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Report to The Congress on

The Taxation of Diesel Fuel Used in Noncommercial Motorboats



Department of the Treasury
June 1997

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The Taxation of Diesel Fuel Used in
Noncommercial Motorboats



Department of the Treasury
June 1997



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY

JUN 17 1997

The Honorable William V. Roth, Jr.
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Chairman Roth:

Section 1208 of Public Law 104-188, the Small Business Job Protection Act of 1996, provides that no tax is imposed on diesel fuel used in noncommercial motorboats during the period beginning on August 20, 1996, and ending on December 31, 1997. In accompanying committee reports, Congress requested that the Department of the Treasury study possible alternatives to the current collection regime for motorboat diesel fuel that will provide comparable compliance with the law, and report its findings to the House Committee on Ways and Means and the Senate Committee on Finance. Pursuant to that request, I hereby submit a report on the taxation of diesel fuel used in noncommercial motorboats.

I am sending a similar letter to Senator Moynihan.

Sincerely,

Donald C. Lubick
Acting Assistant Secretary
(Tax Policy)

Enclosure



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY

JUN 17 1997

The Honorable Bill Archer
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Archer:

Section 1208 of Public Law 104-188, the Small Business Job Protection Act of 1996, provides that no tax is imposed on diesel fuel used in noncommercial motorboats during the period beginning on August 20, 1996, and ending on December 31, 1997. In accompanying committee reports, Congress requested that the Department of the Treasury study possible alternatives to the current collection regime for motorboat diesel fuel that will provide comparable compliance with the law, and report its findings to the House Committee on Ways and Means and the Senate Committee on Finance. Pursuant to that request, I hereby submit a report on the taxation of diesel fuel used in noncommercial motorboats.

I am sending a similar letter to Mr. Rangel.

Sincerely,

Donald C. Lubick
Acting Assistant Secretary
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INTRODUCTION AND SUMMARY

The Internal Revenue Code has imposed a tax on diesel fuel used in noncommercial motorboats since 1994. Section 1208 of the Small Business Job Protection Act of 1996 (Pub. L. No. 104-188) provides, however, that this tax is not imposed during the period beginning on August 20, 1996, and ending on December 31, 1997. In accompanying committee reports, Congress requested that the Department of the Treasury study possible alternatives to the current collection regime for motorboat diesel fuel that will provide comparable compliance with the law, and report its findings to the House Committee on Ways and Means and the Senate Committee on Finance.

This report describes the current regime for collecting the tax on motorboat diesel fuel (i.e., the rules that applied before the enactment of the moratorium and that will apply after its expiration). Under these rules, the tax on diesel fuel used in recreational motorboats is collected at the terminal rack. Tax-free fuel is dyed at the terminal rack, and owners of recreational motorboats are penalized if they are found using dyed fuel.

The report also describes the concern that led to the imposition of the moratorium. This is the failure of some marinas to offer clear fuel, leading to shortages of diesel fuel for recreational motorboat use in some areas. Although the Department of the Treasury questioned this concern in the past and argued that the availability of clear fuel for recreational boaters was improving, the report recognizes that there is likely to be little further improvement. This is because marinas are unlikely to install the additional tankage necessary to provide clear fuel when, as described in the report, there is now substantial uncertainty over the permanence of current law.

The report concludes that the current collection regime is ineffective. In part, this is because tax is not imposed on diesel fuel sold for use in commercial vessels, and the decision to supply clear taxed fuel or dyed untaxed fuel is made by the retailer, generally based on the boatowner's representation. In addition, the potential revenue from the tax is very small. Thus, Internal Revenue Service (IRS) enforcement activities that might check the natural tendency of boatowners to claim that fuel is being purchased for commercial use and of retailers to accept those claims would not be cost effective. The report notes that, as a result of concerns over noncompliance under the current regime, the Department of the Treasury has reduced its estimate of receipts from the tax on motorboat diesel fuel from approximately \$50 million per year to approximately \$7 million per year.

The report also concludes that no other collection regime would be any more effective. The alternative collection regimes involve downstream collection of the tax, which has been tried before for both gasoline and diesel fuel. The Department of the Treasury's experience has been that collection at the terminal rack is more efficient and results in better compliance than any downstream collection regime.

The report offers two suggestions. As background for the first of these suggestions, the report describes the genesis of the tax on diesel fuel used in recreational motorboats to show that the tax is a replacement for the luxury tax on boats. The report then suggests that, in view of recent Congressional actions phasing down and repealing the luxury taxes, Congress may want to consider whether there is any continuing policy justification for a tax on motorboat diesel fuel. Finally, the report suggests a possible revenue offset for a repeal of the tax on motorboat diesel fuel: the restoration, at reduced levels and only for larger boats, of the Coast Guard user fee repealed in 1994.

BACKGROUND

Before the enactment of the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), diesel fuel used in motorboats was not subject to tax. OBRA '93 imposed a tax on noncommercial motorboat diesel fuel at a rate of 24.4 cents per gallon during the period beginning on January 1, 1994, and ending on December 31, 1999, and at a rate of 4.3 cents per gallon after December 31, 1999.¹ The tax did not apply, however, to fuel used in commercial fishing or transportation for compensation or hire, or (except in the case of boats used predominantly for entertainment, amusement, or recreation) to fuel used in any other business.

The reason given for the change was to eliminate the discrepancy between the treatment of gasoline used by motorboats, which has been taxable since 1965, and the treatment of diesel fuel used by similar motorboats. It should be noted, however, that there are many other discrepancies, which were not addressed by OBRA '93, between the treatment of gasoline and the treatment of diesel fuel.²

¹ A 24.3-cents-per-gallon tax is currently applicable to both highway and motorboat diesel fuel, but the tax is scheduled to fall to 4.3 cents per gallon after September 30, 1999 (for highway fuel) and after December 31, 1999 (for motorboat fuel). In addition, a 0.1-cent-per-gallon Leaking Underground Storage Tank (LUST) tax is imposed on motorboat diesel fuel until December 31, 1999 (the LUST tax on all other fuels expired on December 31, 1995). If these taxes were extended beyond December 31, 1999, without any further modification, the full 24.4-cents-per-gallon tax on motorboat diesel fuel would remain in effect during the period of the extension. The Administration is proposing in the National Economic Crossroads Transportation Efficiency Act of 1997 to extend the 24.3-cents-per-gallon tax on highway diesel fuel through September 30, 2005, but does not propose to apply this tax to motorboat diesel fuel after December 31, 1999. The Administration has also proposed in its FY 1998 budget to reinstate the LUST tax. Under the Administration's proposal, this tax would apply to motorboat diesel fuel during the reinstatement period. Thus, if the Administration's proposals were adopted, a 4.4-cents-per-gallon tax would be imposed on motorboat diesel fuel after December 31, 1999.

² In general, all gasoline, whether used on or off the highway, is subject to tax unless a specific exemption (such as for State and local government use, off-highway business use, or farm use) applies. Diesel fuel, however, is taxed only if it is used as fuel in a diesel-powered highway vehicle, a diesel-powered train, or a diesel-powered boat. Thus, gasoline used in an off-highway nonbusiness use is taxed, but diesel fuel (other than motorboat diesel fuel) is not taxed in similar circumstances. In addition, although the same specific exemptions from tax generally apply to both gasoline and diesel fuel, there are significant differences in the motorboat fuel exemptions: most business use of diesel fuel in motorboats is exempt, but motorboat gasoline is exempt only if used in commercial fishing or whaling. Receipts from the tax on motorboat gasoline and the tax on motorboat diesel fuel are also treated differently. Estimated receipts from the tax on motorboat gasoline, to the extent attributable to a rate of

Another consideration Congress apparently had in mind was the need to find an appropriate offset to the repeal of the luxury tax on boats. The Omnibus Budget Reconciliation Act of 1990 (OBRA '90) imposed an excise tax on the retail sale of passenger vehicles, boats, aircraft, jewelry, and furs.³ The tax was equal to 10 percent of the amount by which the sale price exceeded a specified threshold (\$100,000 in the case of boats). The taxes went into effect on January 1, 1991, and were scheduled to expire on December 31, 1999.

Almost immediately after the taxes went into effect, Congress began having second thoughts about the luxury tax on boats. On February 19, 1991, Mr. Shaw (R.-Fla.) introduced a bill to repeal the luxury tax on boats (H.R. 951, the Boating Industry Jobs Preservation Act of 1991). Before the end of 1991, the bill had 166 co-sponsors. Senator Breaux (D.-La.) introduced a corresponding bill in the Senate also with broad support. In 1992, provisions repealing the taxes on boats, airplanes, jewelry, and furs were included in H.R. 4210 and H.R. 11, as passed by Congress, but both bills were vetoed for unrelated reasons. However, in OBRA '93, the luxury taxes (other than the tax on automobiles) were successfully repealed, retroactively to January 1, 1993.

Support for repeal of the tax on boats was attributable to concerns that the tax was damaging the boat-building industry. Senator Chafee (R.-R.I.) expressed these concerns as follows:

[T]he boatbuilding industry has been devastated since the imposition of the luxury tax beginning in 1991. Certainly the recession has had an impact on the industry, but the ill-conceived luxury tax has also played a big role. Sales of boats subject to the excise tax . . . have dropped by 75 percent compared to 1990. This is far greater than the drop in sales that has occurred during similar economic downturns.⁴

The legislative history of OBRA '93 also cited job losses and increased unemployment in the boat, aircraft, jewelry, and fur industries during the 1990-91 recession and concluded that it was "appropriate to eliminate the burden these taxes impose in the interests of fostering economic recovery in those and related industries."⁵

14 cents per gallon, are transferred to the Aquatic Resources Trust fund. All receipts from the tax on motorboat diesel fuel are retained in the general fund.

³ Business use exceptions were provided for taxicabs, aircraft, and boats. The exception for boats exempted the same uses as are currently exempt from the tax on motorboat diesel fuel.

⁴ 138 CONG REC. S13,259 (1992).

⁵ STAFF OF HOUSE COMMITTEE ON WAYS AND MEANS, 103D CONG., 1ST SESS., FISCAL YEAR 1994 BUDGET RECONCILIATION RECOMMENDATIONS OF THE COMMITTEE ON WAYS AND MEANS 188 (Comm. Print 1993).

Although the legislative history does not explicitly link the imposition of the tax on motorboat diesel fuel with the repeal of the luxury tax, the simultaneous enactment of the two provisions does not appear to have been coincidental. The tax on motorboat diesel fuel was included in the luxury tax provisions (part V, subchapter A of the revenue provisions) of OBRA '93 and had been similarly linked to luxury tax repeal in H.R. 4210 and H.R. 11. Moreover, advocates of repeal had suggested as early as October 1991 that a tax on diesel fuel used by large pleasure boats had significant advantages over the luxury boat tax and would raise more than enough revenue to offset the revenue lost by repeal of the tax on boats.⁶ Press reports at the time similarly suggested that Congressional sponsors of repeal legislation were interested in using a tax on motorboat diesel fuel as a revenue offset for the repeal of the luxury tax on boats.⁷

⁶ Letter from Jim Burnley of Shaw, Pittman, Potts & Trowbridge to Kenneth W. Gideon, Assistant Secretary (Tax Policy) (October 18, 1991). The letter noted the following advantages:

Broadening of the diesel fuel tax will not distort the new and used boat markets as the boat excise tax has.

Thousands of U.S. boatbuilding jobs lost by imposition of the boat excise tax may be restored.

The same class of taxpayers Congress intended to tax (i.e., large pleasure boat users) would be taxed by broadening the diesel fuel tax in this way.

Because Congress has imposed excise taxes on fuels for decades, the system to administer the broadening of this tax is currently in place.

The net revenues generated by broadening the diesel fuel tax will be more predictable and steady than the net revenues raised, if any, by the boat excise tax.

Broadening of the diesel fuel tax to include large pleasure boats increases fairness by requiring the boats' owners to pay the same tax as struggling truckers.

⁷ *Shaw Interested in Expanding Diesel Tax To Offset Cost of Luxury Boat Tax Repeal*, Daily Tax Report, Nov. 7, 1991, at G-8, col. 1.

CONCERNS RELATING TO DYED FUEL REQUIREMENT

The diesel fuel tax is imposed on removal of the fuel from a registered terminal facility (i.e., at the "terminal rack"). Tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Department of the Treasury regulations. If fuel on which tax is paid at the terminal rack (i.e., undyed diesel fuel) is ultimately used in a nontaxable use, a refund is allowed. Depending on the aggregate amount of tax to be refunded, this refund may be claimed either by filing a claim for excise tax refund with the Internal Revenue Service or as a credit against income tax. Dyed diesel fuel (fuel on which no tax is paid) may not be used in a taxable use. A penalty equal to the greater of \$10 per gallon or \$1,000 is imposed on persons found to be using or selling dyed diesel fuel for a taxable use.

Under this statutory framework, noncommercial motorboats are not permitted to use dyed diesel fuel during periods in which the tax on motorboat diesel fuel is in effect. While many marinas carried only clear diesel fuel and others carried both dyed and clear fuel, some marinas carried only dyed fuel for their commercial customers due to limited tankage. This was reported to have resulted in shortages of diesel fuel for recreational boat use in some areas.⁸

Although it is generally possible for marinas to install an additional fuel tank so that both dyed and clear fuel can be offered, they are often reluctant to do so. This is primarily a function of the costs (including the regulatory costs) of installing an additional tank. In the early 1990's, the estimated costs of an additional 1,000 gallon tank varied from approximately \$5,000 for above-ground tanks to approximately \$15,000 for underground tanks.⁹

Other factors no doubt contributed to the reluctance of marinas to install additional tanks. The first is the possibility that the prohibition on the use of dyed fuel in recreational motorboats will not apply for periods after 1999. Under current statutory provisions, the tax on diesel fuel used in recreational motorboats will be reduced from 24.4 cents per gallon to 4.3 cents per gallon beginning on January 1, 2000. If the prohibition against the use of dyed fuel in those boats remains in effect (as current law provides), post-1999 recreational boaters will, nevertheless, be required to use clear fuel that has been taxed at a rate of 24.4 cents per gallon (assuming the taxes on fuel used in highway vehicles are extended beyond 1999). This would be an anomalous result because current law does not provide a procedure for refunding

⁸ *Hearing on Deficit Reduction Fuel Taxes and Diesel Dyeing Requirements Before the Senate Comm. on Finance*, 104th Cong., 1st Sess. (July 18, 1995) (statement of Michael Sciulla, Vice President, Boat Owners Association of the United States).

⁹ B. Lively-Diebold, W. Driscoll, P. Ameer, and S. Watson, *Storage of Oil Aboveground or Underground: Regulations, Costs, and Risks* 19 (paper 270 presented at the 1993 International Oil Spill Conference).

the 20.1-cents-per-gallon difference between the rate at which tax will be imposed at the terminal rack and the reduced tax rate that will apply to motorboat diesel fuel. Congress could be expected to address this anomaly when it extends the taxes on fuel used in highway vehicles either by providing a procedure for refunding the excess tax on diesel fuel used in motorboats or by allowing recreational motorboats to use dyed fuel and imposing the 4.3-cents-per-gallon tax on motorboat diesel fuel at the retail level.¹⁰ When confronted with a similar choice in OBRA '93 with respect to diesel fuel used in trains and intercity buses,¹¹ Congress permitted the use of dyed fuel and provided for collection of tax at the retail level. In light of this background, marina operators may well have concluded that the prohibition on the use of dyed diesel fuel in recreational motorboats will likely be repealed for periods after 1999.

In addition, uncertainty over whether the prohibition on the use of dyed fuel would continue even through 1999 may have contributed to the reluctance of marina operators to incur the additional costs of installing the new fuel tanks to serve their pleasure boat customers. This uncertainty was the result of various initiatives to curtail the dyeing requirement for motorboat diesel fuel. For example, S. 2029, introduced on April 19, 1994 (less than four months after the dyeing requirements went into effect), would have allowed all motorboats to use dyed diesel fuel. Later that year, H.R. 4539, the Treasury/Postal appropriations bill, was amended on the Senate floor to prohibit the IRS from using any funds to enforce the dyeing requirement.¹² The following year, Congress passed H.R. 2491, which would have exempted motorboat diesel fuel from tax for an 18-month period, but the bill was vetoed for unrelated reasons. Subsequently, as noted above, the Small Business Job Protection Act imposed a somewhat shorter moratorium.

During the period in which Congress considered these various relief measures, the Department of the Treasury questioned the need for relief and opposed proposals to modify

¹⁰ Alternatively, Congress could, of course, extend the 24.4-cents-per-gallon tax on diesel fuel used in motorboats or simply let the anomaly stand (which, for all practical purposes, would have the same effect as an extension).

¹¹ Under OBRA '93, diesel fuel used in trains was taxed at the following rates: 6.3 cents per gallon from October 1, 1993, through September 30, 1995; 5.55 cents per gallon from October 1, 1995, through September 30, 1999; and 4.3 cents per gallon after September 30, 1999. Diesel fuel used in intercity buses was taxed at a rate of 7.3 cents per gallon through September 30, 1999, and 4.3 cents per gallon thereafter. The LUST tax (0.1 cent per gallon) was also imposed through December 31, 1995.

¹² The Senate amendment was not enacted. The House concluded that the amendment infringed the privileges of the House with respect to tax legislation and returned the bill to the Senate. House Resolution 479 (140 CONG. REC. H5,740 (1994)).

the tax on motorboat diesel fuel.¹³ The Department of the Treasury questioned whether shortages of undyed motorboat diesel fuel were widespread and affected a substantial percentage of recreational boaters. Anecdotal evidence, which was all that was available on either side of this issue, suggested that many marinas had incurred the expense of adding a separate tank for clear taxed fuel in order to serve both recreational and commercial boaters. In addition, during 1994 and 1995, the Department of the Treasury conducted telephone surveys of marinas in various areas. In general, the surveys found that clear diesel fuel was readily available in areas where recreational boating is popular, and that availability improved significantly between 1994 and 1995. Moreover, clear fuel availability had improved even in areas, such as the Gulf Coast of Louisiana, where commercial boating predominates and retailers are least likely to accommodate recreational users. Based on these surveys, the Department of the Treasury concluded that the availability of clear diesel fuel was likely to continue improving as the market adjusted to the new tax rules.

The Department of the Treasury is, however, concerned about the effect the moratorium has had. It is unlikely that marinas will install additional tankage for clear diesel fuel during the period the moratorium is in effect. Moreover, even after the expiration of the moratorium, the tax on motorboat diesel fuel will remain in effect at the 24.4-cents-per-gallon rate for only two more years. The limited duration of the full tax, coupled with the fact that Congress has clearly indicated, in the legislative history accompanying the enactment of the moratorium, its desire to change the system of taxing motorboat diesel fuel, provides very little incentive to incur any significant expense to accommodate the needs of recreational boaters under the current system. Accordingly, the Department of the Treasury now expects little additional improvement in the availability of clear diesel fuel for recreational boaters.

¹³ See, e.g., *Hearing on Miscellaneous Tax Proposals Before the House Comm. on Ways and Means*, 104th Cong., 1st Sess. (July 11-13, 1995) (written statement of Leslie B. Samuels, Assistant Secretary (Tax Policy)).

OTHER CONCERNS RELATING TO TAX ON MOTORBOAT DIESEL FUEL

The Department of the Treasury is also concerned that the difficulty of ensuring compliance with the tax on motorboat diesel fuel will encourage widespread evasion.

It is very difficult to devise a system that will ensure a reasonable degree of compliance with a tax as narrowly focused as the current tax on motorboat diesel fuel. The diesel dyeing requirement has been very effective in improving compliance with the tax on diesel fuel used in highway vehicles. The Department of the Treasury estimates that in calendar year 1994, the first year in which tax was collected at the terminal rack and the diesel dyeing requirement was in effect, improved compliance resulted in a \$600-\$700 million increase in diesel fuel tax receipts (net of refunds) over the preceding calendar year. The tax on diesel fuel used in highway vehicles is, however, much broader than the tax on motorboat diesel fuel. The tax generally applies to all diesel fuel used on the highway, with very limited exceptions such as for State and local government use. The key to the effectiveness of the diesel dyeing requirement is that the tax applies to both business and nonbusiness use on the highway. Because diesel fuel delivered into a highway vehicle is almost always taxable, retailers can easily determine when it is inappropriate to sell dyed fuel to a customer. Similarly, roadside inspections can easily establish when dyed fuel is being used for taxable purposes.

The situation is very different for motorboat diesel fuel because motorboat diesel fuel used in commercial fishing or in other businesses is generally not subject to tax. Thus, a retailer of motorboat diesel fuel must determine whether the boat into which the fuel is delivered is a commercial vessel or a pleasure craft. This is often not readily apparent, particularly since the same vessel can be used alternately in the owner's business as a tour boat or chartered fishing vessel and for the owner's personal recreation. If it is not readily apparent whether a boat is commercial or recreational, marina operators are likely to accept the boatowner's representation that the boat is a commercial vessel. Even if the marina operator requires substantiation, it is often easy to satisfy the requirement because commercial fishing and other business licenses are readily available and can be obtained at a nominal cost in many jurisdictions. While the situation might be alleviated by a comprehensive registration and certification program for business users, even this would not satisfactorily address the problem of dual-use vessels. In any event, the relatively small amount of potential revenue from the tax on motorboat diesel fuel would not justify the cost of administering such a program.

The small amount of potential receipts from the tax on motorboat diesel fuel (approximately \$50 million per year assuming full compliance) effectively limits the resources that can be dedicated to enforcement of the tax. By way of comparison, total receipts from taxes on highway motor fuel were approximately \$25 billion in fiscal year 1996, and the IRS devoted approximately 300 staff years to enforcement of those taxes (i.e., one staff year for each \$83 million of receipts). At the same ratio of staff years to receipts, the resources available to enforce the tax on motorboat diesel fuel would be limited to one part-time IRS employee.

The tax will become even more difficult to administer after 1999 when the tax rate drops to 4.3 cents per gallon. The rate reduction will not alleviate the compliance problems described above (other than by reducing the revenue loss attributable to noncompliance). It is, however, likely to result in large numbers of refund claims from boatowners who, assuming Congress extends the taxes on fuel used in highway vehicles and provides a refund procedure for boatowners, will be eligible for a 20.1-cents-per-gallon refund when they purchase clear fuel on which tax has been imposed at a 24.4-cents-per-gallon rate.

Finally, the Department of the Treasury is concerned that taxes targeted at boat owners may not serve any continuing Congressional purpose. It is difficult to determine whether this is the case, in large part because Congress has never clearly explained why boat owners have been targeted. As noted above, the reason given for imposing the tax on motorboat diesel fuel was the discrepancy between the treatment of gasoline and diesel fuel. This, of course, does not explain why taxes should be targeted at boat owners in the first instance.¹⁴ The legislative history of the luxury tax might be expected to provide some guidance on this issue. To the extent the tax on motorboat diesel fuel is a substitute for the luxury tax on boats, the same purposes may underlie both taxes. Thus, any reasons given for targeting boat owners under the luxury tax might also explain the purpose of the tax on motorboat diesel fuel. However, the legislative history of OBRA '90 says only that "it is appropriate to impose an excise tax on certain luxury goods."¹⁵

Whatever the reasons for targeting boatowners and other owners of luxury goods, it is apparent that Congress no longer finds those reasons as compelling as in 1990 or even in 1993. In 1993, the luxury taxes on boats, airplanes, jewelry, and furs were all repealed. In addition, the Small Business Job Protection Act of 1996 provided for a phasedown, beginning in 1996, of the only remaining luxury tax (that on automobiles), with complete repeal of that tax after 2002. Thus, it may be appropriate for Congress to consider whether there is a continuing policy justification for retaining the tax on motorboat diesel fuel as a last vestige of the OBRA '90 luxury taxes.

¹⁴ In fact, the Energy Tax Act of 1978 eliminated the provision allowing refunds of tax on gasoline used in motorboats and in other nonbusiness, off-highway uses in part because the refund procedures resulted in additional complexity and because relatively few taxpayers found it worthwhile to take advantage of those procedures. S. REP. NO. 529, 95th Cong., 1st Sess. 49 (1977). Paradoxically, extending the tax to motorboat fuel, which ameliorated administrative concerns in the context of the gasoline tax, has had the opposite effect in the case of diesel fuel.

¹⁵ H.R. REP. NO. 881, 101st Cong., 2d Sess. 289 (1990).

ESTIMATED RECEIPTS UNDER CURRENT SYSTEM

The compliance problems discovered in the course of this study have caused the Department of the Treasury to revise substantially its estimate of the expected receipts from the tax on motorboat diesel fuel. Before the study, the Department of the Treasury estimated that, at a rate of 24.4 cents per gallon, current services baseline receipts from the tax on motorboat diesel fuel would be approximately \$50 million per year. The following table shows the Department of the Treasury's most recent (March 1997) estimate of current services baseline receipts from the tax:¹⁶

| Fiscal year | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 1998- 2002 | 1998- 2007 |
|---------------------------|------|------|------|------|------|------|------|------|------|------|---------------|---------------|
| Receipts (\$ millions) | 7 | 7 | 3 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 19 | 26 |

The amounts in the table represent gross receipts from the tax. If the tax were repealed, revenue losses would be approximately 25 percent lower to reflect the effects of the income tax offset.¹⁷

¹⁶ The table reflects the scheduled reduction of the tax to 4.3 cents per gallon for periods after December 31, 1999.

¹⁷ The income tax offset is the result of the revenue estimating assumption of a constant gross national product (GNP). The assumption of a constant GNP means that income in the economy must decline by the amount of the excise tax. This reduction in income will lower income-related tax receipts by approximately 25 percent.

ALTERNATIVES TO CURRENT SYSTEM

While, as noted above, the current system for taxing motorboat diesel fuel leaves much to be desired, the current regime for collecting the tax is the most efficient of the available alternatives. The principal alternative to the current regime is a retail level tax on dyed diesel fuel sold to recreational boaters. Adoption of this alternative would ignore the lessons of our experience in administering taxes on motor fuel.

Before 1988, the tax on diesel fuel was generally imposed and collected at the retail level. In the Omnibus Budget Reconciliation Act of 1987 the point of imposition was moved upstream to the wholesale level. The legislative history includes the following reasons for change:

Imposing these taxes at an earlier stage in the marketing of these fuels would reduce opportunities for evading payment of the fuels taxes. Collection of excise taxes at the point in the distribution chain with a smaller number of taxpayers provides for more efficient administration of the tax since there are fewer taxpayers for the Internal Revenue Service to monitor.¹⁸

OBRA '93 moved the point of imposition further upstream to the terminal rack. The reasons for change in the legislative history indicate Congressional concern that there might be substantial levels of diesel fuel tax evasion under the rules enacted in 1987. The legislative history adds:

Advancing the collection point of the diesel fuel taxes reduces the number of times the fuel changes ownership prior to tax, and reduces the number of taxpayers. As a result, the diesel fuel taxes should be easier to collect and payments of tax should be easier to monitor.¹⁹

The collection point for the tax on gasoline had previously been moved to the terminal rack by the Tax Reform Act of 1986 for similar reasons.

Experience with the enforcement of motor fuels excise taxes collected at various levels (retail, wholesale, and terminal rack) clearly establishes that collection at the terminal rack is the most effective and efficient method. As noted above, in the first year after the collection point was moved to the terminal rack and the dyeing requirement was imposed, improved compliance resulted in a \$600-\$700 million increase in diesel fuel tax receipts. Based on this experience,

¹⁸ H.R. REP. NO. 391, 100th Cong., 1st Sess. 1121 (1987).

¹⁹ STAFF OF HOUSE COMMITTEE ON WAYS AND MEANS, 103D CONG., 1ST SESS., FISCAL YEAR 1994 BUDGET RECONCILIATION RECOMMENDATIONS OF THE COMMITTEE ON WAYS AND MEANS 311 (Comm. Print 1993).

the Department of the Treasury concludes that any collection regime for motorboat diesel fuel in which the tax is collected at the wholesale or retail level would not provide comparable compliance with the law unless substantial additional resources were diverted to collection of the tax. The additional enforcement activities necessary to provide comparable compliance would result in an inefficient allocation of limited IRS resources and lead to far greater revenue losses in other areas.

A possible alternative to the tax on motorboat diesel fuel is restoration of the boat user fee previously deposited in the general fund of the Treasury as offsetting receipts for Coast Guard activities. The boat user fee was imposed under Coast Guard regulations implementing an OBRA '90 provision directing the Secretary of Transportation to establish a fee schedule for recreational vessels. The fee applied, beginning in August 1991, to any recreational vessel greater than 16 feet in length. The amount of the fee ranged from \$25 per year for vessels of less than 20 feet to \$100 per year for vessels of 40 feet or more. The fee was repealed by the Driftnet Enforcement Act (P.L. 102-582) for periods after September 30, 1994.

The Department of the Treasury understands that the boat user fee was repealed not because of difficulties in administering the fee system but because boatowners considered the fee levels onerous. The fee structure necessary to replace the revenue loss from repeal of the motorboat diesel fuel tax would, however, be significantly less burdensome than the fees imposed under OBRA '90. Fees could be set at lower levels than the \$25-to-\$100 range authorized by OBRA '90, and exemptions could be provided for larger boats than under the Coast Guard regulations and for boats without diesel engines. For fiscal years after FY 2000, exemptions could be provided for all but the very largest boats. It is likely that boatowners would consider such a fee structure, when coupled with relief from the motorboat diesel fuel tax, much less onerous than the boat user fees imposed under OBRA '90.

Department of the Treasury
Washington, D.C. 20220

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