations of the fuel distribution industry in Montana. The Battelle Team obtained a list of companies from MDT who is currently involved in fuel distribution within the State of Montana. This list included the names of various companies involved in each stage of the fuel distribution process including the bulk and non-bulk transfer system (terminals, refineries, importers, exporters, and retailers). In addition, prior to conducting the interviews, an interview protocol was developed by the Battelle Team. The interview protocol included topics such as: (1) the process for tax compliance and the types of reporting procedures; (2) shortcomings of data reported and costs for reporting; (3) fuel tax evasion and improving compliance; (4) electronic funds reporting; (5) compliance issues with Native American reservations; and (6) improving compliance through public outreach within the State of Montana.

Nine companies dealing in motor fuel were contacted. These companies included businesses involved in importing, exporting, distributing, and retailing of motor fuel. The particular individuals who responded were those that had the most expertise in the tax filing process for the State of Montana within the companies. Interviewees were reluctant to answer questions over the phone; therefore, the questionnaires were transmitted via fax or email. Replies were received and the data were compiled. Appendix B contains the motor fuel industry survey.

7.1 Tax Payment Remittance Process

The process for remitting taxes and the types of tax reports that are filed varies somewhat from company to company, although almost all (7 out of 9) of the companies interviewed remitted tax payments electronically by computer on a monthly basis. Five of the companies use EDI, which refers to transfer of data between different companies using the Internet. EDI is becoming increasingly important as a convenient mechanism for companies to trade information; in this case tax information between the fuel distribution companies and the State of Montana.

Four of the companies interviewed use the ZyTax tax preparation software. ZyTax assists the petroleum suppliers, fuel distributors, and retailers with tax compliance and reporting to local, state, and federal authorities by helping them automate motor fuel excise tax calculations and reporting. In general, the steps for the ZyTax process include:

1. Compare and analyze fuel movements from terminals and refineries to product billing and to the data in the tax reporting system (verify accuracy of data),
2. Create an import file from the billing application software, which contains all of the bill of lading data required for tax reporting,
3. Import this file into the ZyTax software,
4. Create an EDI file in ZyTax and export that file to the State of Montana's website, and
5. Payment is transmitted via EFT.

ZyTax updates and modifies the software periodically based on State of Montana tax requirements.

In addition to EDI, Montana also offers Internet filing and manual reporting. Distributors who choose to file on the web can fill in data manually and certify their reports when complete. Distributors who choose to file on paper mail their tax report to the department. All distributors have the option of paying their tax liability by check or EFT. Distributors who pay by electronic funds transfer are given five extra days to pay.

Eight of the nine companies interviewed supported electronic filing and reporting. Several reasons for this include ease of use, cost savings, and time saved by employees. One company stated that they especially liked the electronic filing feature that allows the EFT debit. It allows less staff members to be involved in the process. When the paper returns were used, accounts payable and mail room staff were involved in making sure the return was filed and the check was issued. Only one company disliked the electronic filing process but favored funds transfer initiated by the company.

In general, most companies felt there were minimal issues with mandating and implementing EFT. Many of them have used the EFT system for years and feel it is much simpler and saves time and money. One company commented how simple the process was and that the staff at MDT is only a phone call away to help with problems. Some issues that were brought up with mandating and implementing EFT include:

- Smaller companies that have limited financial resources may dislike the idea of having to implement electronic reporting, especially if they have a small number of transactions;
- Initial setup of the electronic system takes time and money; and
- Electronic reporting requires more attention to specific details and some fields must be manually corrected before submitting the EDI.

To overcome the cost issue smaller companies may have in setting up electronic systems, one company commented that several states have created a website in which the tax filers, who are unable to comply with the formal EDI, can fill in data manually, or actually attach a file, such as an Excel spreadsheet. Thus, the state has the data in electronic format and the filer has not expended a large amount of resources to comply.

7.2 Tax Reports and Data Filed

All companies interviewed stated that they file tax reports on a monthly basis. Seven of the nine companies file a Distributor's License Tax Report, which in some cases is performed online through EDI. Various data contained on these reports include:

- Carrier, supplier, and purchaser name;
- Type(s) of fuel purchased;
- Date of purchase, pickup, and drop-off;
- Manifest number;
- Gallons of gas and gallons of diesel;
- Invoice number;
- Destination and origin (city and state);
- Terminal code;
- Bill of lading number; and
- Customer FEIN.

One respondent company files a Bulk Dealers' Report. This report shows all fuel delivered to customers on an Indian reservation. All licensed distributors file an MF-32 Distributor's License Tax Report and an MF-32AR Distributor's Schedule of Receipts on a monthly basis. If a distributor exports fuel or sells to another licensed distributor, they also must fill out the MF-32AD Distributor's Schedule of Disbursements to exempt that fuel from taxation.

7.3 Changes in Reporting

The main change in tax reporting over the last 10 years that all companies commented on was the transition from handwritten/manual reporting to electronic filing. The implementation of EDI, EFT, and ZyTax has had a major impact on the process for reporting taxes, although not all companies reported using this complete electronic system.

Another change in reporting is the transition from using independent tax services to using the state-run website, which began in August 2004. There now exists a standard tax report format which was not available, or mandatory, in the past. One company reported that changes in rates and customer licensing has required more frequent updates to reporting and billing systems. A few years ago, they began sending a more comprehensive terminal report than what was submitted in the past, as the standard tax format and are requiring more and more information.

7.4 Availability and Shortcomings of Data Reported

In general, most of the interviewees felt there were little or no availability issues or shortcomings in the data reported to Montana. They commented that the data are, for the most part, transmitted trouble-free. One company commented that the availability seems good and the reporting system is efficient although there have been errors, at times, in the load information; however, these errors are corrected quickly and efficiently. Another interviewee reported that bill of lading data is readily available in both electronic and hard copy format. All the data

necessary for the State of Montana to compare reported loads sold by the supplier with loads reported on the tax return by the distributors is currently being reported.

7.5 Costs Associated with Fuel Tax Compliance

Most companies felt the major cost in fuel tax compliance is incurred from employee salaries and time; terminal personnel ensure product codes, the tax preparer analyzes the data and prepares the return, and systems employees prepare programming tools to accurately gather the necessary data required by the State of Montana. The cost for tax preparation, in and of itself, is minimal. Other costs are incurred from software licensing fees, the purchase and design of tax reporting systems, and taxes on fuels in the inventory and carrying those costs until collection from the customers takes place. On the upside, licensed distributors retain one percent of the state tax on gas and clear diesel. According to the interviewees, costs associated with complying with the State of Montana's motor fuel tax, expressed as a percentage of total tax payments, is approximately 5-10 percent.

Costs are driven by whether or not an accurate tax filing process has been established. Once this is accomplished, costs are minimal. Costs are also driven by the reporting and record-keeping requirements implemented by the State of Montana; the more information that the state requires, the higher the cost in gathering that information for tax purposes.

7.6 Reducing Compliance Costs

According to the interviewees, tax compliance costs could be minimized in several ways including:

- Minimizing manual processes;
- Automating bill of lading data into application software by receiving data electronically from suppliers;
- Automating the control and reconciliation processes related to tax billings to customers and payment to the state;
- Developing a state-prepared software program;
- Receiving data directly from the refinery;
- Requiring quarterly, rather than monthly, reporting (the monthly accounting cycle prevents companies from preparing tax returns until the second week of the month). Due to the volume of data, it prevents additional accuracy checks. More accurate data means more accurate returns and, therefore, less amended returns; and
- Changing the point of taxation, for non-supplier entities, from the wholesale distributor to the supplier that the distributor purchased the product from at the terminal.

All companies felt that current practices, such as electronic filing, already help reduce costs.

7.7 Perspectives on Fuel Tax Evasion and Improving Compliance

Seven of the nine companies were not aware of any deliberate fuel tax evasion techniques or were even aware there was a problem. One company stated that they were aware of fuel improperly designated for the state to which it is actually delivered and that false exports were a possible area of fuel tax evasion.

The interviewees had several suggestions on how the State of Montana could improve compliance and reduce evasion including:

- Not allowing split drops between states;
- Continue dipping tanks on diesel outfits;
- Cross-check supplier-to-supplier returns receipts/disbursements from other suppliers and neighboring states; and
- Cross-check distributor returns with supplier returns, along with sharing export information with other states.

One distributor commented that they pay state tax on all gas and clear diesel and felt that evasion was impossible at their level.

Five of the nine companies interviewed had no idea how to improve compliance through public outreach. Two felt that MDT does a very good job in communicating with the fuel industry. One company stated that MDT staff are very helpful and don't waste time visiting unless they have changes in the reporting procedure. Respondent suggestions for improving compliance through public outreach included:

- When changes in procedures are necessary, it would be helpful and appreciated if MDT allows the industry time to perform the changes in its reporting systems.
- There should be a common tax filing system for all states using electronic filing and data exchange.
- There should be an updated "motor fuel tax guide" for all states; some states have them, some don't, and the ones that do are not updated. Companies must search for answers to questions in actual legislative statutes, which can be difficult to read and interpret. All states should mandate such a guide which contains, in simple language, the laws related to motor fuel taxes. It should cover such things as: (1) who is the responsible party to pay the tax, (2) who is exempt from paying tax, and (3) tax reporting requirements.

7.8 Ensuring Against Fraudulent Activity

The following techniques were cited as used by the respondent companies to ensure against fraudulent activity:

- Hiring and training honest drivers;
- Requesting all vendors and customers use great diligence in reporting transactions clearly and accurately;

- Posting all pumps properly;
- Implementing an efficient double and triple check system;
- Maintaining internal controls, such as account reconciliations, to ensure that taxes billed to retail stations are paid to the taxing authority; and
- Marking customer tanks clearly. Drivers are trained to fill each tank with the product that is tagged.

Most companies agreed that filing tax returns online using EDI aids in improving tax compliance. The process is relatively straight-forward which encourages fuel distributors to stay in compliance. Other methods that industry uses to improve tax compliance include:

- Improving the reliability and accuracy of data while making sure that systems are periodically checked to ensure accurate, timely, and consistent data;
- Monitoring of all facilities, as one company stated that they had implemented a flashing screen which notes, "You are being monitored;"
- Maintaining a good working relationship with the tax officers in Helena;
- Using the standard EDI tax return format;
- Mandating electronic filing; and
- Reconciling loads of product delivered to retail stations to actual taxes paid.

7.9 Compliance Issues with Native American Reservations

Only one respondent company reported that they deal with Native American reservations. They reported no compliance issues but felt it was unfair that they prepare the quarterly report and the state gives the fuel tax back to the reservation. They felt this was a sovereignty issue and would, most likely, remain this way.

CHAPTER 8.0 ESTIMATION OF REVENUE LOSS

To compute motor fuel tax errors, omissions, and evasion (EOE) in the State of Montana, a model was used to estimate the amount of fuel consumed in the State of Montana and compare that amount to reported gallons in 2002, 2003, and 2004. The results for 2004 are presented in Table 8-1 and a discussion of the model used is provided in Section 8.1. To disaggregate the total amounts of evasion to specific evasion techniques (e.g., illegal use of dyed fuel), several estimation methods were used. For this study, an "evasion technique" is defined as an approach intentionally used to defraud jurisdictions of motor fuel taxes. For example, bootlegging would be considered an evasion technique. For this study, an "estimation method" is defined as a method used to estimate levels of EOE. Thus, estimation methods are used to estimate EOE levels resulting from evasion techniques. For example, analysis of on-road inspection data (an estimation method) may be used to estimate EOE resulting from abuse of tax-exempt dyed fuel (an evasion technique).

Table 8-1 presents the results of the EOE analysis. Based on the results of the analyses presented later in this section, it is estimated that EOE of diesel taxes totals roughly 16.3 percent of total tax liability, an amount equal to 43.4 million gallons. This level of EOE represented a loss in revenue to Montana of approximately $12.1 million in 2004. Fraud perpetrated by distributors using cross-border evasion techniques and various forms of motor carrier EOE as detected through IFTA audits represent the most significant evasion techniques, collectively accounting for $4.9 million in lost diesel tax revenue in 2004. The data collected for this study suggest that gasoline tax EOE is not as significant, totaling roughly 2.1 percent of total tax liability: an amount equal to $2.8 million or 10.3 million gallons in 2004. Note that the consumption model estimated overall EOE levels and the other models prepared for this study attempted to attribute the overall EOE level to numerous evasion techniques. In both the gasoline and diesel tax EOE modeling process, the research team was unable to attribute 100 percent of the total EOE estimates to the evasion techniques. This result was expected due to the lack of available data to estimate EOE for certain evasion techniques (e.g., retailer fraud, illegal importation of dyed fuel reported as clear from Canada, illegal use of dyed fuel in pickup trucks, illegal blending schemes) and the inability to imagine every evasion technique deployed. Thus, the difference between the total estimated EOE levels and the EOE attributed to the major evasion techniques is identified in Table 8-1 as EOE attributed to *other schemes*. The remainder of this section examines the estimation methods and data used to estimate EOE.

Table 8-1. Gasoline and Diesel Tax EOE in the State of Montana

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%

8.1 Estimates of Total EOE – Diesel and Gasoline Tax

The research team designed a model to estimate total gasoline and diesel consumption within the State of Montana and compared the estimated amounts to reported gallons in order to estimate total EOE levels. The first step in the estimation process was to pick eight states where evasion was thought to be low. The criteria used to select these states included: enforcement levels, reputation in terms of evasion levels monitored within the state, proximity to international borders, and proximity to low-tax states. The states selected to establish the baseline were: Delaware, Idaho, Minnesota, Missouri, Nevada, Texas, Virginia, and Vermont. The second step in the estimation process involved the estimation of reduced form equations for gasoline and diesel consumption for each of the eight baseline states. Then, using the regression coefficients from the estimation based on the lower evasion states, estimates were made of gasoline and diesel consumption in Montana.

Table 8-2 reports the output for diesel consumption. In the model, diesel consumption serves as the dependent variable. Diesel consumption was regressed on the real diesel price, a ratio of interstate lane miles to total lane miles plus interstate lane miles, real personal state income, and population. The model was estimated with least squares corrected for heteroskedasticity and auto-correlation on pooled cross-sectional data for eight states. The fixed effects indicate the individual state intercept values for each state in the pooled data. All regressors except the ratio of interstate lane miles to total lane miles plus interstate lane miles were significant at the 5 percent level. The ratio of interstate lane miles was marginally significant at the 15 percent level. The research team explored options for adding another variable related to freight traffic but was unable to identify reliable freight flow data at the state level over the time-horizon included in the data set used to support the model.

Table 8-2. Per Capita Diesel Consumption Estimation for Eight Lower Evasion States

Dependent Variable: Diesel Consumption
Method: Pooled Least Squares
Date: 10/05/06 Time: 14:07
Sample (adjusted): 7 30
Included observations: 24 after adjustments
Cross-sections included: 8
Total pool (balanced) observations: 192
White cross-section standard errors & covariance (d.f. corrected)
Convergence achieved after 10 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	(1,376,282.0)	465839.5	-2.954412	0.0036
Distillate Price including Tax	91.7	41.32098	2.219642	0.0277
Interstate Lane Miles/Total Lane Miles	(2,982,653.0)	2072233	-1.439342	0.1518
Real Personal Income	0.0	0.001008	3.177057	0.0018
Population	0.3	0.071242	4.19652	0
AR(1)	0.9	0.042095	22.21145	0
Fixed Effects (Cross)				
Delaware	1,150,692			
Idaho	1,166,412			
Minnesota	(15,151)			
Missouri	253,337			
Nevada	839,819			
Texas	(4,209,412)			
Virginia	(495,533)			
Vermont	1,309,837			
	Effects Specification			
Cross-section fixed (dummy variables)				
R-squared	0.997962	Mean dependent var		534462.8
Adjusted R-squared	0.997825	S.D. dependent var		672725.4
S.E. of regression	31370.4	Akaike info criterion		23.61042
Sum squared residuals	1.76E+11	Schwarz criterion		23.83098
Log likelihood	-2253.601	F-statistic		7304.687
Durbin-Watson stat	2.248258	Prob (F-statistic)		0

Table 8-3 shows the predicted values for Montana. As indicated, from 2002 to 2004 under reporting of diesel gallons totaled 41-43 million annually in Montana. The estimated shortfall was extremely consistent during those years.

Table 8-3. Diesel EOE in Montana – 2002-2004

(thousands of gallons)

Year	2002	2003	2004
Diesel Gallons Predicted	243,419	253,329	267,071
Actual Reported Gallons	202,477	210,712	223,636
Estimated EOE	40,942	42,617	43,435

Table 8-4 reports the results of estimating gasoline and gasohol consumption for the eight lower evasion states. The regression used gasoline/gasohol consumption as the dependent variable. The model was estimated using pooled cross-section time series data with the least squares method after correcting for auto-correlation and heteroskedasticity. The model has two coefficients which were not significant: the ratio of interstate lane miles to total lane miles and population. Other significant variables were real gasoline price including tax, automobile numbers, and state personal income.

Table 8-4. Output for Estimated Lower-Evasion Gasoline States

Dependent Variable: Gas Consumption
Method: Pooled Least Squares
Date: 06/28/06 Time: 08:55
Sample (adjusted): 7 30
Included observations: 24 after adjustments
Cross-sections included: 8
Total pool (balanced) observations: 192
White cross-section standard errors & covariance (d.f. corrected)
Convergence achieved after 20 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	58501.06	369763.4	0.158212	0.8745
Real Gas Price including Tax	-338.3237	156.444	-2.162586	0.0319
Auto Numbers	0.297953	0.088798	3.355408	0.001
Interstate Lane/Total Lane Miles	1891143	3469675	0.545049	0.5864
Real Personal Income	0.0081	0.00238	3.403802	0.0008
Population	0.147845	0.138824	1.064983	0.2883
AR(1)	0.518407	0.136612	3.794732	0.0002
Fixed Effects (Cross)				
Delaware	-80163.42			
Idaho	-43833.32			
Minnesota	-208430.9			
Missouri	208248.4			
Nevada	-56425.81			
Texas	593881.1			
Virginia	-332397.4			
Vermont	-80878.65			

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.99915	Mean dependent var	2409387
Adjusted R-squared	0.999088	S.D. dependent var	2845110
S.E. of regression	85904.44	Akaike info criterion	25.62998
Sum squared residuals	1.31E+12	Schwarz criterion	25.86751
Log likelihood	-2446.478	F-statistic	16102.3
Durbin-Watson stat	2.307463	Prob(F-statistic)	0

The gasoline/gasohol consumption prediction for Montana is presented in Table 8-5. The differences between estimated gasoline/gasohol consumption and actual gallons reported for Montana were 9.3, 2.6, and 10.3 million gallons for 2002, 2003, and 2004, respectively. Note that the total listed under actual gallons reported in Table 8-5 includes gasohol consumption.

Table 8-5. Gasoline/Gasohol EOE in Montana – 2002-2004
(thousands of gallons)

Year	2002	2003	2004
Estimated Consumption	518,452	512,167	516,485
Actual Reported Gallons	509,178	509,611	506,144
Estimated EOE	9,274	2,556	10,341

8.2 False Refunds or Credit Schemes

A model similar to one used by Eger (2002) was developed to examine the relative difference in the off-road use of gasoline between Montana and its U.S. neighboring states. The model was designed to estimate the EOE associated with gasoline tax refunds based on tax rates and consumption information. The model was developed using the same methodology as Eger (2002). However, Eger estimated only agriculture refunds while the model used here estimates the total amount of off-road consumption. The results indicate that after accounting for differences in tax rates and economic variables by state that Montana issued refunds on approximately 2.7 million gallons of gasoline more than could be predicted by the model.

The model was estimated using total gallons consumed off-road as the dependent variable. Real gas tax rate and real state construction product (from gross state product) were the significant regressors. A dummy was used to remove 1994 from Washington's data due to an anomaly in that year. The model was estimated on pooled cross-section time series data using least squares correcting for auto-correlation and heteroskedasticity.

Audits of special fuel users conducted by MDT indicate that EOE related to false refund and credit requests is not limited to gasoline taxation. However, the audit data set was not used to construct estimates of gasoline or diesel taxation EOE levels because it was deemed to be highly biased. For each audit, a trigger for the audit was identified in the data set. Triggers included referral from the Fuel Tax Management and Analysis (FTMA) Bureau, other referral, high-risk designation due to a high refund request or a lack of previous audits, or a high refund to total volume ratio. Thus, the results from the sample (audited special users) could not be applied to the overall population. Table 8-6 is an output estimating off-road usage by state.

Table 8-6. Output Estimating Off-Road Usage by State

Dependent Variable: TOTAL OFF_ROAD GALLONS
Method: Pooled Least Squares
Date: 06/28/06 Time: 18:08
Sample (adjusted): 20 30
Included observations: 11 after adjustments
Cross-sections included: 7
Total pool (balanced) observations: 77
White cross-section standard errors & covariance (d.f. corrected)
Convergence achieved after 12 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4885.925	11598.31	-0.421262	0.675
Real State Construction Product	8.796297	2.676669	3.286286	0.0016
Real gas tax rate lag 1	823.9505	317.7428	2.593137	0.0117
Washington dummy for 1994	-53277.24	2927.277	-18.20027	0
AR(1)	0.854289	0.132155	6.464303	0
AR(2)	-0.31627	0.139311	-2.270236	0.0265
Fixed Effects (Cross)				
Idaho	-1171.761			
Montana	2762.961			
North Dakota	10542.41			
South Dakota	9788.897			
Utah	-18250.29			
Washington	-23086.4			
Wyoming	19414.19			

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.943671	Mean dependent var	34783.18
Adjusted R-squared	0.934139	S.D. dependent var	16559.74
S.E. of regression	4249.804	Akaike info criterion	19.6894
Sum squared resid	1.17E+09	Schwarz criterion	20.05467
Log likelihood	-746.042	F-statistic	98.99451
Durbin-Watson stat	1.948266	Prob(F-statistic)	0

8.3 Loads Not Reported to MDT – Gasoline Tax

Statistical sampling involves taking the percentage of all audits/inspections in which illegitimate activities occurred and generalizing to an EOE assessment over the reported tax liability for the sample population and applying this factor to reported tax liability for the entire population of taxpayers. If the sample were truly random, the difference between true tax liability and reported

tax liability found in the sample could be applied to the population as a whole to get an unbiased estimate of the total amount of EOE.

For example, the basic equation would be as follows:

$$E = \frac{X}{n} \times N \times t$$

Where:

E = $ Distributor EOE
X = Violations (in gallons of fuel)
n = Sample size – total distributor audits (in gallons of fuel)
N = Population size – total distributors (in gallons of fuel)
t = gasoline tax rate

MDT distributor audits were examined during the 2002-2004 time period. During the three-year analysis timeframe, MDT conducted 162 desk audits and four field audits. On average, desk audits covered approximately 41 percent of the population of distributors while field audits captured approximately one percent. Through these audits, MDT made $437,043 in total assessments to distributors due to unreported loads of gasoline. Based on the results of these audits and the percentage of the distributor population captured through the audit process, expanding the assessment rate to the population of distributors generates an annual EOE amount of 1.3 million gallons or $343,860 in lost revenue.

Note that MDT supplied audit data that could have been used to estimate unreported diesel loads. However, the research team chose not to report this amount, instead constructing a model to estimate cross-border distributor EOE, which would include many unreported loads. Using both techniques would result in double counting of imported loads not reported to MDT.

8.4 Dyed Fuel EOE

The traditional audit/inspection review method applied to dyed fuel inspections provides a means to estimate the level of EOE occurring due to the illegal use of dyed fuel on-road. During the 2002-2004 time period, MDT conducted between 13.7 and 14.7 thousand inspections annually where tanks were dipped in order to determine if vehicles were burning dyed, tax-exempt diesel. Inspections were performed on heavy trucks, including combination vehicles, and pickup trucks. To determine a total number of gallons inspected, it was assumed that fuel tanks for combination vehicles, non-combination heavy trucks, and pickup trucks could carry 100, 63, and 27 gallons of diesel on average, respectively. Based on these assumptions, MDT was estimated to have inspected 4.1 million gallons of fuel, reporting only 16.9 thousand gallons in violations, representing an EOE rate of 0.42 percent. Applying this EOE rate to the total diesel volumes consumed in the State of Montana in 2004 generates an estimated EOE due to on-road use of dyed fuel of 932 thousand gallons. Note that the inspections data used to support this analysis primarily exclude diesel pickup trucks and other vehicles weighing less than 10,000 pounds. Trucks weighing in excess of 14,000 pounds are required to pull into weigh stations. MDT may require vehicles weighing over 10,000 pounds to be weighed and inspected by mobile patrol officers but cannot inspect vehicles weighing less than 10,000 pounds without probable cause.

In addition to on-road use of dyed fuel, MDT distributor audit data during 2002 to 2004 was examined in order to determine additional distributor dyed fuel violations related to the misreporting of dyed fuel. Based on the percentage and degree of fraudulent activity found through random distributor audits, dyed fuel violations by distributors was estimated to account for an additional 1.3 million gallons of EOE annually. Thus, total EOE tied to the misuse of dyed fuel was estimated at 2.3 million gallons annually: an amount that equates to $632,493 in lost revenue annually.

8.5 Motor Fuel EOE by Motor Carriers

Audit data for motor carrier IFTA returns were obtained and analyzed in order to estimate motor fuel tax evasion committed by motor carriers. The assessments made in these carrier audits involved checking and cross-matching fuel receipts and route and mileage documentation and may encompass intentional evasion, calculation errors, or inadequate record keeping. Various evasion techniques perpetrated by motor carriers could be reflected in these data. For example, a motor carrier could over-report mileage in a low tax state and under report mileage in a high tax state to avoid the additional taxes in the high tax state. Further, a motor carrier could purchase illegally untaxed fuel, purchase a blending agent, and illegally blend the fuel or report the state of purchase as different than the state in which the fuel was actually purchased.

The statistical sampling approach was used to explore motor fuel tax abuse by motor carriers. The statistical sampling approach is described in Section 8.3. Evasion estimates were created by taking the percentage of all motor carrier audits in which an assessment was made and generalizing the results to a population of motor carriers.

The statistical sampling of motor carrier audits in Montana shows that average assessments were 4.7 percent of total motor carrier tax liability for the audited carriers during the period 2002-2004 (Table 8-7). This percentage takes into consideration both positive and negative EOE since the audit data reflects both positive and negative assessments or overpayments. Statistical sampling using motor carrier audit data is a reasonable approach to estimate motor fuel tax evasion because the 3 percent audits are almost completely randomly selected according to MDT officials and there were no signs of sample bias found.

Table 8-7. Montana IFTA Audit Summary Statistics

Year	Number of IFTA Audits Completed	Sample Size (%)	Positive EOE ($)	Negative EOE ($)	Sample Net EOE
2002	57	3.86	400,680	-5,386	395,295
2003	50	3.43	548,847	-37,012	511,835
2004	50	3.34	19,761	-19,170	590
Total	157	3.55	969,288	-61,568	907,720

8.6 Import/Export Schemes

When perpetrators bootleg fuel across state borders in order to evade motor fuel excise taxes, they can either purchase fuel tax paid in a low tax state and sell it in a higher tax state or they can illegally import the fuel from a neighboring state without reporting the gallons in either the import or export state. In the first case, as depicted in Figure 8-1, the perpetrator profits by the number of gallons times the difference in the state tax rates. In the second case, the perpetrator yields the entirety of the tax in the high tax rate state. In both cases, the high tax rate state loses the taxed owed.

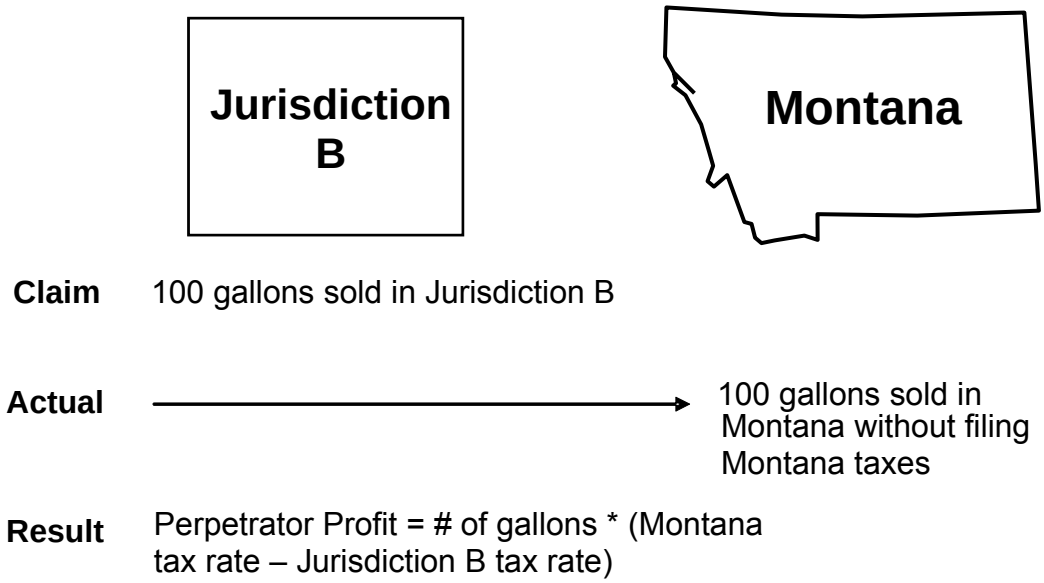


Figure 8-1. Bootlegging Taxed Fuel into a Higher Tax Rate State

The State of Wyoming was targeted as a potential source of significant cross-border evasion for a number of significant reasons. First, per-capita diesel consumption in Wyoming is extraordinarily high, totaling roughly 671 gallons per person in 2004. The per-capita diesel consumption rate in Wyoming is more than four times the un-weighted national average per-capita diesel consumption rate of 154.6 gallons and more than twice that of the second highest state, which is Alaska at 316 gallons per person. Montana's per capita diesel consumption is relatively high at 241 gallons. The high per-capita diesel consumption numbers for Wyoming are partly explained by the significant presence of freight traffic traversing the state in combination with the state's low population; however, vehicle mileage estimates and the consumption model prepared for this study suggest that Wyoming's reported per-capita diesel consumption rate is implausibly high. Note that Wyoming's reported diesel consumption estimates are based on gallons taxed by the state.

Second, Wyoming has the lowest tax rate in the region at 14 cents per gallons. Wyoming's fuel tax rate is roughly half the rate imposed in Montana (27.75 cents per gallon).

Third, Montana has significantly curtailed its field investigations in recent years, removing the most significant deterrent to cross-border evasion. For example, MDT performed only four distributor field audits during this analysis time period (2002-2004).

Finally, bills of lading (BOLs) collected by MDT enforcement officers at weigh stations and other remote locations around the state indicate that the vast majority of the BOLs tied to loads originating in Wyoming show hand-written notes indicating that the loads have been diverted into Montana. The diversion rates associated with loads originating in Wyoming are much higher than those for loads originating in other states in the region. A diversion occurs when a load is diverted in-route to a destination point not originally identified when the fuel was removed from the terminal rack. The diversion of loads is a legal practice provided taxes are remitted after the load is dropped at its ultimate destination. However, the current Montana enforcement strategy of ensuring that each BOL corresponds to a subsequent tax payment would do little to curtail cross-border evasion because the distributor could simply report taxes on any BOL pulled by MDT enforcement personnel and not remit taxes when a truck reaches its destination in Montana without coming into contact with MDT enforcement personnel.

The consumption model outlined in Section 8.1 was used to estimate diesel and gasoline/gasohol consumption in Wyoming. The model predicted 283.4 million gallons of diesel consumption for Wyoming in 2004, as compared to actual reported gallons of 339.5 million. Thus, the model estimates that in 2004, Wyoming collected taxes on approximately 56 million more gallons of diesel than it should have based on model output.

One more step is needed before determining the amount of fuel that is crossing the border from Wyoming to Montana without the tax being paid. Two different assumptions were made that generated a lower- and higher-case estimate. The lower-case apportions the fuel to surrounding states according to reported diesel consumption. Knowledge of the population or consumption in surrounding states within 200-300 hundred miles of terminals would have lent more precision to the estimate but the research team was unable to accurately stratify the population or consumption estimates based on close proximity to Wyoming terminals. The economic incentive to evade declines the further one travels from the terminal to the delivery place because transportation costs eat away at the savings realized through evasion. Using the assumptions underlying the lower-case scenario, cross-border evasion is estimated at 6.5 million gallons in 2004.

Idaho was removed in the higher-case estimate because there are physical and enforcement barriers preventing easy cross-border evasion between Wyoming and Idaho. There are no easy direct routes to Idaho population centers from Wyoming. Further, Idaho's enforcement program is well designed to deter cross-border evasion. Although Idaho relies on IRS for on-road enforcement, this is only one method in deterring cross-border evasion. The distributor must only adjust his paperwork to suggest that the tanker has been diverted from the location originally identified in the BOL to avoid detection of on-road enforcement officers. When no on-road enforcement is encountered, no adjustments are made and evasion occurs. Field audits and investigations are the principal means to detect cross-border evasion, and Idaho conducts field audits of nearly 20 percent of its distributors (30 total) each year. Further, Idaho compares import/export records and gathers terminal records from terminals located in all border states,

including Montana. Idaho matches these terminal records with retail-level receipts in order to verify that taxes are paid to Idaho. Removing Idaho from the calculation expands the cross-border evasion estimate to 7.5 million gallons in 2004 (Table 8-8).

Table 8-8. Higher and Lower Case Estimates of Diesel Impact on Montana

Lower Case:	
Diesel Consumption in Surrounding States	2004
Colorado	508,032
Idaho	239,434
Montana	223,636
Nebraska	404,167
South Dakota	176,387
Utah	367,644
Total Consumption	1,919,300
Montana Consumption as % of Wyoming Border States	11.65%
EOE Allocation to Montana	**6,529,640**
Higher Case:	
Diesel Consumption in Surrounding States	
Colorado	508,032
Idaho	
Montana	223,636
Nebraska	404,167
South Dakota	176,387
Utah	367,644
Total Consumption	1,679,866
Montana Consumption as % of Wyoming Border States	13.31%
EOE Allocation to Montana	**7,460,320**

The gasoline model detected no measurable EOE related to cross-border evasion. This result was unexpected due to the similar incentives to evade both gasoline and diesel taxes. There are a number of reasons, however, that might explain the lack of detectable gasoline cross-border evasion. First, most evasion studies report much lower evasion levels for gasoline taxes relative to diesel taxes. For example, a study sponsored by the FHWA and prepared by the Joint Federal/State Motor Fuel Tax Compliance Project estimated the diesel fuel tax evasion rate at

between 15 and 25 percent and gasoline tax evasion rate at 3 to 7 percent (FHWA 1992). Second, cross-border evasion often involves collusion between distributors and retailers or special users. The diesel tax provides more potential in terms of potential partners in the illegal operation because there is significant incentive to evade taxes on the part of special users (i.e., farming operations) and motor carriers when evading diesel taxes. Third, tax refunds tied to common off-road use of gasoline such as in lawn mowers or recreation boating is often not sought by consumers because the small refund amount is not viewed as worth the time to complete and submit a claim to the state. When all such unreported claims are summed, the impact could be significant and serve as a counter-balancing mechanism when the model attempts to detect evasion.

CHAPTER 9.0 MONTANA MOTOR FUEL TAX PROGRAM RECOMMENDATIONS

Based on the information on enforcement and compliance activities undertaken by the MDT and other agencies collected for this study and the results of the evasion analysis, the following are recommendations to reduce fuel tax evasion.

9.1 Perform More Distributor Audits and Modify Auditing Procedures

There is a great deal of evidence to suggest that a lack of auditing resources and inadequate auditing levels generally means that illegal activities will most likely go unidentified and unscrupulous marketers may recognize overburdened auditors as an opportunity to enhance profits through evasion. In a 2001 study on the impact of auditors on assessments, it was found that an additional state motor fuel tax auditor increased assessments by an average of $415,219 (Eger 2001). This, however, does not necessarily mean that for every fuel tax auditor a state employs assessments will grow by an additional $415,219 because it is likely that there is a diminishing marginal productivity relationship between the number of auditors and the amount of assessments, and the total amount that could possibly be assessed is a finite sum. Rather, this number expresses an average increase in assessments with the addition of one auditor given the concentrations of auditors in state fuel tax programs at this time. Given the particular incentives (e.g., comparatively high tax rate) and opportunities (e.g., bootlegging and illegal importation) for evasion, it is important for Montana to have a strong audit program.

The marginal benefit of additional auditors can not only be judged based on the extra amounts that are assessed. Strengthening an audit program may deter potential acts of evasion, which would contribute to overall collections. Therefore, it would be incorrect to determine that an additional auditor is not of value simply because the auditor brings in assessments of a lesser value relative to the cost of the additional auditor. It could be the case that the increased compliance plus assessments brings in the same, if not a greater, amount of revenue on the margin. Unfortunately, the marginal compliance benefit of an additional auditor on overall collections (collections plus assessments) is much more difficult to decipher than the marginal assessment impacts due to the many other factors affecting total assessments (e.g., seasonal variation, other enforcement and administration program changes, activities in surrounding states).

Historically, MDT has performed very few distributor field audits. From 2002 through 2004, the FTMA Bureau performed approximately 148 desk reviews of distributor tax records, resulting in less than $500,000 in assessments. Most of these assessments were tied to loads not reported as identified by cross-matching distributor, terminal, and import records. Those reviews triggered only four Internal Audit Unit (IAU) field audits during the same timeframe. Today, there are 135 distributors operating in Montana. Of the 135 distributors, 45 are importers. Thus, MTD is presently auditing a very small percentage of the taxpayer population.

In order to address this issue, it is recommended that MDT add four to six auditors in order to ensure that desk audits are performed on every distributor in the state at least once every three years. These auditors should be completely dedicated to motor fuel tax enforcement.

Furthermore, more field audits are required, and during these field audits, auditors should compare terminal reports, distributor reports, bills of lading, tax reports, driver log books, import/export schedules, financial records, bulk plant inventory records, and sales receipts in order track fuel from the point of the terminal to its ultimate destination. To the extent that distributors can pay the Wyoming motor fuel tax at 14 cents per gallon, import it into Montana and pocket the difference in tax rates (13.75 cents per gallon), there is a strong incentive to overpay in Wyoming and under report in Montana. Given current enforcement efforts, which concentrate on desk audits and motor fuel tracking at the distributor level, it would be difficult for MDT to identify and address most import/export schemes.

9.2 Expand Field Operations

Historically, MDT has performed extensive and effective field investigations bringing down illegal cross-border operations and reducing evasion resulting from the importation and mis-reporting of dyed diesel fuel originating in Alberta, Canada. Between September 1995 and September 1996, MDT conducted a joint border fuel/commercial vehicle inspection program in cooperation with the IRS, United States Customs, members of the Montana and Idaho National Guard, the USDOT, and Alberta Treasury. At numerous Ports of Entry – including the Ports of Sweetgrass, Roosville, Del Bonita, and Whitlash – inspections were conducted on fuel loads, cargos, vehicle safety, driver logs, fuel use, licensing of drivers, and registration of vehicles. The results of the program indicated that cross-border evasion was a significant issue.

As part of the joint border project, 1,188 commercial vehicles were inspected. Of those vehicles inspected, 512 (43 percent) were not in compliance with the federal highway use tax, 4 commercial vehicles (0.3 percent) were operating with dyed fuel in their supply tanks, and 26 (2.2 percent) were not in full compliance with IFTA and IRP regulations. During the operation, 36 fuel tankers were checked and 22 (61 percent) were guilty of dyed fuel violations, including improper invoicing or the mislabeling of the fuel. The border project yielded $1.4 million in state and federal assessments, averaging $86,609 per day. As a result of the joint border project, Canadian importers now must identify dyed fuel on the BOL prior to transporting it into Montana.

In spite of the success of the joint border program, MDT has seriously curtailed field operations during the past 10 years. The research team has concluded that field operations (e.g., border interdiction efforts, distributor field audits, covert operations at rural fueling stations) are an essential element of a motor fuel program. This conclusion is based on interviews conducted with tax administrators representing approximately 22 states and 3 provinces. The tax administrators interviewed for this study repeatedly noted that to the extent that field investigations and audits were not being performed, evasion would be a significant issue. This opinion is largely based on the belief that paperwork, including tax returns and BOLs, can be easily manipulated and that additional investigation was required to detect some evasion techniques. Thus, it is recommended that MDT recommit itself to performing more field operations, including:

- Distributor field audits,
- Border interdictions,

- Vehicle and tanker field inspections,
- Retailer audits, and
- Covert operations, including the posting of personnel near operations where illegal activities (e.g., illegal use of dyed fuel in personal vehicles) are suspected to occur.

Furthermore, adequate resources should be made available to support these field operations.

9.3 Extend the Statute of Limitations for Motor Fuel Tax Fraud

The research team recommends extending the statute of limitations associated with motor fuel tax fraud from three to five years. The five-year statute of limitations would mirror those applied to other forms of taxation, including the Montana State Income Tax, collected by the Montana Department of Revenue. Extending the statute for a longer time frame would provide compliance and enforcement more time to gather the necessary documentation for prosecution and would deter non-compliance. Related code sections regarding records retention would also need to be amended to increase the length of time to five years from the current three years.

9.4 Conduct Analysis to Determine Correct PTO Rate Schedule

Those who operate vehicles and trailers on Montana roads with power take-off (PTO) units are given credits as a percentage of fuel purchases without justification or consumption data to support the claim. A power take-off unit is a device that diverts power to equipment, such as a cement mixer, attached to a vehicle. The theory underlying the PTO credit is that the fuel not used to power the vehicle down Montana roads should not be taxable. Examples of motor vehicles qualifying for PTO credits include cement mixers (30 percent credit), sanitation trucks (30 percent credit), fire trucks (30 percent credit), and dump trucks (20 percent credit).

The PTO credit is a reasonable concept. In Montana, however, the PTO rates appear excessive when compared with those in other states. For example, cement and sanitation trucks in Utah receive only a 20 percent credit. In Washington State, cement and sanitation trucks receive a 25 percent credit, fire trucks a 25 percent credit, and dump trucks a 15 percent credit. Thus, the research team recommends that MDT conduct an analysis to determine more reasonable PTO rates and also to determine the appropriate vehicle types that should be included in the schedule. The analysis should consider PTO rate schedules in other states and data from manufacturers concerning fuel consumption rates for various forms of equipment. The PTO rate schedule should be revised in accordance with the findings of the MDT analysis.

9.5 Further Examine the Economic and Policy Implications of Moving the Point of Taxation to Terminal Rack

Taxing at the terminal rack is widely thought to be the best practice, and moving the point of taxation up the distribution chain to the terminal rack has resulted in significant revenue increases at both the federal and in some cases, the state level as well (See Section 3.3.1). The primary benefits of moving the point of taxation up the distribution chain include:

- There are fewer tax entities involved in collecting and remitting tax,
- There are reduced opportunities for certain evasion techniques (e.g., daisy chains),
- Alleviates the administrative burden on the state and compliance burden on the industry, and
- The State of Montana could receive a 1 percentage point increase in revenue resulting from the elimination of the distributor collection fee or it could retain some form of a collection fee.

There are, however, numerous drawbacks as well, including:

- Increased refund volumes generate potential for evasion,
- Greater incentive to evade taxes since tax liability on a per taxpayer basis would be greater, and
- More chance of evasion resulting from blending techniques.

There are variants of the tax at the rack approach, including taxing the first receiver. When taxing the first receiver, generally the entity that physically receives the motor fuel at the terminal rack is responsible for remitting tax. With respect to imports, the responsible party is generally either the company that imports the motor fuel or the one that first receives the motor fuel from an importer. This approach represents a less significant shift in collection policy, but would still retain some of the benefits associated with moving the point of taxation up the distribution chain.

Great consideration was given to this recommendation but the research team did not choose to recommend moving the point of taxation up the distribution chain for three primary reasons. First, the principal evasion issues in Montana appear to be cross-border schemes, refund claims, and motor carrier evasion. Moving the point of taxation up the distribution chain would not significantly reduce and could exacerbate these problems. Second, Montana is reliant on motor fuel imports, with 45 of 135 licensed distributors being importers, and moving the point of taxation up the distribution chain would not aid in collecting taxes from these distributors. Finally, moving the point of taxation up the distribution chain would not yield a significant reduction in the number of taxpayers due to the large presence of both importers and exporters operating in Montana.

The research team could not ignore the success realized by many states through moving the point of taxation up the distribution chain. However, it is not clear that the level of success experienced elsewhere would be achieved in Montana due to its unique characteristics. Thus, it is recommending that Montana further examine the economic and policy implications of moving the point of taxation to the terminal rack.

9.6 Attempt to Achieve Total Fuel Accountability

Tracking motor fuel though the distribution system and having multiple party confirmation regarding the position of fuel gallons is an important step towards ensuring fuel tax compliance and was sited as a key priority in the 11-point plan authored by the FTA Uniformity Committee.

Total fuel accountability means instituting reporting requirements for all entities dealing in motor fuel (e.g., terminals, suppliers, common or contract carriers, distributors, retailers, and bulk dealers) and using these reports to cross-reference information regarding the transactions and movement of motor fuel gallons in order to account for all the motor fuel.

Montana developed a system in-house that tracks fuel at the refinery, terminal, and distributor levels with the additional capability to include carrier reports though the department does not require it at this time. The total cost of this system – $200,000 – was significantly less than systems instituted in other states. Though the Montana system is useful, it fails to track fuel to the retailer and bulk dealer level, thus enabling illegal import/export schemes to go undetected. Expanding the system to track the fuel from the terminal to the end user would greatly enhance its ability to identify loads not reported due to illegal import/export practices.

9.7 Perform Random and Targeted Retailer Audits

The random and targeted audits of retail outlets is a proven technique for ensuring total fuel accountability and for identifying the illegal distribution of dyed diesel fuel. Retail audits could also enable the identification of the ultimate destination of certain fuel shipments in order to discover loads for which taxes were not reported. Retail audits could also involve tank dipping and sharing with the IRS in concert with its fuel fingerprinting program.

9.8 Require Attendants at Weigh Stations and Ports of Entry to Pull Bills of Lading from Tanker Trucks

Based on data provided to the research team, bills of lading (BOLs) are presently pulled from tanker trucks on an extremely limited and inconsistent basis. The vast majority of the BOLs are being pulled by a small number of diligent attendants. Requiring that attendants pull BOLs and enforcing the mandate would add data that could be used to cross-check imports with distributor tax records. To the extent that importers can freely transport fuel into Montana without detection, it is possible for them to avoid taxation. MDT should also consider reopening scales located along the Wyoming border, such as the one located near Frannie, Wyoming.

9.9 Establish an Internet Website for Individuals to Report Incidents of Evasion

The FTA Subcommittee on Model Legislation suggests that states consider instituting an anonymous toll-free telephone hotline for individuals to report suspected incidents of evasion. MDT has established such a hotline and is now in the process of establishing a website where informers can log on and report instances of evasion. The website, which is currently under development, should be designed in such a manner as to enable informants to log on, complete a motor fuel tax evasion report and submit it electronically to MDT. The website will only be useful, it should be noted, if resources are expended to publicize and make industry aware of it. The State of Washington places flyers near any fuel pumps dispensing red dyed diesel to alert consumers of the consequences associated with evasion and to present the hotline number to potential informants. MDT should consider similar methods (e.g., e-mail notification, flyers,

notices posted on the MDT motor fuel tax website) in order to inform taxpayers and industry representatives of the presence and purpose of the website.

9.10 Obtain and Share Data with Neighboring Jurisdictions on a More Consistent Basis

The sharing of fuel tax distribution data between states has become a recommended practice, recognized by the FTA and within a number of studies. Sharing import and export data can aid in identifying and deterring border evasion schemes. Montana does participate in the Northwest Task Force of the Joint Federal/State Motor Fuel Tax Compliance Project, which shares licensing, audit, and evasion information among the western jurisdictions. However, there is a general lack of consistent sharing of data regarding imports and exports between Montana and its bordering jurisdictions. One contributing factor to effective exchange of data is the lack of automation. It is recommended that Montana obtain import schedules from and share export schedules with at least the following states and provinces: Alberta, British Columbia, Idaho, North Dakota, Oregon, Saskatchewan, South Dakota, Utah, Washington, and Wyoming. These schedules should be consulted when cross-checking distributor reports. Further, audit data and tips concerning illegal operations can be shared between states and used to target disreputable distributors. Presently, MDT uses information presented from other states but has not established a systematic process whereby these reports are requested, attained or examined on a routine basis. It is recommended that MDT define a region (Alberta, British Columbia, Idaho, North Dakota, Oregon, Saskatchewan, South Dakota, Utah, Washington, and Wyoming), and ensure that they exchange export schedules with these states and provinces on a monthly basis. Further, Montana is encouraged to obtain reports from terminals in other states (at least Wyoming) in order to support auditing efforts. Finally, MDT should share relevant auditing/evasion information with other states such that states within the region work collaboratively to identify and eradicate disreputable distributors. The continued collaboration between disparate jurisdictions has proven valuable at the national level, and would likely generate previously unforeseen benefits to MDT.

9.11 Maintain Distributor/Importer Education Program

Motor fuel tax educational programs have been established by some states as a method of curbing fuel tax evasion. By increasing public knowledge and awareness regarding the nature and implications of fuel tax evasion, further public, government, and industry support will be generated for programs aimed at curtailing motor fuel tax evasion. Such campaigns could encompass the development of a web page, brochures, and posters alerting the public to tax evasion or a telephone hotline for reporting evasion activities.

More targeted campaigns are often directed at taxpayers and are designed to enhance their knowledge of the motor fuel tax remittance process and the consequences associated with non-compliance. Such a campaign was recently carried out in Montana for motor carriers. In the two years prior to the education campaign, initial assessments through motor carrier audits averaged $3.3 million. In the year following the education campaign, initial assessments through motor carrier audits declined to roughly $3,000. The decline in errors and omissions identified through

audits suggests that the campaign was successful. It should be noted, however, that in the same year, MDT eliminated the practice of abating assessments when motor carriers passed a six-month review and also brought the auditing function in-house.

The distributors interviewed for this study concluded that public outreach was important, particularly when changes in procedures were necessary. Education classes offered in the field are viewed as especially helpful. Further, distributors noted that when changes in procedures are necessary, it is important that they be given a reasonable implementation timeframe in order to allow them to perform necessary changes in their reporting systems.

In recent years, Montana has conducted a distributor education program, attempting to visit all distributors on a three year cycle. Based on the information presented within this section, it is recommended that MDT continue this practice targeting distributors and importers, with particular focus on best practices in tax preparation and tax data collection and tracking. Furthermore, MDT should discuss methods for reducing compliance costs, methods for identifying and eliminating tax evasion, and penalties associated with non-compliance. Finally, attention should be paid to any changes in tax codes or administrative practices requiring taxpayer action. If other recommendations presented within this report are adopted, it is recommended that extensive public outreach be conducted in order to present these program changes not only to distributors, but also to terminal operators, importers, motor carriers, retailers, and others involved in the production, distribution, and sale of motor fuels.

9.12 Centralize Fuel Tax Administration

As discussed in section 3.3.5, there is a wide variance in the administrative structure of fuel tax programs from jurisdiction to jurisdiction. Some jurisdictions have one department for fuel tax collection and fulfill audit and enforcement functions in another department. Other jurisdictions split the responsibility for administering fuel taxes between departments based on the type of tax (i.e., general fuel tax collections occur in a DOR while IFTA is administered by the DOT). Many jurisdictions, however, have sought the centralization of all fuel tax programs in recent years as a method of increasing the efficiency (i.e., reduced overhead, ease in the exchange of valuable compliance information, increased institutional knowledge through maintaining staff dedicated solely to fuel tax administration).

In recent interviews with motor fuel tax administrators representing 22 states and three Canadian provinces conducted in support of research currently being performed for the National Cooperative Highway Research Project, frustration was expressed concerning experiences when DOR agents, who were mainly focused on the high-dollar fraud cases tied to income and sales taxes, ignored evidence of motor fuel tax evasion. It was repeatedly stated during these interviews that DOR agents often lacked the knowledge or proper motivation to enforce motor fuel tax laws.

The 11th point of the FTA Uniformity Committee's 11-point plan encourages states to, "establish and adequately maintain a compliance staff dedicated to fuel tax enforcement." At present, Montana has four units that work together to collect, analyze, audit, and enforce motor fuel

taxes. It is recommended that this group be centralized under one bureau and that this bureau be dedicated exclusively to motor fuel tax enforcement.

9.13 Pierce the Corporate Veil

It is recommended that Montana adopt a code section imposing joint and several liabilities on any business entity, each director, officer, manger, member, employee, or agent of such entity or other contracting party for failure to file required reports, returns or information, or the payment of taxes, penalties, or interest for financial and criminal liability. This will provide a powerful deterrent to any individual who may consider evading fuel taxes with the notion that the consequences would not personally follow them. It should be noted that Montana's Common Law Business Judgment Rule can be exercised as a defense if the directors, officers, managers, members, or employees exercised the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances to prevent the corporation's failure to file the required reports, returns, or information, or pay the taxes penalties or interest required. The Business Judgment Rule will not protect directors, officers, mangers, members, or employees for acts of negligence, willfulness, or fraud.

9.14 Authorize the Examination of Records, Fuels, and Equipment

It is recommended that Montana institute code sections that would authorize the inspection and examination of motor fuel and paper work of any persons engaged in storing, selling, transporting, or distributing of motor vehicle fuel or other petroleum product or related products within Montana, and such other investigations as it considers necessary in carrying out the provisions of the statutes regarding motor fuel. These changes would allow for the inspection and examination of fuel contents of all fuel containers whether stationary or mobile to ensure that they contain the fuel stated on the related documents or paperwork. The documents and paperwork would include, but not be limited to records, receipts, invoices, shipping papers, and any other pertinent papers supporting sales or movement of each distributor or any person dealing in, transporting, or storing motor fuel. These code sections will also allow for inspections and examination of motor fuel and paper work of all persons in the motor fuel supply chain.

- MCA 15-70-208 should be modified to authorize the department to examine or sample fuel tanks and lay out the penalty or consequences of not making available the books, records, equipment, or fuel for examination or inspection.
- MCA 15-70-713 should be modified to authorize the department to examine or sample the liquefied petroleum gas itself in addition to the ability to examine records, receipts, invoices, documents, and equipment of any compressed natural gas dealer, any liquefied petroleum gas dealer, or any person importing, manufacturing, refining, dealing in, transporting, or storing compressed natural gas or liquefied petroleum gas.
- MCA 15-70-713 should be modified to give a penalty or other consequences for not making available the books, records, equipment, or fuel for examination or inspection.

- MCA 61-10-141 authorizes the weighing and inspection, including dipping of fuel tanks, of motor carriers operating on-road but limits their ability to inspect motorists.[8] An enforcement officer may only dip the tanks of motorists when there is "reasonable cause" to believe that illegal activity is taking place (e.g., the motorist is caught pumping dyed fuel into their fuel tanks, the state receives a tip that a motorist is operating with untaxed dyed fuel on-road). From a practical standpoint, the "reasonable cause" requirement effectively eliminates MDT's ability to enforce code relating to the on-road use of dyed diesel by operators of non-commercial vehicles. Montana should eliminate the reasonable or probable cause requirement as it relates to on-road inspection of non-commercial vehicles.

9.15 Perform Background Checks/Investigation of Licensee Applicants

It is recommended that Montana develop a code section or regulation that details registration requirements. Any increased costs that result in strengthened licensing procedures could be included in the cost of the application fee of the applicant. These requirements should include the following:

- Background checks should include finger printing. The fingerprint check should include the State of Montana records and the FBI.
- License applications currently include spaces for names and social security numbers of the officers of the company. The officer's names should be checked to ensure that they do not owe motor fuel tax from other companies that they are an officer of or a related party. All other state, provinces, and the federal government records should be checked to ensure that the applicant's license is in good standing in the respective jurisdiction.
- An enforcement officer should be sent to examine the site and facilities of all licensee applicants.

9.16 Expand Penalties and Fines for Non-compliance

Analysis of the jurisdictions surrounding Montana show that there is significant variance in the nature and severity of the penalties and fines for non-compliance between Montana and its neighboring jurisdictions. To strengthen Montana's penalties and fines and to ensure that Montana does not provide a reduced risk environment in comparison with its neighboring jurisdictions for unscrupulous marketers, Montana should adopt more rigorous penalties and interest for non-compliance to bring them in-line with those found within bordering states and provinces. Recommended changes to penalties are shown in bolded italics below with current penalties struck through in the following sections of Montana State Tax Code (as shown below):

[8] Trucks weighing in excess of 14,000 pounds are required to pull into weigh stations. MDT may require vehicles weighing over 10,000 pounds to be weighed and inspected by mobile patrol officers.

- **MCA 15-70-232 Penalties:** A distributor or others who fail, neglects, or refuses to file reports or statements or in the manner or time, or who makes any false statement, for a false claim for refund or violates any provision in relation to motor fuel tax shall be fined up to ~~$1,000.00~~ ***$10,000*** and/or imprisoned up to 6 months in addition to other penalties.
- **MCA 15-70-242 civil penalty:** A civil penalty not to exceed ~~$100~~ ***$5,000*** may be imposed for any violation of this part in addition to the criminal penalties imposed under 15-70-232.
- **MCA 15-70-333 Fraudulent return – penalty:** If a special fuel **user** files a false or fraudulent return with intent to evade the tax imposed by this part: (1) there must be added to the amount of deficiency determined by the department a penalty equal to 25% of the deficiency, together with interest at 1% per month or fraction of a month on the deficiency from the date the tax was due to the date of payment, in addition to all other penalties prescribed by law; and (2) the person is guilty of a misdemeanor and upon conviction is punishable by fine of not less than ~~$100~~ ***$1,000*** or more than ~~$2,000~~ ***$10,000*** or by imprisonment of not less than 30 days or more than 6 months, or by both fine and imprisonment.
- **MCA 15-70-336 Criminal penalties:** (1) A person violating any provision of this part, except for 15-70-311 through 15-70-314 and 15-70-321, is guilty of a misdemeanor and upon conviction is punishable by fine of not less than ~~$100~~ ***$1,000*** or more than ~~$1,000~~ ***$10,000*** or by imprisonment of not less than 30 days or more than 6 months or both. (2) The fine and imprisonment provided for in this section is in addition to any other penalty imposed by any other provision of this part.
- **MCA 15-70-366 Penalties:** A distributor or others who fail, neglects, or refuses to make and file statements required by this part in the manner or within the time provided, or who is delinquent in the payment of any license tax imposed by this part, who makes any false statement with reference to the distributor's business, who makes any false claim for refund or who violates any provision of this part shall, in addition to any other penalty imposed, be guilty of a misdemeanor and upon conviction shall be fined in an amount not to exceed ~~$1,000~~ ***$10,000*** or be imprisoned in the county jail for a time not to exceed 6 months, or both.

9.17 Mandate Electronic Tax Reporting

Many states require all motor fuel taxpayers to file their tax returns electronically. This system doesn't take the time and space that a traditional paper system would, freeing up resources for both industry and state collection agencies by reducing tax administration and compliance costs. Further, information becomes easily accessible for enforcement efforts within states and improves flexibility with respect to the analyses that can be readily performed using taxpayer data. That is, with greater ease of access to information comes an improved ability to perform evasion analysis or audit records. The FTA uniformity committee encourages states to not only adopt an electronic reporting system, but also adopt uniform methods and standards for their

systems so that states can share detailed information with each other in an efficient manner (FTA 2003).

Eight of the nine distributors/importers operating in Montana that were interviewed for this study supported electronic filing and reporting. Reasons given for this position included ease of use, cost savings, and time saved by employees. One company noted that it especially supported the electronic filing feature that allows for EFT. It allows less staff members to be involved in the process. When the paper returns were used, accounts payable and mail room staff were involved in making sure the return was filed and the check was issued. Only one company disliked the electronic filing process but favored funds transfer initiated by the company.

In general, most companies felt there were minimal issues with mandating and implementing electronic filing and EFT. Many of them have used electronic and EFT systems for years and prefer them to manual paper-based approaches because they save time and money. Some issues that were brought up with mandating and implementing EFT include:

- Smaller companies that have limited financial resources may dislike the idea of having to implement electronic reporting, especially if they have a small number of transactions.
- The initial setup of the electronic system takes time and money.
- Electronic reporting requires more attention to specific details; some fields must be manually corrected before submitting through EDI.
- The system should be designed with industry input to ensure that whatever is established is generally compatible with industry-adopted systems.

To overcome the cost issue smaller companies may have in setting up electronic systems, the web-based system already offered by MDT could be used to provide a cost-effective solution.

Based on the analysis presented within this section, it is recommended that MDT mandate the electronic filing of tax reports and payment of taxes. With respect to small companies not capable of complying with an electronic filing mandate, it is recommended that either (a) small companies have the option of using the current web-based program, or (b) an exemption be granted based on either a minimum tax liability or a minimum number of monthly loads.

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APPENDIX A: MOTOR FUEL TAX ADMINISTRATOR SURVEY

Date: November 2004 – March 2005

Interview Questions

Montana Department of Transportation Study:
"Determine Current Rates of Motor Fuel Tax Evasion in the State of Montana"

Interview Introduction

We are conducting research for the MDT, *"Determining Current Rates of Motor Fuel Tax Evasion in the State of Montana,"* that is intended to document methods of fuel tax evasion, examine differences between states in administration and enforcement that may affect fuel tax evasion, create a methodology and model designed to estimate motor fuel excise tax evasion rates in the State of Montana and develop recommendations for closing gaps in current tax codes and enforcement programs.

State Enforcement and Auditing Practices

How does your state or province collect motor fuel taxes? What point in the distribution chain does your state tax motor fuel? In the last 10 years, has your state moved the point of taxation? If so, what was the impact of this shift? If not, why has it not changed the point of taxation?

How are gasohol and blended fuels treated?

Do you use paper, electronic or some combination for tax payments?

Are refunds issued for non-taxable uses or some other method? If refunds are issued, how are they administered? What information is required on refund claims?

How does your state enforce and audit fuel tax collections? How many motor fuel tax auditors and enforcement officers does your state employ?

What information do you require on your motor fuel excise tax forms? What sort of documentation must accompany motor fuel tax forms?

How have collection and enforcement procedures changed over time?

What is the perceived revenue impact, or return on investment, of your enforcement programs? Which program elements are most successful? Have you found any correlation between new enforcement/compliance programs and evasion? For the recent past, can you provide gross and net assessment revenue (recoveries) by year by major fuel type?

What are the major issues that arise in auditing? Are any of these issues tied to particular factors or circumstances specific to your state? How would you describe best practice with regards to auditing of motor fuel excise taxes, either as it is or should be done? If you do not follow best practice, why not (e.g., laws, cost)?

What are the penalties and fines for late payments, fraud and other forms of non-compliance? Are you aware of any studies relating to state enforcement and auditing practices?

What are the overhead (e.g., administrative, compliance, enforcement) costs associated with your motor fuel tax programs, and what percentage of total tax collections do these costs represent? Can these estimates be verified in budget or other documents?

What is the perceived impact of public awareness and involvement programs on evasion?

Evasion Techniques and Methods for Measuring and Curtailing Evasion

What evasion techniques are you aware of from experience?

What evasion techniques have you heard about as either occurring in other places or as conceptual possibilities?

Are you aware of any court cases or other public records that highlight innovative evasion techniques or the extent of evasion?

Looking at specific enforcement issues, does your state perform on-road inspections for dyed fuel? How are on road inspections conducted in your state? Do you ever, or have you in the past, been involved in joint inspection efforts with IRS?

Has the dyed fuel requirement been effective? Consider both the inherent effectiveness and the level of enforcement in answering this question.

Is a lack of uniformity or variation in tax rates/systems between your state and other neighboring states creating an opportunity or incentive to evade taxes in your state?

Does your state coordinate with other government agencies, including inter- and intrastate as well as local and federal, regarding enforcement? Do you share information with your neighboring states? In what format (paper, electronic, etc.)? If you receive information from you neighboring states, what do you do with it? What would you do to improve coordination?

Is IFTA reporting effective? Could it be improved?

Which specific state enforcement and compliance programs/practices are especially effective in reducing evasion?

How can enforcement be improved in your state?

What is the impact of organized crime on evasion?

Are you aware of any studies that document motor fuel tax evasion techniques?

Has your state studied the evasion issue and estimated rates of motor fuel excise tax evasion? How much evasion would you estimate takes place in your state, in percentage terms?

Data

Can you provide a general overview of data sources (e.g., motor fuel, economic, transportation) useful in tracking fuel usage?

What are the methods of collection and data frequency?

What agencies are responsible for data collection?

How good is the data on fuel production, use and collections? What problems do you see with reporting practices, accuracy, availability, etc.?

Does your state employ a motor fuel tracking system? Is this system effective? In what ways is this system currently effective and how can it be improved?

Do you know of any recently conducted studies on motor fuel tax evasion? Do you have any suggestions as to how motor fuel tax evasion could be estimated or issues you think would be important to consider while estimating motor fuel tax evasion?

What is the availability and shortcomings of data and reports provided to federal and state agencies?

Are there discrepancies in how the data are prepared for various state and federal agencies?

Have there been any changes to how motor fuel tax data are reported over time? What were those changes and what were the reasons for these changes?

Tax Codes

What are the most important provisions of your state tax code related to fuel tax evasion? If you could change your state tax code to minimize evasion, how would you?

Are there recent tax code changes or proposed legislation related to motor fuel and other highway taxes in your state? How have or would these changes address evasion?

Are there significant gaps or loopholes in state tax codes that could be used to evade the motor fuel tax reporting, assessment or collection process?

Has your state prosecuted any fuel tax evasion cases? Please provide details. Do your state's prosecutors have a good understanding of motor fuel tax law?

How could tax codes be updated to curtail motor fuel tax evasion?

Variables Used to Estimate Demand for Fuel and Model Evasion

If fuel is sold on Native American lands, is it reported? Does your state have motor fuel tax agreements in place with Native American Tribes? If not, what needs to be done to achieve such agreements?

Do motor fuel tax rates in neighboring states and/or enforcement in those states affect motor fuel tax collections?

Is fuel imported across international borders into your state? How do you collect the tax on these shipments? Does your state track those shipments? How are those shipments tracked – e.g., tracking of U.S. Customs data.

What is the relationship between the point of taxation and evasion?

Does your state use a statistical model to forecast revenue? Would you share that model, or the name of a contact person who uses the model, with the research team?

Conclusions

Recap of requests for specific information and data

Arrangements for further contacts with agency personnel

Scheduling next discussion meeting(s)

Any questions/concerns?

APPENDIX B: MOTOR FUEL INDUSTRY SURVEY

Date: April 2005 – May 2005

1. Describe the process that your business undertakes to remit tax payments to the State of Montana?

2. What procedures must you go through to implement state motor fuel excise tax policy?

3. What reports must be filed with Montana? What types of data are submitted in these reports? How often must these reports be filed?

4. How has reporting changed over the past 10 years?

5. What is the availability and shortcomings in the data reported to Montana?

6. What are the costs associated with complying with the State of Montana's motor fuel tax, expressed as a percentage of total tax payments? What drives these costs? How could these costs be minimized?

7. What could Montana do to reduce compliance costs?

8. What fuel tax evasion techniques are you aware of either as occurring or as a potential problem in Montana and its bordering states and provinces?

9. What could Montana do to improve compliance and reduce evasion?

10. How does your business ensure against any of its members engaging in fraudulent activity?

11. What has your industry done generally, and your company more specifically, to improve fuel excise tax compliance?

12. Do you support the concept of electronic reporting and electronic funds transfer (EFT)?

13. What are the problems associated with mandating and implementing electronic reporting and electronic funds transfer programs?

14. Does the presence of Native American reservations pose a significant compliance issue? If so, what challenges are posed by the presence of Native American reservations?

15. How could the State of Montana enhance compliance through public outreach and enhanced communication with industry?