

**Testimony of David L. Skinner, Fuel Tax Compliance Coordinator, Florida
Department of Revenue, before the U. S. Senate Finance Committee, July 17, 2002**

Tax on Jet Fuel - Florida's Experience

On January 1, 1994 there were significant changes to the federal tax law on diesel fuel. In Florida, a working group was established, (called the "Industry/DOR Fuel Tax PIT Crew"), to review Florida's fuel tax system and make recommendations for improvements. The working group was comprised of representatives from the Florida Petroleum Council (representing major oil companies), the Florida Petroleum Marketers and Convenience Store Association (representing the marketers and distributors), the Florida Department of Revenue, and other stakeholders. At that time, Florida's motor fuel, special fuel and aviation fuel taxes were imposed at points in the distribution chain that were below the terminal rack. It soon became apparent to the group that Florida's fuel taxation system could be much more efficient and less burdensome on the industry if we could synchronize the state law with the federal law.

There were many difficult issues to be resolved:

- The marketers' loss of "float" if they had to pay the tax up front.
- The marketers' loss of collection allowance.
- The major oil companies' risk of bad debt losses.
- The retailers' shrinkage and evaporation allowances.
- How to handle temperature gains and losses.
- How to handle exports to other states.
- How to handle imports from other states.
- How to handle changes in destination or split loads.
- How to handle terminal rack exchange agreements between major oil companies.
- How to collect Florida's complicated system of local option taxes on gasoline.
- How to handle refunds or credits for off road exemptions if tax was pre-collected at the rack.

One by one these issues were resolved through a very cooperative process of negotiations between the three principal parties, and in consultation with other affected stakeholders. It was a remarkable experience as all the parties came together with a common interest to make the Florida system more efficient while at the same time minimizing the burden for the industry and building in provisions that would help to prevent tax fraud and evasion. The industry members fully understood that if tax cheats were allowed to prosper, their business would be hurt.

One major issue was the last to be resolved - the kerosene/jet fuel issue. The parties knew that this product, while not normally subject to highway taxes, could easily be blended with diesel fuel and used by tax cheats to evade highway taxes. The federal government had not yet resolved the issue, but there were changes under consideration that would impose federal highway tax on undyed kerosene at the terminal rack. (This federal change ultimately took effect July 1, 1998.)

The group had learned that as much as 90% of the kerosene stored in Florida's terminals was refined to meet the specifications for aviation jet fuel. The decision finally reached by the group was to recommend to the Florida Legislature that kerosene be included with jet fuel and aviation gasoline in Part III of the motor fuel tax statutes. The tax would be imposed at the terminal rack, same as motor fuel and diesel fuel, but at the aviation fuel tax rate, 6.9 cents per gallon. If the kerosene was dyed at the terminal rack to the same specifications as the off-road diesel fuel, it could be sold tax-free.

This would allow the aviation fuel taxes to be placed on the same reporting form with the motor fuel tax and diesel fuel tax and be paid by the same position holders in the terminals who were responsible for the payment of motor fuel and diesel fuel taxes. Special provisions were made to allow tax-free sales of kerosene for home heating with an ultimate vendor credit or refund for the distributor, much the same as with diesel fuel sold to farmers. In Florida, unlike the federal system, these ultimate vendors would be

responsible for paying any local option taxes due on gasoline sales, and thus could take a credit on their return against those taxes instead of having to wait for a refund.

The statutory language for all these changes was drafted by various members of the group, and presented to the 1995 Florida Legislature. The Executive Vice President of the Florida Petroleum Marketers and Convenience Store Association, G. Alan Whidby, took the lead in securing a sponsor for the bill and lobbying it through the Legislature. The group's recommendations were adopted into law with very little change and the new motor fuel tax laws took effect on July 1, 1996.

A year after the law changed, we analyzed the effects on revenue collections. We were expecting significant increases in diesel fuel tax collections, as had been experienced by the federal government and several other states that had moved their taxation points. We also expected improvements in the collections of local option fuel taxes which had previously been paid at the retailer level, but now were being paid at the wholesaler level. What we did not anticipate was the large increase in collections of aviation fuel tax.

After adjusting for pending refunds, we found that our aviation fuel tax had increased by 21.4% over the prior 12 month period. Until the recent tragedy of September 11th, aviation jet fuel has continued to increase. While the reasons for the increase are not clear, there are several possibilities.

One very likely reason is that some customers are paying the 6.9 cents per gallon aviation fuel tax on kerosene, but are not claiming the allowable refund. If the aviation fuel tax is NOT paid or if it is refunded, the purchase price of the kerosene is subject to Florida's sales and use tax – up to 7% of the purchase price, unless there is a specific exemption. Therefore, if the kerosene sells for \$1.00 per gallon or more (excluding taxes) the sales tax would actually be more than the aviation fuel tax. (There are exemptions from the sales and use tax for farming and home heating.)

Another possibility is that there was some tax evasion by distributors of aviation fuel before it was moved to the terminal rack. Furthermore, jet fuel and/or kerosene could be illegally blended and used as highway fuels, with the crooks simply absorbing the cost of 6.9 cents per gallon in order to profit from non-payment of the 26.4 cent state and 24.4 cent federal highway taxes. We have not seen any direct evidence of this in Florida.

To some extent, the economic growth in the 1990's may have been a factor. After the first year, the aviation fuel gallons reported on tax returns continued to grow by .5% in FY 1997-98, 5.5% in FY 1998-99, 5.6% in FY 1999-2000, and 3.1% in FY 2000-01.

The reported gallons of aviation fuel in Florida since September 11th clearly reflect the decrease in consumption that has been reported by the airlines.

Collection Month	Applied Month	Prior Year Gallons	Current Year Gallons	Percent Change
10/01	Sept. 2001	76,186,744	52,791,907	-30.7%
11/01	Oct. 2001	83,539,587	66,435,504	-20.5%
12/01	Nov. 2001	89,346,300	88,242,676	-1.2%
1/02	Dec. 2001	101,471,596	72,139,152	-28.9%
2/02	Jan. 2002	103,586,849	84,498,340	-18.4%
Totals		454,131,076	364,107,578	-19.8%

In Florida there are several locations that store duty-free supplies of jet fuel under U. S. Custom Bond, which is eligible for tax-free use in qualified foreign flights. Florida recognizes that this bonded jet fuel is exempt from its aviation fuel tax, thus bonded aviation fuel is not included in the figures noted above.

Imposing the tax at the terminal rack does create some problems. The most significant problem is seen when there are exempt uses for the fuels. If the tax has been pre-paid by the user, there must be a means of claiming a refund or credit against other taxes.

In Florida we have tried to solve this by allowing an ultimate vendor credit in certain circumstances, to be claimed against other tax liabilities or as a refund to the vendor. The sale could be made tax-free to the consumer, and the vendor could claim the credit or refund if the taxes were already paid to a supplier.

For kerosene, this credit is allowed when there is a direct delivery for home heating, a sale of 5 gallons or less through a so called "blocked pump", or a sale in pre-packaged containers of 5 gallons or less. In this manner we were able to avoid causing a hardship on consumers using kerosene for home heating.

For jet fuel, there is a provision that allows an airline which has met certain employment thresholds in Florida to be exempt from the aviation fuel tax. In a similar fashion, their supplier would sell aviation fuel to them tax-free and take an ultimate vendor credit on their tax return.

Overall, the difficulties in making the change in our tax law for aviation fuel were minor compared to the other major changes for gasoline and diesel fuel. The tax reporting forms were completely revamped and the aviation fuel taxes were combined on the same forms with motor fuel tax and diesel fuel tax. The feedback I have heard from industry has been generally positive, and I am unaware of any particular problems stemming from the movement of the aviation fuel tax to the terminal rack in Florida.