

## Memorandum

**DATE:** April 16, 2007  
**TO:** Members, Joint Finance Committee  
**FROM:** Wisconsin Petroleum Council/API, Marathon Oil Company, Flint Hills Resources, Murphy Oil USA Inc.  
**RE:** Oil Suppliers Gross Receipts Tax

**Request:** Oppose the Governor's proposal to impose a 2.5% gross receipts tax on oil suppliers who provide product for sale in Wisconsin..

### Introduction

The Governor's budget bill would establish a new tax on suppliers of motor vehicle fuel for sale in Wisconsin equal to 2.5% of the supplier's gross receipts. In addition, the bill prohibits oil suppliers from increasing the selling price of gas to recover the tax, subject to penalties, imprisonment, or both. Proceeds of the new tax are to be deposited into the Segregated Transportation Fund with estimated revenue of \$115 million in FY 08 and \$157 million in FY 09.

### **We urge you to reject this tax proposal for numerous reasons:**

1. It represents bad tax policy.
2. The logical extension of the provision leads to negative supply implications for Wisconsin consumers and independent marketers in Wisconsin.
3. It provides an unreliable source of funding for the Transportation Fund.
4. The anti-pass-through provision is unworkable and legally questionable.

### **Gross Receipts Tax is Bad Tax Policy**

- The tax is punitive. It represents a 5 cent per gallon penalty for doing business in Wisconsin. In addition, it prohibits a business from attempting to legitimately recover the external costs of doing business in this state.
- This type of tax policy discourages the supply of fuel into the state and discourages investment in Wisconsin supply infrastructure and employment.
- The stated rationale for targeting oil companies is their high level of profits. Yet, the tax misses the mark on several fronts.
  1. For the first three quarters of 2006, the oil and gas industry's earnings averaged 9.4 cents per dollar of sales compared to 9.6 cents on the dollar for all manufacturing industry (excluding the financially stressed auto industry). Using earnings as a policy litmus test puts all Wisconsin industries at risk.
  2. The major oil companies are publicly traded companies owned by shareholders. Pension plans and retirement accounts constitute over 40% of oil stock holdings,

including private pension funds (15%), federal and state pension funds (12%), and IRA's (14%). The remaining 59% of stocks are held by individuals, firms, mutual funds etc. The State of Wisconsin Investment Board (the world's 24<sup>th</sup> largest pension fund) owns over \$400 million in ExxonMobil stock alone. Who does the tax on "Big Oil" really hurt?

3. The tax is imposed on any "supplier" of motor vehicle fuel sold in Wisconsin. "Supplier", as defined in s. 78.005 (14), encompasses numerous Wisconsin oil jobbers and Wisconsin's lone oil refinery in Superior. These businesses could be severely damaged by a 2.5% tax penalty for bringing product into the state.
- Wisconsin tax policy should not be used to erect economic development barriers. Nor should it be used to render the state an unattractive tax island with respect to the sale of a market driven, international commodity.

### **The Proposed Tax Creates Negative Implications for Fuel Supply in Wisconsin**

- The Director of the Oil Pricing Information Service (OPIS) recently stated that the tax "will likely increase the price of gas" and "could result in supply shortages for Wisconsin." When and where possible, and especially during times of tight supply, fuel supplies will logically flow to the market offering the best return on investment. The proposed tax on oil company gross receipts has the effect of depressing supply to Wisconsin, which in turn has the effect of increasing demand, which has the effect of increasing consumer prices. With a proposed tax that essentially creates a 5 cent per gallon penalty for doing business in Wisconsin, it is reasonable to assume that suppliers will look first to markets outside of Wisconsin to move available supply.
- Oil companies will certainly honor supply contracts already in place. However, the proposed tax could serve as a disincentive for expanding operations and could impact future supply agreements in Wisconsin.
- The vast majority of the petroleum that flows into Wisconsin as gasoline, diesel fuel and heating oil comes from refineries located in Illinois, Indiana, Minnesota and Superior, Wisconsin. In relation to the rest of the United States, Wisconsin is literally and figuratively at the end of every petroleum pipeline. There are approximately 3,300 retail outlets that receive motor fuel from terminals located in and outside of Wisconsin who, in turn, receive motor fuel from the refineries. These 3,300 stations have two primary methods of receiving motor fuel:
  1. Long-term contracts with refiners. These long-term contracts are often up to five years in length and stipulate that the retail marketer must purchase the contracting refiner's fuel. In Wisconsin, these marketing relationships are sold under brands like Mobil, BP, Citgo and Shell. The refiners guarantee a minimum supply under all circumstances through these contracts. In return, marketers agree to look, act and market under the refiner's brand and image.
  2. Spot market purchases by independent marketers. "Spot" purchasers buy fuel on a day-to-day basis, usually buying from an array of suppliers based upon the lowest

price that day. There is no guaranteed fuel supply and the retailers often market under independent brands or even as individual stores.

- Roughly one-fourth of all fuel purchased by retail marketers is sold on a non-guaranteed “spot” basis. These “spot” marketers are most vulnerable when the flow of petroleum to Wisconsin is disrupted. They are the first to feel the pinch. “Spot” marketers are often found in rural Wisconsin.

### **The Tax is an Unreliable Revenue Source for the Segregated Transportation Fund**

- The non-pass-through provision is unworkable and may be illegal.
- While a few other states impose a gross receipts tax, no state has successfully implemented such a tax with a provision that prohibits the supplier from recouping the business cost of the tax.
- If this precedent setting tax is enacted in Wisconsin, litigation may result, which would put the revenue stream to the Transportation Fund in jeopardy.
- The “Puerto Rico” case, cited by the Administration as the legal basis for imposing the tax, is off point. That case was brought on pre-emption grounds as a violation of the Supremacy Clause. The U.S. Supreme Court found that the Puerto Rico regulations did not violate the Supremacy Clause, absent any federal law preempting state authority. The Court did not address — and was not asked to address — whether the tax and regulations violated the Commerce Clause of the U.S. Constitution. While the U.S. Supreme Court has not addressed the issue of whether a pass-through prohibition violates the Commerce Clause, at least one lower court has. In 1983, the New York Appellate Division found that such a provision *did* violate the Commerce Clause, found the provision void, and concluded the State would have to refund taxes collected for any period during which the provision was held invalid. A parallel court determination on this Wisconsin tax could create a liability hole in the Transportation Fund approaching \$1 billion.
- Wisconsin is already too reliant on fuel taxes to support the state’s transportation infrastructure. According to the Wisconsin Transportation Development Association, *“Wisconsin’s transportation funding base is the most restrictive of any state in the nation. Other states provide general fund revenue, sales tax revenue, local tax options, tolls or other revenue sources for transportation.”* The current gas tax is the single largest state revenue source for the transportation fund and accounted for 63.2% of gross revenues in 2005-06. The proposed gross receipts tax is ultimately a 5 cent per gallon increase in the gas tax.
- Wisconsin currently has the 7<sup>th</sup> highest federal/state fuel taxes in the country, at 51.3 cents per gallon. With the addition of the roughly 5 cents per gallon tax associated with the budget proposal — Wisconsin would rank 4<sup>th</sup> in the nation at 56.3 cents, exceeded only by New York (60.8 cpg), Hawaii (60.4 cpg) and California (58.6 cpg). (Tax figures current as of March 2007)

- The proposed gross receipts tax is not recognized under IFTA, which negatively affects the revenue stream from IFTA tax allocations that go to the Transportation Fund. Diesel fuel reporting and collection of tax revenues is standardized among the various states under the International Fuel Tax Agreement (IFTA). Under the agreement, diesel tax revenues are allocated among the various states based on the number of miles traveled in the state and the carrier's fuel efficiency.

### **The Proposed Tax is Unworkable and Unenforceable**

- As reported in the Wisconsin State Journal, February 18, 2007 “...experts were skeptical whether state auditors could prove that rising gas prices reflected the costs of the tax, as opposed to some other factor in a complex global market.” “...One problem for the state in shielding consumers, economists said, is that oil and gas prices bounce up and down according to a dizzying array of factors — from unrest in Nigeria to problems at Gulf Coast refineries to holiday traffic.”
- Attempting to insulate Wisconsin consumers from the cost of the tax by prohibiting oil suppliers from passing it on fails to recognize that retail prices are the product of many other decision-makers and cost components, both upstream and downstream of the oil companies. It is hard to imagine how regulating one aspect of one cost component of price, imposed on one type of company in the overall delivery system, will effectively insulate Wisconsin consumers from price adjustments at the point of a retail sale.
  1. The total amount of crude oil reserves held by all investor owned oil companies is just 6%. Over the first nine months of 2006, crude oil costs averaged 56% of the retail price of gasoline or 3 times the next highest cost components, with refining at 18% and taxes at 17%. In other words, major oil companies do not own, nor control, the major cost factors that comprise retail prices.
  2. Of the roughly 3,300 retail gas stations in Wisconsin, 3,200 are owned and managed by operators who are independent of the major petroleum refiners. These marketers make retail pricing decisions based on a variety of factors, including the right to base prices on market factors and what the market will bear.

### **Summary**

The proposed gross receipts tax on oil suppliers is a punitive tax that discourages petroleum supply investment in Wisconsin, creates an uncertain funding mechanism for the Transportation Fund, and does not effectively protect Wisconsin consumers against price increases.