

**REPORT OF THE
DEPARTMENT OF MOTOR VEHICLES
DEPARTMENT OF TRANSPORTATION
STATE CORPORATION COMMISSION,
MOTOR CARRIER DIVISION**

**A Study of Further Means
of Combatting Fuels Tax
Avoidance and Evasion**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



SENATE DOCUMENT NO. 31

**COMMONWEALTH OF VIRGINIA
RICHMOND
1994**



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December 21, 1993

TO: The Honorable L. Douglas Wilder
Governor of Virginia

and

The General Assembly of Virginia

Senate Joint Resolution 182 of the 1993 General Assembly requested that the Department of Motor Vehicles, the Department of Transportation, and the Motor Carrier Division of the State Corporation Commission study further means of combatting fuels tax avoidance and evasion.

On behalf of the Departments of Motor Vehicles and Transportation, and the Motor Carrier Division of the State Corporation Commission, it is my privilege to transmit the report of the findings and recommendations of the requested study.

Respectfully submitted,

A handwritten signature in cursive script that reads "Donald E. Williams".

Donald E. Williams
Commissioner

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SENATE JOINT RESOLUTION NUMBER 182 B-1

Executive Summary

The 1993 General Assembly passed Senate Joint Resolution 182, which called on the Department of Motor Vehicles, the Department of Transportation and the Motor Carrier Division of the State Corporation Commission to study further means of combatting fuels tax avoidance and evasion.

Representatives from the Department of Motor Vehicles, Department of Transportation and the Motor Carrier Division of the State Corporation Commission formed a Steering Committee to provide policy leadership and coordinate a final report. The Steering Committee was joined by an Advisory Committee consisting of representatives from selected state agencies and affected interest groups. These two committees formed the study group which met on July 19, 1993 to consider the following issues identified by the study resolution:

- ◆ The point of taxation on fuels sales;
- ◆ The need to simplify the present exemption/refund system for tax exempt sales; and,
- ◆ The appropriate scheduling of payments of fuels taxes to the Commonwealth.

The study group concluded that it would be prudent to allow for time to evaluate the full impact of the fuels tax legislation enacted by the 1993 General Assembly before considering additional measures. The study group also believes that federal and other states' initiatives recently undertaken could impact the need and desirability for any further proposals that could result from this study resolution.

The group recommends a reexamination of the resolution issues at some point in the future, after the new Virginia laws and the federal and state initiatives have been implemented, enforced and evaluated for their effectiveness in combatting fuels tax evasion.

Introduction

Fuels tax evasion is recognized as a nationwide problem that results in revenue losses to state and federal governments. Some estimates put combined state and federal losses in the one-to five-billion dollar range. The Federal Highway Administration estimates that diesel fuel tax evasion is 15 to 25 percent of gallons consumed nationwide, while gasoline tax evasion estimates are 3 to 7 percent.

Lost fuels tax revenues harm both government and the public, limiting the funds available to construct and maintain highways. Fuels tax evasion also impacts honest businesses trying to compete with evaders selling fuel far below legitimate costs.

In February 1992, Operation Total Commitment exposed the problem in Virginia for the first time. This multi-jurisdictional operation, led by the Virginia Department of Motor Vehicles, uncovered out-of-state deliveries of home heating oil being sold as diesel fuel without the fuels tax being remitted to the Commonwealth. It also helped uncover a number of weaknesses in the existing fuels tax statutes that make them difficult to enforce, thereby making Virginia attractive to potential fuels tax evaders.

Operation Total Commitment led Governor L. Douglas Wilder to request the appointment of the Task Force on Fuels Tax Evasion. This Task Force was composed of three members each from the House of Delegates and the Senate of Virginia as well as representatives of selected state agencies and affected interest groups. As a result of the work of the Task Force, the 1993 General Assembly passed several bills designed to strengthen the laws of Virginia and help prevent fuels tax evasion. These bills provided for increased reporting and recordkeeping of fuels transactions by dealers, increased bonding requirements, higher penalties for tax evasion and fraud, and increased resources for auditing and enforcement.

Senate Joint Resolution 182

The 1993 General Assembly also passed Senate Joint Resolution 182 (**APPENDIX A**), which called on the Department of Motor Vehicles, the Department of Transportation and the Division of Motor Carriers of the State Corporation Commission to study further means of combatting fuels tax avoidance and evasion. Representatives from these three agencies formed a Steering Committee which met on July 19, 1993. They were joined by an Advisory Committee consisting of representatives from selected state agencies and affected interest groups (**APPENDIX B**) to consider the following issues:

- ◆ The point of taxation on fuels sales;
- ◆ The need to simplify the present exemption/refund system for tax exempt sales; and
- ◆ The appropriate scheduling of payments of fuels taxes to the Commonwealth.

The members of the two committees discussed the issues, citing the advantages and disadvantages of changes in each. The discussion centered around raising the point of taxation; most who commented were against changing it at this time. There were a few comments offered that related to the tax payment schedule and the simplification of the present exemption/refund system. Those who commented expressed the desire not to change either the payment schedule or the exemption/refund system at this time.

After hearing the advantages and disadvantages of changes to the current tax system, the study group agreed that there had not been enough time to evaluate the full impact of the fuels tax legislation enacted by the 1993 General Assembly. It also was determined that a change in the point at which the fuels tax is collected could impact the need for certain tax exemptions and could eliminate the need to accelerate payments.

In addition, the study group believes that federal and other states' initiatives recently undertaken could impact the need and desirability for any further proposals that could result from this study resolution. For the most part, these initiatives relate to the point of taxation and fuel dyeing along with systematic changes being developed and implemented by the Federation of Tax Administrators.

Point of Taxation Initiatives

Most states, including Virginia, collect fuel taxes from the wholesale distributor. State fuel tax administrators are united in their belief that taxation at the wholesale level is subject to fraud and abuse, but there is not yet a clear consensus on whether raising or lowering the point of taxation will minimize the potential for abuse. Michigan and Indiana are two states which have raised the point of taxation to terminal withdrawal within the last 12 months. On the other hand, New Jersey moved its point of taxation to the retail level in July of 1992, and Florida is contemplating a similar move.

Effective January 1, 1994, the federal Omnibus Budget Reconciliation Act of 1993 will move the federal point of taxation on diesel fuel to the terminal, the same point of taxation used by the federal government for gasoline. This law is expected to reduce the number of tax-free and taxable transactions, reduce the size of the audit trail, and lower the number of persons capable of purchasing tax-free fuel, all at the federal level. The next year should provide much more information on industry reaction to the federal law change, administrative complexities of the law and the difficulties associated with redefining tax-exempt sales.

Fuel Dyeing Initiatives

Another major development in fuel tax administration is fuel dyeing. Two federal laws have been enacted requiring the establishment of dyeing programs. The United States Environmental Protection Agency (EPA), as part of the 1990 Clean Air Act Amendments, enacted a fuel dyeing program which became effective October 1, 1993. This program requires that high-sulphur diesel fuel be dyed blue, and prohibits the use of this dyed fuel in motor vehicles.

The above-referenced Omnibus Budget Reconciliation Act also requires that tax-exempt diesel fuel destined for off-highway use be dyed before leaving the terminal. This program is designed to reduce evasion opportunities caused by tax-exempt sales of diesel fuel. The presence of dyed diesel fuel in a highway vehicle would indicate that the tax had not been paid on the fuel and would enhance the federal government's ability to identify illegal uses of tax-free fuel.

Some states, such as Indiana and Wisconsin, are planning their own fuel dyeing programs in an effort to better track tax-exempt sales. Virginia may wish to consider a similar program; however, the prudent course would be to wait for the EPA and the Internal Revenue Service to develop joint regulations for the two dyeing programs before determining how dyeing requirements can aid in the enforcement of state tax laws.

FTA Initiatives

Changes in the point of taxation are frequently accompanied by other statutory and administrative changes that enhance collection efforts. Some fuels tax administrators feel that administrative controls ensure a more reliable means of protecting fuels tax revenues. The recent changes in Virginia and other states will provide more evidence on the most effective ways to discourage tax evasion.

In conjunction with these efforts, the Motor Fuel Tax Section of the Federation of Tax Administrators (FTA) is working to establish uniformity in fuels tax laws and administrative practices to further enhance the state and federal initiatives. Rather than focus on solutions for one or two elements of fuels tax evasion, the FTA is striving to coordinate the legislative and administrative efforts of all states in order to develop and maintain a system designed to provide better, more consistent tracking and enforcement. Virginia's fuels tax administrators have been and will continue to be active participants in the FTA efforts.

Conclusion

The Senate Joint Resolution 182 study group felt that the new Virginia laws should be fully implemented and evaluated in order to determine the need for and the best approach to developing further initiatives to control fuels tax evasion before it made any specific recommendations. The study group believes that these issues should be examined again at some point during the next several years after the new Virginia laws and other federal and state initiatives have been implemented, enforced and evaluated.

APPENDIX A

SENATE JOINT RESOLUTION NUMBER 182

SENATE JOINT RESOLUTION NO. 182

Requesting the Departments of Motor Vehicles and Transportation, and the Division of Motor Carriers of the State Corporation Commission to study further means of combatting fuels tax avoidance and evasion.

Agreed to by the Senate, February 25, 1993

Agreed to by the House of Delegates, February 23, 1993

WHEREAS, the experience of the federal government and various states of the Union, including the Commonwealth of Virginia, is that evasion of fuels taxes is pervasive and substantial; and

WHEREAS, the Commonwealth of Virginia, through the Departments of Motor Vehicles and State Police, with the cooperation of local law-enforcement officers and prosecutors, conducted its own investigation into fuels tax evasion activities in December 1991 in a project dubbed "Operation Total Commitment"; and

WHEREAS, the investigation of seven truckstops in Virginia uncovered significant criminal activity and resulted in tax assessments of \$1.5 million (later revised to \$685,000); and

WHEREAS, other states have stiffened their fuels tax laws to curtail such evasion activities, leaving Virginia with less severe penalties for such evasion schemes and, therefore, a candidate to inherit such criminal activities; and

WHEREAS, Operation Total Commitment revealed certain limitations in the Commonwealth's law-enforcement and tax-collection statutes; and

WHEREAS, certain tax-evasion schemes are possible because Virginia's tax-collection and remittance mechanism permits series of tax-free transactions to occur, permitting unscrupulous parties to establish dummy corporations and complex paper trails; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Departments of Motor Vehicles and Transportation, and the Division of Motor Carriers of the State Corporation Commission be requested to study further means of combatting fuels tax avoidance and evasion. The Departments and the Division shall consider raising the point of taxation on fuel sales, the need to simplify the present exemption/refund system for tax exempt sales, and the appropriate scheduling of payments of taxes to the Commonwealth.

The Departments and the Division shall complete their work in time to submit their findings and recommendations to the Governor and the 1994 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

APPENDIX B

**STEERING & ADVISORY COMMITTEE MEMBERS
SENATE JOINT RESOLUTION NUMBER 182**

SENATE JOINT RESOLUTION 182 - FUELS TAX EVASION STUDY

STEERING COMMITTEE MEMBERS

William H. Leighty, Deputy Commissioner
Department of Motor Vehicles

Ralph M. Davis, Assistant Commissioner
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Peter Kolakowski, Budget Director
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SENATE JOINT RESOLUTION 182 - FUELS TAX EVASION STUDY

ADVISORY COMMITTEE MEMBERS

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