**Opinion Letter**

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| **Letter Number:** | **O-2009-010** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax; Motor Vehicle Fuel Tax** |
| **Brief Description:** | **Wholesale diesel and gasoline fuel supplies.** |
| **Keywords:** |  |
| **Approval Date:** | **03/23/2009** |

**Body:**

Office of Policy & Research

March 23, 2009

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XXXX

RE: Your letter received on February 23, 2009

Dear XXXX:

Thank you for your recent letter. You work for XXXXX in Winesburg, Ohio. The company's website contains the following description of its business operations:

XXXXX focuses on being the number one wholesale diesel and gasoline fuel supplier to the continental United States and does not import or export fuels outside of the United States like some other wholesale suppliers. We offer turnkey wholesale diesel fuel and wholesale gasoline fuel service at levels that separate us from the other wholesale diesel and wholesale gasoline suppliers across the nation.

We provide discount fuel to commercial, government, and wholesale customers of all sizes. Commercially, we service the trucking, construction, railroad, mining, and manufacturing industries as well as utilities and private fleets. In the public sector, we are both a contract and spot supplier to government agencies of all types, mass transit, and school boards. Our shipping and supply strength also allow us to provide savings to wholesale jobbers, hypermarketers, and other unbranded retailers.

We offer a full range of pricing programs, including floating index references (such as OPIS), firm prices, caps, collars, and fuel swaps. We compliment our leading edge price programs with dispatch and tank monitoring services that are unmatched in our industry.

By combining large national supply strength with local proactive service, XXXXX Corporation is the perfect 'hybrid" supplier. Contact us today and let one of our customer service representatives tell you more about the value we can create for your firm.

Your letter raises two issues about non-payment of sales tax by your customers. While you do not ask about Kansas motor fuel tax, the interrelationship between motor fuel tax and the possibility that sales tax is owed on the sale of motor fuel requires a discussion of your company's sales tax and motor-fuel tax collection duties.

Motor fuel taxes fund highway construction and maintenance in Kansas. *K.S.A. 79-3402.* Motor fuel tax is viewed as an indirect tax on highway use, since motor fuel is consumed by vehicles that operate on state highways, and the motor fuel tax proceeds pay for the construction and maintenance of those highways. *K.S.A. 79-3402.* Motor fuel tax is imposed on the use, sale, or delivery of "motor-vehicle fuels" (gasoline & gasohol) or "special fuels" (diesel, including bio-diesel) in Kansas.

Kansas sales tax is imposed on sales of tangible personal property to final users or consumers. Sales tax is not imposed on sales to retailers or distributors for resale. K.S.A. 79-3606(a) is a sales tax provision that exempts, in parts relevant here:

(a) All sales of motor-vehicle fuel . . . upon which . . [an] excise tax has been paid, not subject to refund, under the laws of this state . . . .

The "excise tax" being referred to in this sales tax exemption is motor fuel tax. This provision means that if motor fuel tax has been paid on motor fuel that is sold to an end user, no sales tax is owed on the sale. (Sales tax does not apply to sales to retailers and wholesalers --- only end users.) The "not subject to refund" provision alludes to the statutory refund procedure that motor fuel consumers must follow to obtain a refund of motor fuel tax paid for fuel the customer uses "off road" or for "non-highway" purposes. "Off road" or "non-highway" use includes the use of tax-paid fuel to power farm equipment used in crop production operations, to power boats, to heat buildings, and so forth. The refunds for off-road or non-highway use are authorized by the Kansas motor fuel tax laws since motor fuel tax is conceptually a tax on highway use.

The legal incidence of the motor fuel tax is on the "distributor of first receipt" rather than on the end user or consumer. Because of this, a customer's nonpayment of the purchase price and motor fuel tax does not relieve a Kansas distributor from reporting and remitting the motor fuel tax to the department. While a Kansas distributor is authorized to pass an amount equal to the motor fuel tax on to its customer by including that amount in it charges to the customer for motor fuel, the distributor is not required to do so. *K.S.A. 2007 Supp. 79-3409.* The distributor of first receipt remains liable for motor fuel tax regardless of whether the distributor has increased the charge to cover the motor fuel tax or collects payment for the motor fuel and associated tax from the purchaser.

Under K.S.A. 2007 Supp. 79-3408, the point of taxation for motor fuel is the terminal rack, which is at the level in the distribution chain that fuel is transferred from the bulk transfer/terminal system. A "rack" is a mechanism for delivering motor fuel from a refinery, a terminal, or a marine vessel at the supplier lever into a railroad tank car, a transport truck, a tank wagon, or other means of transfer outside of the bulk transfer/ terminal system. The distributor, manufacturer, or importer that delivers fuel from the rack is the "distributor of the first receipt of the motor fuel," and as such is responsible for computing, reporting, and paying tax on the motor fuel being delivered. However, there are several significant exceptions to the motor fuel tax imposition that are found in K.S.A. 2007 Supp. 79-3408(c). This subsection reads:

(c) No tax is hereby imposed upon or with respect to the following transactions:
(1) The sale or delivery of motor-vehicle fuel or special fuel for export from the state of Kansas to any other state or territory or to any foreign country.
(2) The sale or delivery of motor-vehicle fuel or special fuel to the United States of America and such of its agencies as are now or hereafter exempt by law from liability to state taxation.
(3) The sale or delivery of motor-vehicle fuel or special fuel to a contractor for use in performing work for the United States or those agencies of the United States above mentioned, provided such contractor has in effect with the United States or any such agency a cost-plus-a-fixed-fee contract covering the work.
(4) The sale or delivery of motor-vehicle fuel or special fuel which is aviation fuel.
(5) The first sale or delivery of motor-vehicle fuel or special fuel from a refinery, pipeline terminal, pipeline tank farm or other place to a duly licensed distributor who in turn resells to another duly licensed distributor.
(6) The sale or delivery of special fuel which is indelibly dyed in accordance with regulations prescribed pursuant to 26 U.S.C. 4082 and such special fuel is only used for nonhighway purposes.
(7) The sale of kerosene used as a fuel only to power antique steam motor vehicles first manufactured prior to 1940. *K.S.A 2007 Supp. 79-3408(c).* *(Underlining provided).*

The underlined language in subsection (5) means that no motor fuel tax is owed by a distributor that would otherwise be a distributor of first use except for the fact that is sells the fuel to *"another duly licensed distributor."* Whether this provision or any of the others provisions in subsection (c) apply is not determined at the time the motor fuel is delivered from the rack to a purchaser. Instead, the motor fuel tax that a licensed distributor owes to the department is determined based on the different motor fuel reports and returns that are filed with the department by motor fuel manufacturers, importers, distributors, retailer and exporters

All of a distributor's motor fuel purchases and sales, including those to a duly licensed distributor that fall within K.S.A. 79-3408(c), are tracked and reported on different motor fuel reports that are filed with the department by motor fuel manufacturers, importers, distributors, retailer and exporters. Motor fuel Distributors and Importers must file an MF-52, *Distributors Tax Return* along with its supporting schedules. These schedules are: (1) an MF-52A (Gasoline) and an MF-52A (Special Fuel), *Motor Fuel Tax Multiple Schedule of Receipts*; and (2) an MF-52B (Gasoline) and an MF-52B (Special Fuel), *Motor Fuel Tax Multiple Schedule of Disbursement*s. Motor fuel retailers are required to file an MF-90, *Motor Fuel Retailers' Informational Return*, along with its supporting schedules. The supporting schedules for the *Retailers' Informational Return* include: (1) an MF-90A, *Motor Fuels Retailer’s Schedule of Receipts*; (2) an MF-90B, *Motor Fuel Retailers’ Totalizer Gallonage Report*, and ( 3) an MF-90C, *Consolidated Retailer Inventory Return.*

The *Distributors Tax Return* contain, among other things, columns for reporting the number of gallons of special fuel and motor vehicle fuel that are: (1) purchased by the distributor; (2) delivered to the United State Government; (3) delivered for use as aviation fuel; (4) dyed diesel fuel; (5) delivered to other licensed distributors, (6) exported, and so forth. Before a *Distributors Tax Return* can be completed, the distributor must complete a *Motor Fuel Tax Multiple Schedule of Receipts* for both gasoline and special fuel and a *Motor Fuel Tax Multiple Schedule of Disbursement*s for both gasoline and special fuel.

A separate *Schedule of Receipts* is required to be filed for motor fuel that was: (1) received tax paid, (2) received from licensed fuel distributors tax unpaid; or (3)delivered directly to customers from other states. Each schedule asks for the name of the distributor that the fuel was acquired from, the distributor's FEIN number, the name and FEIN number of the carrier that hauled the fuel, the manifest number, the places of origin and destination, and other pertinent information.

A separate *Schedule of Disbursements* is required to be filed that reports gallons of motor fuel: (1) delivered tax collected; (2) delivered to licensed motor fuel distributors tax not collected; (3) exported; (4) delivered to the US government tax exempt; (5) delivered to other tax exempt entities, and so forth. Each schedule contains columns for reporting the buyer's name and federal employer identification number, the nameand federal employer identification number of the carrier that makes the delivery, the place of the fuel's origin and destination, the manifest number, and so forth.

Numbers from these schedules are then transferred to the appropriate line on the *Distributors Tax Return.* The completion of the return determines the amount of motor fuel tax that is owed by the distributor. In almost every instance, the reporting and accounting requirements for motor fuel tax are sufficient to document that a transaction is exempt from retailers' sales tax because motor fuel tax was paid on the fuel, the sale was for resale, the sale was to the United States Government, and so forth.

The documentation provided in these reports means that the only potential *sales tax* reporting responsibilities that a distributor can have are for the distributor's sales of fuel to end users. This is because: (1) sales tax is levied on retail sales, which are sales to the final user or consumer; and (2) sales tax does not apply to sales of motor fuel that has been subject to motor fuel. All of a distributor's sales to other licensed distributors and retailers are not subject to sales tax because they are sales for resale rather than retail sales. *See K.S.A. 79-3602(jj).* Sales for resale are adequately documented by the distributor's motor fuel reports that show the sales were made to motor fuel retailers or distributors. Similarly, all of a distributor's sales of tax paid motor fuel are exempt from sales tax under K.S.A. 79-3606(a). Again, sales that are exempt under this sales tax exemption is adequately documented by the distributor's motor fuel reports that show the sale or delivery of tax paid motor fuel. As noted, the sale or delivery of tax paid motor fuel means that sale or delivery is not subject to sales tax.

Whether or not the motor fuel tax is or is not "subject to refund" under K.S.A. 79-3606(a) is determined by the department as part of the statutory procedure for refunding motor fuel tax paid on fuel that is used "off road." As was discussed above, a motor fuel purchaser can apply to the department for a refund of motor fuel tax that was paid on taxed motor fuel used off road. Once the department determines that a refund of motor fuel tax is due, the department becomes responsible for determining whether or not sales or use tax is owed because the customer's off road use is not exempt from sales tax.

This means that a motor fuel distributor may be responsible for collecting sales tax only when it sells dyed diesel fuel to an end user or aviation fuel for aviation use to an end user. A distributor knows that it is making a retail sale of these fuels to a buyer/end user if the buyer/end user cannot provide a distributor's motor fuel license number to the distributor at the time of the buyer/end user's purchase. Whenever a distributor sells these fuels to a buyer/end user that does not have a motor fuel distributor's license, the distributor is required to either: (1) secure a sales tax exemption certificate from the buyer/end user or (2) charge and collect state and local sales tax that is sourced to the location where the fuel is delivered.

Sales tax exemption certificates that a buyer/end users typically give to a distributor for purchases of dyed diesel fuel include agricultural exemption certificates from farmers, project exemption certificates from contractors, consumed-in-production exemption certificate from a quarry, and so forth. Sales tax may also be due when a distributor sells aviation fuel for aviation use to a buyer/end user that has not been issued a motor fuel distributor's license. Sales tax exemption certificates that buyers/end users typically give to a distributor for aviation fuel purchases include interstate common carrier exemption certificates and consumed in production exemption certificates or ag exemption certificates for crop dusters. A distributor should charge and collect sales tax unless it has received one of these sales tax exemption certificate from the buyer/end user that does not have a motor fuel distributors license.

This brings us to your questions. Because I suspect that your questions may be asking about motor fuel rather than sales tax, I will answer your questions as if they are asking about both sales tax and motor fuel tax.

1. If we were to sell fuel to a licensed distributor and they default on submitting the *sales tax* to the State, would XXXXX be held accountable for the defaulted monies?

**Answer:**No. XXXXX is not liable for either sales tax or motor fuel tax on its sales to another licensed distributor.

The sale or delivery of motor fuel from one licensed motor fuel distributor to another licensed distributor are not subject to motor fuel tax or to sales tax. See *K.S.A. 2007 Supp. 79-3408(c)(5); and K.S.A. 79-3602(jj).* That these sales or deliveries are exempt from both taxes is documented by the various motor fuel reports that are filed with the department. A distributor, who would normally be considered the "dealer of first receipt," is not liable for the motor fuel tax because K.S.A. 79-3408(c)(5), in effect, shifts the legal incidence of the motor fuel tax from it to the licensed distributor that purchases and take delivery of the motor fuel. *See K.S.A. 2007 Supp. 79-3408(c)(5).* The information required in the distributor's motor fuel tax reports also establishes that the sale is a sale for resale that is exempt from sales tax. Thus, a distributor would not be subject to either motor fuel tax or sales tax for sales that a distributor can establish are sales to a second licensed motor fuel distributor.

It is important to note that when a distributor takes delivery of motor fuel and *is*responsible for the tax as the "distributor of first receipt," the distributor owes the motor fuel tax whether or not the customer pays for the motor fuel. Kansas motor fuel tax laws do not authorize a refund to be paid to a distributor that remits motor fuel tax to the state but is not paid for the fuel by its customer. Because the legal incidence of motor fuel tax is on the distributor of first receipt, the distributor's legal remedies for recovering the motor fuel taxes are the same ones it has for securing payment from the buyer. *See K.S.A. 2007 Supp. 79-3409.*

2. If we sell fuel to an end-user who defaults on paying the *sales tax* money to us as their supplier, what avenue does XXXXX have in obtaining refunds of *sales tax* monies paid on behalf of the end user?

**Answer:** In this scenario, the motor fuel is being sold to the end user. The motor fuel must be dyed diesel fuel or aviation fuel since these sales to end users are the only ones that are subject to sales tax. Therefore, this question suggests that XXXXX' reports sales tax on the accrual basis and has reported a sale and remitted the sales tax to the department. After paying the tax to the department, XXXXX determines that it is unable to collect payment from the customer. When this happens, Petroleum Trader has a bad debt that was previously reported as a taxable sale of dyed diesel fuel for sales tax purposes.

To recover the sales tax that XXXXX has reported and remitted to Kansas but never received from the customer, XXXXX is required to treat the transaction as a bad debt in accordance with the bad debt provisions set forth in the retailers' sales tax act at K.S.A. 2007 Supp. 79-3674.Treating the transaction as a bad debt allows XXXXX to recover the sales tax that it had remitted to the state but did not receive from its customer.

It is important to note that XXXXX has no recourse for recovering any motor fuel tax that it owes and paid as a "distributor of first receipt," even when a customer defaults on its payment obligations. This is because the legal incidence of motor fuel tax is on the distributor of first receipt.

The sales tax act was amended recently to change the way in which a business can recover sales tax that is paid to the state and later becomes part of a bad debt held by the retailer. *See K.S.A. 2007 Supp. 79-3674.* I hope that this letter adequately answers your questions.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 06/16/2009 Date Modified: 06/16/2009**