TWO PERCENT LOSS & BAD DEBT ALLOWANCES AND LOST OR DESTROYED FUEL TAX CREDIT/REFUND

EVALUATION SUMMARY

JULY 2019
2019 -TE14

THESE EVALUATIONS WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

	TWO PERCENT LOSS ALLOWANCE	BAD DEBT ALLOWANCE	LOST OR DESTROYED FUEL TAX CREDIT/REFUND
YEAR ENACTED	1929	1969	1929
REPEAL/EXPIRATION DATE	None	None	None
REVENUE IMPACT	$13.1 Million TAX YEAR 2017	$3.2 million TAX YEAR 2017	$12,100 TAX YEARS 2011- 2017
NUMBER OF TAXPAYERS	About 200	About 200	8
AVERAGE TAXPAYER BENEFIT	$65,500	$16,000	$1,500
IS IT MEETING ITS PURPOSE?	Yes	Yes	Yes

WHAT DO THESE TAX EXPENDITURES DO?

The Two Percent Loss Allowance allows fuel distributors to reduce the amount of fuel on which taxes are due by 2 percent for the purposes of calculating the State's fuel excise tax.

The Bad Debt Allowance allows fuel distributors to retain 0.5 percent of all fuel excise taxes owed.

The Lost or Destroyed Fuel Tax Credit/Refund provides a credit or refund to distributors in the amount of any taxes paid on 100 gallons or more of fuel that is lost or destroyed before reaching the consumer.

WHAT DID THE EVALUATION FIND?

We determined that all three expenditures are meeting their purposes because distributors are claiming them.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the expenditures.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

According to statute, the purposes of the allowances were to:

- Two Percent Allowance—prevent distributors from paying taxes on fuel that is lost during transfer or transportation and never reaches the consumer and help offset distributors' costs associated with collecting and remitting fuel taxes.

- Bad Debt Allowance—recompense distributors for taxes that they paid, but for which payment was never received from the buyer and help offset distributors' costs associated with collecting and remitting fuel taxes.

- Lost or Destroyed Fuel Tax Credit/Refund—recompense distributors for taxes that they had paid on fuel that is lost or destroyed and never reaches the consumer.

TWO PERCENT LOSS & BAD DEBT ALLOWANCES AND LOST OR DESTROYED FUEL TAX CREDIT/REFUND

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers three fuel excise tax expenditures provided to fuel distributors: (1) Two Percent Loss Allowance [Section 39-27-102(1)(b)(I), C.R.S.], (2) Bad Debt Allowance [Section 39-27-105 (2), C.R.S.], and (3) Lost or Destroyed Fuel Tax Credit/Refund [Section 39-27-103(1), C.R.S.].

- **THE TWO PERCENT LOSS ALLOWANCE** was created in 1929. The original legislation provided "an allowance of two percent of the total amount [of fuel] received…shall be made and deducted by the distributor to cover his losses in transit and in unloading such motor fuel" [House Bill 29-529]. This provision allowed distributors to reduce the amount of fuel used to calculate taxes owed by 2 percent. Statute was amended in 1953 to further provide that the 2 percent allowance was to cover losses "and costs of collection and payment of this [fuel] tax to the state" [House Bill 53-436]. That bill also directed the distributor to share a portion of the allowance with retailers, stating "the distributor shall make to each retailer…an allowance of 1 [percent] of the amount of motor fuel delivered during each calendar month" [House Bill 53-436]. The current language in Section 39-27-102(1)(b)(I), C.R.S., is substantially the same.

- **THE BAD DEBT ALLOWANCE** was created in 1969 and provides that, when calculating the amount of fuel excise tax due to the State, distributors "shall deduct one-half of one percent to cover expenses of collection of the tax and bad debt losses." The current language in Section 39-27-105(2), C.R.S., is substantially the same. The Bad Debt Allowance can be taken concurrently with the Two Percent Loss Allowance for a combined allowance amount of 2.5 percent.

- **THE LOST OR DESTROYED FUEL TAX CREDIT/REFUND** was created in 1929 and provides a credit or refund to distributors and transporters for the "tax paid or accrued on gasoline or special fuel that is lost or destroyed by fire, lightning, flood, windstorm, explosion, accident, or other cause beyond the control of the distributor or transporter" [Section 39-27-103(1), C.R.S.]. The credit/refund only applies to lost or destroyed fuel of 100 gallons or more at any one time. The only significant change to the expenditure occurred in 2012, when legislation increased the amount of time that distributors and transporters have to file for the credit/refund from 7 days to 30 days from when the loss or destruction occurred. According to a statewide distributors' association, the amount of time that distributors or transporters have to file for the credit/refund was extended due to the other issues that they often have to deal with immediately following the type of event that would qualify for the expenditure, which could include loss-of-life and environmental clean-up.

Colorado first imposed an excise tax on motor fuel in 1919. In 1935, Article X, Section 18 of the Colorado Constitution was enacted, which requires that all excise taxes collected on motor fuel be used for the construction and maintenance of Colorado's highways. The fuel excise tax is assessed on the number of gallons of gasoline or special fuel acquired, sold, or offered for sale in Colorado for any purpose. Special fuel includes diesel engine fuel, kerosene, compressed natural gas, and liquefied natural gas [Section 39-27-101(29), C.R.S.]; statute specifically excludes liquefied petroleum gas as a special fuel for this purpose [Section 39-27-102(1)(a)(I)(A), C.R.S.].

The excise tax is paid by a distributor, and any of the distributors in the chain of distribution can pay the tax. However, statute provides that "no more than three tax-deferred transactions shall take place after the gasoline or special fuel has left the terminal of its origin" and "if more than three distributors acquire the gasoline or special fuel, the third distributor shall be liable for payment of the tax imposed" [Section 39-27-102(1)(a)(I)(A), C.R.S.]. Generally, the distributor who pays the tax will include it in the cost of the fuel sold to the next distributor in the distribution chain or to the retailer. Ultimately, the cost of the tax is included in the price of the fuel sold to consumers, as happens with most excise taxes.

EXHIBIT 1.1 shows the fuel excise tax rates for Calendar Year 2017. Overall, Colorado collected $630 million in fuel excise taxes in Fiscal Year 2017.

EXHIBIT 1.1.
EXCISE TAX RATES BY FUEL TYPE
CALENDAR YEAR 2017

FUEL TYPE	RATE PER GALLON
Gasoline	$ 0.22
Diesel and Kerosene	$ 0.205
Compressed Natural Gas	$ 0.12
Liquefied Natural Gas	$ 0.08

SOURCE: Office of the State Auditor analysis of Sections 39-27-102(1)(a)(II)(A) and (B), (VI)(D), (VII)(D), (VIII)(D), C.R.S.

Distributors file fuel taxes through the Department of Revenue's Colorado Fuel Tracking System (COFTS). The Distributor Tax Return and Schedules Workbook (Form DR 7050) guides taxpayers' entry of information related to the tax and includes two separate lines, one for the Two Percent Loss Allowance and one for the Bad Debt Allowance. To claim the Lost or Destroyed Fuel Tax Credit/Refund, the distributor must submit the Claim for Refund Form (Form DR 0137), as well as sufficient documentation to verify the loss or destruction (e.g., accident report, insurance claim, etc.).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly identify the intended beneficiaries of the tax expenditures. Based on our review of Colorado and other state statutes, and interviews with stakeholders, we inferred that the intended beneficiaries of the allowances and the credit/refund are fuel distributors in the state. According to the Department of Revenue, there are about 200 fuel distributors operating in Colorado.

In addition, since the cost of the fuel excise tax is generally included in the price consumers pay for fuel, we also inferred that consumers (i.e., people who buy fuel for their vehicles) indirectly benefit from the expenditures. According to Division of Motor Vehicle data, there were about 5 million registered vehicles in Colorado that operated on gasoline or special fuel in Calendar Year 2017.

WHAT ARE THE PURPOSES OF THE TAX EXPENDITURES?

Statutes and the Colorado Constitution provide the following purposes for these expenditures:

THE PURPOSE OF THE TWO PERCENT LOSS ALLOWANCE IS TO PREVENT DISTRIBUTORS FROM PAYING TAXES ON FUEL THAT IS LOST DURING TRANSFER OR TRANSPORTATION AND NEVER REACHES THE CONSUMER AND TO HELP OFFSET DISTRIBUTORS' COSTS ASSOCIATED WITH COLLECTING AND REMITTING FUEL TAXES. According to stakeholders, when fuel is transferred from the refinery to the truck for transit, there is "shrinkage" in the volume of fuel caused by changes in temperature. Shrinkage and loss also occur during the transfer of the fuel from trucks into the underground tanks at retailers. Generally, the State's fuel excise tax is intended to place part of the cost of building and maintaining the State's highways on highway users in the form of higher prices when distributors pass the excise taxes they pay on to highway users who purchase fuel. However, since lost fuel never reaches the consumer, it is not used on the highways and any excise taxes collected on it cannot be passed through to consumers, so the purpose of the excise tax no longer appears applicable. In addition, distributors incur costs to collect the tax since they must track and report to the State the amounts of fuel that they transfer.

THE PURPOSE OF THE BAD DEBT ALLOWANCE IS TO RECOMPENSE DISTRIBUTORS FOR TAXES THAT THEY PAID, BUT FOR WHICH PAYMENT WAS NEVER RECEIVED FROM THE BUYER, AND TO HELP OFFSET DISTRIBUTORS' COSTS ASSOCIATED WITH COLLECTING AND REMITTING FUEL TAXES. Similar to the Two Percent Loss Allowance, because the fuel excise tax is generally intended to be passed on to consumers, the Bad Debt Allowance offsets the taxes distributors pay that they could not effectively pass on to consumers because they never received payment, which would typically be due from another distributor or a retailer. In addition, distributors incur costs to collect the tax since they must track and report to the State the amounts of fuel that they transfer.

THE PURPOSE OF THE LOST OR DESTROYED FUEL TAX CREDIT/REFUND IS TO RECOMPENSE DISTRIBUTORS FOR TAXES THAT THEY HAD PAID ON FUEL THAT IS LOST OR DESTROYED AND NEVER REACHES THE CONSUMER. Like the Two Percent and Bad Debt Allowances, this expenditure also prevents distributors from paying tax on fuel that is not sold to consumers or used to operate vehicles on state highways.

These expenditures are common structural provisions in states that collect fuel taxes.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that these tax expenditures are accomplishing their purposes since distributors are claiming them when filing their taxes and when fuel is lost or destroyed. Statute does not provide quantifiable performance measures for these expenditures. Therefore, we created and applied the following performance measures to determine the extent to which these expenditures are meeting their purposes.

PERFORMANCE MEASURE #1: *To what extent are fuel distributors applying the Two Percent Loss and Bad Debt Allowances to offset the cost of fuel lost during transportation or transfer, bad debts, and collection costs?*

RESULT: Distributors claimed the Two Percent Loss Allowance for

$13.1 million and the Bad Debt Allowance for $3.2 million in Tax Year 2017. Although the Department of Revenue does not have data on how many distributors applied the allowances, stakeholders indicated that distributors are well aware of both expenditures and apply them. In addition, since the State collected about $630 million in fuel excise taxes in Fiscal Year 2017, the amounts claimed for the Two Percent Loss and Bad Debt Allowances represent 2 percent and 0.5 percent of the fuel excise taxes paid respectively, which is consistent with all or nearly all distributors applying the allowances.

Although both allowances are widely used, we did not identify a reliable source of information to quantify actual fuel losses, bad debt costs, or the costs to distributors for collecting the tax. Therefore, we were unable to assess whether the allowance amounts were aligned with the actual costs to distributors.

PERFORMANCE MEASURE #2: *Are distributors and transporters applying for a credit or refund on fuel that is lost or destroyed before reaching consumers and on which they had already paid the fuel excise tax?*

RESULT: According to a statewide distributors' association, distributors are aware of the Lost or Destroyed Fuel Credit/Refund and apply for it when they have 100 gallons or more of fuel lost or destroyed. However, it has been used infrequently. Since Tax Year 2011, eight distributors have claimed a credit/refund under this expenditure, for a total of about $12,100.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

According to Department of Revenue taxpayer data, for Tax Year 2017:

- The Two Percent Loss Allowance reduced state revenue by $13.1 million. The amount claimed under this allowance increased between Tax Years 2011 and 2017 from $11.5 million to $13.1 million, an increase of 14 percent. According to Department of Revenue data, there were approximately 200 distributors that filed fuel taxes in Tax Year 2018, assuming they all applied the allowance, which appears consistent with the Department of Revenue data on tax collections, we estimate that the average amount claimed per distributor would have been about $65,500.

- The Bad Debt Allowance reduced state revenue by $3.2 million in Tax Year 2017. Between Tax Years 2011 and 2017, the amount claimed under this allowance increased from $2.8 million to $3.2 million, an increase of 14 percent. Assuming all 200 distributors applied the allowance, we estimate that the average amount claimed per distributor was $16,000.

- The Lost or Destroyed Fuel Tax Credit/Refund reduced state revenue by $12,100 for Tax Years 2011 through 2017, and the eight distributors that claimed the credit/refund saved an equivalent amount.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If these tax expenditure were eliminated, distributors would have to pay the full amount of taxes due for all fuel purchased, regardless of whether the fuel is lost or destroyed before it reaches consumers. For the Two Percent Loss and Bad Debt Allowances, this would have meant that distributors would have paid $16.3 million more in fuel taxes in Tax Year 2017, or about $81,500 per distributor. Since the cost of excise taxes is typically passed on to consumers, then consumers would likely have also paid much of this additional cost in the form of higher fuel costs in Tax Year 2017. According to Division of Motor Vehicles data, during this same time, there were a total of about 5 million gasoline or special fuel powered vehicles registered in Colorado. These additional fuel costs would equate to $3.26 per registered vehicle.

If the Lost or Destroyed Fuel Tax Credit/Refund were eliminated, the eight distributors that claimed the credit/refund would have paid, in total, about $12,100 more in fuel taxes for Tax Years 2011 through 2017.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES OR THROUGH OTHER PROGRAMS?

According to a statewide distributors' association, these types of expenditures are common in many states, although the states vary in the benefit provided. We found that six states surrounding Colorado have allowances similar to these three expenditures, as shown in EXHIBIT 1.2.

EXHIBIT 1.2.
SURROUNDING STATES' FUEL TAX ALLOWANCES

STATE	LOSS AND/OR ADMINISTRATIVE COSTS	BAD DEBT	LOST OR DESTROYED
Kansas	3.5%	None	100 gallon threshold
Nebraska	5%—first $5,000 collected 2.5%—collections over $5,000	None	Claim cannot be less than $25
New Mexico	None	None	100 gallon threshold
Oklahoma	0.1%	Credit against the current amount due equal to the tax paid that is uncollectable	No threshold
Utah	2%	Refund for the portion of account relating to 4,500 gallons or more in a single transaction after it has been discharged in a bankruptcy proceeding	8,000 gallon threshold
Wyoming	1%	Credit for the amount that was unpaid	No threshold or limit

SOURCE: Office of the State Auditor analysis of other state statutes.

As shown, Colorado's 2.5 percent combined allowance for losses and bad debts is similar to surrounding states, although the other states' percentages ranged from 0.1 percent up to 5 percent. Furthermore, Colorado differs from surrounding states in that it provides for a standard allowance to offset taxes paid on bad debts, with all of the surrounding states either providing no allowance for bad debts, or basing the amount on the amount actually paid.

Additionally, the Internal Revenue Service (IRS) allows for a bad debt business deduction when filing income taxes, which may be taken in conjunction with the Bad Debt Allowance. According to IRS guidance, bad debts can be deducted from total gross income when calculating the amount of federal taxable income. Since Colorado taxable income is based on the taxpayer's federal taxable income, all taxpayers can take advantage of a similar allowance [Section 39-22-304, C.R.S.]. However, the IRS requires taxpayers to identify and quantify the amount of bad debt incurred, rather than providing a credit at a flat rate. Distributors can claim this deduction, which decreases their income tax liability.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

We did not identify any data constraints related to the Two Percent and Bad Debt Allowances or the Lost or Destroyed Fuel Tax Credit/Refund.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Two Percent and Bad Debt Allowances or the Lost or Destroyed Fuel Tax Credit/Refund.