FUEL TAX COMPLIANCE
BEST PRACTICES

Avalara
Tax compliance done right

Contents

DISCLAIMER

Automation reduces errors and maximizes efficiencies

Downstream energy suppliers, distributors, and retailers are subject to a variety of fuel excise taxes and other complex taxes at the federal, state, and local levels.

Keeping up with all the rules, rates, and filing requirements while maintaining accurate and timely monthly filing entails considerable operational costs.

Taking shortcuts to avoid these costs can lead to tax errors and risk of significant fines and penalties.

Using technology to improve business processes

Although most businesses don't do their taxes with a pencil and calculator anymore, many fuel suppliers still use manual, error-prone, spreadsheet-based processes for tax calculation and filing. And when it comes to tackling audit readiness, critical license and exemption documents are often still kept in accordion files in filing cabinets.

KEY BUSINESS PROCESSES HAVE THE GREATEST IMPACT ON TAX COMPLIANCE COSTS AND AUDIT RISK FOR FUEL SUPPLIERS:

1

TAX CALCULATION FOR SALES INVOICING

2

MONTHLY EXCISE TAX FILING

3

AUDIT PREPARATION

In each case, we'll outline traditional business process approaches many fuel suppliers use today and contrast these with how best practices and use of automation can help optimize cost reduction and risk avoidance.

Tax calculation for sales invoicing

To accurately invoice indirect taxes, a tax determination and calculation step must be included as part of the sales invoice pricing process of the ERP or back-office system.

Automating tax determination makes it possible to consistently and more accurately calculate a complex set of fuel taxes covering multiple jurisdictions, products, and tax types. Timely cash flow requires that once a delivered bill of lading is available, the pricing and invoicing process can immediately generate an invoice. Accurate tax determination also requires ongoing tax research to ensure that critical data, such as tax rules, rates, and business partner licenses and exemptions, be maintained and kept up to date.

TRADITIONAL AUTOMATION APPROACHES

While most back-office systems are designed to automate the calculation of simple sales and use taxes, they're usually not able to handle the complexity of excise tax determination. For fuel suppliers, this kind of system typically calls for the development of custom excise tax calculation code for integration into their back-office pricing process or sales and use tax calculator. Building and maintaining this code to support complex and changing tax regulations is a costly and ongoing IT challenge. Additionally, the burden on the tax department to research tax changes, maintain tax tables, and test that your system is calculating correctly based on changes is considerable. Some back-office systems are designed specifically for bulk fuel distributors and can directly support the calculation of excise taxes. This approach eliminates the need for IT customizations, but it does nothing to ease the burden of these tasks for the tax department.

8.53%

9.47%

8.21%

#123744B5B7532#

TOTAL $25.19

INVOICE

TOTAL $

SEND

TAX ON TAX

ERP and custom-built systems also have to deal with tax on tax challenges when a sales tax (percentage based tax) needs to not only tax the price of the fuel but also add into that price the excise taxes associated with the fuel.

In California the state excise tax on gasoline is added to the price of the fuel for sales tax calculation, but diesel fuel doesn't add the state excise tax on diesel to the sales price for sales tax calculations. This calculation must be handled by the custom tax configuration within an ERP system and the rule changes must be kept up to speed.

CALIFORNIA

Fuel sales tax
State excise tax

CALIFORNIA

Fuel sales tax
(State excise tax included)

DIESEL

GASOLINE
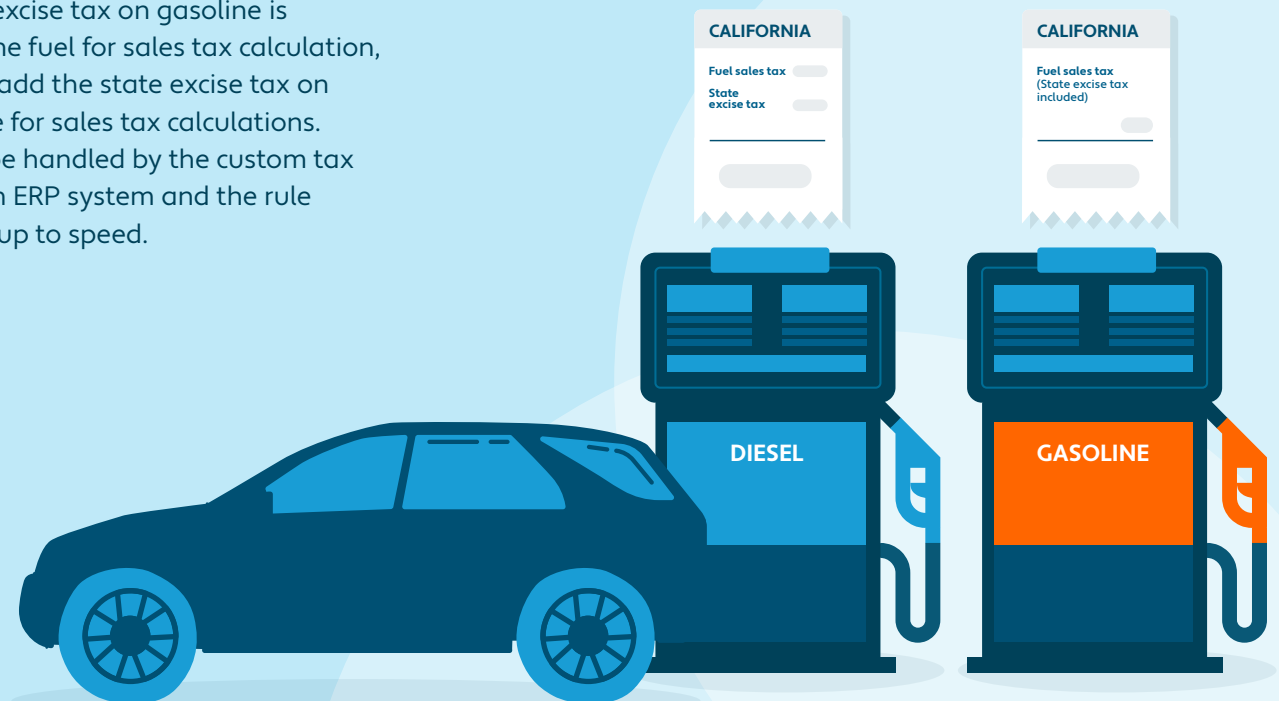
SHRINKAGE ALLOWANCE

ERP systems also have to account for shrinkage allowance calculations which differ by state and product within the state. These differing calculations can also occur in some county excise taxes. Shrinkage allowance is a negative tax (reimbursement) for licensed suppliers and distributors. Any company's marketing or sales department will pass on this shrinkage allowance to their key customers, but not all customers.

In Texas, a licensed supplier gets a 2% shrinkage allowance on the 20 cents per gallon tax charged at the rack. But if they sell to a licensed distributor then the supplier gets 0.25% and the licensed distributor gets a 1.75% shrinkage allowance varies by the following product categories: gasoline, diesel, aviation gas, and jet fuel.

0.00

GASOLINE

DIESEL

AVIATION GAS

JET FUEL
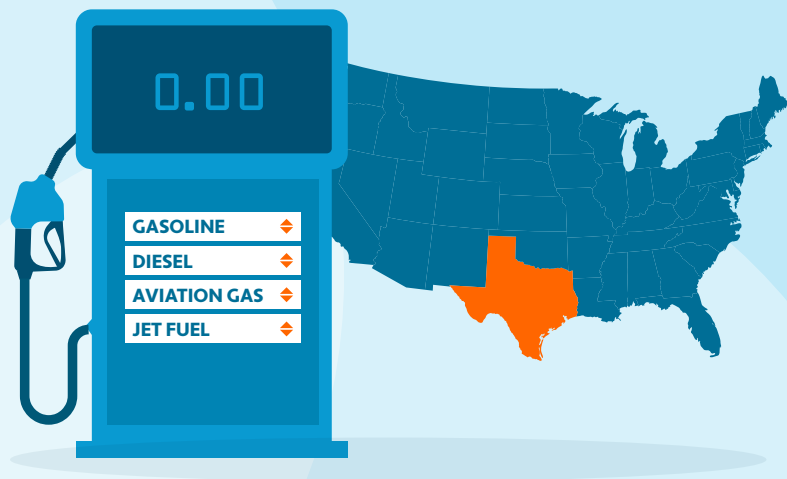
EXCEPTION PROCESSING

(usually initiated by jurisdictions)

The fuel industry often refers to the old adage that for every rule there's an exception and for every exception, there are two new rules. The best example is the federal government's ruling that suppliers have the option (or right) to legally include the lust fee, oil spill fee, and Superfund fee in the price of the product, or to separate any of them or all three as individual taxes on the invoice. The lust fee is 0.001 cents per barrel, the oil spill fee is 0.002143 cents per barrel, and the Superfund fee changed in January 2024 to 0.004048 cents per barrel.

These are the published rates for these fees. The other exception is some ERP systems can only handle three, four, or five decimal places. It's possible to take the same truckload of fuel to the same street intersection and deliver it to four different customers and they are all taxed four different ways due to the exemption options defined above. The systems all need to be able to handle customer-based exceptions.

California, New York, and several other states also have oil spill fees that operate the same way as the federal fee. There are numerous other types of exceptions to consider and keep up to date, like the California AB32 rates, which differ by supplier and product combinations.

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Many fuel suppliers are discovering that building, maintaining, and managing their own excise tax determination system is not worth their time. Third-party, off-the-shelf solutions can not only handle fuel excise taxes but can also offload the ongoing research of tax changes and tax table maintenance. These excise tax determination systems are designed to integrate with any back-office system, providing the same real-time invoice generation of custom solutions without the cost or maintenance required with a traditional approach.

Furthermore, these systems eliminate IT involvement in tax determination and change the role of the tax department from operations to exception management. Licenses and exemption documents can also be captured automatically and used to make sure taxes are only exempted when proper documentation is available. Unlike typical homegrown systems, these commercial excise tax systems provide tax transparency, so it's easy to determine exactly why a specific tax was charged or not charged.

2 Monthly excise tax filing

Ensuring monthly filing that's on time and accurate is critical to the ongoing profitability of any business. The risk of penalties and fees can quickly compound as a result of just one small error that goes unchecked. Unfortunately, that's a risk many are taking with either manual or homegrown solutions.

TRADITIONAL AUTOMATION APPROACHES

In most cases, monthly filing is a semi-automated, manual process that relies heavily on homegrown, custom spreadsheets to aggregate, normalize, and format data to comply with jurisdictional requirements. These processes depend on an expert operator who must know all about the source data, jurisdiction rules and rates, and spreadsheet macros. Typically, this person must make potentially error-prone manual entries and overrides. If the expert becomes unavailable for any reason, tax compliance is at risk. This spreadsheet-based, manual approach requires a major monthly time commitment, especially when there are multiple jurisdictions or multiple back-office systems. If corners are cut to reduce costs, tax errors or missed filing deadlines are often the result.

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A critical part of any tax compliance best practice is looking for exceptions, which is best done through automation. The first step in filing is to aggregate and validate the data from all sources. Once complete, apply any certificates and determine form requirements. Review forms and analyze for any anomalies. Once determined acceptable, prepare forms for either paper or electronic filing.

MOST COMMON ERROR FOUND WHILE FILING RETURNS

The calculation engine doesn't use the same rates, rules, and license information the returns engine does. Calculations and returns don't share master data.

Keeping master data in sync in both systems is near impossible due to the different means of storing the information in each system. This lack of cohesion will cause situations where your company pays taxes to a supplier at the rack, then turns around the next month and pays them again to the state. You might also charge your customer a different tax than you paid the state.

3

Audit preparation

Achieving audit readiness requires ongoing effort and investment. Waiting until an audit notification arrives usually brings compliance problems. The most basic requirement is to make sure the retrieval of historical transactions, schedules, returns, and amendments is easy. This information should be available for any jurisdiction, timeframe, or product at a moment's notice. A common audit problem is the inability to provide license or exemption documentation, so audit readiness requires a trusted indexing and retrieval system for these documents to be certain that if the exemption is allowed, there's a document to prove it.

A key requirement is to lock down information, including exemption documentation, when filing. This process will ensure that information is not accidentally deleted or misplaced.

TRADITIONAL AUTOMATION APPROACHES

Audits are infrequent, so audit readiness is commonly not a high priority. Typically, information required for audits is stored in a combination of databases, spreadsheets, and paper files. The storage mechanisms may even evolve over time as staff and back-office processes change. Often transactions are only captured by month as part of the returns process, which makes it difficult to pull together larger transaction sets when requested by an auditor.

Similar approaches are typical for license and exemption document storage. They're often stored as computer images, hard-copy files, or email attachments. Older files may even be archived off-site. With no central index, even if you have the document, it can be extremely hard to locate when required in an audit.

Without centralized control and a trusted lockdown method, it's very easy for an employee to misplace or accidentally delete documents that may be required in a future audit.

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Optimal audit preparation requires centralized information storage with computerized indexing for easy retrieval. Excise tax filing software acts as a storage mechanism and allows for flexible ad hoc query for any transaction, schedule, or return information across a range of dates, products, or business partners. Any information your auditor requests can be produced in minutes.

To handle quick document retrieval, tax document management software acts as the centralized storage and retrieval mechanism for all license and exemption documents. By linking directly to the tax filing system, programmed controls ensure that the exemption is not allowed if the required document is not on file. Once the taxes are filed, these files are locked and made available for a future audit. By automating the entire document life cycle, including customer solicitation, document capture, tax filing, and storage, this software eliminates the cost of manually managing these documents. Since all documents are stored electronically and indexed to the business partner and affected transactions, any document requested during an audit can be produced instantly.

Avalara

Use technology to lower costs and reduce audit liabilities

Using the right technology to audit excise tax compliance processes can have a big impact on bulk fuel suppliers, distributors, and retailers. While spreadsheets and generic tax engines provide some flexibility, they're not optimized to handle the complex rules, rates, and forms of fuel excise taxes. Using manual or partially automated solutions for tax calculation, monthly filing, or audit preparation processes can add to costs and risk tax errors and audit liabilities.

Consider tax automation software or services designed to solve the complexities of fuel excise taxes. These services monitor jurisdictions and see to it that you're using the latest rules, rates, and forms. Full automation of both tax calculation and filing eliminates manual processes and entry, resulting in the reduction of both operational costs and tax errors. Centralized tax information and document storage will provide the controls and process discipline required to ensure that you're always prepared for an audit.

LEARN MORE ABOUT HOW <u>AVALARA AVATAX FOR ENERGY AND AVALARA RETURNS FOR ENERGY</u> CAN HELP WITH YOUR COMPLIANCE NEEDS.

To learn more about Avalara for Energy solutions visit **avalara.com** or call **877-803-9818**.