✦ Other State Taxes

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✦ OTHER STATE TAXES—OVERVIEW

The remaining state tax expenditure programs (TEPs), detailed in the following section, involve state excise taxes (alcoholic beverage taxes, cigarette and tobacco taxes, and various fuel taxes) and the insurance tax. The responsibility for administration of these tax programs lies with the Board of Equalization (BOE) and the Department of Insurance, respectively. Revenues collected from these tax sources may be distributed, depending on the tax, to the state General Fund, designated special funds, or both. (For example, cigarette and tobacco taxes provide revenues to the General Fund *and* three special funds.) Thus, the TEPs that apply to these revenue sources affect revenues that fund a variety of programs. The following provides a brief description of other state taxes.

ALCOHOLIC BEVERAGE TAXES

Current state law levies excise taxes on the sale of alcoholic beverages by manufacturers, distillers, wine growers, certain wholesalers, purifiers, and importers. The point of taxation varies depending upon the alcoholic beverage sold. For example, distilled spirits are taxed when the product is sold by the wholesaler to the retailer; however, taxes on imported beer and wine may occur when these products are first brought into the state. Depending upon market structure, these taxes may be fully or partially passed through to the final consumer in the form of higher prices (the same is true for the other excise taxes discussed below). The state's sales and use tax is applied "on top" of the excise tax.

Alcoholic beverages are taxed by the gallon and state excise tax rates vary by beverage type. The current tax rates are: 20 cents per gallon for beer, hard cider, and most wines; 30 cents per gallon for champagne or sparkling wine; $3.30 per gallon for distilled spirits that are 100 proof or less; and $6.60 per gallon for distilled spirits over 100 proof. All revenues collected from alcoholic beverage taxes go into the state's General Fund.

In addition to state excise taxes, the federal government levies its own excise taxes on alcoholic beverages.

CIGARETTE AND TOBACCO TAXES

Current state law levies a tax on distributors for the sale of cigarettes and other tobacco products. As with alcoholic beverage taxes, the state sales and use tax is applied "on top" of the excise tax.

The current state excise tax rate on cigarettes is 87 cents per pack. Of this amount:

- 25 cents is deposited into the Cigarette and Tobacco Products Surtax Fund as required by Proposition 99, which was approved by the voters in November 1988. Revenues from this fund are used for education, natural resources, health services, and research in the areas of tobacco use and tobacco-related diseases.
- 10 cents is deposited into the state General Fund.

- 2 cents is deposited into the Breast Cancer Fund and used for research and administration of programs in this area.
- 50 cents is deposited into the California Children and Families First Trust Fund as required by Proposition 10, which was approved by the voters in November 1998. Revenues from this fund are used for early childhood development, and health education and research programs, primarily at the local level.

Tax rates on other tobacco products such as loose tobacco, cigars, and snuff are adjusted by the BOE each year so that the tax levied is in the same proportion to the wholesale price of these products as the 87-cents-per pack tax levied on cigarette products is of their wholesale price. An additional tax, equivalent to 50 cents per pack, will be levied on these other tobacco products beginning July 1, 1999. Revenues collected from the tax on such other tobacco products are distributed to the Cigarette and Tobacco Products Surtax Fund and the California Children and Families First Trust Fund.

In addition to state excise taxes, the federal government also levies an excise tax on cigarette and tobacco products.

FUEL TAXES

Current law imposes three major categories of fuel taxes: the Motor Vehicle Fuel License Tax (referenced herein as the "Motor Vehicle Fuel Tax"), the Diesel Fuel Tax, and the Use Fuel Tax. Revenues collected from all fuel taxes are deposited into the State Transportation Fund. These revenues provide the state and its localities with a major source of funding for maintaining, replacing, and constructing highways, streets, and other transportation facilities. The following provides a brief description of each type of state tax levied.

Motor Vehicle Fuel Tax. Current state law imposes a tax on distributors for the sale of motor vehicle fuel including gasoline, aviation gasoline, and certain blended gasolines for vehicular use on public streets and highways. The tax does not apply to fuel used for racing motor vehicles at a race track, diesel fuel, liquified petroleum gas, kerosene, methanol, ethanol, or natural gas. The state sales and use tax is applied "on top" of the excise tax.

The current state excise tax is 18 cents per gallon of gasoline, excluding aircraft jet fuel (which is taxed at 2 cents per gallon). As specified in the reviews that follow, certain air common carriers, aircraft manufacturers and repairers, and the U.S. Armed Forces are exempt from the tax on jet fuel.

Diesel Fuel Tax. Current state law imposes a tax on distributors at the wholesale level for the sale of diesel fuel and blended diesel fuel sold for use in propelling vehicles on public streets and highways. Unlike most other state excise taxes, this excise tax is *not* included as part of the base for calculating the sales and use tax.

The current state excise tax is 18 cents per gallon. Prior to July 1, 1995, this tax was collected under the use fuel tax, at which time the diesel fuel tax was established as a separate tax under the California Revenue and Taxation Code. Under the diesel fuel tax, the imposition of the tax was shifted to the first point of distribution (the "rack"), partly in order to ensure greater tax compliance.

Use Fuel Tax. Current state law levies a tax on the sale of alternative fuels such as liquified petroleum gas (LPG), liquified natural gas (LNG), compressed natural gas (CNG), alcohol fuels (ethanol or methanol), and kerosene. These alternative fuels remain untaxed until they are dispensed into a motor vehicle that is operated on California highways, or that is suitable for highway operation.

The current state excise tax rates are 18 cents per gallon for kerosene, 6 cents per gallon for LNG, 7 cents per cubic foot for CNG, 9 cents per gallon for alcohol fuels, and 6 cents per gallon for LPG. As with the diesel fuel tax, this excise tax is *not* included as part of the base for calculating the sales and use tax. An alternative flat tax based on the weight of the vehicle is available for LPG, LNG, and CNG consumers. This rate ranges from $36 for passenger cars to $168 for larger vehicles.

Other Fuel Taxes. A special fuel tax rate of 1 cent per gallon is levied on fuel used by local transit systems, school and community college districts, and certain common carriers. This special tax is in lieu of the other fuel taxes described above.

In addition to the state fuel taxes, the federal government levies an excise tax on fuel products sold.

INSURANCE TAX

In general, insurers conducting business in California are subject to a tax on their gross premiums written in the previous year, less "return" premiums and dividends. ("Return" premiums are refunds paid to policyholders that cancel their policy before its expiration date.) Certain types of insurers and plans, such as title insurers and ocean marine insurers, are taxed slightly differently. Insurers are subject to the gross premiums tax in lieu of all other taxes except real property taxes and business license fees. The basic gross premiums tax rate is 2.35 percent.

In addition, out-of-state insurers operating in California may be subject to an additional "retaliatory tax." This occurs if the effective tax rate imposed by their home state on California insurance companies operating in that state is higher than the tax rate imposed in California on these out-of-state insurers.

There is no comparable gross premiums tax at the federal level. Instead, insurance companies are typically subject to federal corporate income taxation.

Exclusion/Exemption:

ALCOHOL USED IN TRADES, PROFESSIONS, AND INDUSTRIES

Program Characteristics

Tax Type:	Alcoholic Beverage Tax.
Authorization:	California Revenue and Taxation Code Section 32052.

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the alcoholic beverage tax the sale of alcohol, distilled spirits, or wine used in trades, professions, or industry applications. Such uses typically include cases where alcohol is used as part of a production or treatment process of some sort, such as in pickling processes or the production of gasohol. To qualify, the sale must be made by a licensed distilled spirit manufacturer, brandy manufacturer, rectifier, industrial alcohol dealer, or wine grape grower.

RATIONALE

This program provides tax relief to the purchasers of exempted items, to the extent that excise taxes levied on them ordinarily would be incorporated into the price of the product. The underlying rationale for the program is the view that the alcoholic beverage tax is intended to be a tax on alcohol only when it is consumed as a beverage, and that other uses of alcohol should not generally be subject to the tax.

Exclusion/Exemption:

BEER CONSUMED BY BREWERS' EMPLOYEES

Program Characteristics	
Tax Type:	Alcoholic Beverage Tax.
Authorization:	California Revenue and Taxation Code Section 32172.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	**Amount**
1996-97	Minor
1997-98	Minor
1998-99	Minor

DESCRIPTION

This program exempts from the alcoholic beverage tax the consumption of beer, when the beer is (1) consumed by the employees of a brewer, and (2) consumed on the premises of the brewer.

RATIONALE

This program provides tax relief to brewers by relieving them of paying taxes on the beer which their employees consume in-house. The underlying rationale for the program appears related to the administrative problems involved with documenting and measuring the volume of in-house beer consumption.

COMMENTS

The Board of Equalization's Regulation 2551 limits the amount of this exemption to the maximum amount allowed by federal alcoholic beverage tax regulations.

Exclusion/Exemption:

DISTILLED SPIRITS USED IN THE MANUFACTURE OF FOOD PRODUCTS

Program Characteristics	
Tax Type:	*Alcoholic Beverage Tax.*
Authorization:	*California Revenue and Taxation Code Section 32214.*

Estimated Revenue Reduction (In Millions)	
Fiscal Year	***Amount***
1996-97	*NA*
1997-98	*NA*
1998-99	*NA*

DESCRIPTION

This program effectively exempts from alcoholic beverage taxation the sale of distilled spirits that are used in the manufacture of food products. Mechanically, it accomplishes this by providing a tax credit equal to the amount of any alcoholic beverage excise taxes paid.

RATIONALE

This program provides tax relief to producers and consumers of food products that incorporate the use of distilled spirits in the manufacturing process. In the absence of the program, excise taxes levied on such distilled spirits ordinarily would be incorporated into the prices of the food products themselves. The underlying rationale for the program is the view that the alcoholic beverage tax is intended to be a tax on alcohol only when it is consumed as a beverage, and that other uses of alcohol should not generally be subject to the tax.

COMMENTS

Some foods use brandy, rum, or other distilled spirits as a flavoring, and little or no alcohol remains in the food after baking or other processing activities. Alcohol also is used as the base for a variety of flavoring extracts. This program specifies that the manufacturer's use of alcohol in food must conform to certain federal regulations.

The tax credit mechanism is used as the means for providing the exemption, as opposed to an outright direct exemption *per se*, due to its relative administrative simplicity.

Exclusion/Exemption:

DISTILLED SPIRITS USED FOR RESEARCH AND MEDICAL-RELATED PURPOSES

Program Characteristics	
Tax Type:	*Alcoholic Beverage Tax.*
Authorization:	*California Revenue and Taxation Code Section 32053.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the alcoholic beverage tax the sale of (1) ethyl alcohol used for scientific research or by any hospital or sanitarium, and (2) alcohol used in medicinal, pharmaceutical, antiseptic, or selected other products. To qualify, packages of distilled spirits must be sold in amounts greater than one gallon.

RATIONALE

This program provides tax relief to the users of alcohol for the above-exempted purposes, including the consumers of products made with such alcohol, by reducing the prices of such products. The underlying rationale for the program is the view that the alcoholic beverage tax is intended to be a tax on alcohol only when it is consumed as a beverage, and that other uses of alcohol should not be subject to the tax. This program also can be rationalized on the grounds that the exempted uses of alcohol are for socially beneficial purposes, and, therefore, their cost should not be increased by taxation.

Exclusion/Exemption:

DISTRIBUTIONS OF TOBACCO PRODUCTS TO U.S. ARMED FORCES AND THE U.S. DEPARTMENT OF VETERANS' AFFAIRS

Program Characteristics	
Tax Type:	*Cigarette and Tobacco Tax.*
Authorization:	*California Revenue and Taxation Code Section 30102.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	***Amount***
1996-97	*$23*
1997-98	*22*
1998-99	*21*

DESCRIPTION

This program exempts from the cigarette and tobacco tax the distribution of cigarettes and tobacco products to the U.S. Armed Forces and to the U.S. Department of Veterans' Affairs.

RATIONALE

This program provides a tax incentive for the U.S. Armed Forces and the U.S. Department of Veterans' Affairs to purchase cigarettes or tobacco products *in* California, as opposed to *outside* of California. It does this to the extent that the tax, if imposed, would make California cigarette and tobacco product prices sufficiently high to cause these entities to purchase cigarettes outside of California. This, in turn, would reduce economic activity in California related to the distribution and retailing of these products.

The program also has been rationalized on the grounds that it grants tax relief to various members of the U.S. Armed Forces and patrons of the U.S. Department of Veterans' Affairs, by enabling them to acquire their cigarettes and tobacco products at reduced costs. It has been argued that such persons are deserving of this public subsidy because of their present or past service to their country.

COMMENTS

The U.S. Armed Forces and U.S. Department of Veterans' Affairs are such large purchasers of cigarettes that they can cost-effectively purchase cigarettes and tobacco products in a low-cost state for subsequent sale in a higher-cost state, provided that the interstate price differential exceeds the interstate shipment costs.

The courts have held that this program applies to cigarette and tobacco product sales through military commissaries and exchanges, but not sales to U.S. officers' clubs and officers' messes.

The estimated revenue reduction shown above is based on data from the Board of Equalization (BOE). The estimate includes expenditures under the other cigarette tax expenditure programs discussed herein, such as distributions to veterans' institutions and small cigarette and tobacco product shipments. This is because data on these transaction types are not reported separately to the BOE. According to estimates, however, sales to the military comprise the majority of all exempt cigarette sales.

The tobacco industry benefits from this program to the extent that the program increases demand for tobacco products.

Exclusion/Exemption:

DISTRIBUTIONS OF TOBACCO PRODUCTS TO VETERANS' INSTITUTIONS

Program Characteristics	
Tax Type:	*Cigarette and Tobacco Tax.*
Authorization:	*California Revenue and Taxation Code Section 30105.5.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	—
1997-98	—
1998-99	—

DESCRIPTION

This program exempts the sale or gift of federally tax-free cigarettes or other tobacco products, when delivered directly from the manufacturer to either a veterans' home located in California, or a hospital or domiciliary facility of the U.S. Department of Veterans' Affairs. To qualify for the program, the cigarettes and tobacco products must be issued free of charge to veterans receiving hospitalization or domiciliary care.

RATIONALE

This program provides a tax incentive for qualified institutions to provide cigarettes and other tobacco products to their patrons. The underlying rationale for the program is that the provision of free cigarettes and other tobacco products to hospitalized veterans is deserving of public financial support, due to the military services that these individuals have provided to their country.

COMMENTS

As with other exemptions for tobacco products, the tobacco industry benefits from this program to the extent that the program increases demand for tobacco products.

The revenue reduction associated with this program is incorporated within the revenue reduction shown for the immediately preceding program entitled, "Distributions of Tobacco Products to U.S. Armed Forces and the U.S. Department of Veterans' Affairs."

Exclusion/Exemption:

SMALL SHIPMENTS OF CIGARETTES TRANSPORTED INTO CALIFORNIA

Program Characteristics	
Tax Type:	*Cigarette and Tobacco Tax.*
Authorization:	*California Revenue and Taxation Code Section 30106.*

Estimated Revenue Reduction (In Millions)	
Fiscal Year	**Amount**
1996-97	—
1997-98	—
1998-99	—

DESCRIPTION

This program exempts from the cigarette tax the distribution of cigarettes transported into California from out of state, provided that the total shipment does not exceed 400 cigarettes. The program requires that the cigarettes either be (1) intended for consumption by the individual bringing them into the state, or (2) obtained at one time or another from the U.S. Department of Veterans' Affairs, or exchanges or commissaries of branches of the U.S. Armed Forces.

RATIONALE

This program provides tax relief to consumers of qualifying small-shipment cigarettes. The program's rationale is that the revenues derived from taxing these small shipments are insufficient to justify incurring the administrative costs of collecting the tax.

COMMENTS

There is no similar exemption for other tobacco products. However, Revenue and Taxation Code Sections 30431 and 30432 implicitly allow transportation of individual quantities of other tobacco products valued at $25 or less and on which tax has not been paid, without a transporter's permit or invoices.

The revenue reduction associated with this program is incorporated within the revenue reduction shown for the prior program, "Distributions of Tobacco Products to U.S. Armed Forces and the U.S. Department of Veterans' Affairs."

Exclusion/Exemption:
NATURAL GASOLINE

Program Characteristics	
Tax Type:	Motor Vehicle Fuel Tax.
Authorization:	California Revenue and Taxation Code Section 7401(a)(1).

Estimated Revenue Reduction
(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the motor vehicle fuel tax the distribution of natural gasoline to a duly licensed distributor.

"Natural gasoline" is not the same as the gasoline that is commonly sold for use in automobiles. Rather, it is a naturally occurring liquid which often is present in crude oil. Generally, natural gasoline cannot be used directly in automobiles. However, natural gasoline may be blended with crude oil distillates during the production of motor vehicle fuel. In this case, the natural gasoline becomes indirectly taxed as a component part of the motor fuel at the retail level. The program therefore, exempts from taxation natural gasoline not used in motor vehicles.

RATIONALE

This program provides tax relief to producers and users of natural gasoline, to the extent that excise taxes levied on such gasoline ordinarily would be incorporated into its production costs and sales price. The program's rationale is that unblended natural gasoline generally cannot be used in vehicles which use the public highways that are supported by the proceeds of the motor vehicle fuel tax.

Exclusion/Exemption:

SHIP OR AIRCRAFT FUEL ULTIMATELY DISTRIBUTED TO THE U.S. ARMED FORCES

Program Characteristics	
Tax Type:	*Motor Vehicle Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 7041(a)(4) and 7041(a)(5).*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the motor vehicle fuel tax the qualified distribution of motor fuel to the armed forces. To qualify for this program, the fuel must be (1) used in a ship or aircraft, or (2) used outside of California. The program includes motor fuel that is distributed to a third party prior to its distribution to the armed forces.

RATIONALE

The basic rationale for this program is that revenues from the motor vehicle fuel tax are directed toward the maintenance of public highways and airports, and these transportation facilities are not used by the vehicles whose fuel use is exempted from taxation under this program. It also has been suggested that the program may increase the purchase of military fuel in California, at least in some circumstances, by reducing its price relative to prices charged in other states.

Exclusion/Exemption:

FUEL FOR OFF-HIGHWAY VEHICLE OPERATIONS

Program Characteristics	
Tax Type:	*Motor Vehicle Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Section 8101(a).*

Estimated Revenue Reduction *(In Millions)*	
Fiscal Year	***Amount***
1996-97	*NA*
1997-98	*NA*
1998-99	*NA*

DESCRIPTION

This program exempts from the motor vehicle fuel tax any motor fuel used for purposes other than operating motor vehicles on public streets and highways.

The program operates via a refund mechanism, whereby the fuel is taxed when purchased and then the purchaser must apply for a refund for qualifying off-road fuel use. Fuel uses that qualify for refunds include use in farm tractors and irrigation pumps, electric generators, and vehicles operated solely on private property (such as within an amusement park). Fuel used by off-road recreational vehicles that are licensed for use on public lands and motor vehicle fuel used in boats are not eligible for this program. Fuel used in construction equipment is addressed in a separate exemption.

RATIONALE

This program provides tax relief to fuel consumers who are not using the fuel to operate vehicles on public streets and highways. The underlying rationale for the program is that the proceeds of the motor vehicle fuel tax are used generally for the construction and maintenance of public streets and highways.

The rationale for *not* exempting fuel used by off-road recreational vehicles licensed for use on public lands is that the estimated amount of revenues collected on that fuel is allocated to special funds that support off-highway recreational activities. Likewise, the estimated amount of tax paid on motor vehicle fuel used in boats is transferred annually to the Harbors and Watercraft Revolving Fund for the support of various boating programs.

COMMENTS

There are many minor fuel uses that qualify for a tax refund but for which refunds are not requested. Fuel used in home lawnmowers is one example.

Exclusion/Exemption:

FUEL SALES TO CONSULATE OFFICERS AND EMPLOYEES

Program Characteristics	
Tax Type:	*Motor Vehicle Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 7401(a)(6), 8101(e), and 8106.1.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the motor vehicle fuel tax fuel sold to an officer or employee of a foreign consulate, providing specified conditions are met. In order to qualify, the program requires that the sale must be charged to a credit card held by the consulate and certified by the U.S. State Department, and that the fuel must be used in a consular vehicle registered with the State Department. Furthermore, the program only applies to consulates of foreign governments that are exempt from taxes by treaty, or who provide a similar tax exemption to U.S. diplomats on a reciprocal basis. The consulate employee may not use the fuel in connection with a private occupation or for personal gain within the state.

RATIONALE

This program provides tax relief to foreign governments. According to the Board of Equalization, this program helps fulfill the terms of treaties and reciprocal arrangements between the U.S. and countries with consulate employees stationed in the U.S. Under the terms of such treaties and arrangements, U.S. consulate employees are not subject to tax on fuel consumed in foreign countries, and foreign consulate employees are not subject to taxes on fuel consumed in the U.S.

Exclusion/Exemption:

FUEL FOR RACE CARS

Program Characteristics	
Tax Type:	Motor Vehicle Fuel Tax and Use Fuel Tax.
Authorization:	California Revenue and Taxation Code Sections 7304 and 8604.

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from fuel taxation inflammable liquids that are specifically manufactured for racing motor vehicles, and that are distributed and used for racing motor vehicles at a racetrack. In the absence of this exemption, distributors of fuel manufactured specifically for race cars would be required to collect the tax from fuel purchasers. Under this program, distributors are exempted from collecting the tax.

Although this type of program mechanism does not ultimately affect vehicle-related fuel tax revenues, it does result in reduced *sales* tax revenues. This is because the sales tax is imposed on the entire price of the fuel, which ordinarily would include the motor vehicle fuel tax.

RATIONALE

This program provides tax relief to race car owners and operators by reducing the fuel tax they pay on fuel used in operating racing vehicles. The rationale for the exemption from the motor vehicle fuel tax is that such vehicles are operated off-road, and hence do not benefit from the street and highway improvements funded by the tax.

COMMENTS

Other operators of vehicles that are not used on public highways must pay the motor vehicle fuel tax, and then apply for a refund of the tax (if they qualify). California Revenue and Taxation Code Section 7304 applies to the exemption under the motor vehicle fuel tax. The exemption under Section 8604 is a parallel exemption under the use fuel tax.

Exclusion/Exemption:

FUEL FOR COMMON CARRIERS AND THE MILITARY

Program Characteristics	
Tax Type:	*Jet Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Section 7374.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	$73
1997-98	77
1998-99	80

DESCRIPTION

This program exempts from the aircraft jet fuel tax all fuel used by common carriers, the military, and persons engaged in the business of constructing or reconstructing aircraft.

RATIONALE

This program provides tax relief to qualified users of jet fuel and their customers, to the extent that taxes on such fuel ordinarily would be incorporated into its price and the prices charged for using planes burning such fuel.

According to the Board of Equalization, the underlying rationale for the program relates to the fact that the tax on jet fuel is used to finance small municipal airports, which are used primarily by private aircraft owners. (Large airports are funded primarily by landing fees and other user charges.) This program exempts common carriers and the military from paying the tax on jet fuel on the grounds that they receive limited benefits from the facilities supported by this tax.

COMMENTS

The aircraft jet fuel tax is imposed upon aircraft jet fuel dealers at the rate of 2 cents per gallon. Recent legislation—Chapter 1027, Statutes of 1998 (AB 66, Baca)—altered the manner in which the local Bradley-Burns *sales* tax revenue on jet fuel is allocated among local jurisdictions. The new allocation formula generally is based on where the fuel is *delivered* as opposed to where negotiations for the fuel contract took place.

Exclusion/Exemption:

FUEL FOR CONSTRUCTION AND AGRICULTURAL MACHINERY

Program Characteristics	
Tax Type:	Use Fuel Tax and Diesel Fuel Tax.
Authorization:	California Revenue and Taxation Code Sections 8652(b), 60100(a)(5)(A), and 60501(a)(4)(C).

Estimated Revenue Reduction (In Millions)	
Fiscal Year	**Amount**
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the use fuel tax and diesel fuel tax the fuel used to propel construction equipment operated within the confines of a construction project, and certain machinery used in agricultural operations. For vehicles used in construction, the exemption from the diesel fuel tax is provided in the form of a reimbursement of the tax paid. To qualify, the equipment can be only incidentally operated on the highways, and must be exempt from vehicle registration under the California Vehicle Code.

RATIONALE

This program provides tax relief to the operators of qualified construction equipment and agricultural equipment that only incidentally is used on state highways. The underlying rationale for the program relates to the fact that fuel taxes primarily fund public street and highway construction and maintenance. Since equipment that only intermittently uses the streets and highways does not generally benefit from these improvements, taxing the fuel used to propel such equipment is viewed as inappropriate.

COMMENTS

In theory, it would be possible to impose fuel taxes on that portion of fuel used in moving construction equipment and agricultural machinery on the public streets and highways. However, the revenues collected under such an approach probably would not offset the costs of administering it.

Exclusion/Exemption:

FUEL FOR NONTRANSPORTATION PURPOSES

Program Characteristics	
Tax Type:	*Use Fuel Tax and Diesel Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 8652(c) and 60501 (a)(4)(A).*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the use fuel tax and diesel fuel tax fuel used for a purpose other than to propel a motor vehicle in California. The exemption under the diesel fuel tax is provided in the form of a reimbursement of the tax paid. Typical examples of exempt uses include fuel used in electric generators, to rotate cement mixer drums, or operate garbage compressors.

RATIONALE

This program provides tax relief to the operators of qualified equipment. The underlying rationale for the program relates to the fact that the use fuel tax primarily funds public streets and highway construction and maintenance. Because the qualifying equipment does not directly benefit from the public streets and highways, taxing the fuel used to operate such equipment is viewed as inappropriate.

Exclusion/Exemption:

FUEL FOR OFF-HIGHWAY VEHICLE OPERATIONS

Program Characteristics	
Tax Type:	Use Fuel Tax and Diesel Fuel Tax.
Authorization:	California Revenue and Taxation Code Sections 8653, 60100 (a)(5)(c), and 60501 (a)(4)(A).

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the use fuel and diesel fuel tax, fuel that is used in the operation of a motor vehicle off-highway. For diesel fuel consumed by diesel powered train engines the tax is not paid in the first place. For other off-highway consumption—for example, by trucks—the exemption is in the form of a reimbursement of the tax paid. The exemption for off-highway use by state or local government vehicles could be provided either through an exemption or reimbursement.

RATIONALE

This program provides tax relief to the operators of off-highway vehicles. The rationale underlying the program relates to the fact that the use fuel tax funds public street and highway construction and maintenance. Because vehicles operated off of the public streets and highways do not directly benefit from the use of the tax revenues, levying the use fuel tax on such vehicles is viewed as inappropriate.

Special Tax Rate:

FUEL FOR LOCAL TRANSIT AND SCHOOL BUS OPERATORS

Program Characteristics	
Tax Type:	*Use Fuel Tax and Diesel Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 8655, 60100 (a)(5)(D), 60502, and 60502.2.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	$25
1997-98	23
1998-99	22

DESCRIPTION

This program provides operators of local transit services and school buses a special use fuel and diesel fuel tax rate. Specifically, it permits qualified entities to pay a special payment of 1-cent-per-gallon instead of the normal tax rate of 18 cents.

In order to qualify for the program, the entity involved must be either (1) a transit district, (2) a school or community college district, or (3) a private entity providing local public transportation services in an urban or suburban area. These latter entities also must meet certain criteria and either: (1) be a passenger stage corporation subject to the jurisdiction of the Public Utilities Commission; (2) provide transportation services under contract to a public agency, school or community college district; or (3) be a common carrier operating over a route entirely within a single city. The program does not include charter carriers.

RATIONALE

This program provides tax relief to the above-specified local transportation agencies and providers. It also provides relief to public transportation users to the extent that the reduced tax liabilities are reflected in lower transit fares. The rationale underlying this program is that it promotes the establishment, maintenance, and use of public transportation systems, by lowering their operating costs. In the case of school buses, the program's rationale is that it supports the public education system by reducing the portion of budgeted funds needed for student transportation, thereby increasing the amount of funds available for classroom educational activities.

Exclusion/Exemption:

FUEL FOR OUT-OF-STATE TOUR BUSES

Program Characteristics	
Tax Type:	Use Fuel Tax and Diesel Fuel Tax.
Authorization:	California Revenue and Taxation Code Sections 8608(b), 60130, and 60116.

Estimated Revenue Reduction (In Millions)	
Fiscal Year	**Amount**
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program relieves qualified interstate tour bus operators of the requirement to obtain a use fuel or diesel fuel tax permit from the Board of Equalization (BOE). The effect of this is to exempt such operators from any tax liability associated with their consumption of fuel *within* the state that has been purchased *elsewhere*. To qualify, the fuel must be used by an out-of-state passenger carrier whose operations consist solely of round-trip tours originating and terminating outside of California. In addition, any fuel purchased *within* California must be used solely for propulsion of the vehicle, and tax must be *paid* on *it*.

RATIONALE

This program provides tax relief to the operators of out-of-state tour buses, to the extent that the fuel they bring into the state exceeds that taken out of the state. Before the advent of this program, out-of-state tour bus operators were required to report the actual amount of fuel brought into California, purchased in California, and taken out of California. If the amount brought in exceeded that taken out (indicating net use of out-of-state fuel in California) the operator was required to pay a tax on the difference. Alternatively, the operator could claim a tax refund if the fuel taken out of the state exceeded that brought in.

This program relieves the qualified tour bus operators from having to register with and report to BOE regarding net use of fuel in California that is purchased out of state. Although the user pays tax to the vendor on the fuel purchased in California, there is no tax on any net use of fuel purchased out of the state.

The underlying rationale for the program is two-fold. First, it simplifies state tax administration and saves the state money, to the extent that the costs of collecting the tax would have exceeded the revenues generated. Second, it relieves tour bus operators of burdensome paperwork requirements.

COMMENTS

Prior to this program, failure to register with the BOE could result in a fine of $500 for tour bus operators.

Exclusion/Exemption:

FUEL FOR PUBLIC AGENCY VEHICLES OPERATED ON MILITARY INSTALLATIONS

Program Characteristics	
Tax Type:	Use Fuel Tax and Diesel Fuel Tax.
Authorization:	California Revenue and Taxation Code Sections 8654 and 60501 (a)(4)(E).

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the use fuel tax and diesel fuel tax certain fuel used in a motor vehicle owned by a county, city, district, or other political subdivision. The exemption from the diesel fuel tax is provided in the form of a reimbursement of the tax paid. The program applies to fuel used to operate qualifying vehicles over a highway that is constructed and maintained by the U.S. government, and that is within a military installation. If the motor vehicle is operated on one continuous trip both over such a highway and over a public highway located outside the military installation, only the fuel used to operate the vehicle on the public highway is subject to the tax.

RATIONALE

This program provides tax relief to qualified agencies operating motor vehicles on military bases. The apparent rationale for the program relates to the fact that the roads on military bases are not supported by use fuel tax revenues. This rationale holds that public agencies, which may have to enter military bases to provide certain services, should be relieved of the use fuel tax on the portion of their fuel used on such roads.

Exclusion/Exemption:

FUEL FOR OPERATION OF VEHICLES ON U.S. DEPARTMENT OF AGRICULTURE ROADS

Program Characteristics	
Tax Type:	*Use Fuel Tax and Diesel Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 8653.1 and 60501(a)(4)(D).*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	*Amount*
1996-97	*NA*
1997-98	*NA*
1998-99	*NA*

DESCRIPTION

This program exempts from the use fuel tax and the diesel fuel tax fuel used to operate a motor vehicle on any highway that is under the jurisdiction of the U.S. Department of Agriculture (USDA). For diesel fuel, the tax exemption is provided in the form of a reimbursement of the amount of diesel fuel tax paid. In order to qualify for the exemption, the user must pay, or contribute to, the cost of the highway's maintenance or construction under an agreement with the USDA.

RATIONALE

This program provides tax relief to the qualified users of USDA roads, such as logging roads in national forests. The underlying rationale for the program relates to the fact that fuel taxes primarily fund public streets and state highway construction and maintenance. Since these funds do not go to improve USDA roads, taxing the portion of fuel used on such roads is viewed as inappropriate. Limiting the exemption to individuals who contribute to road maintenance serves to confine favorable tax treatment to heavy users of USDA roads, such as logging trucks. A tax expenditure exists since absent the program, fuel consumed for these purposes would be taxed.

Exclusion/Exemption:

FUEL FOR THE U.S. GOVERNMENT AND ITS INSTRUMENTALITIES

Program Characteristics	
Tax Type:	*Diesel Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Sections 60100 (5)(e) and 60100 (a)(8).*

Estimated Revenue Reduction (In Millions)	
Fiscal Year	**Amount**
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the diesel fuel tax, fuel used in vehicles owned by the U.S. government, and its agencies and instrumentalities. Under the program, fuel is sold by the retailer to the U.S. government at the consumer price less the 18 cents per gallon diesel fuel tax incorporated into the price. The retailer then files a claim for reimbursement of the tax paid based on the number of gallons sold to the government consumer.

RATIONALE

The basic rationale for the program is that federal government agencies are engaged in activities that benefit the public generally, and should not be subject to local taxation. In addition, when the diesel fuel tax was established as separate from the use fuel tax in 1995, an attempt was made to leave unchanged the treatment of fuel consumers. Since U.S. government consumption was not taxed under the more direct use fuel tax, this consumption was also granted an exemption under the diesel fuel tax.

Special Tax Rate:

FUEL USED IN PUBLIC TRANSIT VEHICLES

Program Characteristics	
Tax Type:	Motor Vehicle Fuel Tax.
Authorization:	California Revenue and Taxation Code Section 8101.6.

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program provides a special motor vehicle fuel tax rate for motor vehicle fuel used in propelling qualified passenger-carrying vehicles. The special rate is provided in the form of a refund of 6 cents of the 18 cents per gallon general tax rate. To qualify for the program, the vehicles involved must be used in transporting persons for compensation, and must be used by the following:

- A transit district, transit authority, or city owning or operating a transit system.
- A private entity providing specified transportation services.
- Certain passenger stage corporations subject to the jurisdiction of the Public Utilities Commission.
- Any common carrier operating exclusively within the limits of a single city using a regular route and not subject to the jurisdiction of the Public Utilities Commission.

RATIONALE

This program provides a tax incentive to encourage the operation and use of qualified public transit services, to the extent that fuel excise taxes ordinarily increase the costs and prices of such services. The underlying rationale for the program is to expand the state's reliance on public transit, thereby reducing traffic congestion and air pollution, and lessening the need for increased highway vehicle capacity.

Special Tax Rate:

LIQUIFIED PETROLEUM GAS

Program Characteristics

Tax Type:	*Use Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Section 8651.5.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	*Amount*
1996-97	$3
1997-98	2
1998-99	2

DESCRIPTION

This program provides a special use fuel tax rate to purchasers of liquified petroleum gas (LPG). The special tax rate is 6 cents per gallon on LPG, compared with the general use fuel tax rate in 1998 of 18 cents per gallon.

RATIONALE

This program provides a tax incentive for the use of LPG, rather than gasoline, in order to encourage the use of alternative fuel sources. Such alternative fuel sources produce lower levels of air pollutants.

In addition, the program has been rationalized on tax equity grounds. Each gallon of LPG has about *75 percent* of the energy content of a gallon of gasoline. At the time that this program was established and prior to August 1990, the general use fuel tax rate on gasoline and diesel fuel was 9 cents per gallon. The 6 cents per gallon rate on LPG (*67 percent* of the general rate) thus approximately equalized the tax on LPG and gasoline in terms of relative energy content (which determines how far a vehicle can travel on a gallon of fuel).

COMMENTS

Since 1994, the tax rate on LPG (6 cents per gallon) has been only *one-third* of the rate of the tax on gasoline (18 cents per gallon). As a consequence, the benefit provided by this program is larger than the amount needed to equalize tax treatment of LPG with gasoline on the basis of relative energy content (see above).

The revenue estimate cited above is based on data from the Board of Equalization (BOE). The estimates include the revenue effect of the special tax rate for liquified *natural* gas. This is because the two types of transactions are not reported separately to the BOE. According to the BOE, however, LPG represents the majority of sales taking place at the reduced tax rate of at 6 cents per gallon.

Special Tax Rate:

ETHANOL AND METHANOL

Program Characteristics	
Tax Type:	*Use Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Section 8651.8*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	*Amount*
1996-97	*Minor*
1997-98	*Minor*
1998-99	*Minor*

DESCRIPTION

This program provides what is equivalent to a partial exemption from the use fuel tax to purchasers of ethanol and methanol. Specifically, the program provides that the excise tax on such alcohol fuels shall be one-half the rate imposed on gasoline and diesel fuels. In order to qualify for the program, the fuel cannot contain more than 15 percent gasoline or diesel fuels (the remainder of the fuel must be ethanol or methanol).

RATIONALE

Proponents argue that this program provides a tax incentive for the use of ethanol and methanol, in order to make the California economy less dependent on conventional petroleum products and to reduce the level of air pollution. In addition, the program has been rationalized on tax equity grounds. Each gallon of methanol or ethanol fuel has about half the energy content of a gallon of gasoline or diesel fuel. Thus, this program approximately equalizes the tax on alcohol fuels with the tax on diesel and gasoline fuels, based on their relative energy content (which determines how far a vehicle can travel on a gallon of fuel).

COMMENTS

Unlike the special tax rates for liquified petroleum gases, liquified natural gas, and compressed natural gas, the special tax rate for alcohol fuels is set at a percentage of the general tax rate on diesel fuel and gasoline (rather than at a specific number of cents per gallon). Consequently, the tax on alcohol fuels maintains its approximate energy equivalence with the tax on gasoline and diesel fuels regardless of changes in the excise tax rate for gasoline and diesel fuels. The amount of revenue loss per gallon of alcohol fuel due to this program grows, however, as the tax rate on gasoline and diesel fuel increases.

Special Tax Rate:
NATURAL GAS

Program Characteristics	
Tax Type:	*Use Fuel Tax.*
Authorization:	*California Revenue and Taxation Code Section 8651.6.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	***Amount***
1996-97	*Minor*
1997-98	*Minor*
1998-99	*Minor*

DESCRIPTION

This program provides what amounts to a special use fuel tax rate to purchasers of compressed natural gas (CNG) or liquified natural gas (LNG). The reduced tax rate is 7 cents per 100 cubic feet of CNG and 6 cents per gallon of LNG, compared with the general use fuel tax rate of 18 cents per gallon in 1998.

RATIONALE

This program provides a tax incentive for the use of natural gas rather than gasoline in motor vehicles. The program's rationale is to encourage the use of alternative fuel sources, in order to make the California economy less dependent on conventional petroleum products and to reduce air pollution.

COMMENTS

The energy content of a gallon of LNG or of 100 cubic feet of CNG is similar to that of a gallon of gasoline, so that this program cannot be rationalized on the grounds of equalizing tax treatment on the basis of relative energy content, as can the preceding two programs.

The estimated revenue loss cited above is based on data from the Board of Equalization (BOE). The estimate includes only the revenue loss due to the lower rate on CNG. The revenue loss on LNG is included in the estimate for liquified petroleum gas (LPG) (see the program entitled "Liquified Petroleum Gas"). This is because the LNG and LPG transactions are not reported separately to the BOE.

Special Tax Rate:

FLAT TAX RATE FOR LIQUIFIED PETROLEUM GAS AND NATURAL GAS FUELS

Program Characteristics	
Tax Type:	Use Fuel Tax.
Authorization:	California Revenue and Taxation Code Section 8651.7.

Estimated Revenue Reduction	
(In Millions)	
Fiscal Year	**Amount**
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program allows the owner or operator of a vehicle fueled by liquified petroleum gas (LPG), liquified natural gas (LNG), or compressed natural gas (CNG) (except an interstate user) to pay the use fuel tax at an annual flat rate based on the weight of the vehicle, as opposed to a per gallon rate. The flat rate varies from $36 for passenger cars and any other vehicles weighing 4,000 pounds or less, to a maximum of $168 for vehicles weighing 12,001 pounds or more.

The total amount of tax generated by these flat rates is approximately equivalent to the total amount of tax that would be paid at the per gallon tax rates for these fuels, assuming that vehicles are driven a typical number of miles each year and have typical fuel efficiency. For example, the flat rate of $36 for a passenger car equals the amount of tax at 6 cents per gallon that would be paid if an LPG fueled car were driven 12,000 miles at an average fuel efficiency of 20 miles per gallon.

For these typical assumptions, the flat-rate tax provides what amounts to a partial exemption from taxation to the same extent as is provided by the special per gallon rates for these fuels. The value of the benefit provided by the flat rate tax relative to the value of the benefit from the special per gallon rate, would be greater for vehicles that use more fuel each year than the typical vehicles on which the flat rates are based.

RATIONALE

This program has the same basic rationales as the special tax rates discussed in the immediately preceding reviews—namely, encouraging the use of alternative fuels, and reducing air pollution. It also serves to equalize taxation with gasoline on an energy-content basis. The program's tax savings and simplified reporting procedures also provide an incentive for taxpayers to convert engines to these alternative fuel sources. Furthermore, the program simplifies the administration of the use fuel tax.

COMMENTS

The tax rates under this program have been unchanged in recent years, whereas the general tax rate on gasoline and diesel fuels has increased. Therefore, the revenue loss per vehicle under this program has increased in a manner similar to the revenue losses from the special per gallon (or per 100 cubic feet) rates on LPG, LNG, and CNG.

Special Tax Rate:

EMPLOYEE PENSION AND PROFIT SHARING PLANS

Program Characteristics	
Tax Type:	*Insurance Tax.*
Authorization:	*California Revenue and Taxation Code Section 12202.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	*Amount*
1996-97	*NA*
1997-98	*NA*
1998-99	*NA*

DESCRIPTION

This program provides a reduced insurance tax rate for employee pension and profit sharing plans. The state's taxes on life insurance, disability insurance, and annuity contracts ordinarily are imposed on dollars of gross premiums written at a rate of 2.35 percent. Under this program, however, qualified insurers pay these taxes at the lower rate of 0.5 percent.

RATIONALE

This program provides tax relief to insurers that serve employee pension and profit sharing plans. It also provides relief to the individuals contributing to such plans, to the extent that the reduced taxes are reflected in lower insurance premium costs. The underlying rationale for the program is to encourage employers to provide insurance coverage under such plans by lowering the cost of the premiums they are charged.

Exclusion/Exemption:

FRATERNAL BENEFIT SOCIETIES

Program Characteristics	
Tax Type:	*Insurance Tax.*
Authorization:	*California Insurance Code Section 10993.*

Estimated Revenue Reduction

(In Millions)

Fiscal Year	Amount
1996-97	NA
1997-98	NA
1998-99	NA

DESCRIPTION

This program exempts from the gross premiums insurance tax any insurance issued by a fraternal benefit society. Fraternal benefit societies include organizations such as Elks and Knights of Columbus.

RATIONALE

This program provides tax relief to fraternal benefit societies. It also provides relief to the individuals who are insured by such organizations, to the extent that the reduced taxes are reflected in lower insurance premiums. The rationale for this program is that fraternal benefit societies are charitable and benevolent institutions engaged in improving social welfare and, as such, they and their members are deserving of public financial support.