**Presentation to the interim**

## Transportation Infrastructure Revenue Subcommittee

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# How New Mexico Major Fuel Taxes Work

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Good morning Mr. Chairman and members of the committee.

I understand my mission today is to explain how the New Mexico gasoline tax and special fuel excise tax work. That is a two-fold task. One part is to elucidate the mechanics of the tax itself, and its place in New Mexico's scheme for taxing fuels. The other part is the outline the industry's structure and how the tax interacts with that structure.

THE TAXES

Before focusing on the gasoline and special fuels taxes, let's look at the overall picture of how New Mexico taxes fuels. All flammable hydrocarbons used as fuel to propel vehicles on the public highways are taxed under one of these programs:

| | Cents/gallon |
|---|---|
| Alternative fuel tax: | |
| compressed natural gas | 13.3 |
| liquified natural gas | 20.6 |
| other alternative fuels | 12 |
| Special fuel excise tax on diesel, biodiesel, blended biodiesel & kerosene | 21 |
| Gasoline tax on all flammable hydrocarbons not taxed above | 17 |

In addition, the petroleum products loading fee applies to fuel subject to either gasoline tax or special fuel excise tax. The 'fee" ranges from 0.5 to 1.875 cents/gallon.

The general purpose of the gasoline, special fuel excise and alternative fuel taxes is to fund creation and maintenance of the public highways, although this is not actually stated in any of the tax acts. It is implicit in the design of the taxes. The definitions of both "gasoline" and "special fuel" include only fuel to be used to propel a motor vehicle on the public highways for transporting persons or property. Revenues from both taxes mainly flow to the State Road Fund, but significant chunks are earmarked for local governments and their projects and small slivers to the State Aviation Fund and Motorboat Fuel Tax Fund.

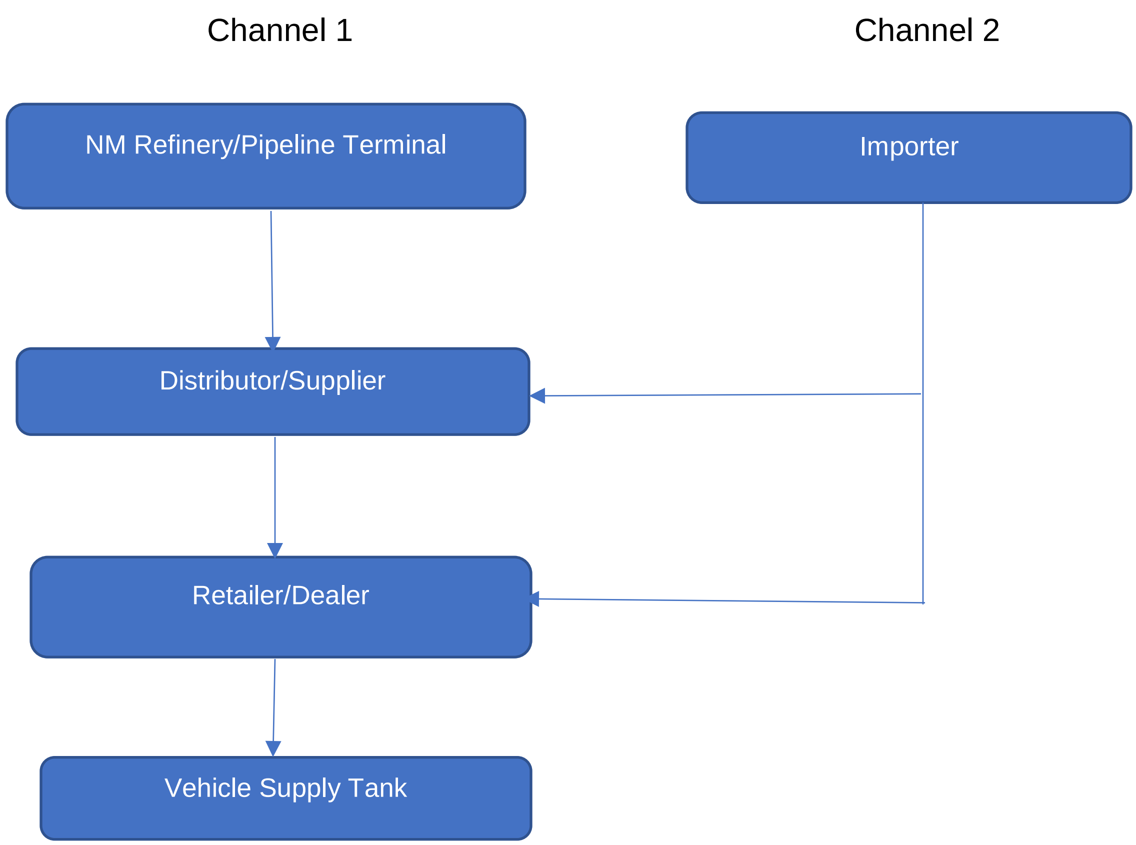
The alternative fuel tax is intended to encourage use of such fuels to increase the market for New Mexico natural gas and to cut emissions. Revenues from this tax flow to the State Road Fund. The petroleum product loading fee, in contrast to the other taxes, supports the Local Governments Road Fund and the Corrective Action Fund. The latter helps remediate leaks from fuel storage tanks.

STRUCTURE OF THE GASOLINE AND DIESEL INDUSTRIES

Knowing the structure of the gasoline and diesel industries is a key to following how these fuels are taxed today and what alternative taxation schemes might be possible.

Unsurprisingly, the structure of the system for producing, delivering and selling special fuels closely mirrors that for gasoline. The Gasoline Tax Act and Special Fuel Supplier Tax Act use different terms to describe essentially the same actors. For example, the intermediaries who pick up fuel at the refineries for sale and delivery to those businesses that sell and deliver the fuel into the fuel supply tanks of motor vehicles are named “distributors” in the Gasoline Tax Act and “suppliers” in the Special Fuels Supplier Tax Act.

There are two main channels by which fuel becomes available at the retail level.




Some businesses may perform at more than one of these levels. For example, an integrated producer may refine crude oil into gasoline and special fuels and distribute/supply those products to its own retailers/deakers as well as to others.

Channel 1--
The fuel (gasoline or diesel) first becomes commercially available in New Mexico primarily at in-state refineries and in-state pipeline terminals. In New Mexico, these are located at Bloomfield, Jamestown, Albuquerque, Moriarty and Artesia.

Generally, distributors (gasoline) and suppliers (special fuel) pick up fuel in tank trucks and other vehicles at the refinery's or terminal's rack for sale and delivery to the retailers (gasoline) and dealers (special fuel) with which they do business. Presently Taxation and Revenue Department lists about 240 such businesses. There may also be some intermediaries called wholesalers between the distributor/supplier and the retailer/dealer.

The retailers and dealers sell and deliver fuel into the fuel supply tanks of motor vehicles.

Channel 2--
Some fuel, particularly in the border areas, is trucked in from out-of-state refineries and pipeline terminals such as those in La Junta and Alamosa in Colorado and Abernathy, Amarillo, Big Spring and El Paso in Texas.

## Current scheme of taxation

I. Imposition of tax

Channel 1:
Gasoline and special fuel are taxed when the product is "received", a carefully defined term. Generally the refinery or pipeline terminal is subject to tax when product is first loaded at the refinery or pipeline terminal into tank trucks or other non-pipeline transportation equipment. But if the loading is for the account of a distributor/supplier (almost always the case), the obligation to report and pay the tax shifts to the distributor/supplier. Note that the taxable incident is the same whether the refiner/terminal or the distributor/supplier is the taxpayer.

Tax is due on the 25$^{th}$ of the month following the end of the month in which the taxpayer received the product. This date will be the same whether, on the one hand, the refinery or pipeline terminal receives the product or the distributor/supplier on the other.

Channel 2:
Persons who import product into New Mexico (other than in the supply tank of a vehicle or by pipeline) receive the product at the time of importation. If the product is delivered

to a distributor/supplier, however, the distributor/supplier receives the product at the time and place of importation.

Tax is due on the 25th of the month following the end of the month in which the taxpayer received the product.

Tax on users:
Special fuel users (mainly truckers), excluding the federal, state, local and tribal governments, are required to pay special fuel excise tax on the special fuel they consume in New Mexico. This is determined by dividing the taxpayer's miles driven in New Mexico by the taxpayer's average miles per gallon and multiplying the result by the tax rate. Procedures for determining amounts due from interstate trucking companies to each state and for paying the tax are governed by the Interstate Fuels Tax Agreement (IFTA), of which New Mexico has long been a member.

Tax is due on the last day of the month following the end of the calendar quarter. Special fuel users can credit against this tax due any amount of special fuel excise they paid at the pump during the quarter.

Blending:
When gasoline or special fuel is blended with another hydrocarbon—like gasoline with ethanol to form gasohol—somewhere other than a refinery or pipeline terminal, the gallons of the blended products are received at the time and place of blending by the owner of the blended product.

## II. What is not taxed[1]

What the gasoline tax excludes from taxation differs from what the special fuel excise tax excludes. The deductions are listed below.

| | Gasoline Tax | Spec Fuels Tax |
|---|---|---|
| Exports | ✓ | ✓ |
| Sales to United States | ✓ | ✓ |
| Sales to NATO nations | ✓ | ✓ |
| Sales to state of New Mexico | | ✓ |
| Sales to PED for school bus use | | ✓ |
| Sales to NM political subdivisions | | ✓ |
| Sales to Indian nation, tribe, pueblo | ✓ | ✓ |
| On-reservation/pueblo grant sales of tribally-taxed fuel | ✓ | |
| Sales by qual. registered Indian tribal distributor up to 2.5 mil gal/month | ✓ | |
| Sales of dyed fuel for off-road use | ✓ | ✓ |
| Imported fuel--tax already paid | ✓ | ✓ |
| Biodiesel fuel | | ✓ |

(a) The process of claiming a deduction can be cumbersome and paperwork-heavy. Take, for example, the deduction for selling gasoline to the federal government. This deduction can arise two general ways.

First, the distributor itself could sell gasoline to a federal agency. For example, distributor X sells and delivers loads of gasoline to storage tanks at a federal fueling facility for federal vehicles. The distributor must obtain and retain documentation that the sale was with a federal agency. If the delivery is made before the end of the month in which the distributor received the gasoline, well and good. If not, the gallons are deducted on the return for the period in which the delivery was made. It is far simpler for both the taxpayer and the tax agency to handle deductions this way than to require amendment of prior returns.

Second, sales to federal agencies by businesses further down the chain. Some of the gasoline the distributor sells to retailers could in turn be sold by them to the federal government as, for instance, into the fuel supply tank of a federal vehicle filling up at a retail station. It is frequently the case that the distributor at the time of filing its return has no notion of the number of such deduction-qualifying gallons that will be sold by

[1] **Under the Gasoline Tax Act and the Special Fuels Supplier Tax Act, provisions excusing gallons from tax are referred to as deductions. The Petroleum Products Loading Fee Act calls them exemptions. The PPL fee specifically exempts only exports and sales to the United States or NATO.**

retailers. The distributor is permitted to deduct these gallons whenever the distributor gets proper documentation from the retailer(s).

The same timing and paperwork flow issues exist for most of the other deductions.

(b) These gallonage taxes do not apply to gasoline or special fuel used off-highway. Fuel sold for such off-highway use is usually required to be dyed. Because these gallons are not subject to the gasoline or special fuel excise taxes, the gross receipts tax exemption at 7-9-26 NMSA 1978 does not apply. Receipts from such sales are subject to gross receipts or compensating tax.

(c) Tribal sovereignty and dual taxation
Since 1832, the United States has considered Indian tribes to be “domestic dependent nations”. Authority of states to impose their taxes on tribal territory is severely limited and generally is allowed only when Congress specifically authorizes the taxation.

If fuel is received on the territory of an Indian nation, tribe or pueblo, the state may not impose its fuel tax. This can happen if gasoline were to be trucked from an Arizona source directly to retailers on the Zuni pueblo grant or from an Arizona or Colorado source to the Navajo reservation. As it happens, all refineries and pipeline terminals in New Mexico are located off tribal territory. So under federal rules, New Mexico may impose its tax on fuel received at a refinery or pipeline terminal rack even if the retailer/dealer is located on tribal land.

Tribal governments also may impose their own fuels taxes and at least two do. This creates the possibility of dual taxation on fuels sold at retail on tribal territory. New Mexico’s gasoline tax resolves this in favor of the Indian government by allowing gasoline sold at retail on tribal territory to be deducted if the Indian government imposes a similar tax on the fuel. The deduction is on a sliding scale. It the tribal tax is at least as much as the state tax, the deduction is 100%.[2]

## ALTERNATIVE BASES

Just because fuel taxes are imposed mainly at the distributor/supplier level today does not mean that is the only way to levy and collect these taxes. There are other bases.

### I. Retail

The tax could be imposed on the retailer/dealer. If the same deductions were retained, deduction information would be substantially more contemporaneous. Administration of local option gasoline taxes, currently authorized at the retail level only, could dovetail

[2] As examples, the Navajo Nation imposes an 18 cents/gallon tax on gasoline; Acoma levies 17 cents/gallon. Gallonage subject to these taxes would be 100% deductible from the state tax.

with the state collection system, much like with gross receipts taxes. Revenue distributions to each local government from the state gasoline tax would be considerably less affected by events happening in other localities since the number of taxable gallons sold in each locality would be determined each tax period.

There are downsides. The administrative system would be more expensive since many more taxpayers would be involved. To protect state revenues, licensing and bonding of retailers would probably be necessary. Transition rules would be needed to account for gallons taxed under the current regime at the distributor/supplier level as those gallons flow through the distribution chain. Because the point of taxation is being moved downstream, the first year of implementation would see a decline in tax revenue collected. In general, this would the method with the most leakage.

II. “Rack”

The refineries and pipeline terminals would pay the taxes and pass the cost of the tax along either explicitly (mandatory disclosure of tax amount) or indirectly (as an element of the price). Essentially this could be much like the current system except that shifting of tax liability from the refinery/pipeline terminal to the distributor/supplier would be discontinued. This is the option with the least leakage.

Prices charged by the rack would increase by the amount of tax, perhaps creating a cash-flow burden for some distributors/suppliers. To the extent that distributors/suppliers presently enjoy float with respect to taxes due, this benefit would shift to the rack operators. Paperwork on deductions would need to flow one more step upstream.

III. Weight-distance

A more radical option is to impose a highway usage tax, like the weight-distance tax, on all vehicles. This could replace or supplement the fuels taxes. Fuels taxes suffer from two basic problems. One, fuel efficiencies are continuously rising. Two, more and more vehicles do not use such fuels or use them in combination with other sources of motive power. Electric and hybrid vehicles of the same weight, however, burden the roads just as much as hydrocarbon-fueled vehicles but pay considerably less in road-use taxes.

A major downside is that a new administrative mechanism would have to be put in place, one which reaches all non-commercial vehicles. The technology to do this effectively may or may not be available at reasonable cost.

Appendix -- Historical Notes

(1) Since the gasoline and diesel industries are structured similarly, why not just one "fuels" tax instead of separate taxes on each? I don't know that there is a good answer. Way back when, it was decided that enforcing fuels taxes should be split between two agencies—the Bureau of Revenue (which collected general revenues) was assigned the gasoline tax and the Motor Transportation Department (which regulated the trucking industry) the special fuels tax. Eventually, responsibility for both taxes wound up in the Taxation and Revenue Department, so this reason for the split disappeared. A more important is the difference in tax bases. Special fuel excise tax has two sets of taxpayers: the diesel fuel sellers in New Mexico and the truckers who are using diesel as they travel in New Mexico, whether or not they bought the fuel here. This difference remains but could be accommodated with a single "fuels" tax.

(2) In the 1980's the effort to clean up ground water-threatening fuel leaks (especially from abandoned underground storage tanks) created a demand for a source of revenue to provide state support. Since the political climate at the time would not permit simply raising the gasoline and special fuels taxes, a separate "fee" amounting to virtually the same thing was enacted instead. The amount of the fee varies with the fiscal year-end balance in the Corrective Action Fund. Later, when CAF balances appeared adequate, the basic "fee" of 0.5 cent/gallon was earmarked for the Local Government Roads Fund.

(3) In the 1990's, a dispute broke out concerning whether gasoline "received" by a distributor located on tribal land (whether or not a tribal business) was subject to the gasoline tax. The version of Section 7-13-2 NMSA 1978 in effect at the time contained a definition of "received" which provided that "when gasoline is shipped to a distributor, or for the account of a distributor, away from the refinery or pipeline terminal, it is "received" by the distributor where it is unloaded". That language allowed any distributor located on tribal territory to receive gasoline tax-free and to sell it anywhere also free of fuel tax. The Pueblos of Nambé and Santo Domingo built retail facilities on their pueblo grants to exploit the deductibility of gasoline shipped to them. When the law was re-written in 1999 to its current form, the tax advantage was converted to a deduction of up to 2.5 million gallons per month for registered distributors owned by these two pueblos. This has morphed subsequently into a tax revenue-sharing agreement between the State Transportation Department and the two pueblo governments.