

## Temperature correction fuss could force marketers to pay fuel tax on “phantom gallons”

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The current flap over temperature correction and whether refiners and marketers are gaming the system to cheat states out of millions of dollars in tax revenue is much ado about nothing, says Dave Breidenbach, former top tax attorney with Marathon Oil.

“If the people who want to change the current system get their way, marketers will end up paying taxes on fuel they never actually purchase – phantom gallons that exist only on paper,” says Breidenbach, who helped 15 states draw up their fuel tax laws during his 26-year career at Marathon.

The trouble over the industry’s temperature correction practices started when the *Kansas City Star* newspaper ran a series of articles claiming that refiners and retailers switch between gross and net billing in order to lower their fuel tax bills (OE ).

According to the Star’s calculations, the practice allows refiners and their retailers to pocket up to \$200 million a year in tax revenue that rightfully belongs to Uncle Sam.

In 2000, when IRS tried to limit the switching back and forth to stop the tax ploy, refiners used their political clout to kill the proposed regulations, the paper claims.

Because states have not adopted a uniform standard – requiring either gross or net gallon measurement – refiners and marketers are able to play games with taxes, the paper says. One way to stop the shenanigans, the Star has suggested, is to require retailers to install temperature-correction devices at retail.

The newspaper’s claims have already attracted the attention of Weights and Measures officials in several states who plan to discuss the issue at a national meeting in January.

Legislators in some states aren’t waiting for the W&M to complete their deliberations, however.

A Texas lawmaker plans to introduce a bill that would require the state Dept. of Agriculture to develop and define temperature correction for retail units based on a total of 10 different climate divisions within the state. Retailers would be required to re-calibrate their dispensers and adjust their meters based on the department's rule, says the Texas jobber group TCPA.

“Requiring marketers to install temperature-correction devices on dispensers is pointless overkill,” says Breidenbach. “It can’t be justified economically and would be practically unenforceable,” he told Oil Express.

“I doubt very much that retail dispensers could read gallonage with the accuracy necessary to precisely deliver volumes within a factor of 0.69%, which would be the variance on a 10 degree temperature adjustment,” he says. “It becomes even more complicated when you consider the new fuel blends and alternative fuels coming into the market. Each one has a different composition and a different expansion factor.”

The Texas scenario, requiring 10 different climate zones, would be even more impractical, he notes. For a start, how would regulators address the issue of ‘hotspots,’ he asks. Fuel that’s shipped from the refinery to a rack or station close by would be warmer than fuel that’s trucked further way. The volume expansion due to the warmer temperature of the fuel would be greater at the nearby station. Would the state create a special temperature zone for stations in the hotspot area? If the proposed Texas legislation is followed to its logical

conclusion, would there have to be state-issued waivers if there were a shortage of the correct-temperature fuel for specific locations?

The newspaper has also mischaracterized the role of refiners in the withdrawal of the IRS rule, Breidenbach says.

“The proposal was withdrawn when Treasury officials realized that it would be illegal under current statutes to collect tax on net gallons when the actual volume of gross gallons sold was less.”

Branded jobbers are particularly angered by the paper’s allegations when it comes to marketers.

“Terminals do not permit marketers to switch from gross or net gallons whenever they feel like it – it doesn’t matter what a state’s law says about temperature correction, the power rests with the terminal, not the marketer.” says Dan Gilligan, president of the Petroleum Marketers Assn. of America.

“This newspaper has unfairly tarnished the reputation of independent petroleum marketers across the U.S. They charged forward with a story based on inaccurate information and now PMAA will be forced to try to correct the misinformation as it shows up in other newspapers,” Gilligan notes.

The Star’s stories also could spur congressional hearings and other inquiries, he notes.

The argument put forward by the newspaper goes like this.

In warm states, retailers buy fuel temperature-adjusted to 60 degrees. By the time they sell it, the fuel is often warmer, and so consumers pay tax on an expanded volume of fuel.

For example, a Florida marketer buys 10,000 gals at a temperature of 80 degrees. The fuel is adjusted to 60 degrees, making it just 9,861 gals for tax purposes. The retailer then sells the gasoline on a gross gallon basis and pockets the extra tax pennies the consumer paid.

In colder states, fuel is sold on a gross gallon basis at both wholesale and retail. If it were temperature-corrected, retailers would have to pay more taxes. A Maine retailer, for example, buys 10,000 gals at 40 degrees. If the temperature is adjusted to 60 degrees, he would pay tax on 10,138 gals.

According to the newspaper, the biggest problem arises in the Midwest, where summers can be as hot as Florida and winters as cold as Maine. Marketers in those states switch back and forth between gross and net gallon billing, in effect gaming the system to lower their tax bills, the newspaper claims.

Breidenbach says that’s not “gaming,” but simply evening things out.

The ground temperature in Midwest states is about 55 degrees. Product that has been sitting in aboveground tanks and trucks in the summer may warm to near-ambient air temperature, anywhere from 65 to 85 degrees, he says.

When stored in an underground tank surrounded by the 55-degree wet, thermally-conductive clay-type soils common to the Midwest, gasoline will shrink. If a supplier collects and remits tax on expanded hot gallons, the retailer will pay an invoiced line greater than the tax on the gallons he sells at retail – one example of what Breidenbach calls “phantom gallons.”

“This fact of nature drives the practice of billing (and paying tax on) net gallons across southern tier states,” says Breidenbach. “If the ‘net’ measurement practice is fair in Texas in summer, why would it be insidious in Ohio in summer? Conversely, if ‘gross’ measurement is fair in Michigan, as determined by the state legislature, why would it be wrong in Ohio in winter?”

Says Breidenbach, “Certainly, the cumulative tax over a year’s time is less when suppliers are switching between seasonal modes of measurement, but there is a rational basis to it, which is why the practice is long-standing and why switching occurs most often in middle-belt states. The switching more or less matches taxes paid to gallons sold at retail – imperfect, perhaps, but a sort of rough justice.”

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