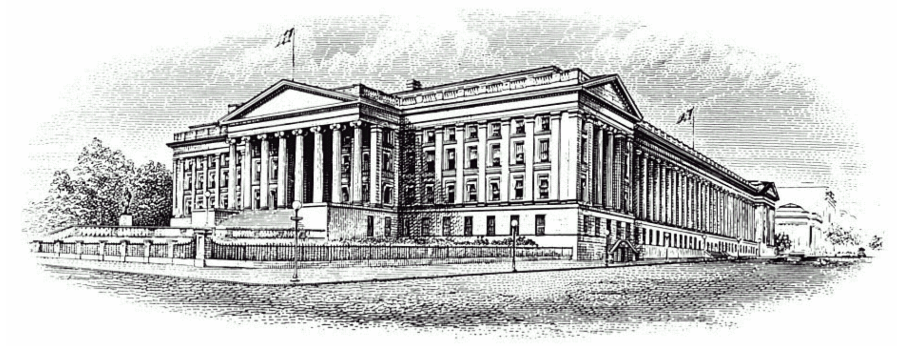

DEPARTMENT OF THE TREASURY

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May 9, 2002 | (202) 622-2014

Statement of
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United States Department of the Treasury
Before the Committee on Finance
United States Senate
Hearing on Revenue Issues Related to the Highway Trust Fund

Mr. Chairman and Members of the Committee, I appreciate the opportunity to describe recent trends in actual highway-related excise taxes, briefly describe how funds are credited to the Highway Trust Fund, discuss the Administration's FY 2003 Budget forecast of related excise taxes, and highlight areas that Treasury is evaluating as a part of its ongoing simplification project.

The Office of Tax Analysis in the Department of the Treasury forecasts most future tax receipts for the President's Budget. These forecasts are made using economic models that are constantly updated to incorporate the most current information on tax collections and reported tax liabilities. The forecast for Fiscal Years 2002 through 2012 incorporates the Administration's economic assumptions formulated for the Budget by the Troika, which consists of the Council of Economic Advisors, the Office of Management and Budget, and the Department of the Treasury.[1] Each of the six dedicated Highway Account excise tax sources are separately forecast: (i) Gasoline, (ii) Gasohol fuels, (iii) Diesel and other fuels, (iv) Retail tax on trucks, (v) Highway-type tires, and (vi) Heavy vehicle use tax. In Table 1, fiscal year receipts for 2000 through 2012 are reported for these six excise tax sources. The 2000 and 2001 figures are actual receipts drawn from the Highway Account Income Statement, while the 2002 through 2012 figures are projections from the President's FY 2003 Budget.[2]

[1] The economic assumptions are described in Chapter 2 of the Analytical Perspectives volume of the Fiscal Year 2003 Budget.
[2] The Income Statement for FY 2000 and 2001 includes three quarters of actual tax receipts certified by the IRS. Receipts for the last quarter of the fiscal year are based on an estimated allocation of total excise tax receipts. Any differences between estimated and actual receipts for the last quarter is adjusted in March and reflected in the Income Statement of the subsequent year.

Recent Excise Tax Receipts

There was a rapid downturn in highway-related excise taxes as the economy began weakening in the summer of 2000 and continuing through 2001. Tax receipts deposited in the Highway Account fell $3.4 billion from Fiscal Year 2000 to Fiscal Year 2001, dropping from $30.3 billion to $26.9 billion, an 11.3 percent decline. As shown in Table 1, five of the six receipt sources were lower in 2001 than in 2000. Only taxes on gasohol fuels show an increase.

The increase in taxes on gasohol fuels is evidence of an ongoing substitution of gasohol fuels for gasoline, which may be used interchangeably in cars and light trucks. We anticipate that there will be an increasing use of gasohol fuels as a proportion of total fuel use as States ban the use of MTBE (methyl tertiary-butyl ether) as a fuel additive. Since the Highway Account receives 15.44 cents per gallon of gasoline but only about 8 cents per gallon of gasohol, the substitution of gasohol fuels for gasoline will result in a net reduction in Highway Account receipts.

The most dramatic declines between FY 2000 and FY 2001, both in percentage terms and in dollars, occurred in excise taxes related to the sales and operations of trucks. The retail tax on trucks, a 12 percent tax on the first retail sale of heavy trucks, buses, truck tractors, and trailers, was down 55.2 percent, a decline of more than $1.8 billion. Tax receipts from the tax on truck tires fell 22.5 percent, and truck use tax receipts fell 33.8 percent. The reductions in retail truck taxes were particularly large because this tax is levied as an ad valorem tax on the first retail sale. During the investment boom of 1998 and 1999, a large volume of new trucks were purchased at premium prices. As the economy weakened, large numbers of these slightly used trucks were placed on the market. This greatly depressed prices and sales in the new heavy truck market, and tax revenues from retail truck taxes declined accordingly.

How Receipts Get to the Highway Trust Fund

Motor fuel, which accounts for more than 90 percent of trust fund receipts, is taxed when it moves out of the bulk transportation and storage network and into tanker trucks at the terminal rack. At this point the fuel is taxed or dyed if it is diesel or kerosene intended for nontaxable purposes. The owner of the fuel as it passes the terminal rack, the registered position holder, is liable for payment of the tax.

Taxpayers with more than $2,500 in net excise tax liability are required to make semi-monthly estimated payments and typically rely on safe harbor rules in determining the amount to deposit. For example, safe harbor rules permit taxpayers to make deposits of 1/6th of their tax liability from the quarter two quarters prior to the current quarter. These deposits are typically made via the Electronic Federal Tax Payment System and are initially deposited in the Treasury's General Fund. At the time of these deposits, taxpayers are not required to itemize what excise taxes they are depositing; they simply indicate that it is for excise taxes. This deposit may be for any of approximately 50 different excise taxes. Even taxpayers that exclusively owe taxes on motor fuel are likely to have tax liability for a combination of gasoline, diesel, kerosene, gasohol and possibly various alternative fuels. These fuels are taxed at different rates and distributed in different proportions across four different accounts: the two accounts of the Highway Trust Fund, the Leaking Underground Storage Tank Trust Fund, and the General Fund.

In the absence of sufficient information from the taxpayer regarding the composition of excise tax deposits, tax receipts appropriated to the Highway Trust Fund are estimated as called for in Section 9601 of the Internal Revenue Code. Thus on a semimonthly basis the Office of Tax Analysis allocates incoming excise tax receipts based on historical liability shares as an estimate of the amounts appropriated to the Highway Trust Fund.

Taxpayers report their excise tax liability quarterly on Form 720, which is due one month following the close of the quarter. On the Form 720 taxpayers itemize their liability, for example reporting the number of gallons of each type of fuel and the tax due, and claims of nontaxable use of the fuel. Any balance due or overpayment is settled at the time the Form 720 is filed. Taxpayers report liability for the heavy vehicle use tax on Form 2290. For vehicles in use in July the return is due by August 31; otherwise it is due by the end of the month following the month the vehicle is first used. In general, payment must be paid in full with the return or in quarterly installments.

In conjunction with taxpayer payment records, the Internal Revenue Service (IRS) uses the Form 720 and Form 2290 returns to calculate the Highway Trust Fund Certification of taxes collected for the quarter. After processing the excise tax return the IRS compares the reported tax liability with the deposits received from each taxpayer. In cases where taxpayers have reported tax liability exceeding their deposits, deposits are allocated based on their prorated reported liability to assure that certified amounts equal tax collections. On the quarterly certification IRS reports the total prorated liability for the quarter. In order to allow time for late filing by taxpayers, amended returns, or adjustments from examinations, the certification is issued approximately four and a half months following the due date of the return. The certified amount is then compared to the amounts transferred as estimated. Reconciling adjustments are made to the trust fund accounts for any differences between the certified amounts and the amounts previously transferred.

In the past, the end of year financial statements for the Highway Trust Fund were not finalized until February, hence the final statements reflected three quarters of certified receipts and one quarter of estimates. The reconciling adjustment for the final quarter of the year would be reflected in the subsequent fiscal year. Beginning in FY 2002 Treasury will finalize the end of year financial statements in November, six weeks following the close of the fiscal year. As a result, beginning this year the end of year financial statements will reflect two quarters of actual receipts and two quarters of estimated receipts.

Forecast of Future Excise Tax Receipts

Looking forward, the Administration projects steady growth in highway-related excise tax receipts. Net receipts in FY 2003 are projected to be 6.2 percent higher than FY 2001 and 2.9 percent higher than FY 2002. Average annual growth is forecast to be more than 3 percent per year over the remainder of the budget period. The FY 2003 Budget forecasts a faster long-run growth in receipts than last year’s Budget; however, this faster rate of growth is relative to a smaller base, so the forecasted levels are lower than previously projected. In the current budget, the Administration forecasts net Highway Account excise tax receipts to be $28.57 billion in FY 2003.

During the first five years of the forecast period, gallons of gasoline and gasohol fuels are projected to grow at an average of 2.3 percent per year. The consumption of gasohol fuels grows faster than gasoline consumption due to the increasing reliance on ethanol as an oxygenate to meet clean air requirements. Because of the difference in the amount per gallon dedicated to the Highway Account, total gasoline and gasohol receipts grow at about 2 percent per year during the first five years of the forecast, which is slower than the rate of growth of fuel consumption.

While Gasoline and Diesel tax receipts are entirely dedicated to the Highway and Leaking Underground Storage Tank Trust Funds, some 2.5 cents per gallon of Gasohol receipts are retained in the General Fund. This general revenue from gasohol fuels is estimated to be almost $600 million in FY 2003 and, if the taxes were extended, almost $800 million in FY 2012. In addition, it is estimated that in FY 2003 approximately $1.1 billion in excise tax receipts will be forgone due to the excise tax exemption for ethanol fuels; in FY 2012 the excise tax exemption is estimated to reduce Highway Trust Fund receipts by $1.5 billion.[3]

The truck related excise tax receipts are projected to grow quickly as the economy recovers. For FY 2003 compared to FY 2001, receipts from the retail tax on trucks are projected to grow 22.1 percent and tire tax receipts are projected to grow by 10.6 percent. Between FY 2003 and FY 2002 receipts from the retail tax on trucks are projected to grow 15.6 percent and tire tax receipts are projected to grow 6.5 percent. This growth reflects the recovery of the heavy truck market and more generally increased investment in equipment. Due to continued weakness in the manufacturing sector of the economy, diesel fuel receipts are forecast to decline slightly between FY 2001 and FY 2002 before resuming growth averaging more than 3.5 percent per year.

In summary, the Administration's forecast of highway-related excise taxes reflects the most recent tax collection and liability data available, and the Administration's economic forecast. The data reflect the weakness in the economy during 2000 and 2001. The forecast for future years is based on the assumption that the economic downturn would end in early 2002 and a strong recovery would be underway later in the year.

Administrative and Compliance Difficulties with Highway Excise Taxes

Maintaining the flow of receipts into the Highway Trust Fund requires continuing efforts to secure better tax compliance. Over the last decade there have been three major compliance success stories. Moving the point of taxation for motor fuels to the terminal rack significantly reduced opportunities for tax evasion, some of it carried out on a multi-million dollar scale by sophisticated criminal organizations. Requiring diesel fuel, home heating oil and other diesel substitutes to be dyed red if sold tax-free eliminated another source of evasion. The third has

[3] This is an updated Tax Expenditure estimate reflecting the ethanol consumption in the current forecast. The Tax Expenditure estimate does not consider changes in the use of fuel that may accompany a change in tax policy. For further detail on Tax Expenditures, see Chapter 6 of the Analytical Perspectives volume of the Fiscal Year 2003 Budget.

been the taxation of undyed kerosene on the same basis as the regular diesel fuel with which it is often mixed.

Combating fuel tax evasion occurring outside the main distribution network is a continuing effort of the IRS in cooperation with State tax authorities. Untaxed kerosene intended to be used as aviation fuel, "transmix" taken out of pipelines, waste vegetable oils, used dry-cleaning fluids, and other chemicals may be mixed with diesel fuel and find their way into the fuel tanks of trucks on the road. New initiatives are under way to combat this form of evasion. One is a detailed, computerized information system developed in cooperation with the petroleum industry and the States that will allow all fuels to be tracked from the refinery gate all the way through the distribution system. Another is "fuel fingerprinting," a technique that tests samples taken from retail stations for adulteration or for a mismatch with samples taken from the terminal racks that normally supply those stations. These continuing efforts are supported in part by a small appropriation from the Highway Trust Fund of moneys used specifically for compliance efforts.

The annual use tax involves all owners of heavy highway vehicles and imposes significant compliance burdens on taxpayers, the IRS, and State agencies. Some vehicle owners evade full compliance by paying the first quarter's tax but not subsequent installments.

The retail truck tax is particularly difficult to administer and compliance is particularly difficult for truck dealers and others. A factual finding must be made to determine if the truck is "heavy," i.e., whether the truck chassis or trailer body is suitable for use with a vehicle that has a gross vehicle weight in excess of 33,000 pounds. The determination of whether a truck has been remanufactured (and is therefore subject to tax) or has been repaired can be involved and may be confusing to the taxpayer. In some cases the distinction between a highway vehicle and a vehicle intended for off-highway use is not clear. There are a number of exemptions for particular types of trucks and installed equipment that are a continuing source of controversy between taxpayers and the IRS.

The Treasury Department expects to announce proposals to both simplify and improve compliance with the excise taxes that support the Highway Trust Fund as part of its ongoing simplification project.

<u>Conclusion</u>

I appreciate this opportunity to describe revenue issued related to the Highway Trust Fund and present our current forecast to you.