

**PRESENT LAW AND BACKGROUND
RELATING TO
FEDERAL EXCISE TAXES IMPOSED ON
TRANSPORTATION MOTOR FUELS**

Scheduled for a Hearing

Before the

COMMITTEE ON WAYS AND MEANS

on May 8, 1996

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a hearing on May 8, 1996, to examine the impact of the 4.3-cents-per-gallon General Fund transportation motor fuels excise tax enacted by the Omnibus Budget Reconciliation Act of 1993. The transportation motor fuels excise tax applies to motor fuels used in all transportation sectors: highway, aviation, rail, inland waterway shipping, and recreational boating.

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the present-law taxes imposed on transportation motor fuels (Part I), background information on historical use of revenues from these taxes to finance General Fund and Federal trust fund activities (Part II), a discussion of effective date issues associated with repeal of the 4.3-cents-per-gallon excise tax (Part III), estimated revenue effects (Part IV), and distributional effects of a temporary repeal of the 4.3-cents-per-gallon excise tax (Part V). The Appendix presents a history of the Federal excise tax rates on highway motor fuels, 1955-1996.

¹ This document may be cited as follows: Joint Committee on Taxation, Present Law and Legislative Background Relating to Federal Excise Taxes Imposed on Transportation Motor Fuels (JCX-18-96), May 7, 1996.

I. PRESENT-LAW FEDERAL EXCISE TAXES IMPOSED ON TRANSPORTATION MOTOR FUELS

Separate Federal excise taxes are imposed on specified transportation motor fuels. Taxable fuels include gasoline, diesel fuel and special motor fuels used for highway transportation, gasoline and diesel fuel used in motorboats, diesel fuel used in trains, fuels used in inland waterway transportation, and aviation fuel (gasoline and jet fuel). Motor fuels used by all of these transportation sectors are subject to a permanent 4.3-cents-per gallon excise tax, enacted by the Omnibus Budget Reconciliation Act of 1993. Revenues from the 4.3-cents-per-gallon excise tax are retained in the General Fund of the Treasury.

The aggregate tax rate varies for each transportation sector. For example, diesel fuel used in trains is subject to an aggregate General Fund tax rate of 5.55 cents per gallon. Transportation sectors that benefit from Federal public works and environmental programs also are subject to additional tax rates (beyond the 4.3-cents-per-gallon General Fund rate) to finance Federal trust funds established as a financing source for those programs. All motor fuels excise taxes other than the 4.3-cents-per-gallon transportation motor fuels excise tax are temporary (i.e., have scheduled expiration dates).

In addition to the taxes imposed on actual transportation motor fuels, excise taxes formerly were imposed on crude oil (and imported refined petroleum products) to finance the Hazardous Substance Superfund program (before January 1, 1996) and the Oil Spill Liability Trust Fund program (before January 1, 1995). A further excise tax on motor fuels, the Leaking Underground Storage Tank Trust Fund tax, expired after December 31, 1995.

Between 1956 and 1990, motor fuels excise taxes generally were imposed only for Federal Trust Fund financing. The Omnibus Budget Reconciliation Act of 1990 imposed a temporary (through September 30, 1995) General Fund motor fuels excise tax of 2.5 cents per gallon on highway and rail transportation. Table 1, on the following page, summarizes the present-law Federal excise tax rates on transportation motor fuels, by trust fund and General Fund components.

**Table 1. Present-Law Federal Motor Fuels Excise Tax Rates
on Various Transportation Sectors**

(rates shown in cents per gallon)

<u>Transportation Sector</u>	<u>Trust Fund</u>	<u>General Fund</u>	<u>Total Tax</u>
<u>Highway Transportation</u> ¹			
In general (trucks, automobiles)			
Gasoline	14.0	4.3	18.3
Diesel fuel	20.0	4.3	24.3
Special motor fuels ²	14.0	4.3	18.3
Intercity bus			
Gasoline	no tax	no tax	no tax
Diesel fuel	3.0	4.3	7.3
<u>Rail Transportation</u>	no tax	5.55	5.55
<u>Water Transportation</u>			
Inland waterway			
Recreational boats	20.0	4.3	24.3
Gasoline	14.0	4.3	18.3
Diesel fuel	no tax	24.4	24.4
<u>Air Transportation</u>			
Commercial aviation	no tax ³	4.3	4.3
Noncommercial aviation			
Gasoline	14.0 ⁴	4.3	18.3
Jet fuel	no tax ⁵	4.3	4.3

¹ Reduced highway motor fuels excise tax rates apply to mixtures of taxable fuels with ethanol and methanol produced from renewable sources (i.e., "gasohol") and to certain "neat" (at least 85 percent pure) methanol fuels produced from natural gas.

² Examples of special motor fuels are propane, liquefied natural gas ("LNG"), other liquids used as a fuel in highway transportation, and compressed natural gas ("CNG"). CNG, a gaseous fuel rather than a liquid fuel, is subject only to a General Fund tax of 48.54 cents per thousand cubic feet.

³ Before January 1, 1996, commercial aviation trust fund taxes consisted of a 10-percent domestic passenger tax, a \$6 dollar international passenger departure tax, and a 6.25-percent domestic air cargo tax.

⁴ Before January 1, 1996, an additional 1-cent-per-gallon tax was imposed on noncommercial aviation gasoline.

⁵ Before January 1, 1996, a 17.5-cents-per-gallon tax was imposed.

II. LEGISLATIVE BACKGROUND OF TRANSPORTATION MOTOR FUELS EXCISE TAXES

Use of motor fuels excise taxes for deficit reduction

Beginning with the establishment of the Federal Highway Trust Fund in 1956 and extending through 1990, excise taxes on transportation motor fuels generally were imposed exclusively to finance Federal trust fund programs, and imposition of the taxes was limited to beneficiaries of the trust funds. In 1990, and again in 1993, transportation motor fuels tax rates were increased as a deficit reduction measure, with revenues from all or part of the increases being retained in the General Fund of the Treasury. Unlike the 1990 General Fund tax rate and the various trust fund rates, the 1993 4.3-cents-per-gallon rate is permanent and all of the revenues are retained in the General Fund.

1993 transportation motor fuels excise tax and extension of 1990 taxes

A 4.3-cents-per-gallon General Fund transportation motor fuels excise tax was imposed as a deficit reduction measure by the Omnibus Budget Reconciliation Act of 1993 (the "1993 Act"). This excise tax was enacted as an alternative to a broad-based energy ("BTU") tax proposed by President Clinton. This transportation motor fuels tax applies to fuel used in all domestic transportation: highway, aviation,² rail, inland waterway shipping, and recreational boating. The tax is imposed on all fuels otherwise subject to excise tax (liquid fuels), plus CNG. Statutorily, the tax is imposed as an add-on to the other excise taxes. Thus, uses of motor fuels that are wholly exempt from other excise tax (e.g., State and local government and farm use) are exempt from this tax.

In addition to imposing the 4.3-cents-per-gallon transportation motor fuels excise tax, the 1993 Act extended the 5-cents-per-gallon excise tax imposed on highway transportation in 1990 and the 1990 tax on diesel fuel used in trains (at a reduced rate of 1.25 cents per gallon), both through September 30, 1999. The 1993 Act provided that revenues from extension of this tax on highway motor fuels would be deposited in the Federal Highway Trust Fund during the extension period (October 1, 1995-September 30, 1999). Revenues from the tax on diesel fuel used in trains continue to go to the General Fund as there is no Federal rail construction trust fund.

1990 transportation motor fuels excise tax

The Omnibus Budget Reconciliation Act of 1990 (the "1990 Act") increased the existing highway motor fuels taxes by 5 cents per gallon. This tax also was imposed on diesel motor fuel used in trains at a reduced rate of 2.5 cents per gallon to reflect the General Fund portion of the

² Fuel consumed in commercial aviation was exempt from this tax prior to October 1, 1995.

highway fuels taxes (explained below). The excise taxes on noncommercial aviation fuel were increased by 25 percent by the 1990 Act as part of a general extension of and increase in Airport and Airway Trust Fund taxes. As enacted, these increases were temporary: the additional highway and rail taxes were scheduled to expire after September 30, 1995, and the additional noncommercial aviation fuel taxes were scheduled to expire after December 31, 1995 (when all other Airport and Airway Trust Fund taxes were scheduled to expire).

Highway transportation motor fuels tax revenues from this 1990 increase were divided equally between the Federal Highway Trust Fund and the General Fund of the Treasury. Revenues from the noncommercial aviation fuels tax increase were retained in the General Fund for a two-year period, followed by three years in which revenues were deposited in the Federal Airport and Airway Trust Fund. Revenues from the 2.5-cents-per-gallon excise tax on train diesel fuel were retained in the General Fund.

Use of transportation motor fuels excise taxes for Federal trust fund financing

Highway Trust Fund

The Highway Trust Fund (the "Trust Fund") was established in 1956 to provide a financing source for the then-new Interstate Highway System and for continuation of other Federal-aid highway programs. The other highway-aid programs previously had been financed through the General Fund. Existing General Fund excise taxes on gasoline, diesel fuel, and special motor fuels were increased from 2 cents per gallon to 3 cents per gallon, through 1958, with the revenues being dedicated to the Trust Fund. The Trust Fund fuels tax rate was further increased to 4 cents per gallon in 1959. The fuels tax rates remained at that level until 1983 following enactment of the Surface Transportation Assistance Act of 1982, which increased these Trust Fund fuels excise tax rates to 9 cents per gallon.

Beginning in 1985, the diesel fuel excise tax rate (but not the gasoline excise tax rate) was increased by an additional 6 cents per gallon, to a total of 15 cents per gallon (all for the Highway Trust Fund). The 1985 increase was enacted as a revenue offset for a reduction in an annual use tax imposed on heavy trucks, the primary users of diesel fuel. No further increases in the highway motor fuels excise tax rates were enacted until 1990.

In 1982, the Highway Trust Fund was divided into two accounts, the Highway Account and the Mass Transit Account. Highway programs continue to be financed from the Highway Account. The Mass Transit Account, which currently is funded by 2 cents per gallon of the Highway motor fuels excise tax revenues, finances Federal mass transit assistance programs.

Inland Waterways Trust Fund

Federal excise taxes have been imposed on motor fuels used in vessels operating on a designated inland waterway system since 1980. The initial tax rate was 4 cents per gallon. Following a series of scheduled, phased increases, the tax currently is imposed at a rate of

20 cents per gallon. Revenues from this excise tax are dedicated to the Inland Waterways Trust Fund to finance construction and rehabilitation expenditures for navigation of 26 specified inland and intracoastal waterways.

Aquatic Resources Trust Fund and Land and Water Conservation Fund

Revenues from the gasoline excise tax imposed on motorboat use are dedicated to the Aquatic Resources Trust Fund (the "Aquatic Fund") and the Land and Water Conservation Fund. The Land and Water Conservation Fund receives \$1 million per year of these revenues. The balance of the revenues is allocated between a Boat Safety Account in the Aquatic Fund and a Sport Fish Account. The Boat Safety Account finances boat safety programs conducted by the U.S. Coast Guard; the Sport Fish Account funds fish restoration grant programs of the Federal Government.

A sub-account in the Sport Fish Account separately receives the portion of highway motor fuel taxes attributable to small engines (e.g., lawnmowers and snowblowers). Amounts in this sub-account are dedicated to coastal wetlands restoration programs.

Airport and Airway Trust Fund

Since establishment of the Airport and Airway Trust Fund (the "Trust Fund") in 1970, excise taxes on commercial and noncommercial aviation generally have been dedicated to programs of that Trust Fund. The majority of the revenues for the Trust Fund are produced by passenger ticket and air cargo taxes imposed on commercial air travel. The noncommercial aviation sector's contribution to the Trust Fund takes the form of motor fuels excise taxes. From 1970 through 1980, both aviation gasoline and jet fuel were taxed at 7 cents per gallon. Following a period when rates were temporarily reduced (because of failure to extend scheduled expirations), the taxes were set at 14 cents per gallon (jet fuel) and 12 cents per gallon (gasoline) until enactment of the 1990 increase described above.

Leaking Underground Storage Tank Trust Fund

A 0.1-cent-per-gallon excise tax was imposed on all otherwise taxable transportation motor fuels (other than propane) from 1987 through December 31, 1995. Statutorily, this tax was structured as an add-on rate to the existing taxes. Revenues from the tax were dedicated to remediation of ground pollution from underground oil storage tanks.

National Recreational Trails Trust Fund

Highway motor fuels excise tax revenues attributable to fuel consumed in recreational trail vehicles are dedicated, subject to appropriations, to the National Recreational Trails Trust Fund to finance Federal programs promoting recreational trail construction and maintenance. To date, no appropriations to this Trust Fund have been enacted.

III. EFFECTIVE DATE ISSUES ASSOCIATED WITH REPEAL OF THE 4.3-CENTS-PER-GALLON TRANSPORTATION MOTOR FUELS EXCISE TAX

In general

If the 4.3-cents-per-gallon General Fund transportation motor fuels excise tax is repealed, failure to provide an early effective date could contribute to consumer-level shortages if wholesale distributors and retail dealers delayed fuel purchases pending implementation of the tax reduction. However, the 4.3-cents-per gallon excise tax statutorily is imposed at different points in the distribution chain for different transportation sectors (as an add-on to other motor fuel excises). The degree to which the proposed excise tax reduction is enjoyed by consumers through price reductions will be dependent on market forces beyond the purview of the proposed tax legislation. This dependence on market forces is particularly strong in the case of gasoline and diesel fuel because, as described below, the excise taxes on these fuels generally are imposed at least two levels in the fuel distribution chain away from the consumer, and the taxes are not separately stated items on consumer bills.

Points of imposition of the tax

The points in the fuel distribution chain at which the transportation motor fuels excise tax is imposed vary by transportation sector. Different points of imposition present different issues on timing of the proposed repeal if the goal of consumer price decreases is to be achieved rapidly. The 4.3-cents-per-gallon excise tax is imposed at the following points in the distribution chain:

<u>Taxable Fuel</u>	<u>Point of Imposition</u>
Gasoline and diesel fuel (all taxable uses except trains and intercity buses using dyed diesel fuel)	Generally, removal from pipeline or barge terminal
Train and intercity bus diesel fuel	Retail use (if dyed); otherwise, removal from terminal facility
Inland waterway	Retail use
Aviation jet fuel	Wholesale sale ³

³ Most major airports are served by wholesale distributors that deliver aviation fuel directly into airplanes, with tax being collected at what is substantively the retail level.

Specific effective date issues

The first issue to be addressed in setting an effective date is the speed with which persons actually paying the tax are made aware that the tax has been repealed (i.e., a law has been signed by the President). In all cases, this could be expected to be accomplished in less than a week. For example, gasoline and diesel fuel terminal facilities (where a substantial majority of the transportation motor fuels excise tax is collected) are required to register with the Internal Revenue Service ("IRS") as a condition of holding non-tax-paid fuel. The IRS could be instructed to notify all registered facilities immediately upon enactment of the legislation.

The second issue involves the speed with which the tax reduction can be expected to be reflected in lower consumer prices. There is no technical tax barrier to immediate flow-through to consumers of the tax reduction. The extent to which the tax reduction is enjoyed by consumers is determined by market forces of supply and demand. Generally, economists believe that in the long run, fuels excise taxes are borne by consumers in the form of higher fuel prices. Likewise, reductions in those excise taxes could be expected to result in lower fuel prices.

In the short-term, the collection structure of the gasoline and diesel fuel excise taxes could mean that a rate reduction is not immediately reflected in price changes. Gasoline and diesel fuel generally are distributed in bulk from refineries (or port of importation) to terminals. Computerized recordkeeping systems track the removal of fuels from terminals and the price charged. Wholesale distributors remove the fuels by truck, with tax being collected on removal as a part of the fuel price they pay. (The tax is imposed on owners of record of the fuel inside the terminal facility, not on wholesale distributors.) Wholesale distributors subsequently deliver the fuel they remove to retail outlets, service stations, truck stops, and fleet purchasers. Stocks of fuel on which tax already has been paid generally are held for sale beyond pipeline terminals at all times. Owners of this fuel may be reasonably expected to attempt to recoup all costs already incurred. However, new lower-taxed fuel being removed from terminals beginning on the effective date of the excise tax reduction may mitigate their ability to charge the cost of these past taxes to consumers.

Present law includes refund provisions that could assist in rapid delivery to consumers of price reductions on fuels taxed at the higher, present-law rates. The present-law Highway Trust Fund gasoline and diesel fuel excise tax rates are scheduled to expire after September 30, 1999. The Internal Revenue Code provides that persons holding fuel on which those taxes have been paid for sale on October 1, 1999, can apply to the person who actually paid the tax (e.g., owners of gasoline and diesel fuel within terminal facilities) for a refund. The actual taxpayers in turn could apply to the Internal Revenue Service for a refund of amounts they pay to their customers. No refunds are provided for fuel held at retail or for use by a consumer. These "floor stocks refund" provisions could be made applicable to any repeal of the 4.3-cents-per-gallon transportation motor fuels excise tax to encourage immediate reductions in fuel tax prices to consumers.

IV. ESTIMATED REVENUE EFFECTS OF TRANSPORTATION MOTOR FUELS EXCISE TAX REPEAL OPTIONS

Fiscal Years 1996 - 2005

[Millions of Dollars]

Provision	Effective	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1996-00	1996-02	1996-05
1. Repeal 1993 tax increase of 4.3 cents per gallon on transportation motor fuels (sunset after 12/31/96).....	6/1/96	-1,655	-1,285	26	9	3	1	---	---	---	---	-2,903	-2,902	-2,902
2. Repeal 1993 tax increase of 4.3 cents per gallon on transportation motor fuels:														
a. Highway gasoline.....	6/1/96	-1,221	-3,848	-3,853	-3,876	-3,940	-4,035	-4,136	-4,239	-4,345	-4,454	-16,738	-24,909	-37,947
b. Highway diesel fuel.....	6/1/96	-247	-772	-761	-756	-764	-781	-799	-818	-837	-856	-3,300	-4,880	-7,391
c. Railroad diesel fuel.....	6/1/96	-39	-124	-123	-123	-124	-124	-124	-124	-124	-124	-533	-781	-1,153
d. Inland waterway diesel fuel.....	6/1/96	-2	-18	-18	-18	-18	-18	-19	-19	-19	-20	-74	-111	-169
e. Aviation gasoline.....	6/1/96	-3	-8	-8	-8	-8	-8	-8	-8	-8	-8	-35	-51	-75
f. Noncommercial jet fuel.....	6/1/96	-8	-25	-25	-26	-27	-27	-28	-29	-29	-30	-111	-166	-254
g. Commercial jet fuel.....	6/1/96	-135	-439	-458	-474	-489	-504	-520	-536	-553	-571	-1,995	-3,019	-4,679
Subtotal.....		-1,655	-5,234	-5,246	-5,281	-5,369	-5,498	-5,634	-5,773	-5,916	-6,063	-22,785	-33,917	-51,669
3. Suspend or repeal the remaining 1.25 cents per gallon tax on railroad diesel fuel:														
a. Suspend tax through 12/31/96.....	6/1/96	-12	-9	---	---	---	---	---	---	---	---	-21	-21	-21
b. Permanent repeal [1].....	6/1/96	-12	-36	-36	-36	---	---	---	---	---	---	-121	-121	-121

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NOTE: Details may not add to totals due to rounding.

[1] The 1.25 cents per gallon tax on railroad diesel is scheduled to expire on 9/30/99.

V. DISTRIBUTIONAL EFFECTS OF A TEMPORARY
 REPEAL OF THE 1993 TRANSPORTATION MOTOR
 FUELS EXCISE TAX (4.3 CENTS PER GALLON) (1)
 Calendar Year 1996

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$287	-4.3%	\$7	0.6%	\$6	0.6%	6.9%	6.6%
10,000 to 20,000.....	-524	-1.5%	34	3.0%	34	3.0%	9.2%	9.1%
20,000 to 30,000.....	-523	-0.8%	69	6.0%	68	6.0%	14.3%	14.2%
30,000 to 40,000.....	-563	-0.6%	96	8.5%	96	8.4%	17.0%	16.9%
40,000 to 50,000.....	-481	-0.5%	99	8.7%	99	8.7%	18.3%	18.3%
50,000 to 75,000.....	-737	-0.3%	234	20.6%	233	20.6%	20.7%	20.6%
75,000 to 100,000.....	-388	-0.2%	173	15.2%	172	15.2%	23.3%	23.3%
100,000 to 200,000.....	-333	-0.2%	215	18.9%	215	18.9%	24.7%	24.7%
200,000 and over.....	-99	(5)	212	18.6%	212	18.7%	29.5%	29.5%
Total, All Taxpayers....	-\$3,935	-0.3%	\$1,139	100.0%	\$1,135	100.0%	20.7%	20.6%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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- (1) The repeal would be effective June 1 through December 31, 1996.
 - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1996 levels.
 - (3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. The indirect effects of excise tax changes are not included.
 - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by: income described in footnote (2) plus additional income attributable to the proposal.
 - (5) Less than .05%.

APPENDIX: History of Federal Excise Tax Rates on Highway Motor Fuels, 1955 - 1996

(rates shown in cents per gallon)

Year	General Fund Rate	Highway Trust Fund Rate		"LUST" Tax Rate ¹	Total Fuels Tax Rate
		Gasoline and special motor fuels	Diesel fuel		
1955	2	no tax	no tax	-----	2
1956 ²	-----	3	3	-----	3
1960	-----	4	4	-----	4
1983	-----	9	9	-----	9
1985	-----	9	15	-----	9 (gasoline) 15 (diesel)
1987	-----	9	15	0.1	9.1 (gasoline) 15.1 (diesel)
1990	2.5	11.5	17.5	0.1	14.1 (gasoline) 20.1 (diesel)
1993	6.8	11.5	17.5	0.1	18.4 (gasoline) 24.4 (diesel)
1995	4.3	14.0	20.0	0.1	18.4 (gasoline) 24.4 (diesel)
1996	4.3	14.0	20.0	no tax	18.3 (gasoline) 24.3 (diesel)

¹ Tax for the Leaking Underground Storage Tank Trust Fund ("LUST") was applicable 1987-1995.

² Highway Revenue Act of 1956 established the Highway Trust Fund.