STATEMENT OF

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BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

"SHORTFALL IN HIGHWAY TRUST FUND COLLECTIONS"

May 5, 1992

The Federal Highway Administration (FHWA) is committed to improving the effectiveness of the motor fuel tax collection process. It is sound public policy and essential for equity in the marketplace to assure that the tax is collected on all motor fuels in accordance with the law. Furthermore, with the ever-increasing demands on the Nation's highway system, the FHWA cannot permit a continuing drain of resources which we believe could be as high as $1 billion annually. We appreciate this opportunity to report on our efforts to reduce motor fuel tax evasion using the funds authorized in section 1040 of the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 (Pub.L. 102-240).

Impact of Recent Changes in Federal Motor Fuel Tax Collection Procedures

State and Federal governments have adopted several strategies to curtail motor fuel tax evasion. When combined with increased enforcement resources and coordinated State and Federal compliance programs, these actions lay the groundwork for more effective administration of motor fuel taxes. At the Federal level, four recent legislative enactments have been adopted:

1. the Tax Reform Act of 1986 (Pub. L. 99-514);
2. the Revenue Act of 1987 (Pub. L. 100-203);
3. the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647); and
4. the Revenue Reconciliation Act of 1990 (Pub. L. 101-508).

The most significant change was to move the point of taxation for motor fuels to a higher level in the distribution chain. Raising the point of taxation to a higher level can facilitate enforcement by reducing the number of taxpayers which allows more thorough monitoring of taxpayers and more frequent audits of taxpayer accounts. These recent enactments also authorized more stringent administrative procedures in several related areas including taxpayer registration, bond and lien requirements, joint liability of officers and agents, and information reporting. The long-term impact of these changes on tax evasion losses cannot be determined at this time because of insufficient experience with the new procedures, incomplete implementation, and difficulty of separating these impacts from other economic factors and increased tax rates which influence the revenue trends.

Current Estimates of Motor Fuel Tax Evasion Losses

Although estimates of revenue losses from motor fuel tax evasion vary widely, evidence suggests a substantial problem with potential losses of hundreds of millions of dollars annually of Federal revenue on gasoline and diesel excise taxes. Most of this revenue is destined for the Highway Trust Fund, and the shortfall means that the traveling public is being cheated out of resources needed to build and maintain the Nation's transportation system. Although legislative and enforcement efforts since 1986 have improved compliance, the higher Federal tax rates enacted December 1, 1990, may have increased evasion losses and offset some of the benefits.

The FHWA has reviewed the evidence of motor fuel tax evasion losses at the Federal and State level in preparing the first report to the congressional committees required by section 1040 of the ISTEA. The evidence includes testimony at previous congressional committee hearings, attempts to compare related motor fuel production and consumption data, and results of enforcement activities such as audits and criminal investigations.

Based on this review, the FHWA believes that the current level of gasoline tax evasion is between 3 and 7 percent of gallons consumed, and that the level of diesel fuel tax evasion is between 15 and 25 percent of gallons consumed. Exhibit 1 shows the estimated State and Federal tax losses for this range based on 1990 estimates of taxable motor fuel consumption. Because of recent changes with respect to collection of the Federal excise tax on gasoline, gasoline tax evasion should be reduced to the lower end of the range. Diesel fuel offers many more opportunities for tax evasion both at State and Federal levels, and tax evasion of approximately 20 percent of the taxable gallons appears to be a reasonable estimate. Because of similarities in tax rates and procedures, it is likely that the States, in the aggregate, suffer comparable losses of State revenues due to motor fuel tax evasion.

Further refinement and tracking of motor fuel tax evasion losses are needed to evaluate the effectiveness of tax compliance strategies. The reporting requirements of the Joint Federal/State Motor Fuel Tax Compliance Project (discussed below) are designed to provide an improved information base for making these estimates.

The Joint Federal/State Motor Fuel Tax Compliance Project

Beginning in FY 1990, Congress authorized funding from the Highway Trust Fund, administered by the FHWA, to boost cooperative motor fuel tax enforcement efforts between the States and the IRS. On July 10, 1990, the Joint Federal/State Motor Fuel Tax Compliance Project, or Joint Project, was formally initiated with the first meeting of the project Steering Committee. In FYs 1990 and 1991, approximately $1.2 million was committed to the Joint Project as follows:

$300,000 for the IRS to develop a central database of registered motor fuel taxpayers;

$500,000 for the IRS to fund additional examination staffing and support for motor fuel tax criminal investigations, primarily in 3 pilot regions;

$330,000 for 12 States (lead by New Jersey, Indiana, and Texas) to participate in pilot regional motor fuel tax enforcement task forces; and

$ 65,000 for the Federation of Tax Administrators (FTA) to develop a training course for State and Federal motor fuel tax auditors and investigators.

In 1986 and 1987, a series of State/Federal exchange projects demonstrated the benefits of cooperative fuel tax enforcement programs. The Joint Project builds on this experience by fostering the organization of motor fuel tax enforcement task forces, comprised of representatives of IRS district offices and State revenue agencies in groups of contiguous States. Three pilot task forces were formed in FY 1991.

Expansion of the Joint Project Under Section 1040 of the ISTEA

Section 1040 of the ISTEA of 1991 provided $5 million per year in contract authority from the Highway Trust Fund and authorized $2.5 million per year from the General Fund through 1997 for highway use tax evasion projects. Approximately $41 million will be available during the next 6 years for this effort, assuming the $2.5 million authorized from the General Fund is appropriated for FY 1994-1997. With the $5 million available from the Highway Trust Fund and $1 million appropriated in FY 1992, funds are available this fiscal year to expand the program to all States and the District of Columbia and to support additional IRS motor fuel tax compliance efforts. Each year thereafter, $3 million will be reserved for the States, with the remainder allocated to the IRS.

Section 1040 of the ISTEA and the act making appropriations for the U.S. Department of Transportation in FY 1992 also directed that a study be conducted of the feasibility and desirability of using motor fuel dyes and markers for detecting octane mislabeling, preventing consumer fraud, and enforcing motor fuel tax laws. The FHWA has entered an agreement with the Volpe National Transportation Systems Center, using $250,000 from the funds appropriated for FY 1992, to conduct the study. The final report will be delivered to the Congress by December 1992.

Pilot program results of the Joint Project, as reported by the participating States and the IRS, are encouraging. Preliminary tabulations for IRS district offices in lead States (Indiana, New Jersey, and Texas) show estimated returns of almost $13 in additional tax assessments for each dollar spent on motor fuel tax examinations. Preliminary State reports estimate additional tax assessments that range from less than $2 to more than $100 per dollar invested in examinations and audits, with an overall average of $20 tax assessed per dollar invested. As the Joint Project expands to all regions in the coming year, State reports on motor fuel tax enforcement activities will provide more complete estimates of State motor fuel tax evasion and the cost-effectiveness of enforcement efforts.

Need for a Transactional Database

The trail of information and reporting is an important aspect of efforts to curtail evasion. Information on product movements and transactions provides the basic records necessary to determine the amount of tax due. The Revenue Reconciliation Act of 1990 expanded IRS authority to require additional information to enforce motor fuel excise taxes on gasoline and diesel fuel by authorizing the Secretary of the Treasury to require information reporting by any person registered as a motor fuel taxpayer and by such other persons as the Secretary deems necessary.

The intent was to allow the IRS to require reports from independent third parties to verify the taxable gallons reported by the taxpayer. Under this authority, the Secretary of the Treasury may, for example, require registered terminal operators to report, with respect to removals of fuel from their terminals, (1) the name, address, and registration number of the owner of the gasoline, (2) the amount of gasoline removed, and (3) such other information as the Secretary of the Treasury may require. In addition, the Secretary may, under this authority, require reporting by persons making tax-free transfers of gasoline to a registered terminal and by producers and wholesale distributors of alcohol that sell alcohol to a gasohol blender.

To use such information effectively, reporting must be required on electronic media (tape or diskette) for computerized matching with taxpayer returns. The IRS has begun to explore developing such a system to match transactions as reported by the terminal operators with taxpayer records -- a so-called "transactional database." At the October 2, 1991, meeting of the joint project Steering Committee, the IRS reported that a draft report on the gasoline transactional database has been completed for internal review. Hardware and software costs, based on specific assumptions listed in the report, would exceed $5 million. Based on information considered by the study team, implementing a computerized system is feasible and could play an integral role in the IRS agency-wide Compliance 2000 strategic plan. The next step toward implementation is developing a formal technical proposal, including an in-depth analysis of system requirements.

FHWA Funding Agreement with the IRS

The FHWA is providing $550,000 from the FY 1992 appropriated funds to the IRS for continued work toward implementing the gasoline transactional database. This will supplement the $800,000 already provided to the IRS in FYs 1990 and 1991 for developing the Form 637 centralized database and participating in the pilot regional enforcement task forces. Form 637 is the document used by the IRS to register motor fuel taxpayers.

Section 1040 of the ISTEA stipulates that the Secretary of Transportation shall not impose any condition on the use of funds allocated to the IRS under this section. Therefore, the anticipated use of the other funds provided to the IRS, from the amounts authorized in the ISTEA, will be covered in a separate report by the Secretary of the Treasury to the appropriate congressional committees, due July 31 each year. The FHWA anticipates that about $2 million per year through FY 1997 will be provided to the IRS from the amount provided by the Highway Trust Fund.

In closing, I wish to advise the Subcommittee that the first report required by section 1040 on the FHWA fuel tax evasion program will be submitted to the appropriate congressional committees within the next few weeks. The report discusses in greater detail the background and status of the Joint Federal/State Motor Fuel Tax Compliance Project.

We expect that the full implementation of our efforts over the next 6 years will increase the revenues available to support the Nation's transportation programs by hundreds of millions of dollars.

Exhibit 1. Ranges of Estimated Annual Motor Fuel Tax Evasion

Gasoline - 110.2 billion gallons in 1990

Percent Evaded	Gallons (1,000's)	Federal Tax Loss ($)	State Tax Loss ($)	Total ($)
		(14.1¢/gal.)	(15.4¢/gal.)	
3 *	3,305,525	466,078,955	509,050,773	975,129,728
5	5,509,208	776,798,258	848,417,955	1,625,216,213
7	7,712,891	1,087,517,561	1,187,785,137	2,275,302,698

Diesel - 21.4 billion gallons in 1990

Percent Evaded	Gallons (1,000's)	Federal Tax Loss ($)	State Tax Tax ($)	Total ($)
		(20.1¢/gal.)	(16.0¢/gal.)	
15	3,209,836	645,176,956	513,573,696	1,158,750,652
20 *	4,279,781	860,235,941	684,764,928	1,545,000,869
25	5,349,726	1,075,294,926	855,956,160	1,931,251,086
***Total**		$1,326,000,000	$1,193,815,701	$2,520,130,596

* Total based on 3% evasion (gasoline) and 20% evasion (diesel)