

CONTENTS

EXEMPTING NON-ROAD USERS FROM PAYING THE DIESEL

LEVY

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| | | |
|----|---|---|
| 1. | Weight-Distance Charges | 2 |
| 2. | Exempting Non-Road Users..... | 3 |
| 3. | Coloring Un-Taxed Diesel..... | 3 |
| 4. | Reimbursement of Taxes Paid | 4 |
| 5. | Compensating non-Road Users Ex Post..... | 4 |
| 6. | Special Arrangements for Dealing With Farmers | 4 |
| 7. | Examples of How Different Countries Deal with Non Road Users: Latvia, USA and japan..... | 5 |

ENSURING NON-ROAD USERS DO NOT HAVE TO PAY THE DIESEL LEVY

When significant amounts of gasoline or diesel are used for non-road purposes and the fuel levy is perceived to be high, efforts must be made to ensure that non-transport users do not have to pay the fuel levy (these problems apply primarily to diesel). Failure to address this problem may generate strong public pressure to suspend the fuel levy. There are six main ways in which different countries attempt to ensure that non-road users do not have to pay the fuel levy destined for the road fund. They include: (i) replacing the diesel levy with weight-distance charges; (ii) offering exemptions; (iii) coloring un-taxed diesel; (iv) reimbursing non-road users who have already paid the diesel levy (i.e., rebate systems); (v) compensating non road users; and (vi) devising special ways of compensating farmers (usually the most difficult group to deal with). **Method number 4 tends to be the easiest to implement in developing and transition economies. However, the best strategy is to: (i) only offer special arrangements when they are essential (i.e., when the levy is greater than \$0.05/liter); (ii) keep the system as simple as possible (to keep costs down and discourage avoidance and evasion); and (iii) search for an acceptable solution which satisfies the most important non road users.**

1. WEIGHT-DISTANCE CHARGES

New Zealand and Iceland use weight-distance fees to charge diesel vehicles for usage of roads. Norway and Sweden used weight-distance fees until the early 1990s, but have now abolished them. Namibia is planning to introduce them in the near future, and a weight-distance fee, the Euro Vignette, is under consideration in the European Union for charging foreign vehicles traveling through member countries (for example, Russian trucks entering Finland).

The basic principle is that all diesel vehicles must buy a license (in New Zealand they are issued in multiples of 1,000 km) graduated according to axle configuration and gross vehicle weight. The charges are administered through sealed hub odometers or other certified distance meters. The charge is lower for vehicles with multiple axles and increases with gross vehicle weight.

The weight-distance fee is administered separately from the general tax system, and all revenues collected from the sale of weight-distance licenses are paid into a special account set aside to support spending on roads. In addition to the weight-distance fees, Iceland and New Zealand also levy a special charge on gasoline. The revenues from this charge are also paid into the special account.

Weight-distance fees can be difficult to administer. There is considerable scope for evasion—mainly by understating vehicle weight—unless the sale of licenses can be

checked for consistency and linked to an active enforcement program. In New Zealand it is estimated that collection and enforcement absorb 3.2 and 2.0 percent respectively of gross revenues, evasion accounts for about 12 percent of net revenues (9.4 percent from heavy vehicles and 2.8 percent from light vehicles), and legal avoidance for 7 percent of net revenues. The system works satisfactorily when it is effectively administered—with fees collected under contract—and vigorously enforced. But the collection technology is now somewhat dated and countries should perhaps wait until electronic systems are available before introducing weight-distance fees. New Zealand is currently piloting such electronic (GIS-based) systems.

2. EXEMPTING NON-ROAD USERS

Under this arrangement, non-road users of diesel fuel obtain the fuel without having to pay the fuel levy that goes into the road fund. Diesel fuel is made available to non-road users either tax-free or at a reduced rate of taxation. The system is generally applied only to large users of diesel (e.g., coastal shipping or power generation). In such cases, there are few users and it is relatively easier to administer. When the exemption applies to a category which includes a large number of users, the users are required to file an exemption certificate or other documentation certifying that the diesel being purchased will not be used to power road vehicles. The exemption certificates are costly to administer when there are a large number of exempted users. Both methods (large users and small users) suffer from extremely high levels of evasion, avoidance and leakage. Road users are generally able to obtain untaxed or reduced-tax diesel very easily, and there is no simple enforcement mechanism to ensure compliance. Such exemption systems have been used in Central African Republic (for river transport and power generation), Chad (national power company) and Sierra Leone (mining industry). It was used in Ghana (fishing industry), but the exemption has been withdrawn due to the high level of evasion and avoidance. The United States also exempts certain categories of diesel user (e.g., school buses).

3. COLORING UN-TAXED DIESEL

Some countries color untaxed diesel fuel and road vehicles are then periodically inspected for use of untaxed fuel. Road vehicles are prohibited from having dyed diesel in their fuel tanks, with substantial penalties for non-compliance. Documentation to purchase dyed, untaxed fuel may or may not be required, depending on the country. There can be one or several colors used in a single country (e.g. one color is sufficient to distinguish taxed from untaxed fuel, but if different categories of diesel users are taxed at different rates, there may be different-colored dyes for diesel used in agriculture, the railways, boats, heating oil, aviation kerosene, etc.). Sometimes, this taxation/exemption system is combined with elements of system (a) whereby certain categories of road vehicles are exempt from taxation or levies (such as vehicles owned by the Government) and are allowed to purchase tax-exempt undyed diesel fuel if they can provide certain documentation. Such systems are used quite widely, although they can be difficult to administer. They also require significant resources for enforcement and prosecution of violators. In some countries, the system has been shown to be susceptible to infiltration

and domination by organized crime groups. Countries using this system include Finland, France, Pakistan, United States and United Kingdom.

4. REIMBURSEMENT OF TAXES PAID

Some countries have chosen to make everyone pay the diesel levy and to permit non-road users to apply for subsequent reimbursement. The non-road user therefore pays the fuel levy and then submits a request for a refund, together with the receipt to which the refund applies. The extent of documentation varies. In some countries, a tax-exemption card is issued and used for reimbursement, while other countries require complete documentation. The system requires a great deal of documentation and checks to prevent fraud are costly and absorb a great deal of staff time. This system is used in New Zealand where the scheme is administered under contract by the Land Transport Safety Authority who, in turn, use New Zealand Post Ltd. as their agents. Applications for refunds have to be accompanied by invoices covering the purchases on which refunds are being claimed and random audits are undertaken by the Land Transport Safety Authority Audit Unit to discourage fraud. In 1996, refunds amounted to about 3 percent of total revenues. Namibia is proposing to operate a similar rebate scheme once their road fund is in place. The United States uses the same system for certain categories of fuel users.

5. COMPENSATING NON-ROAD USERS EX POST

Instead of offering exemptions or rebates – which are difficult to administer – Latvia and Mozambique compensate selected non-transport users of diesel for having to pay the diesel levy. In Latvia, the Ministry of Finance estimates how much diesel is consumed by each main non road user group and relates this to the output of each group (i.e., number of liters of diesel used to cultivate one hectare of land, land one tonne of fish, etc.). The group is then compensated on the basis of their output and the average number of liters of diesel fuel consumed per unit of output. Mozambique uses an even simpler method to compensate farmers. Twenty percent of the diesel levy is paid into a special fund which provides financial support for agriculture.

6. SPECIAL ARRANGEMENTS FOR DEALING WITH FARMERS

Zambia does not exempt any users, although their road fund board recognizes that commercial farmers are penalized by the levy on diesel fuel. The levy is still fairly low (i.e., about \$0.03 per liter) and the problem may get more difficult as the levy rises towards the planned level of \$0.10 per liter. The board has nevertheless addressed the concerns of the farming community in two main ways: (i) the farmers are represented on the board and participate actively in all decisions about the level of the fuel levy and how the proceeds will be spent; and (ii) the funds nominally allocated for spending on rural roads (i.e., to rural district councils) is higher than might otherwise have been the case. Funds are currently divided between national, urban and rural roads in the ratio 20:40:40. Typically, rural roads receive 20 to 25% of road fund revenues. Hence, instead of offering

exemptions, the board in Zambia compensates farmers indirectly by allocating more funds for maintenance of the rural road network than might otherwise be the case.

7. EXAMPLES OF HOW DIFFERENT COUNTRIES DEAL WITH NON ROAD USERS: LATVIA, USA AND JAPAN

LATVIA: They reimburse a number of sectors to ensure they do not have to pay the diesel levy paid into the road fund.

Agriculture: Owners of agricultural land, or persons leasing such land, are entitled to claim a refund of the fuel levy, provided they have at least one hectare of land under cultivation. The refund is equal to the levy paid on 120 liters of diesel fuel per hectare of cultivated land. This figure represents the estimated amount of diesel fuel used to cultivate one hectare of land. Supportive documents include: (i) an application for refund of the diesel levy; (ii) a certified copy of the area of applicable land (certified by the head or deputy head of the regional municipality); and (iii) invoices showing purchase of diesel during the year for which reimbursement is claimed. The refund is issued within 2 weeks by the regional State Revenue Service office and is paid from the consolidated fund.

Fisheries: Fishery enterprises and individual fishermen can claim a refund of the diesel levy equal to the levy paid on 500 liters of diesel for each ton of fish caught during the year. This figure represents the estimated amount of diesel fuel used to land one ton of fish. The refund will take effect from 1st January 1998. The refund will be issued by the State Revenue Service and paid from the consolidated budget.

Industry: The government intends to extend the above exemption system to industry to cover use of diesel as a raw material in the manufacturing process. The regulations outlining how the system will work have not yet been published.

Railways: The railways are entitled to claim a refund of the levy paid on diesel used to operate and maintain the railways (currently 18 percent of total sales). The rebate is based on actual monthly purchases of diesel and is reimbursed from the road fund.

Public Transport: Rural bus services are able to claim a refund of the diesel levy used to operate their services and are also entitled to a subsidy to cover operating losses. The rebate is administered by the Ministry of Transport, while the subsidies are administered by the Regional Subsidy Commission. Payment is made from the road fund.

UNITED STATES: Farmers are exempt from paying federal tax destined for the Highway Trust Fund on the motor fuel they use in farm vehicles. Briefly, the fuel sold to farmers is dyed and does not include the tax. The vendor of the fuel has to pay the tax up front and must file for a refund from the Internal Revenue Service (IRS) to recover tax paid on tax exempt payments. The detailed mechanisms used can be downloaded from the IRS publication "Farmer's Tax Guide." The web address for IRS publications is --

"http://www.irs.ustreas.gov/forms_pubs/index.html" Once there look for Publication 225, which is the Farmer's Tax Guide. The guide is over 100 pages long. The relevant information on agricultural exemptions is on pages 88-92.

JAPAN: The entire gasoline tax is deposited into the Road Improvement Special Account. This tax is collected from wholesalers and, since there are very few exempt users (mainly chemical manufacturers), it is relatively easy to exempt them.

The diesel tax is a local government tax and is collected at the prefectural level. The entire diesel tax is earmarked for spending on local government roads. Diesel is sold to end users through wholesalers (original sellers), special assigned traders and retailers. Wholesalers are designated by the Ministry of Autonomy (local government), while special assigned traders are designated by the prefectures. Wholesalers and special assigned traders are responsible for paying taxes to the prefectures and also for collecting the diesel tax from retailers. A number of users are exempted from paying this tax, including: (i) boat users with diesel engines; (ii) the Maritime Safety Agency and the Self Defense Force (only for off road usage of diesel – power generation, operation of tanks, etc.); (iii) railway and tramway operators; (iv) farmers using diesel equipment; and (v) pottery manufacturers and wood processors who use diesel for drying and baking.

Users who are exempted from paying the diesel tax apply for a certificate from the prefectural government. They are required to submit evidence on which of their machinery uses diesel fuel and how much they are likely to consume during the year for which exemption is sought. Based on this information, the prefecture issues a Certificate of tax Exempted Diesel Fuel User. To purchase fuel tax free, the user must then obtain a Tax Exemption card from the prefecture. The cards are issued to cover purchase of 18, 100, 1,000 or 10,000 liters of fuel and are valid for one year. Complementary card for 1.5 and 10 liters are also issued. The user submits the card to the seller when purchasing diesel and the seller submits the card back to the prefectural office when accounting for the total taxes to be paid on their sales of diesel. As a check on this, end users of diesel are required to submit a monthly report to the prefectural office stating the amount of fuel purchased/used during the month and the name of the trader from whom the fuel was purchased.

The Ministry of Agriculture, Forestry and Fishery (MAFF), which is responsible for provision of agricultural and fishery roads, has successfully argued that the above exemption scheme does not fully compensate farmers and fishermen for the taxes paid on diesel fuel. As a result, the Ministry of Finance allocates some hundreds of millions of dollars a year from the general budget to support operation and maintenance of these roads. The roads financed under this program are called agricultural exemption and fishery exemption roads. Their status is usually indicated on a sign at the side of the road.