HIGHWAY FUNDING

Problems With Highway Trust Fund Information Can Affect State Highway Funds
## Contents

<table>
<thead>
<tr>
<th>Letter</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Appendixes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appendix I: Relationship Between Highway User Tax Receipts and Federal Highway Program Funds</td>
</tr>
<tr>
<td>Appendix II: Treasury's Process for Allocating Tax Receipts to the Highway Account of the Highway Trust Fund Is Complex and Error Prone</td>
</tr>
<tr>
<td>Appendix III: Reliability of FHWA's Attribution Process Has Not Been Demonstrated</td>
</tr>
<tr>
<td>Appendix IV: Problems With Treasury's and FHWA's Processes Can Affect Fund Distributions to the States</td>
</tr>
<tr>
<td>Appendix V: Scope and Methodology</td>
</tr>
<tr>
<td>Appendix VI: Comments From the Internal Revenue Service</td>
</tr>
<tr>
<td>Appendix VII: GAO Contacts and Staff Acknowledgments</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Related GAO Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>60</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1: Highway User Tax Structure</td>
</tr>
<tr>
<td>Table 2: Gross Highway User Tax Receipts Credited to the Highway Account of the Highway Trust Fund, Fiscal Year 1999</td>
</tr>
<tr>
<td>Table 3: Factors for Attributing Highway User Taxes to Highway Users in Each State</td>
</tr>
<tr>
<td>Table 4: Estimated Motor Fuel Usage and Contributions to the Highway Account of the Highway Trust Fund Attributable to Highway Users in Each State, Apportionment Cycle for Fiscal Year 2000</td>
</tr>
<tr>
<td>Table 5: Calculation of the Revenue Aligned Budget Authority Adjustment, Fiscal Years 2000 and 2001</td>
</tr>
</tbody>
</table>
Abbreviations

DOT        Department of Transportation
ExFIRS     Excise Files Information Retrieval System
FHWA       Federal Highway Administration
GAO        General Accounting Office
IRS        Internal Revenue Service
ISTEA      Intermodal Surface Transportation Efficiency Act of 1991
RABA       Revenue Aligned Budget Authority
TEA-21     Transportation Equity Act for the 21st Century
June 29, 2000

The Honorable Bud Shuster
Chairman
The Honorable James L. Oberstar
Ranking Democratic Member
Committee on Transportation and Infrastructure
House of Representatives

The Transportation Equity Act for the 21st Century (TEA-21)1 authorized $217.9 billion for highway, mass transit, and other surface transportation programs for fiscal years 1998 through 2003. TEA-21 continued the use of the Highway Trust Fund—which is divided into a Highway Account and a Mass Transit Account—as the mechanism to account for federal highway user tax receipts that fund various surface transportation programs. Highway user taxes include excise taxes on motor fuels (gasoline, gasohol, diesel, and special fuels) and truck-related taxes on truck tires, sales of trucks and trailers, and the use of heavy vehicles.

TEA-21 also established mechanisms for ensuring that the level of federal highway program funds distributed to the states would be more closely linked than before to the highway user tax receipts credited to the Highway Account of the Highway Trust Fund.2 The process for distributing these tax receipts has two separate components: (1) the Treasury Department determines the overall amount of receipts in the Highway Account and (2) the Federal Highway Administration (FHWA) estimates the portion of the overall amount that is attributable to each state by using state data on motor fuel usage. Under TEA-21, billions of dollars in highway program funds—about $13 billion in fiscal year 2000 alone—are distributed to the states on the basis of information developed by the Treasury and Transportation departments.

1P.L. 105-178 (June 9, 1998).

2The Treasury Department credits most of the highway motor fuel tax receipts and all of the truck-related tax receipts to the Highway Trust Fund's Highway Account. The remaining motor fuel tax amounts are credited to the Highway Trust Fund's Mass Transit Account and to three other funds—the Leaking Underground Storage Tank Trust Fund, the Aquatic Resources Trust Fund, and the General Fund.
Given the increased linkage between Highway Account receipts and the level of highway program funds distributed to the states—and the magnitude of the dollars involved—effective processes for collecting and reporting accurate information on such receipts are critical to the effective implementation of TEA-21. As agreed with your offices, this report discusses (1) the Treasury Department's process for allocating highway user tax receipts to the Highway Account of the Fund, (2) FHWA's process for estimating motor fuel usage and the contributions to the account that are attributable to highway users in each state, and (3) the impact of these processes on the amount of highway program funds distributed to each state. This letter summarizes our findings. A more detailed analysis of each of the issues we address is presented in appendixes II through IV.

Background

Under TEA-21, the linkage between highway user tax receipts in the Fund's Highway Account and federal highway program funding levels was enhanced by (1) guaranteeing specific annual funding levels for most highway programs over a 6-year period on the basis of the projected receipts in the Highway Account, (2) providing that the guaranteed spending level for each fiscal year would be adjusted upward or downward if the receipt levels in the Highway Account increased or decreased from those projected in TEA-21, and (3) changing some of the formulas for distributing highway program funds to the states to more closely reflect estimated Highway Account contributions that are attributable to highway users in each state.

Federal highway user taxes include excise taxes on motor fuels (gasoline, gasohol, diesel, and special fuels) and truck-related taxes on truck tires, sales of trucks and trailers, and the use of heavy vehicles. The motor fuel taxes are generally paid by someone other than the consumer. Oil companies typically pay a per-gallon tax on the motor fuels at the point where their fuel is loaded into tanker trucks or rail cars at a terminal.³ Tire manufacturers pay taxes on truck tires, by weight, and retailers pay taxes on the sales price of trucks and trailers. Owners of heavy highway vehicles pay taxes on the use of these vehicles, making this the only highway tax directly paid by the highway user. The highway user pays the other taxes indirectly, since the costs of these taxes become part of the purchase price.

³A terminal is a fuel storage and distribution facility that receives fuel supplies by pipeline or vessel and from which fuel may be disbursed into a truck, rail car, or other means of transfer.
of the products taxed. Thus, the motor fuel taxes are paid by businesses rather than by consumers at retail fuel pumps.

The Treasury Department uses a revenue allocation and reporting process to distribute the highway user taxes to the Fund's Highway Account. Twice a month, business taxpayers make deposits of excise taxes—including highway user taxes—generally through Treasury's Electronic Federal Tax Payment System. Excise taxes are deposited into Treasury's General Fund as received. Treasury uses a complex and lengthy process—involving four organizations within the Department—for allocating excise tax receipts to the various trust funds, including the Highway Trust Fund. The Department uses this process, in part, because it does not obtain data from taxpayers, at the time they make semimonthly deposits, on the types of excise taxes that these deposits are intended to cover.

Since highway user taxes are generally paid by businesses, rather than consumers, most of the federal motor fuel and truck taxes come from only the handful of states where those businesses have their corporate headquarters and pay their taxes. As a result, the Treasury Department does not provide FHWA with state-level data on highway tax receipts, and FHWA must therefore estimate these data in order to distribute Highway Account funds to the states under various highway programs. FHWA estimates state-level contributions through what it refers to as its “attribution process.” Through this process, it determines each state's share of highway motor fuel usage on the basis of data provided by the states, and it uses that information to estimate the amount of contributions to the Highway Account attributable to each state's highway users. FHWA described this process in a June 1985 Federal Register notice and, according to FHWA officials, obtained comments on it from the states and from congressional staff. The information developed by Treasury and FHWA is used to determine the amounts of funds distributed to each state under several major highway programs.

TEA-21 requires that billions of dollars in highway program funds be distributed to the states on the basis of Highway Account receipts information developed by the Treasury and Transportation departments—about $13 billion in fiscal year 2000 alone. The $13 billion figure includes (1) $11.5 billion in highway program funds that were distributed to the states in fiscal year 2000 on the basis of FHWA's analysis of data on each state's motor fuel usage and (2) a $1.5 billion increase to the fiscal year 2000 overall highway program funding level originally projected in TEA-21 on the basis of Treasury's reports on Highway Account receipts. (See app. I
Results in Brief

Given TEA-21’s increased linkage between the receipts in the Highway Account of the Highway Trust Fund and the level of highway program funds distributed to the states, the quality of information developed by the Treasury Department and FHWA is more critical than ever before in determining accurate funding amounts to be distributed to the states each year. The processes used by Treasury and FHWA to estimate overall receipts and the portion of those receipts attributable to highway users in individual states are highly complex and susceptible to error, and the reliability of the estimates has not been demonstrated. As a result, there is little assurance that the actual amounts distributed to the states are accurate, although there is no way of knowing the extent of over- or under-payments, if any, to individual states, given the information currently available from the two agencies. Although the Treasury Department and FHWA are taking actions to review and improve their estimating processes, these actions are not sufficient to correct all the weaknesses. For example, although Treasury has a number of ongoing efforts aimed at improving its revenue allocation and reporting process for trust funds, it does not have a comprehensive plan, with time frames, that addresses all of the policy and process changes needed to fully implement those efforts. Furthermore, FHWA’s efforts to improve the data and methodology used in its attribution process do not verify the accuracy of the information resulting from that process. This report makes recommendations to the Treasury and Transportation departments that are designed to reduce the risk of errors and increase the reliability of the information used to distribute federal highway program funds to the states. We provided a draft of this report to the Treasury Department, the Internal Revenue Service (IRS), and the Transportation Department. IRS did not fully address whether or when the agency will take actions to implement our recommendations to the Secretary of the Treasury. Transportation and FHWA officials agreed with our recommendations to the Secretary of Transportation and indicated that they would address them as part of the agency’s ongoing efforts to improve its attribution process. All agencies, including Treasury, made technical clarifications, which we incorporated as appropriate.
The Treasury Department’s process for allocating the appropriate amounts of highway user tax receipts to the Highway Account of the Fund is complex and lengthy, in part, because the Department does not obtain data from the taxpayer on the amounts deposited for highway user taxes at the time those deposits are made. Treasury uses a very cumbersome process—involving four organizations within the Department—to estimate highway user tax receipts, credit the estimated amounts to the Fund, and subsequently certify the amounts collected and adjust the amounts credited by analyzing payment and tax return data. Furthermore, our prior reviews have repeatedly identified errors in the information used in Treasury’s process. In addition, the process may result in yearly reports on Highway Trust Fund receipts that do not contain timely information because, for example, the amounts attributable to a particular quarter have not been included in the certification for that quarter. Since Treasury’s reports on receipts are used to calculate yearly adjustments to the funding levels authorized by TEA-21, problems with the accuracy and timeliness of the information in these reports can affect the accuracy of the amounts distributed to the states.

Within Treasury, IRS is taking the lead in considering changes aimed at improving Treasury’s trust fund revenue allocation and reporting process. IRS has undertaken three major efforts in this area. For example, IRS recently completed a study that included an assessment of the taxpayer burden, potential benefits, and feasibility of requiring taxpayers to report, with their semimonthly deposits, a detailed breakdown of the amounts deposited for each excise tax, including highway user taxes. The study found that while the benefits to the government would be high, imposing such a requirement at this time would be potentially burdensome for payers of excise taxes and the quality of the data would likely be poor.

---

In this report, we use the term “allocation” to refer to the processes for transferring amounts from the General Fund to the Highway Trust Fund, on the basis of initial estimates of highway user tax receipts, and for subsequently adjusting the amounts transferred, on the basis of certified collections.

Since companies do not currently have such detailed information at the time they make their deposits. The study recommended that IRS (1) implement incentives at this time to encourage taxpayers to start providing IRS with a detailed tax breakdown with their tax deposits and (2) do another study in several years to determine whether taxpayers’ capability to provide these detailed data has improved and whether IRS should require taxpayers to provide the detailed data at that time. IRS is also designing, as part of its modernization efforts, a new payments information database that would be capable of recording payment data, by specific tax type, if provided by taxpayers with their deposits. Furthermore, IRS is planning to design a new method for allocating tax receipts to the excise-tax-related trust funds—including the Highway Trust Fund—using the taxpayer-supplied data if they become available. If taxpayers do not provide the more detailed data, the new allocation method will allocate their deposits to the trust funds using estimated tax breakdowns, as derived from their past tax returns.

While these efforts may improve the accuracy and timeliness of Treasury’s reporting on the receipts in the Highway Account of the Fund, IRS does not have a comprehensive plan, including time frames, for addressing all of the policy and process changes needed to implement its efforts, and full implementation is still years away. For example, IRS has no formal plan, including time frames, for carrying out its study’s recommendations that the agency (1) use incentives at this time to encourage taxpayers to provide detailed data with their deposits and (2) reexamine, in several years, whether taxpayers have the capability to provide these data and whether IRS should require them to do so. Furthermore, IRS’ plan for developing and implementing the new database and revenue allocation method does not address what changes may be needed—as a result of changes being planned in the revenue allocation method—in Treasury’s methods for certifying and adjusting the amounts allocated to the trust funds on the basis of analyses of tax return and payment data. IRS officials told us that the agency is tentatively planning to implement the new database and revenue allocation method in about 4 years.

Reliability of FHWA’s Attribution Process Has Not Been Demonstrated

FHWA’s “attribution” process—which estimates each state’s relative highway motor fuel usage from state tax data and uses that information to estimate the relative contributions to the Highway Account from each state’s highway users—also has significant weaknesses that raise concerns about its reliability. For example, the state data on motor fuel usage submitted to FHWA for use in the attribution process have not been
thoroughly and independently reviewed to verify their accuracy, reliability, and consistency across all states. Furthermore, FHWA's methodology for analyzing the state motor fuel data is susceptible to error, since it (1) has never been fully documented or independently reviewed; (2) is extremely complicated, involving nearly 200 formulas that are needed to accommodate all of the differences in states' methods for taxing and reporting on motor fuels; and (3) has been repeatedly adjusted over several decades in response to changing state tax laws and federal program requirements. Finally, the responsibility for collecting, analyzing, and evaluating the source data submitted by the states and for carrying out the attribution methodology rests with only two officials in FHWA headquarters, thus increasing the need for strong oversight.

FHWA has a number of ongoing efforts to review the quality of the state data and improve its attribution process, but these efforts do not fully address our concerns. For example, FHWA performs trend analyses of the state data to ensure consistency in how they are reported from year to year, and it also conducts periodic reviews of each state to review the overall methodology used to develop the key motor fuel figures reported to FHWA. While we view these as positive efforts to improve reporting by the states, these efforts do not verify the accuracy and reliability of the state data submitted to FHWA. FHWA is also addressing issues and areas for improving the reporting system for state motor fuel data with the help of a multiagency committee. The scope of FHWA's work with this committee, which was initially focused on a small percentage of the total data used in the attribution process, has evolved to include broader concerns about the attribution process. For example, FHWA plans to issue a paper describing its attribution methodology to better inform state officials about how their state motor fuel data are used in the attribution process, and the agency has also conducted outreach efforts to state officials by holding several workshops in cities across the country. However, FHWA still needs to address additional issues that we have raised about the reliability of the state motor fuel data and the attribution methodology.

In addition to FHWA's efforts, IRS is developing a data system—known as the Excise Files Information Retrieval System (ExFIRS)—that may provide information that would be useful for FHWA's attribution process. Specifically, the system may provide data on highway usage of motor fuel by federal taxpayers in each state. FHWA could use these data as a tool to validate the state motor fuel data currently used in its attribution process. Since there are some possible limitations in the reliability of the ExFIRS
information, however, FHWA and IRS would need to evaluate the information when it becomes available.

Problems With Treasury’s and FHWA’s Processes Can Affect Fund Distributions to the States

Problems with the reliability of Treasury’s and FHWA’s processes for estimating the overall level of highway user tax receipts, and the portion of those receipts attributable to the highway users in individual states, can affect the amounts that are distributed to the states under the following two methods. First, Transportation uses Treasury’s revenue reports to calculate any changes to the overall amounts of highway program funds that go to the states each year, as authorized by TEA-21.6 Second, FHWA distributes funds to the states for several major highway programs using formulas that rely to a large extent on state-level estimates of motor fuel usage and contributions to the Highway Account developed from FHWA’s attribution process. Since the amount of money distributed to the states using Treasury’s and FHWA’s information is large—about $13 billion in fiscal year 2000 alone—the potential impact of problems with the accuracy and timeliness of that information are significant. Given that the reliability of the estimates developed by Treasury and FHWA has not been demonstrated, there is little assurance that the actual amounts distributed to the states are accurate.

Conclusions

Given TEA-21’s increased linkage between the receipts in the Highway Account of the Fund and the level of highway program funds distributed to the states, the quality of the information developed by the Treasury Department and FHWA on such receipts is critical to the effective implementation of TEA-21. Taken together, the processes used by the Treasury Department and FHWA are highly complex and susceptible to error, and the reliability of the estimates resulting from those processes has not been demonstrated. As a result, there is little assurance that the actual amounts distributed to the states are accurate. The actions being taken by both the Treasury Department and FHWA to improve their estimating processes are not sufficient to correct the weaknesses and reduce the risk of errors. Treasury is several years away from implementing its efforts to improve its revenue allocation and reporting process, and it has not yet

---

6Transportation’s Office of the Secretary works with the Office of Management and Budget to develop this calculation. FHWA executes any distribution or reduction in funding resulting from this calculation.
developed a comprehensive plan, with time frames, for carrying out those efforts. Such a plan is crucial to ensure that the Department places adequate priority on examining ways to improve estimates of highway user tax receipts, which are used to make allocations to the Highway Trust Fund. With regard to FHWA’s attribution process, the state motor fuel data and the extremely detailed and complicated methodology used by FHWA to analyze those data have not been thoroughly and independently reviewed to verify their accuracy, reliability, and consistency across all states. Moreover, the methodology is not adequately documented and is the responsibility of just two FHWA officials. Finally, given the complexity of the activities reviewed in this report, the fact that two major federal departments (including four organizations within the Treasury Department) share responsibility for addressing the issues we have identified, and the magnitude of the dollars involved, the cognizant congressional oversight committees need to be annually informed of Treasury’s and FHWA’s actions to improve the reliability of the information used to distribute federal highway funds to the states.

Recommendations

To reduce the risk of errors and increase the reliability of the information used to distribute highway program funds to the states, we recommend the following:

- The Secretary of the Treasury should place greater emphasis and priority on the agency’s efforts to improve its process for allocating receipts to the Highway Trust Fund and other excise-tax-related trust funds by developing a comprehensive plan that addresses all of the policy and process changes that will be needed to fully implement these efforts. In particular, the plan should include steps and time frames for:
  - evaluating and deciding whether to use incentives as a near-term method for encouraging taxpayers to provide detailed data—at the time of deposit—on the specific types of excise taxes for which deposits are made;
  - reexamining taxpayer capabilities to provide these detailed data in several years and deciding whether to require the data from taxpayers at that time, considering the potential burden to taxpayers and the potential benefits to the government; and
  - determining what changes may be needed—as a result of changes being planned in the revenue allocation method—in Treasury’s
methods for certifying and adjusting the amounts allocated to the trust funds on the basis of analyses of tax return and payment data.

- The Secretary of Transportation should direct the Administrator of FHWA to improve the reliability of the attribution process by

- ensuring that detailed, independent verifications of motor fuel data are performed for each state, perhaps on a rotational basis over a period of years;

- fully documenting FHWA's current methodology for analyzing the state motor fuel data used in the attribution process to explain its contents and rationale and to specify the procedures for carrying it out;

- conducting an independent, comprehensive review of this methodology; and

- evaluating the potential reliability of IRS' ExFIRS data, once they become available, for use as a tool to validate the state motor fuel data currently used in the attribution process.

- The secretaries of the Treasury and Transportation should report to the cognizant highway-related authorizing committees in Congress—the Committee on Transportation and Infrastructure in the House of Representatives and the Committee on Environment and Public Works in the Senate—within 12 months, and annually thereafter, on their progress in implementing our recommendations and on the extent to which their processes for collecting and reporting information on Highway Account receipts are producing accurate, reliable data for use in distributing highway program funds to the states.

Agency Comments and Our Evaluation

We provided the Treasury Department, IRS, and the Transportation Department with copies of a draft of this report for their review and comment. Treasury officials, including the Director of the Office of Tax Analysis, deferred to IRS for a position on our recommendations to the Secretary of the Treasury—on the need to develop a comprehensive plan for improving Treasury's trust fund revenue allocation and reporting process—because they said that IRS has the lead role in considering changes aimed at improving that process. Also, Treasury officials said that they are considering our recommendation that the Secretary of the
Treasury annually report to the cognizant highway-related authorizing committees in the Congress. The officials also provided minor technical clarifications, which we incorporated into the report.

The Commissioner of Internal Revenue provided written comments on a draft of this report, which, along with our response, appear in appendix VI. IRS suggested some clarifications, which we made, in our discussion of the agency’s processes for collecting excise taxes and certifying the amounts collected. While these changes improved the accuracy of this discussion, they did not affect our conclusions and recommendations on Treasury’s process for allocating tax receipts to the Highway Trust Fund. IRS also stated that initial allocations to the Highway Trust Fund will continue to be based on estimates, which will require adjustment on the basis of factual data as such data become available. We agree. However, we believe that Treasury may have the opportunity to improve the quality of the estimates on which initial allocations are based if it obtains tax type information from taxpayers when they make their deposits. While IRS did not take exception to our recommendations, it did not fully address whether or when the agency will take actions to implement them.

To obtain Transportation’s comments on the draft of this report, we met with agency officials, including the Director of FHWA’s Office of Highway Policy Information. These officials agreed with our recommendations, indicating that they would be addressed as part of FHWA’s overall efforts to improve its attribution process. In addition, the officials asserted that FHWA uses the best available information provided by the states, along with a “reasonable, logical, and consistent process,” to produce what they believe are reproducible results and the best possible estimates of federal highway taxes attributable to each state. Although we do not dispute FHWA’s intent to develop a “reasonable, logical, and consistent” attribution process, our review showed that the reliability of that process has not been demonstrated and, as a result, there is little assurance that the actual amounts of highway program funds distributed to the states are accurate. While we recognize that state motor fuel data may be the best available information source for estimating the Highway Account receipts attributable to highway users in each state, we believe that until FHWA (1) performs detailed verifications of each state’s motor fuel data and (2) fully documents and assesses the reliability of its attribution methodology, the agency cannot ensure that its attribution process yields reliable information and the “best possible” estimates for use in distributing highway program funds to the states. These officials also made clarifying comments, which we incorporated as appropriate.
The officials also emphasized that FHWA's attribution process was based on the agency's interpretation of relevant statutes. They noted that the process was reviewed through a Federal Register notice in 1985, which allowed for broad public comment. They also said that, when TEA-21 was enacted, they recognized the need to review the attribution process, address any concerns from the states, and provide any necessary improvements. The FHWA officials also believe—on the basis of the results of a series of outreach sessions they held with the states—that the states have few specific concerns with the overall accuracy of the attribution process. Finally, these officials told us that they have identified a number of ways that the process could be improved and are continuing their efforts with the states to identify and implement any necessary modifications to the attribution process. Since our report already recognized that FHWA obtained comments on its attribution process and is working with the states to improve the process, we did not revise the report further.

In addition, the officials stated that their confidence in the results of their attribution analysis is reinforced by its relationship with an “available, independently derived, alternative method for assessing highway use.” According to FHWA officials, this alternative method involved comparing state-level data on “vehicle miles traveled” and motor fuel usage. However, the data on vehicle miles traveled have limitations as a tool for assessing the reliability of the motor fuel data currently used in the attribution process, and the comparison does not address our concern that the reliability of the attribution data and methodology has not been demonstrated. Therefore, we did not make changes to the report.

Our work was performed at several offices within the Treasury and Transportation departments. (See app. V for a detailed description of our scope and methodology.) We conducted our work from August 1999 through June 2000 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Honorable Rodney E. Slater, Secretary of Transportation; the Honorable Kenneth R. Wykle, Administrator, Federal Highway Administration; the Honorable Lawrence H. Summers, Secretary of the Treasury; the Honorable Charles O. Rossotti, Commissioner of Internal Revenue; and the Honorable Jacob Lew, Director, Office of Management and Budget. We will make copies available to others on request. If you have any questions about this report, please call me at
(202) 512-3650 or Gregory D. Kutz at (202) 512-3406. GAO contacts and staff acknowledgements are listed in appendix VII.

Phyllis F. Scheinberg
Associate Director,
Transportation Issues
The Transportation Equity Act for the 21st Century (TEA-21) continued the use of the Highway Trust Fund as the mechanism for accounting for federal highway user tax receipts that fund various surface transportation programs. Established in 1956, the Fund has been divided since 1983 into two accounts: a Highway Account and a Mass Transit account. Receipts from the Highway Account are used to fund highway programs, through which billions of dollars are distributed to the states annually for the construction and repair of highways and related activities.

Financing for the Fund is derived from a variety of federal highway user taxes including excise taxes on motor fuels (gasoline, gasohol, diesel, and special fuels) and truck-related taxes on truck tires, sales of trucks and trailers, and the use of heavy vehicles. The motor fuel taxes are generally paid by someone other than the consumer. Oil companies pay a per-gallon tax on motor fuels at the point where it is loaded into tanker trucks or rail cars at a terminal. Tire manufacturers pay taxes on truck tires, by weight, and retailers pay taxes on the sales price of trucks and trailers. Owners of heavy highway vehicles pay a tax annually on the use of these vehicles, making this the only highway tax directly paid by the highway user. The highway user pays the other taxes indirectly, since the costs of these taxes become part of the purchase price of the products taxed. Table 1 provides further details on the highway user tax structure and the rates currently in effect, as described by the Federal Highway Administration (FHWA).

<table>
<thead>
<tr>
<th>Tax type</th>
<th>Tax rate (as of Aug. 1999)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gasoline</td>
<td>18.4 cents per gallon</td>
</tr>
<tr>
<td>Diesel</td>
<td>24.4 cents per gallon</td>
</tr>
<tr>
<td>Gasohol (10 percent ethanol)¹</td>
<td>13 cents per gallon</td>
</tr>
<tr>
<td>Special fuels</td>
<td></td>
</tr>
<tr>
<td>General rate</td>
<td>18.4 cents per gallon</td>
</tr>
<tr>
<td>Liquefied petroleum gas</td>
<td>13.6 cents per gallon</td>
</tr>
<tr>
<td>Liquefied natural gas</td>
<td>11.9 cents per gallon</td>
</tr>
<tr>
<td>M85 (from natural gas)</td>
<td>9.25 cents per gallon</td>
</tr>
<tr>
<td>Compressed natural gas</td>
<td>48.54 cents per thousand cubic feet</td>
</tr>
</tbody>
</table>

¹A terminal is a fuel storage and distribution facility that receives fuel supplies by pipeline or vessel and from which fuel may be disbursed into a truck, rail car, or other means of transfer.
The Treasury Department credits most motor fuel tax receipts and all truck-related tax receipts to the Highway Account of the Highway Trust Fund. The Department of Transportation relies on Treasury to allocate highway user tax receipts to the Fund and report on the amounts credited. Transportation uses Treasury’s reports on the Fund’s overall Highway Account receipts in determining the levels of funding to be distributed to the states through several major highway programs. Table 2 shows receipts of these taxes credited by Treasury to the Highway Account of the Fund in fiscal year 1999.

Table 2: Gross Highway User Tax Receipts Credited to the Highway Account of the Highway Trust Fund, Fiscal Year 1999

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Amount of taxes</th>
<th>Percentage of total taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gasoline</td>
<td>$21,373.1</td>
<td>61</td>
</tr>
<tr>
<td>Gasohol</td>
<td>1,310.7</td>
<td>4</td>
</tr>
<tr>
<td>Diesel</td>
<td>8,388.3</td>
<td>24</td>
</tr>
</tbody>
</table>

Some of the motor fuel tax amounts are credited to the Mass Transit Account of the Highway Trust Fund, the Leaking Underground Storage Tank Trust Fund, the Aquatic Resources Trust Fund, and the General Fund.
Appendix I
Relationship Between Highway User Tax Receipts and Federal Highway Program Funds

Page 18 GAO/RCED/AIMD-00-148 Problems With Highway Trust Fund Information

(Continued From Previous Page)

Dollars in millions

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Amount of taxes</th>
<th>Percentage of total taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subtotal—all motor fuels</td>
<td>$31,072.1</td>
<td>89</td>
</tr>
<tr>
<td>Truck tires</td>
<td>416.0</td>
<td>1</td>
</tr>
<tr>
<td>Truck and trailer sales</td>
<td>2,809.9</td>
<td>8</td>
</tr>
<tr>
<td>Heavy Vehicle Use</td>
<td>813.7</td>
<td>2</td>
</tr>
<tr>
<td>Subtotal—all truck-related taxes</td>
<td>$4,039.6</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total—gross highway user taxes</strong></td>
<td><strong>$35,111.7</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

An additional $6.7 million in fines and penalties for motor carrier safety violations was credited to the Fund in 1999.

Source: GAO’s presentation of data from Treasury’s financial statements for the Highway Trust Fund for fiscal year 1999.

As shown in table 2, in fiscal year 1999, these taxes generated about $35.1 billion in gross receipts for the Fund. About 89 percent of the total receipts were derived from the excise taxes on motor fuels, and the remaining receipts came from the truck-related taxes. The total tax collections ($35.1 billion), however, were subject to certain refunds, credits, and transfers totaling about $1.3 billion; thus, net taxes totaled about $33.8 billion in fiscal year 1999.

TEA-21 established guaranteed spending levels for certain highway and transit programs. Prior to TEA-21, these programs competed for budgetary resources through the annual appropriations process with most other domestic programs. In a major change to federal budget rules, TEA-21 guaranteed a minimum level of spending for these programs. New budget categories were established for highway and transit spending, effectively establishing a budgetary “firewall” between those programs and other domestic discretionary spending programs. Of the $217.9 billion authorized for surface transportation programs over the 6-year life of TEA-21, about $198 billion is protected by the budgetary firewall—about $162 billion for highway programs and $36 billion for transit programs.

Under TEA-21, the amount of highway program funds distributed to the states is tied to the amount of tax receipts credited to the Highway Account of the Highway Trust Fund. As part of the budgetary firewall, TEA-21

Refunds and credits reflect amounts returned to taxpayers because the motor fuel was ultimately used for a tax-exempt purpose. Transfers reflect amounts transferred from the Highway Trust Fund to other trust funds as required by law.
guaranteed specific levels of funding for highway programs from fiscal year 1999 through fiscal 2003, on the basis of projected receipts of the Highway Account. Specifically, TEA-21 set a minimum amount to be available for obligation each year for the federal-aid highway program as well as several highway safety programs. The federal-aid highway program—administered by FHWA—is the umbrella term used to describe various separate highway programs or activities, such as Interstate Maintenance, the National Highway System, Surface Transportation, and others.

TEA-21 also provided that beginning in fiscal year 2000, this guaranteed funding level for each fiscal year would be adjusted upward or downward if the levels of Highway Account receipts increased or decreased from those projected in TEA-21. The Treasury Department provides information on Highway Account receipt levels used in calculating the amount of this adjustment, called Revenue Aligned Budget Authority (RABA). Any higher funding levels resulting from the RABA calculation are then distributed to the states for certain highway programs. Thus, the RABA adjustment ensures that highway program funding levels will change as Highway Account receipt levels change.

Highway account receipts are also used as a factor in distributing, or “apportioning,” funds to each state under several major programs included in the federal-aid highway program. TEA-21 significantly changed some of the formulas used to apportion funds to the states. The formulas were changed to more closely reflect factors related to the use of motor fuel and Highway Account contributions that are attributed to each state's highway users. For example, estimated Highway Account contributions are significant factors in the apportionment formulas for three of the major highway programs—the Interstate Maintenance, Minimum Guarantee, and Surface Transportation programs. In addition, data on the highway use of diesel fuel—one of the factors used to estimate contributions to the Highway Account that are attributed to highway users in each state—is used in the formula for apportioning funds for the National Highway System program.

If this RABA adjustment lowers the guaranteed funding level for a given fiscal year, TEA-21 requires that the Department of Transportation reduce proportionately the amount of funding authorized for the next fiscal year.

Apportioning is the distributing of funds using a formula provided in law.
Treasury’s Process for Allocating Tax Receipts to the Highway Account of the Highway Trust Fund Is Complex and Error Prone

The Treasury Department uses a very complex and lengthy process for allocating highway user excise taxes to the Highway Account of the Highway Trust Fund, in part, because the Department does not obtain data from taxpayers, as they make semimonthly deposits, on the specific types of excise taxes for which deposits are made. Taxpayers make semimonthly deposits of estimated excise taxes but do not provide a breakdown of the amounts owed, by tax type, until they file their quarterly tax returns. Treasury uses a process—involving four separate bureaus and offices—for making initial estimates of highway user tax receipts, allocating these amounts to the Fund, and subsequently adjusting the amounts allocated after analyzing payment and tax return data. Our previous reviews of this process have found that it is cumbersome and prone to error. In addition, the process may result in yearly reports on Highway Trust Fund receipts that do not contain timely information, for example, because the amounts attributable to a particular quarter have not been included in the certification for that quarter. The Internal Revenue Service (IRS) is considering changes aimed at improving its revenue allocation and reporting process for trust funds. Specifically, IRS has studied the taxpayer burden, potential benefits, and feasibility of obtaining more detailed excise tax payment data from taxpayers as deposits are made. IRS is also planning to develop a new database that would allow the agency to record and process more detailed tax payment data as well as a new revenue allocation method to utilize the detailed tax payment data if they become available. However, IRS’ plans for the development of the new database and revenue allocation method are not comprehensive in that they do not address policy changes needed to fully implement them, such as the actions that IRS would need to take to obtain the detailed payment data from taxpayers, if it decides to do so.

Four different bureaus and offices within Treasury—IRS, the Office of Tax Analysis, the Financial Management Service, and the Bureau of Public Debt—share responsibility for allocating excise tax receipts¹ to the Highway Account of the Highway Trust Fund. This process is highly complex and lengthy, in part, because IRS does not obtain data from taxpayers, as they make semimonthly deposits, on the types of excise taxes for which the deposits are made.

¹For the purpose of this discussion, the term receipts refers to semimonthly deposits by taxpayers for estimated tax liabilities as well as any additional amounts subsequently received for each quarter.
Appendix II
Treasury's Process for Allocating Tax Receipts to the Highway Account of the Highway Trust Fund Is Complex and Error Prone

Payers of highway user excise taxes on motor fuels, truck tires, and trucks and trailers make semimonthly deposits to cover their estimated excise tax liabilities, generally through Treasury's Electronic Federal Tax Payment System. Businesses that make these deposits do not specify which types of excise taxes they are paying with each semimonthly deposit. They are required to report the amounts owed for each specific excise tax on a quarterly tax return due 1 to 2 months after the end of each quarter. When filing the return, the taxpayer is required to make a final payment to make up the difference between the total of semimonthly deposits and the reported total amount owed for the quarter, if the latter amount is greater. Payers of the heavy vehicle use tax generally file returns annually and make payments directly to IRS. These payments may be made with the annual returns or in up to four installments.

Excise taxes received are deposited into Treasury's General Fund. Because data are not available to determine the amounts of these receipts that represent highway user taxes, Treasury uses estimates of highway user tax receipts prepared by its Office of Tax Analysis to make initial allocations from the Treasury General Fund to the Highway Trust Fund each month. After this initial allocation, IRS certifies quarterly the amounts collected for highway user taxes that should have been allocated to the Fund on the basis of tax returns and payment data. However, IRS does not certify collections for each quarter until about 6 months after the quarter ends. IRS needs this amount of time to allow for the submission and processing of returns as well as recording, reviewing, and analyzing payment and liability data. Following certification, Treasury adjusts the amount initially allocated to the Highway Trust Fund for that quarter. In fiscal years 1998 and 1999, these quarterly adjustments, which can be downward or upward, ranged from a decrease of $711 million (which changed the initial allocation by 9 percent) to an increase of $917 million (which changed the initial allocation by 11 percent).

---

2The Electronic Federal Tax Payment System allows taxpayers to make tax deposits electronically. All business taxpayers that have an annual federal tax liability exceeding $50,000 are required to use this system for making tax deposits.

3In preparing these estimates of monthly tax receipts, the Office of Tax Analysis uses estimated fiscal year tax receipts published in the President's budget each February and in a subsequent review and update of the budget each July. The Office develops overall fiscal year estimates using economic models and then develops monthly estimates by using additional models to spread the fiscal year receipt estimates over a 12-month period.
Treasury’s Financial Management Service and Bureau of Public Debt share responsibility for making the initial allocations to the Highway Trust Fund, on the basis of the Office of Tax Analysis’ estimates, and subsequent adjustments to these amounts, on the basis of IRS’ certifications. The Financial Management Service prepares vouchers for these allocations and adjustments. The Bureau of Public Debt, which maintains accounting records for the Fund, uses these vouchers to record and process the allocations and adjustments.

Following the close of each fiscal year, the Bureau of Public Debt prepares a report on the amount of tax receipts that were allocated to the Fund during that fiscal year. The Bureau issued final versions of its fiscal year 1998 and 1999 reports in January 1999 and January 2000, respectively. The Department of Transportation and the Office of Management and Budget use the Highway Account receipts figures in these reports to determine the amounts of highway program funds to be distributed to the states.

A number of our reports have cited significant weaknesses in Treasury’s process for allocating and reporting on excise tax receipts to various trust funds, including the Highway Trust Fund. Specifically, under the current process, IRS does not certify quarterly receipts that should be credited to the Highway Trust Fund until about 6 months after the end of the quarter, and this process is cumbersome and prone to error. Since Treasury’s reports on Highway Trust Fund receipts are based on IRS’ certified collections, problems with the timeliness and accuracy of IRS’ certification process may result in misstatements of receipts in the Fund for a given fiscal year.

We have reported instances in which the amounts attributable to a quarter have not been included in the certification for that quarter. For example, the amount that IRS certified to the Highway Trust Fund for the third quarter of fiscal year 1998 included approximately $590 million that was related to the previous quarter. We continued to find such instances in fiscal year 1999. For example, the amount that IRS certified to the Highway Trust Fund for the second quarter of fiscal year 1999 included nearly $700 million from previous quarters. There are a number of reasons why the

---

4IRS’ certified collection figures represent those receipts that IRS classifies as highway user tax receipts for each quarter on the basis of processed tax returns, rather than actual receipts of these taxes in that quarter.
Appendix II
Treasury’s Process for Allocating Tax Receipts to the Highway Account of the Highway Trust Fund Is Complex and Error Prone

amounts attributable to a given quarter may not be included in the certification for that quarter, but rather in a subsequent quarter’s certifications. These reasons include (1) delays in IRS’ processing of tax returns; (2) the late filing of returns by taxpayers; and (3) subsequent activities, such as amended returns submitted by taxpayers or IRS examinations resulting in adjustment or reclassification. IRS has recently implemented new procedures to address the problems of processing delays and late-filed returns. These procedures include new processes for expediting the processing and recording of high-dollar tax returns and for identifying and contacting taxpayers who have not filed by the due date in an attempt to obtain returns in time to include associated collections in the certification for the quarter.

Instances in which the amounts from a given quarter are certified as collections in a subsequent quarter sometimes result in large adjustments to initial allocations to the Highway Trust Fund. Such instances, particularly those that occur in the latter part of the fiscal year, could affect the amounts distributed to the states for that fiscal year because the certification would not be reflected in Treasury’s report on the receipts in the Fund for that fiscal year. In such cases, these amounts would be included in Treasury’s report on receipts in the Fund for the next fiscal year.

We have also reported that ineffective controls over the certification process—such as a lack of written procedures and ineffective supervisory reviews—have resulted in misstatements of the amounts certified. Although IRS implemented improvements in its certification process in response to our previous reports, we found, in reviewing certifications for fiscal year 1999 and the underlying data, that similar errors have continued. These included (1) taxpayers’ errors on excise tax returns that IRS did not identify when processing the returns, (2) errors made by IRS when processing excise tax information, and (3) errors made in IRS’ preparation of excise tax certifications.
IRS has a number of efforts aimed at improving Treasury’s trust fund revenue allocation and reporting process, but it has not yet developed a comprehensive plan with milestones for carrying out all of those efforts. For example, IRS recently completed a study that included an assessment of the taxpayer burden, potential benefits, and feasibility of requiring taxpayers to report a detailed breakdown of all excise taxes—including highway user taxes—when they make deposits of these taxes. IRS is also designing a new payment information database that would be able to record payment data, by specific tax type, if provided by taxpayers with their deposits. Furthermore, IRS is planning to design a new method for making initial allocations of tax receipts to the excise-tax-related trust funds—including the Highway Trust Fund—using the taxpayer-supplied data if they become available. If taxpayers do not provide the more detailed data, the new method will allocate their deposits to the trust funds using estimated tax breakdowns derived from their past returns. While these changes, if implemented, may improve the accuracy and timeliness of Treasury’s reporting on Highway Trust Fund receipts, IRS has not addressed all of the policy and process changes needed to fully implement its efforts, and full implementation is still years away. The effectiveness of these changes largely depends on IRS’ obtaining data from taxpayers, at the time of deposit, on the associated excise taxes. However, IRS has not yet determined whether or how to seek this information from taxpayers. IRS is preparing a plan for developing and implementing the new database and revenue allocation method. This plan includes milestones for completing the various steps involved and focuses on changes to be made in IRS’ information systems but does not address all of the policy and process changes needed to fully implement the new database and revenue allocation method.
We have raised concerns about IRS’ inability to identify revenue received for each excise-tax-related trust fund, including the Highway Trust Fund, at the time taxpayers make deposits of these taxes. Obtaining this information could improve the quality of estimates used to make initial allocations to the trust funds and could reduce the likelihood of significant adjustments. In response to our concerns, IRS completed a study in January 1999 to determine the taxpayer burden, potential benefits, and feasibility of requiring taxpayers to provide detailed tax breakdowns at the time of deposit. The study found that while the perceived benefits to the government would be high for excise taxes, imposing such a requirement at this time would be potentially burdensome for payers of these taxes, especially companies with large operations and that the quality of these data would likely be poor. In particular, large companies said they do not currently have this information available at the time of deposit and they would have to collect it from multiple plants in various states to comply with a new requirement. These companies generally make semimonthly deposits using estimates of the amounts owed, as of the previous quarter, and report actual amounts owed for each tax type on their quarterly tax returns. Although the companies interviewed for the IRS study reported that it would be difficult to comply with a new reporting requirement at this time, they indicated that they are improving their information systems and may be able to provide a detailed tax breakdown at the time of deposit in several years.


7For example, the study reported that Federal Highway Administration officials said that the detailed data would likely increase the predictability of the excise tax revenue stream and reduce the number of adjustments made to the data.
The American Petroleum Institute officials we interviewed also expressed concerns about imposing a new requirement on oil companies to provide the detailed excise tax data at this time. They explained that oil companies generally use an estimate—one-sixth of their actual total excise tax liability in the prior quarter\(^8\)—to determine the amount of their semimonthly excise tax deposits. They use this method, which allows them to fulfill IRS’ deposit requirements, because they do not have detailed tax breakdown information on a semimonthly basis.

Given the concerns about imposing a new reporting requirement at this time, the IRS study recommended that the agency implement incentives, such as a small rebate, at this time to encourage taxpayers to start providing a detailed tax breakdown with their deposits by using Treasury’s Electronic Federal Tax Payment System. This system, which most excise taxpayers use to pay their taxes, allows the taxpayer to provide a detailed tax breakdown with their deposits. The study noted that the use of this system has increased rapidly in the past several years and that an increasing number of companies could develop the capability to provide this detailed information through the system if IRS provides some encouragement, such as financial incentives, for them to do so. In order for IRS to develop such incentives, the study noted that the agency should undertake a study, as soon as possible, of state incentive programs for business taxpayers that are already in place, such as those in Pennsylvania and Virginia.

\(^8\)During any given quarterly period, taxpayers make a total of 6 semimonthly excise tax payments.
The study also recommended that IRS do another study in 2002 or 2003 to determine whether taxpayers' capability to provide these detailed data has improved and whether IRS should require taxpayers to provide this information with their deposits. IRS officials told us that the agency intends to reevaluate taxpayers' ability to provide these detailed tax breakdown data with their deposits, as recommended, but that the agency would prefer to use incentives, rather than a requirement, if it decides to obtain this information. They explained that business and taxpayer organizations are sensitive to IRS' mandating additional information from taxpayers and that the agency's goal would be to get most taxpayers to provide the needed information through an incentive system. They noted that if IRS could get large oil companies to provide information through an incentive system, it could get detailed information for a high proportion of Highway Trust Fund tax receipts. However, these officials stated that it is not possible to determine, at this point, whether or when incentives could be implemented because IRS must first determine what incentives could be offered.  

IRS officials acknowledged that the agency currently has no formal plans, including time frames, for (1) carrying out the study's recommendation that IRS examine, as soon as possible, existing state tax incentive programs to identify possible incentives that IRS could offer to taxpayers or (2) determining whether to implement incentives to obtain these detailed data from taxpayers. They also acknowledged that IRS has no formal plans, including time frames, for reexamining in several years taxpayers' capabilities for providing these detailed data and determining whether IRS should require the data from taxpayers at that time, considering the potential burden on taxpayers and the potential benefits to the government.

---

9 We have not considered whether IRS would be authorized to provide taxpayers with financial incentives to report detailed data by tax type at the time of deposit or whether IRS would require additional statutory authority to implement such a program.
IRS’ Plans for Improving Its Revenue Allocation Process for Trust Funds Do Not Address All Changes Needed for Full Implementation

IRS is pursuing two related initiatives—including the development of a payments information database and a revised revenue allocation method—for improving its process for allocating excise tax receipts to the Highway Trust Fund as well as other trust funds. Both the payment information database and the new revenue allocation method are part of an IRS modernization project, called the Custodial Accounting Project, which is aimed at developing a new integrated IRS financial information system. ¹⁰

The first initiative—which IRS started planning in October 1998 as part of a broad effort to modernize its information systems—involves establishing a database that can record and process the detailed tax breakdown data discussed above, should taxpayers provide that information with their deposits. According to IRS officials, the database will be capable of recording such detailed tax data and will serve as a repository for all IRS payment data.¹¹ Although the Electronic Federal Tax Payment System allows taxpayers to provide detailed tax breakdowns with their deposits, IRS’ information systems are not currently capable of accepting these data.

The other initiative—which IRS started planning in response to a recommendation in its January 1999 study—involves revising the method used to make initial allocations of tax receipts to the trust funds to incorporate the more detailed tax payment information in the database or in taxpayers’ historical records. This new method would make initial allocations automatically, shortly after the time of deposit, on the basis of a detailed tax breakdown provided by the taxpayer, if that information is

¹⁰Since 1995, the Congress and GAO have raised concerns about IRS’ capability to effectively build modernized systems. While IRS has taken actions aimed at addressing these concerns, we have recently reported that IRS continues to lack this capability and that substantial challenges remain to establishing it. See, for example, Tax Systems Modernization: Results of Review of IRS’ March 7, 2000, Expenditure Plan (GAO/AIMD-00-175, May 24, 2000), IRS Modernization: Long-term Effort Under Way, but Significant Challenges Remain (GAO/T-GGD/AIMD-00-154, May 3, 2000), IRS Modernization: Business Practice, Performance Management, and Information Technology Challenges (GAO/T-GGD/AIMD-00-144, Apr. 10, 2000), Tax Systems Modernization: Results of Review of IRS’ Initial Expenditure Plan (GAO/AIMD/GGD-99-206, June 15, 1999), Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998), Tax Systems Modernization: Actions Underway, but IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996), and Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected if Modernization Is to Succeed (GAO/AIMD-95-156, July 26, 1995).

¹¹These payments include taxes, penalties, fees, and other remittances.
available. If that information is not available, this new method would automatically allocate deposits to the trust funds using estimated tax breakdowns derived from each taxpayer's past tax returns. IRS is developing this new revenue allocation method in coordination with the Office of Tax Analysis, the Financial Management Service, and the Bureau of Public Debt.

IRS officials explained that the goal of this new revenue allocation method is to improve the accuracy and timeliness of allocations to the trust funds. For example, Treasury officials expect that the new initial allocation method will be more precise than the current method because it will be based on taxpayers’ actual deposit amounts\(^{12}\) rather than overall estimates of tax receipts, by tax type, prepared by Treasury's Office of Tax Analysis. Furthermore, IRS officials explained that—although IRS would still need to certify the amounts due to the trust funds and make adjustments to initial allocations that are based on tax returns—the certification and adjustment methods used could be improved as a result of the development of the new revenue allocation method and the integrated financial information system. They explained that the current certification and adjustment methods, which are performed quarterly through a combination of manual procedures and computer programs, could be replaced by an automated method that occurs more frequently. However, it is not yet clear exactly how these methods would change, and IRS officials noted that any changes would need to be determined jointly by responsible Treasury organizations. Furthermore, the changes being considered do not address all of the control weaknesses identified in our prior reports, such as taxpayers’ errors on excise tax returns that IRS does not identify when processing the returns and errors made by IRS when processing excise tax return information.

IRS' plan for the development and implementation of the new database and revenue allocation method is still in the early stages and does not address all of the factors that will need to be considered to implement these two initiatives. IRS officials told us that, on the basis of tentative milestones in this plan, they expect to start implementing the new database and allocation method in 2004. Although the plan contains specific tasks and associated time frames, IRS officials acknowledged that the plan focuses on the technical changes needed in IRS’ information systems and does not

\(^{12}\)These amounts will be broken down by tax type on the basis of information provided by the taxpayer (if available) or in IRS’ historical taxpayer account records.
address all of the policy and process changes needed to fully implement the new database and revenue allocation method. In particular, the plan does not include time frames for examining, in the near-term, possible incentives for encouraging taxpayers to provide these data and determining whether to implement incentives. Also, the plan does not include time frames for reexamining, in several years, taxpayers’ capabilities for providing these detailed data, and determining whether IRS should require the data from taxpayers at that time. Finally, the plan does not address the need for, or include time frames for, determining what changes may be needed in Treasury’s methods for certifying the amounts due to the trust funds and adjusting initial allocations on the basis of these certifications.
Reliability of FHWA’s Attribution Process Has Not Been Demonstrated

While Treasury reports on the overall amounts of highway user taxes credited to the Highway Account of the Fund, FHWA must estimate the portion of the overall amounts that are attributable to each state—information that is ultimately used in distributing funds to the states through the apportionment process used in several major highway programs. FHWA estimates the amounts attributable to each state through its “attribution” process. The underlying premise of this process is that federal highway user tax payments to the Highway Account are received from highway users in each state in proportion to the highway use of motor fuel in that state relative to total highway use of motor fuel in all states. Under this process, FHWA goes through a two-fold process to (1) collect and analyze state motor fuel information to develop a uniform database across all states and determine the portion of motor fuel that was used on highways in each state and (2) use the resulting analyses to estimate the amount of Highway Account contributions that are attributable to highway users in each state. The steps related to the state motor fuel analysis used in the attribution process are complicated, utilizing nearly 200 formulas for analyzing the data. In designing these formulas, FHWA’s intent was to analyze the state motor fuel data in a manner that ensures equitable treatment of all states. The large number of formulas reflect the wide variation in the ways that states (1) tax motor fuels and (2) define, capture, and report certain data items to FHWA.

Given the complexity of the state motor fuel analysis used in the attribution process and the fact that it has been developed over decades without any thorough, systematic, or independent review of its accuracy, reliability, or consistency, we have concerns about the overall reliability of the process. Furthermore, FHWA has identified some specific weaknesses in the motor fuel data and attribution methodology, which it is addressing through its participation in a multiagency committee aimed at improving the motor fuel reporting process. In addition, IRS is developing a system that will provide an alternate source of information on motor fuel that may be useful as a tool in validating the state motor fuel data currently used in FHWA’s attribution process.
FHWA Attribution Process Is Needed Because of Limitations in Federal Highway User Tax Data

FHWA must estimate the contributions to the Highway Account that are attributable to each state's highway users because state-level data on federal highway tax receipts are not available. Most of the federal highway user taxes are not collected directly from the consumer. For example, all of the federal taxes on motor fuels are imposed when the fuel is first removed from bulk storage. Thus, the taxes are paid by businesses—typically the major oil companies—rather than by consumers at retail fuel pumps. As a result, most of the federal motor fuel taxes come from the handful of states where the businesses are headquartered. Similarly, the tax on truck tires is collected from the manufacturer and, as a result, the truck tire tax receipts are concentrated in Ohio, the home of the U.S. tire industry.

FHWA estimates state-level contributions to the Fund through its “attribution” process, which is basically a process of determining each state's share of highway motor fuel use from state tax data and using that information to estimate the amount of contributions to the Highway Account attributable to each state's highway users. The relative percentage of contributions attributed to each state is then used to calculate a portion of the amount of federal-aid highway dollars distributed to each state.

FHWA and its predecessor agencies have been collecting state data on motor fuels since 1919 to determine the highway use of motor fuel and to identify how states tax motor fuel. FHWA publishes statistics on motor fuel usage and other highway topics in an annual report. FHWA first began using that information to estimate Fund payments during the 1970s as part of an analysis of issues related to so-called “donor/donee” states. Since fiscal year 1984, FHWA has used state-reported data on motor fuel, supplemented with information from other sources, to attribute federal tax payments to the Fund to highway users in each state for the purpose of apportioning highway program funds. FHWA also uses statistical methods to estimate missing or unreported state data used in the state motor fuel

---

1 These taxes become part of the price of the product and are ultimately paid by the highway user.

2 For example, see Highway Statistics '98, U.S. Department of Transportation, Federal Highway Administration (1999).

3 In some states, known as “donor” states, highway users pay more in highway user taxes than those states receive in federal highway funds. Conversely, in states known as “donee” states, highway users pay less in highway user taxes than those states receive in federal highway funds.
data analysis portion of the attribution process. FHWA informed the states of its proposed attribution methodology in 1983 and solicited their comments on it. FHWA finalized the methodology and published a description of it in a June 1985 *Federal Register* notice. According to FHWA officials, the methodology has generally been supported by the states since that time.

In the attribution process, FHWA calculates ratios of the highway use of motor fuel in each state to the highway use of motor fuel in all states. As shown in table 3, FHWA prepares a separate attribution analysis for each type of motor fuel tax (gasoline, gasohol, and diesel and special fuels), and it attributes the truck-related taxes (tires, truck and trailer sales, and heavy vehicle use) to the states using data on the highway use of diesel and special fuels.

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Attribution factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gasoline</td>
<td>Ratio of highway use of gasoline in each state to highway use of gasoline in all states.</td>
</tr>
<tr>
<td>Gasohol</td>
<td>Ratio of highway use of gasohol in each state to highway use of gasohol in all states.</td>
</tr>
<tr>
<td>Diesel and special fuels</td>
<td>Ratio of highway use of diesel and special fuels in each state to highway use of diesel and special fuels in all states.</td>
</tr>
<tr>
<td>Truck-related taxes (truck tires, truck and trailer sales, heavy vehicle use)</td>
<td>Ratio of highway use of diesel and special fuels in each state to highway use of diesel and special fuels in all states.</td>
</tr>
</tbody>
</table>

Source: FHWA.

The factors shown in table 3 are used by FHWA to attribute Highway Account receipts to the states, and that information is incorporated, in turn, in the apportionment formulas used for distributing certain federal-aid highway program funds back to the states.
In its attribution process, FHWA first performs complicated and lengthy steps to collect information from the states on the gallons of motor fuels consumed and to analyze that information in a consistent format for the purpose of determining each state's share of the highway use of motor fuel. FHWA's intent is to analyze the state motor fuel data in a manner that ensures equitable treatment of all states. Once this is done, FHWA uses the results of the analysis to estimate the relative contributions to the Fund from each state's highway users. The following is a summary of the key steps involved in the attribution process and their associated time frames for the process culminating in the apportionment of funds in fiscal year 2000.

The attribution process begins with the collecting and reporting of information on the use of motor fuels by each state. To do this, each state submits a monthly report on the volume of motor fuels used within that state (FHWA Form 551M, entitled “Monthly Motor Fuel Consumption”). The report is designed to capture and report many details about the motor fuel, including the (1) type of fuel used (e.g., gasoline, gasohol, and diesel and other special fuels\(^4\)), (2) tax status of the fuel (e.g., amounts that are fully taxed at the state's prevailing rate, taxed at some other rate, or subject to exemptions or refunds), (3) reason for tax exemption (e.g., loss or shrinkage of fuel, federal government use), and (4) reason for tax refund (e.g., specific classes of nonhighway use of fuel, such as agriculture, aviation, industrial and commercial, construction, and marine).

States have 60 days from the end of the month to submit the Form 551M for that month to FHWA. While each state's transportation department generally takes the lead in providing FHWA with the motor fuel data, the source data come from the state's revenue department or agency. FHWA provides the states with detailed instructions for reporting the motor fuel data in chapter 2 of its publication, *A Guide to Reporting Highway Statistics*.

---

\(^4\)Special fuels include liquefied petroleum gases, compressed natural gas, and other fuels.
FHWA Prepares an Annual Summary of State Motor Fuel Data and Analyzes the Data to Identify Highway Usage of Motor Fuel and to Reconcile Inconsistent Data

After the states have submitted all of the monthly reports for a given calendar year, FHWA prepares a summary version of Form 551M for each state; the summary version contains data for the preceding 12-month calendar period. FHWA then performs a quality check that involves (1) estimating state tax receipts by using the summary data on motor fuel gallons and information about each state's motor fuel tax rates and (2) comparing the estimated receipts with actual state tax receipts reported to FHWA on another form.5

FHWA must analyze the monthly motor fuel data submitted by the states to determine the portion of the motor fuel that was used on the highways and to develop a uniform database across all states. State data on motor fuel usage are derived primarily from information from their tax agency, and there is significant variation among states in the ways that various motor fuels are taxed and the ways that certain data items are defined, captured, and reported to FHWA. Generally, state motor fuel taxes are levied on road users, and exemptions to the tax or refunds of the taxes paid are given for nonhighway use of the motor fuel. However, not all states offer the same exemptions or refunds for all classes of nonhighway use, and not all refunds are actually claimed. Thus, the net volume of motor fuels taxed in a state is not always the same as the volume consumed on the highways.

Typically, state revenue departments have data on motor fuels that are exempted, refunded, or taxed at multiple rates. From this information, FHWA attempts to identify the use of the fuel and thus its place in the attribution process. To do this, FHWA maintains records on about 90 subcategories in which these data are reported by the states and uses this information to estimate highway versus nonhighway use of motor fuels and reconcile any data that were inconsistently reported by the states. FHWA's methodology for analyzing the motor fuel data submitted by the states has evolved over several decades and is very complex—involving nearly 200 formulas that analyze the subcategories of motor fuel data.

In many cases, sufficient data do not exist at the state level to determine the highway versus nonhighway use of the various motor fuels and, in other cases, FHWA considers some of the motor fuel data submitted by the states to be inconsistently developed. As a result, FHWA estimates some components of motor fuel usage—including the government use of

5FHWA Form 556 entitled “State Motor Fuel Tax Receipts And Initial Distribution By Collection Agencies.”
Reliability of FHWA's Attribution Process Has Not Been Demonstrated

To estimate state-level contributions to the Fund's Highway Account, FHWA computes each state's relative share of fuel gallons used on the highways and multiplies this computation by the amount of highway user tax receipts allocated to the account (as determined by Treasury's revenue reports). To do this, FHWA first calculates three main data elements on motor fuel gallons used on highways for each state: (1) total motor fuel gallons, (2) total diesel and special fuels gallons, and (3) total gasoline and gasohol gallons. FHWA then computes each state's relative share of highway gallons by calculating the ratio of the gallons used in the state to the total gallons used in all states.

In general, the ratio for a given fuel type is used to attribute tax receipts for that particular fuel type (e.g., the ratio for gasoline and gasohol use is used to attribute gasoline and gasohol tax payments). The one exception pertains to the truck-related taxes (truck and trailer sales, truck tires, and
heavy vehicle use), which are attributed to states on the basis of highway use of diesel and special fuels—a factor that FHWA considers to be the best available proxy measure for truck use in each state.

For each of the fuel types, the resulting percent share of gallons used in each state is then multiplied by the amount of highway user tax receipts allocated to the Fund’s Highway Account, as reported by the Treasury Department. FHWA generally receives reports on Highway Account receipts from Treasury about 9 to 10 months prior to the effective date of the apportionment of funds to the states. For the fiscal year 2000 apportionment cycle, for example, FHWA used a report on Highway Account receipts for fiscal year 1998 that it received from the Treasury Department in January 1999. The end result of this analysis is a table showing estimated contributions to the Highway Account of the Fund attributed to each state for each of the fuel types.

FHWA finalizes its estimate of state-level data on contributions to the Highway Account of the Fund about a month before the effective date of the apportionment. For example, it prepared the estimates for the apportionment for fiscal year 2000—which became effective on October 1, 1999—in August 1999, using the state data on motor fuel usage for calendar year 1997 and the Treasury report on Highway Account receipts for fiscal year 1998.

In total, FHWA’s overall attribution process takes about 19 months from the time that states submit their final reports on motor fuel usage for a given calendar year to the time that FHWA apports funds to the states on the basis of its state-level analysis of estimated contributions to the Fund. The lengthy time period associated with the process is largely due to the amount of time (about 17 months6) that FHWA, in consultation with the states, devotes to analyzing the state motor fuel data. For the fiscal year 2000 apportionment cycle, for example, FHWA received the state motor fuel data in March 1998, obtained Treasury’s revenue reports in January 1999, and apportioned the highway program funds to the states in October 1999. Table 4 contains the results of FHWA’s attribution process for the fiscal year 2000 apportionment cycle.

---

6FHWA obtained and analyzed the 1997 state motor fuel data from March 1998 through August 1999—a period of about 17 months.
## Table 4: Estimated Motor Fuel Usage and Contributions to the Highway Account of the Highway Trust Fund Attributable to Highway Users in Each State, Apportionment Cycle for Fiscal Year 2000

Dollars in thousands

<table>
<thead>
<tr>
<th>State</th>
<th>1997 highway motor fuel usage (percent share)</th>
<th>1998 Highway Account receipts attributable to states</th>
<th>Percentage of total Highway Account receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gasoline</td>
<td>Gasohol</td>
<td>Diesel and other special fuels</td>
</tr>
<tr>
<td>Alabama</td>
<td>2.11</td>
<td>0.27</td>
<td>2.28</td>
</tr>
<tr>
<td>Alaska</td>
<td>0.16</td>
<td>0.60</td>
<td>0.17</td>
</tr>
<tr>
<td>Arizona</td>
<td>1.62</td>
<td>2.65</td>
<td>2.04</td>
</tr>
<tr>
<td>Arkansas</td>
<td>1.28</td>
<td>-</td>
<td>1.84</td>
</tr>
<tr>
<td>California</td>
<td>11.09</td>
<td>16.37</td>
<td>7.92</td>
</tr>
<tr>
<td>Colorado</td>
<td>0.97</td>
<td>5.93</td>
<td>1.22</td>
</tr>
<tr>
<td>Connecticut</td>
<td>1.21</td>
<td>0.23</td>
<td>0.84</td>
</tr>
<tr>
<td>Delaware</td>
<td>0.33</td>
<td>-</td>
<td>0.22</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>0.16</td>
<td>-</td>
<td>0.07</td>
</tr>
<tr>
<td>Florida</td>
<td>6.22</td>
<td>0.09</td>
<td>3.92</td>
</tr>
<tr>
<td>Georgia</td>
<td>3.94</td>
<td>-</td>
<td>4.11</td>
</tr>
<tr>
<td>Hawaii</td>
<td>0.36</td>
<td>-</td>
<td>0.10</td>
</tr>
<tr>
<td>Idaho</td>
<td>0.55</td>
<td>-</td>
<td>0.76</td>
</tr>
<tr>
<td>Indiana</td>
<td>2.08</td>
<td>4.08</td>
<td>3.34</td>
</tr>
<tr>
<td>Iowa</td>
<td>0.75</td>
<td>3.79</td>
<td>1.59</td>
</tr>
<tr>
<td>Kansas</td>
<td>1.14</td>
<td>0.18</td>
<td>1.31</td>
</tr>
<tr>
<td>Kentucky</td>
<td>1.85</td>
<td>0.43</td>
<td>2.29</td>
</tr>
<tr>
<td>Louisiana</td>
<td>1.78</td>
<td>0.05</td>
<td>1.82</td>
</tr>
<tr>
<td>Maine</td>
<td>0.62</td>
<td>-</td>
<td>0.48</td>
</tr>
<tr>
<td>Maryland</td>
<td>2.05</td>
<td>0.3</td>
<td>1.44</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>2.38</td>
<td>-</td>
<td>1.22</td>
</tr>
<tr>
<td>Michigan</td>
<td>4.07</td>
<td>1.76</td>
<td>2.82</td>
</tr>
<tr>
<td>Minnesota</td>
<td>0.33</td>
<td>13.61</td>
<td>1.73</td>
</tr>
<tr>
<td>Mississippi</td>
<td>1.36</td>
<td>-</td>
<td>1.5</td>
</tr>
<tr>
<td>Missouri</td>
<td>2.63</td>
<td>0.45</td>
<td>3.04</td>
</tr>
<tr>
<td>Montana</td>
<td>0.42</td>
<td>-</td>
<td>0.61</td>
</tr>
</tbody>
</table>
### Appendix III
Reliability of FHWA’s Attribution Process Has Not Been Demonstrated

(Continued From Previous Page)

<table>
<thead>
<tr>
<th>State</th>
<th>1997 Highway Motor Fuel Usage (Percent Share)</th>
<th>1998 Highway Account Receipts Attributable to States</th>
<th>Percentage of Total Highway Account Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gasoline</td>
<td>Gasohol</td>
<td>Diesel and Other Special Fuels</td>
</tr>
<tr>
<td>Nebraska</td>
<td>0.55</td>
<td>1.28</td>
<td>1.10</td>
</tr>
<tr>
<td>Nevada</td>
<td>0.60</td>
<td>1.47</td>
<td>0.77</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>0.57</td>
<td>-</td>
<td>0.40</td>
</tr>
<tr>
<td>New Jersey</td>
<td>3.31</td>
<td>1.30</td>
<td>2.35</td>
</tr>
<tr>
<td>New Mexico</td>
<td>0.64</td>
<td>1.31</td>
<td>1.18</td>
</tr>
<tr>
<td>New York</td>
<td>4.83</td>
<td>1.91</td>
<td>3.13</td>
</tr>
<tr>
<td>North Carolina</td>
<td>3.19</td>
<td>2.28</td>
<td>2.93</td>
</tr>
<tr>
<td>North Dakota</td>
<td>0.27</td>
<td>0.32</td>
<td>0.48</td>
</tr>
<tr>
<td>Ohio</td>
<td>2.98</td>
<td>9.87</td>
<td>4.71</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>1.62</td>
<td>-</td>
<td>1.94</td>
</tr>
<tr>
<td>Oregon</td>
<td>1.29</td>
<td>-</td>
<td>1.38</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>3.85</td>
<td>4.57</td>
<td>4.28</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>0.36</td>
<td>-</td>
<td>0.15</td>
</tr>
<tr>
<td>South Carolina</td>
<td>1.92</td>
<td>-</td>
<td>1.8</td>
</tr>
<tr>
<td>South Dakota</td>
<td>0.21</td>
<td>1.07</td>
<td>0.49</td>
</tr>
<tr>
<td>Tennessee</td>
<td>2.55</td>
<td>0.02</td>
<td>2.68</td>
</tr>
<tr>
<td>Texas</td>
<td>8.71</td>
<td>2.79</td>
<td>8.04</td>
</tr>
<tr>
<td>Utah</td>
<td>0.85</td>
<td>-</td>
<td>1.02</td>
</tr>
<tr>
<td>Vermont</td>
<td>0.29</td>
<td>-</td>
<td>0.27</td>
</tr>
<tr>
<td>Virginia</td>
<td>2.85</td>
<td>2.30</td>
<td>2.88</td>
</tr>
<tr>
<td>Washington</td>
<td>2.08</td>
<td>2.34</td>
<td>1.62</td>
</tr>
<tr>
<td>West Virginia</td>
<td>0.77</td>
<td>0.01</td>
<td>0.87</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>1.50</td>
<td>4.14</td>
<td>2.19</td>
</tr>
<tr>
<td>Wyoming</td>
<td>0.28</td>
<td>0.01</td>
<td>0.90</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
<td><strong>100.00</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>
Reliability of FHWA's Attribution Data and Process Has Not Been Demonstrated

On the basis of our review and recent work by FHWA, we have a number of concerns regarding both the motor fuel data submitted by the states and FHWA's methodology for analyzing those data for use in its attribution process. Some of these concerns involve the overall reliability of the state data and FHWA's methodology, and FHWA's efforts to improve its attribution process only partly address these concerns. Other concerns relate to specific weaknesses in certain aspects of the state data and FHWA's methodology, and FHWA has formed a committee that is helping the agency take actions to address these concerns.

FHWA Has Not Fully Addressed Concerns About the Overall Reliability of the Attribution Data and Methodology

The state motor fuel data submitted to FHWA have not been thoroughly and independently reviewed to test and verify their accuracy, reliability, and consistency across all states, which raises questions about the overall reliability of the state data and FHWA's attribution methodology. Although the original source data on motor fuel tax receipts prepared by the state revenue agencies may be audited by the states, according to FHWA officials, FHWA does not trace the individual data elements submitted on Form 551M to their supporting documentation to verify the underlying support. Since the source data provided by the state revenue agencies must be reformatted and analyzed by officials in the state transportation agencies and by FHWA, there are significant opportunities for errors to occur. Given the wide variation in state tax methods and data, FHWA would probably have to review and verify each state's summary tax records. While the potential magnitude of any errors that would be identified as a result of such detailed reviews is unknown, conducting such reviews would provide an indication of the scope of any inaccuracies or assurance that the motor fuel data submitted by the states are sound. At the same time, we recognize that since the costs involved with conducting such reviews may be high, FHWA would have to consider various options for doing them. One option might be for FHWA to conduct the reviews on a rotational basis over a period of years.

Another concern about the reliability of FHWA's attribution process pertains to the complexity of FHWA's methodology, the way it has been developed, and the fact that it has never been fully documented or independently reviewed. Because of the wide variation in the ways that
Appendix III
Reliability of FHWA’s Attribution Process Has Not Been Demonstrated

states tax motor fuels—and the ways that certain data items are defined, captured, and reported to FHWA—FHWA’s methodology for analyzing the motor fuel data submitted by the states is extremely complicated. The methodology involves a spreadsheet program that has nearly 200 separate formulas needed to analyze the state data in a manner that is consistent across all states. Furthermore, the methodology has been repeatedly adjusted over several decades in response to changing state tax laws and federal program requirements. Moreover, the methodology has never been fully documented to explain the content and rationale for the formulas it contains and to specify the procedures for carrying it out. The methodology now contains some factors that are not used because FHWA officials consider them unreliable. Finally, the attribution methodology has never been subject to a comprehensive, independent review to validate its reliability and provide assurance that the information resulting from the methodology is accurate.

In addition, FHWA considers some of the motor fuel data submitted by the states to be inconsistent with that provided by other states—such as data on the gallons consumed by various industries for nonhighway purposes—so it estimates those gallons using other federal data sources. FHWA officials told us that they use their judgment in deciding which figure to use in the attribution process—sometimes they choose to use the state-submitted data, sometimes they choose to use FHWA’s own estimates, and sometimes they use a figure that combines both data sources. According to FHWA officials, once FHWA decides how it will handle a particular state’s data, it makes note of that decision and follows it consistently from year to year until it makes a judgment that further changes are warranted.

Finally, all of the responsibility for collecting, analyzing, and evaluating the motor fuel data—which are submitted by 50 states and the District of Columbia—rests with only two officials in FHWA headquarters. Each state submits hundreds of data elements for review by these two officials, thus increasing the risk that errors could occur during the attribution process. Moreover, since the attribution methodology has never been clearly documented, FHWA management does not have an adequate basis for providing oversight of the attribution process or delegating the responsibility for this process to other individuals in the event that the two officials depart or are otherwise no longer available to handle this responsibility.

FHWA’s efforts to validate the state motor fuel data and its own methodology only partially address questions about the overall reliability of
Appendix III
Reliability of FHWA's Attribution Process Has Not Been Demonstrated

the agency's attribution process. First, FHWA performs trend analyses to compare each state's data submission with comparable data submitted in earlier years and identify any major discrepancies. It then works with the state to determine the cause of the discrepancy and make any needed adjustments. This is a helpful quality control technique to ensure consistency from year to year, but it does not verify the accuracy of the underlying data submitted by the states.

Second, FHWA has a policy to conduct motor fuel reviews in each state every 3 years. These reviews are designed to identify and review the overall methodology used by the states to develop the key motor fuel figures reported to FHWA. Officials in FHWA's division offices in the states conduct these reviews, using guidance from FHWA headquarters. FHWA renewed its efforts to conduct these reviews in June 1997, and as a result, about 83 percent of the states have undergone a motor fuel review during the past 3 years. We view this as a positive effort to improve state reporting, but it does not verify the accuracy and ensure the reliability of the state data submitted to FHWA. To accomplish a detailed verification, FHWA would need to trace the figures on the Form 551M submitted by the states to the supporting documentation prepared by the state transportation and revenue agencies, and the agency would have to verify the accuracy of the underlying support.

FHWA Has Established a Multiagency Committee to Help the Agency Address Specific Weaknesses in the Attribution Data and Methodology

FHWA has identified a number of weaknesses in the state motor fuel analysis portion of its attribution process, which the agency is discussing with the Motor Fuel Reporting Information Committee. This committee—which includes representatives from FHWA, state revenue and transportation agencies, the American Association of State Highway and Transportation Officials, and the Federation of Tax Administrators—was established by FHWA in September 1998 to address issues and areas for improving the reporting system for state motor fuel data and FHWA's attribution methodology.

FHWA has identified and is addressing a number of specific weaknesses in the data and methodology used in the attribution process, including problems with the reporting on government entities' use of fuel, fuel loss allowances, and gasohol usage. FHWA officials told us that the impact of these problems is relatively small—representing only 2 to 3 percent of the total state motor fuel data. Nonetheless, FHWA believes the problems are significant enough to require discussion with the committee and action by the agency. Although the scope of FHWA's work with this committee was
initially focused on these limited areas, it has evolved to include broader concerns about the attribution process. For example, FHWA also plans to issue a paper describing its attribution methodology to better inform state officials about how the motor fuel data are used to estimate contributions to the Highway Account of the Fund that are attributable to each state. Furthermore, FHWA has conducted significant outreach efforts to state officials through this committee by holding workshops in Washington, D.C.; Atlanta, Georgia; Philadelphia, Pennsylvania; and Denver, Colorado to discuss issues related to state motor fuel reporting and other aspects of the attribution process.

Three of the weaknesses—involving problems with FHWA’s treatment of motor fuel usage by government versus private and commercial vehicles—are relatively significant. The first weakness is that the state data on diesel fuel usage may not be accurate because states have a problem identifying and quantifying the amount of diesel fuel that is used by private and commercial entities versus government entities. FHWA guidance directs states to submit data on only the private and commercial use of diesel fuel because many states are unable to provide information on government use of such fuel. However, many states cannot split out the government uses from the private and commercial uses, so they incorrectly include government use in their data submission for diesel fuel. This, in turn, affects the accuracy of FHWA’s attribution of contributions to the Highway Account of the Fund associated with the use of diesel fuel—a factor used to apportion funds for the Interstate Maintenance and National Highway System programs.

The second weakness involves an inconsistency in the way FHWA attributes government entities’ use of gasoline versus diesel fuel to the states for the purpose of estimating contributions to the Highway Account of the Fund. FHWA’s attribution methodology includes government use of gasoline fuel but excludes government use of diesel fuel in attributing motor fuel usage to each state. FHWA decided to exclude government use of diesel from its motor fuel data collection because many states were unable to provide this information. FHWA officials stated that this inconsistency in FHWA’s attribution methodology has caused considerable confusion in state reporting; for example, many states include the wrong numbers on the Form 551M or provide unnecessary and confusing information to FHWA.

The third weakness is that FHWA’s use of diesel fuel as a factor in apportioning funds for one of the major highway programs—the National
Appendix III
Reliability of FHWA's Attribution Process Has Not Been Demonstrated

Highway System program—is not consistent with TEA-21's requirements. TEA-21 identifies total highway use of diesel fuel as a factor for apportioning the National Highway System funds. In practice, however, FHWA excludes government use of diesel fuel and calculates the apportionment factor using only private and commercial vehicle use of diesel fuel. Current FHWA reporting procedures instruct states to exclude government use of diesel fuel—that is, use by federal, state, and local government entities—in their reports to FHWA. Again, FHWA decided to exclude government use of diesel fuel from its motor fuel data collection because many states were unable to provide this information. FHWA is exploring alternative solutions to this problem, which include requiring states to develop the information or developing estimates at FHWA by using modeling techniques.

FHWA is exploring ways of addressing all of the weaknesses it has identified, and it will develop an action plan—in consultation with the committee—with a schedule for implementing the corrective actions. FHWA plans to publish the proposed implementation schedule in a Federal Register notice, solicit comments, and finalize the schedule in December 2000. During 2001 and beyond, FHWA plans to revise its guidance to the states on compiling motor fuel data, to conduct training sessions on motor fuel data requirements for officials in state transportation and revenue agencies and FHWA division offices, and to take other actions that are included in its plan.

IRS—in partnership with the states, industry representatives, and FHWA—is developing a fuel-tracking system that will monitor the movement of motor fuel through the distribution chain to determine if the proper federal tax is being paid. This system—known as the Excise Files Information Retrieval System (ExFIRS)—will include data on the gallons of motor fuel, by type, that are sold to retailers and wholesalers in each state. The ExFIRS data project is being jointly administered by IRS and the Department of Transportation through a Memorandum of Understanding.
According to IRS officials responsible for ExFIRS, the data will provide details that could be used to analyze highway versus nonhighway use of motor fuels in each state. Specifically, ExFIRS will provide data on the final destination state for motor fuel when it is removed from bulk storage tanks at the terminal. Thus, the ExFIRS data could be used as a tool in validating the state motor fuel data currently used in FHWA’s attribution process.

One potential limitation with using the ExFIRS data in the attribution process—that would need to be evaluated by FHWA and IRS—is that the data on the destination state come from the terminal owner, as reported by the truckers or rail carriers, and are not independently verified by IRS. This raises the possibility that, in some cases, the truckers or rail carriers may divert the gasoline to a state other than the “destination state” that they reported to the terminal operator in an attempt to evade the higher motor fuel taxes imposed by the true destination state where the fuel was actually sold. However, such diversions would also affect the state-reported data on motor fuels currently used by FHWA in its attribution process. Moreover, IRS is developing a compliance technique that may reduce the likelihood that this type of evasion will occur. This technique, known as “fuel fingerprinting”, is designed to identify the terminal source for fuel that is sampled from a retail or wholesale establishment. According to the IRS official responsible for ExFIRS, this technique, when fully developed, will probably be useful for determining whether the fuel sampled came from an in-state terminal source or was diverted across state lines.

IRS is developing the requirements and procedures for ExFIRS, and, according to the officials responsible for the system, the agency can begin implementing it by October 2000. Once the system is implemented, taxpayers will start reporting data to IRS. According to those officials, if the agency meets all of its current milestones for implementing ExFIRS, IRS will be able to report on a full year’s worth of motor fuel data (i.e., fiscal year 2001) by November 2001.

The federal motor fuel taxes are imposed at the terminal rack, the facility where fuel from bulk storage tanks is loaded into tanker trucks or rail cars for delivery to retail stations or to bulk users. Bulk users include the power companies, hospitals, and farmers who use the fuel for nonhighway purposes, and wholesalers who place the fuel into intermediate storage, according to an IRS official.
Problems with the reliability of the processes used by the Treasury Department and FHWA for estimating highway user tax information can affect (1) the calculation of any changes to the overall amounts of highway program funds that go to the states each year, as authorized by TEA-21, and (2) the amounts that are apportioned to individual states under several major programs. FHWA uses Treasury’s revenue reports and the results of its attribution process to distribute highway program funds to the states in two ways. First, FHWA distributes any additional funds (or fund reductions) called Revenue Aligned Budget Authority (RABA). The amounts of these additions to or reductions in funds are determined by analyzing changes in receipts in the Fund on the basis of information provided by the Treasury Department. Second, FHWA apportions funds to the states for several major highway programs by using formulas that rely to a large extent on the state-level estimates of motor fuel usage and contributions to the Highway Account of the Fund developed during the attribution process. The amount distributed to the states on the basis of information developed by the Treasury Department and FHWA is large—totaling about $13 billion in fiscal year 2000 alone—so the potential impact of problems with the accuracy and timeliness of that information are significant. Although we have concerns about the reliability of the estimates developed by Treasury and FHWA, there is no way of knowing the extent of over- or under-payments, if any, to individual states, given the information currently available from the two agencies.

The yearly adjustment to the highway program’s funding levels authorized in TEA-21, called RABA, is based on available Treasury Department information on Highway Account receipts. Problems with the accuracy and timeliness of the information in Treasury’s reports on Highway Account receipts can thus affect the amounts distributed to the states under the RABA provision. As discussed in appendix II, Treasury’s reporting on these receipts has contained errors and is not timely. In response to concerns raised by the Transportation Department, Treasury revised its fiscal year 1998 and 1999 revenue reports to incorporate the most recent information available on Highway Account receipts. Nonetheless, this action does not fully address our concerns about the accuracy and timeliness of Treasury’s reporting on those receipts, which could potentially affect the RABA calculations.
Appendix IV
Problems With Treasury's and FHWA's Processes Can Affect Fund Distributions to the States

The RABA adjustment is based on a comparison between currently available information on Highway Account receipts and projections of those receipts contained in TEA-21. TEA-21 used projections of Highway Account receipts to develop guaranteed highway funding levels for fiscal years 1999 through 2003. Beginning in fiscal year 2000, these guaranteed levels were to be adjusted upward or downward each year on the basis of actual Highway Account receipts and new projections of these receipts.¹

The RABA adjustment to the funding levels authorized in TEA-21 is based on actual receipts from 2 years prior to the fiscal year, as reported by Treasury, plus revised Treasury receipt projections for the fiscal year in question. For example, for fiscal year 2000, TEA-21 requires that this adjustment be calculated by comparing (1) actual Highway Account receipts for fiscal year 1998 with the TEA-21 projection of these receipts and (2) revised projections of Highway Account receipts for fiscal year 2000 with the TEA-21 projection of these receipts. The sum of these differences becomes the RABA funding level. Table 5 shows how this adjustment was calculated for fiscal years 2000 and 2001. As shown, for fiscal year 2000, the RABA adjustment, included in the President's budget, added $1.5 billion to the $28.1 billion estimate of Highway Account receipts in TEA-21. For fiscal year 2001, the adjustment added $3.1 billion to the $28.5 billion estimate of Highway Account receipts. FHWA apportions any additional RABA funds to the states on October 15 of each fiscal year—about 2 weeks after apportioning the amount of highway program funds for the fiscal year that was authorized in TEA-21. This RABA adjustment ensures, for the first time, that highway program funding levels will change as Highway Account receipt levels change.

¹If this RABA adjustment lowers the guaranteed funding level for a given fiscal year, TEA-21 requires that the Department of Transportation reduce the amount of funding authorized on October 1 of the next fiscal year.
Appendix IV
Problems With Treasury's and FHWA's Processes Can Affect Fund Distributions to the States

Table 5: Calculation of the Revenue Aligned Budget Authority Adjustment, Fiscal Years 2000 and 2001

<table>
<thead>
<tr>
<th>Fiscal year that funds are made available</th>
<th>Comparison of actual Highway Account receipts from 2 years prior to the fiscal year with TEA-21 projection of these receipts</th>
<th>Comparison of revised projection of Highway Account receipts for the fiscal year with TEA-21 projection of these receipts</th>
<th>Revenue Aligned Budget Authority adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TEA-21 projection of FY1998 Highway Account receipts 22,164</td>
<td>TEA-21 projection of FY 2000 Highway Account receipts 28,066</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Difference $971</td>
<td>Difference $485</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$971 + $485 = $1,456</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2001</td>
<td>FY 1999 actual Highway Account receipts $33,815</td>
<td>Revised projection of FY 2001 Highway Account receipts $30,368</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Difference $1,196</td>
<td>Difference $1,862</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$1,196 + $1,862 = $3,058</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Legend
FY = fiscal year

Note: Actual Highway Account receipts are net receipts (excluding fines and penalties) after the deduction of transfers and refunds.

Source: Department of Transportation.

To include the amount of the RABA adjustment for the next fiscal year in the President's budget for that fiscal year, the Office of Management and Budget and the Office of the Secretary in the Department of Transportation rely on information on Highway Account receipts supplied by the Treasury Department. The Bureau of Public Debt provides them with the prior fiscal year's Highway Account receipts in a report on Highway Trust Fund receipts for the fiscal year, and the Office of Tax Analysis provides them with a projection of Highway Account receipts for the next fiscal year.

Problems with the accuracy and timeliness of information in Treasury's reports on Highway Account receipts can affect the amounts distributed to the states, since these reports are used in calculating the RABA adjustment. In developing the RABA calculations for fiscal years 2000 and 2001, the Department of Transportation raised concerns with the Treasury Department regarding its reporting on Highway Account receipts. In its
yearly reports on Highway Trust Fund receipts, the Bureau of Public Debt has generally used estimates of these Highway Account receipts, rather than certified figures, for the third and fourth quarters of the fiscal year because of the 6-month lag in IRS' certification of quarterly collections. The Bureau has generally finalized its reports on Highway Trust Fund receipts for each fiscal year by December—about the time that IRS issues its third-quarter certification. Transportation requested that the Bureau incorporate the third-quarter certification in its fiscal year 1998 and 1999 reports, so that the RABA calculation could be based on the most recently available information. In the case of the report for fiscal year 1998, Transportation was particularly concerned because the third-quarter certified collection amount for that fiscal year was unusually large. As noted in appendix II, this certified amount included approximately $590 million that was related to the previous quarter.

In response to the Transportation Department's concerns and considering applicable accounting standards, the Bureau of Public Debt revised its reporting on the Highway Account receipts for fiscal years 1998 and 1999 to reflect the third-quarter certifications. While this action helped ensure that the most recent available information was used in the calculation of the RABA adjustments for fiscal years 2000 and 2001, it did not address the underlying issues discussed earlier in this report regarding the accuracy and timeliness of Treasury's reporting on Highway Trust Fund receipts. For example, in the future, if significant amounts attributable to the third or fourth quarter of a given fiscal year are certified as collections in subsequent quarters, the RABA calculation for that fiscal year would be affected because those amounts would not be reflected in Treasury's report on Highway Trust Fund receipts for that fiscal year. The amounts would be reflected in the report for the following fiscal year. Therefore, although we do not have information on the extent of over- or under-payments to the states, if any, it is evident that problems with the accuracy and timeliness of information in Treasury's revenue reports could affect the accuracy of the amounts distributed for a particular fiscal year.
Given the concerns about the reliability of the data and methodology used in FHWA’s attribution process, the reliability of the estimates resulting from that process has not been demonstrated, and there is little assurance that the actual amounts distributed to individual states are accurate. FHWA uses the information developed in its attribution process to apportion large amounts to states—about $11.5 billion in fiscal year 2000 alone. Although we have concerns about the accuracy of the relative amounts apportioned to individual states, there is no way of knowing the extent of over- or under-payments, if any, to individual states because FHWA has not systematically verified the accuracy of the state motor fuel data or its own methodology used in the attribution process.

Under TEA-21, the state motor fuel data used in FHWA’s attribution process has considerably greater importance in apportioning highway program funds than under the predecessor legislation known as ISTEA. For example, under TEA-21’s formulas for the three programs and the “Minimum Guarantee” provision discussed below, state motor fuel data directly affected the apportionment of about $11.5 billion in federal highway program funds in fiscal year 2000. In contrast, under ISTEA, an average of about $1.2 billion of highway program funds was apportioned each year on the basis of state motor fuel data during the fiscal year 1992 through fiscal 1997 period, according to FHWA officials.

On October 1 of each fiscal year, FHWA’s Office of Budget and Finance apportions funds for several major highway programs to each state on the basis of various formulas. These formulas, established by TEA-21, involve an array of data and factors combined into a series of mathematical calculations that are applied to the highway programs’ funding levels authorized in TEA-21. While the apportionment factors influence the relative funding that is distributed to each state, those factors do not influence each year’s overall funding levels for the highway programs.

Footnotes:
2The $11.5 billion included about $1.3 billion of the Interstate Maintenance funds, $2 billion of the Surface Transportation Program funds, $1.4 billion of the National Highway System funds, and $6.8 billion in “Minimum Guarantee” funds.
3In addition to motor fuel usage and estimated state-level contributions to the Highway Account, TEA-21’s apportionment formulas include such factors as vehicle miles traveled, population, and highway lane miles.
which are estimated in TEA-21 and then annually adjusted through the RABA calculation on the basis of Highway Account receipts information.

The attribution data on each state's estimated motor fuel usage and contributions to the Highway Account of the Highway Trust Fund are used for apportionment purposes in three major highway programs—the Interstate Maintenance, Surface Transportation, and National Highway System programs. In addition, the data on attributed contributions are used to implement the “Minimum Guarantee” provision of TEA-21. The attribution data for each state are applied to the apportionment formulas in the following ways:

- Commercial vehicle contributions are used as a factor in distributing 33.3 percent of Interstate Maintenance program funds to the states. This factor is defined as the sum of contributions from the motor fuel taxes on diesel and other special fuels and the truck-related taxes on tires, truck and trailer sales, and heavy vehicle use.

- Highway Account contributions are used as a factor in distributing 35 percent of the Surface Transportation Program's funds. This factor is defined as the sum of contributions from all motor fuel and truck-related taxes.

- Total diesel fuel used on highways is a factor in distributing 30 percent of the National Highway System program's funds. FHWA excludes the public use of diesel fuel and calculates this apportionment factor using only private and commercial vehicle use of diesel fuel.

- Highway Account contributions are used as a factor in calculating the “Minimum Guarantee” provision in TEA-21, which states that each state is guaranteed that its share of apportionments will be at least 90.5 percent of its percent share of contributions to the Highway Account.

FHWA uses the results of its motor fuel attribution analysis to calculate each state's relative share of motor fuel consumed on highways. It then multiplies the resulting percent share of gallons by the amount of highway tax receipts allocated to the Fund's Highway Account to estimate each state's attributed contributions to the Fund.
Appendix V

Scope and Methodology

Our approach in reviewing Treasury's and FHWA's processes, and the impact of those processes on the level of highway program funds distributed to the states, was to (1) document the major steps in these processes and the times when these steps occur; (2) identify and evaluate any issues regarding the accuracy, timeliness, or reliability of the data and the methodologies used in Treasury's and FHWA's processes; and (3) describe and assess any efforts by those agencies to improve their data or processes. To do this, we reviewed pertinent agency documentation and interviewed knowledgeable agency officials at several offices within the Treasury and Transportation departments. Within Treasury, our work was performed at IRS, the Office of Tax Analysis, the Bureau of Public Debt, and the Financial Management Service. Within Transportation, our work was performed at several offices in FHWA and at the Office of the Secretary.

With regard to our work on Treasury's revenue allocation process, we incorporated the results of our prior work addressing Treasury's processes for allocating tax receipts to federal excise-tax-related trust funds, including the Highway Trust Fund. With regard to our work on FHWA's attribution process, we reviewed the ongoing efforts of the Motor Fuel Reporting Information Committee—an organization of officials in FHWA and state transportation and revenue agencies that is identifying issues and improvements needed in the motor-fuel reporting system. Additionally, we visited FHWA field offices and state revenue and transportation agencies in two states—Florida and North Carolina—to develop an understanding of states' role in providing data used in estimating states' contributions to the Fund. We chose these two states because they are members of the Motor Fuel Reporting Information Committee. Also, an FHWA official responsible for the attribution process told us that officials in these two states were very knowledgeable about the motor-fuel reporting process and thus their insights would be useful to our work. We conducted our work from August 1999 through June 2000 in accordance with generally accepted government auditing standards.
Appendix VI

Comments From the Internal Revenue Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Ms. Phyllis Scheinberg
Associate Director, Transportation Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Scheinberg:

Thank you for the opportunity to review and comment on the draft report entitled "Highway Funding: Problems With Highway Trust Fund Information Can Affect State Highway Funds (GAO/RCED/AIMD-00-148)," which focuses on the allocation and estimation processes used by the Department of Treasury and Department of Transportation Federal Highway Administration and its effect on the amount of Highway Program Funds distributed to the States.

Before addressing your specific recommendations, I would like to share some concerns we have about some legal and technical concepts discussed in the report. The report uses “payment” and “deposit” as interchangeable, when the two are separate legal terms. Taxes received in Treasury are transferred to the trust fund and may be received either as semimonthly deposits or as payments with the return. Deposits are not accompanied by data that would permit the IRS to determine highway taxes received. Only the quarterly return provides the data that permits the IRS to determine the extent to which the taxpayers deposits and payments for the quarter are attributable to highway taxes.

Taxpayers make deposits, under 26 U.S.C. 6302 and its Regulations, which represent the taxpayers' estimates of excise tax liabilities. Payments, on the other hand, are due with the return on the return due date per 26 U.S.C. 6151. The actual liability for tax is not determined until the taxpayer files the return and the assessment is made.

Treasury is required under 26 U.S.C. 9601 to make monthly transfers from the general fund to the trust fund on the basis of estimates. Currently the Treasury Department uses economic models to make these monthly estimates for transfers. The trust fund amounts are then adjusted to reflect the actual amounts collected based on the quarterly certifications.

See comment 1.
This distinction helps in understanding two important facts:

1) Until the actual return is filed and processed and the amount of the actual liability is certified, all monies transferred to the various trust funds are and will continue to be estimates, and

2) The IRS’ ability to determine and report the specific amount of highway user tax should be measured from the time the return is filed rather than when the advance deposit is made.

As stated in the report, the returns (Form 720) are quarterly, and are due either one or two months following the end of the quarter in accordance with the Regulations. The certification is issued approximately 3 ½ months after the return is due allowing us time to process the returns, monitor returns to ensure correct and timely postings, maximize the amount of current quarter activity in the certification process, and prepare and review all certifications issued for the quarter.

The report notes that because of delays in recording return data, amounts relating to tax liability for a quarter may not be reflected in the quarterly certification until a subsequent quarter. There are basically three reasons why amounts received in a quarter are certified in a subsequent quarter:

1) Late filed returns - quarterly certifications are amounts collected as reported on the Form 720. As such, an amount may be deposited and if no return is filed by the taxpayer making the deposit, that amount will not be included in the certification until it can be certified as a collection based on the filing of a return.

2) Processing delays - this may occur when we are unable to correct error and posting conditions while processing the return and update our masterfile within the certification period.

3) Subsequent activities (e.g., taxpayer-submitted amended returns and/or requests for adjustment or reclassification and Examination activity resulting in adjustment or reclassification) - resulting in changes to the amounts reported for prior quarters routinely occur in the current quarter and are appropriately reported in that quarter.

We recognize the need to ensure expedited processing of the tax return to ensure certification in the period the return was filed. We are happy to report that between March and August of 1999, IRS implemented procedural changes in the field to expedite processing of million dollar returns (8 day-cycle). We also issued procedures requiring the field to monitor the timely posting of returns. As an additional measure, we issued procedures to help the field identify taxpayers who have not yet filed their returns in an effort to obtain and process their returns before the end of the certification period.

Through these efforts, the prior period activity for the most recent certification quarter (September 30, 1999 certified on March 20, 2000) was $413 million, or 3.37 percent of the total certification amount. For the quarter ended June 30, 1999, the prior period
activity was $101.7 million, or 89 percent of the total amount certified. Although we have controls in place, variances of this magnitude between quarters may continue to occur in the ordinary course of business. This can happen as the proximate result of even one large corporation with a tax liability of over half a billion dollars filing a late return; and/or making subsequent adjustments to their account.

Our comments about your recommendations for improving Treasury’s process for allocating (estimating) receipts to the Highway Trust Fund follow.

FINDING

The Secretary of the Treasury should place greater emphasis and priority on the agency’s efforts to improve its process for allocating receipts to the Highway Trust Fund and other excise tax-related trust funds by developing a comprehensive plan that addresses all of the policy and process changes that will be needed to fully implement these efforts. In particular, the plan should include steps and timeframes for the following recommendations:

RECOMMENDATION

Evaluate and decide whether to use incentives as a near-term method for encouraging taxpayers to provide detailed data - at the time of payment - on the specific types of excise taxes being paid.

COMMENT

Detailed tax liability at the time of payment is currently available. The issue you are raising is whether there should be a reporting of each tax being deposited at the time of deposit. Deposits are required under current regulations, not by statute. Since, under existing regulations, deposits may be 95 percent of current liability or based on amounts reported during the look-back quarter (safe harbor rules), the deposit only estimates liability for excise taxes. The actual liability will be reported on Form 720 and the difference between the amounts estimated and the actual liability is paid with this return.

The IRS’ Enterprise Life Cycle for systems development calls for Organizational and Business Process Transformation Plans to be developed for the Custodial Accounting Project (CAP). We have not prepared these plans yet, since they are not part of the exit criteria for Milestone 3. These comprehensive plans will include the review of the recommendations of the Tax Type/Fee Code study such as evaluating the use of incentives. I anticipate the review of the Tax Type/Fee Code study recommendations will take place in mid-2003, approximately a year before CAP is deployed. Our preliminary analysis of the incentives concept has not produced any ideas, legislative or otherwise, which we consider realistic. Considering the target population (mostly large
oil companies and related entities), any monetary incentive which would be likely to
change business practices and behaviors would almost certainly be too large to
implement. Perhaps the Department of Transportation could obtain more accurate data
for current estimates as they evaluate their regulatory process and refine their
attrition model.

RECOMMENDATION

Reexamine taxpayer capabilities to provide detailed data in several years and decide
whether to require the data from taxpayers at the time, considering the potential burden
to taxpayers and the potential benefits to the government.

COMMENT

As noted in GAO’s report, requiring taxpayers to provide a breakdown of their tax
deposits would impose an extremely high burden on large corporations that pay a large
percentage of excise taxes. Some simply do not have the information available at the
time of their deposit. Amounts deposited in the current quarter are not based on current
quarter liability if the taxpayer is making deposits under the look-back safe harbor rule.
Again, deposits are estimates and the breakdown, even if provided by the taxpayer, is
subject to a margin of error. However, in four years we will reexamine the taxpayer’s
ability to provide this data with deposits and reassess the requirement to provide tax
type fee code information and the benefit of this information at the time of deposit.

RECOMMENDATION

Determine what changes may be needed – as a result of changes being planned in the
revenue allocation method – in Treasury’s methods for certifying and adjusting amounts
allocated to the trust funds on the basis of analysis of tax return and payment data.

COMMENT

These issues are being considered as part of a review of the Department of Treasury’s
trust fund duties and responsibilities undertaken at the direction of Secretary Summers.
This review is still in progress.

The Office of Chief Counsel is available to discuss the report’s legal accuracy. If you
have any questions or need additional information, please contact Sheldon D. Schwartz,
Acting Assistant Commissioner (Forms and Submission Processing), at (202) 622-6860.

Sincerely,

[Signature]

Charles O. Rossotti
The following are GAO's comments on the Internal Revenue Service's letter dated June 16, 2000.

**GAO's Comments**

1. We agree that “payment” and “deposit” are separate terms since semimonthly deposits are based on estimates of tax liability, while final payments are due with the quarterly return on the return due date. We have revised the report language as appropriate.

2. We agree that initial allocations to the trust funds are and will continue to be estimates. As stated in our report, once the new method for making initial allocations to the trust funds is in place, IRS will still need to certify the amounts due to the trust funds and make adjustments to initial allocations on the basis of tax returns. We also made revisions to the report to clarify that we are not implying that IRS certify collections of highway user tax receipts on the basis of deposits. While these changes improved our description of the allocation process, we believe that opportunities exist for improving the quality of the estimates on which initial allocations to the Highway Trust Fund and other excise-tax-related trust funds are based. Our report points out that obtaining more detailed data from taxpayers at the time they make tax deposits could improve these estimates.

3. We agree that there are a number of reasons why the amounts attributable to a given quarter are certified as collections in a subsequent quarter. To clarify this point, we have revised our description of such instances and our explanation of the reasons they occur. As stated in our report, such instances can affect Treasury's yearly reports on Fund receipts and consequently the amounts distributed to the states, particularly those that occur in the latter part of the fiscal year.

4. IRS did not fully address our recommendation that Treasury develop a comprehensive plan for implementing its efforts to improve the process for allocating receipts to the excise-tax-related trust funds. While IRS indicated that it will develop comprehensive plans for the Custodial Accounting Project—which includes these efforts—it did not provide information on when these plans will be developed.

5. IRS did not fully address our recommendation that this comprehensive plan include milestones for evaluating, as a near-term measure, the use of incentives for encouraging taxpayers to start providing a detailed
excise tax breakdown with their deposits. We believe that waiting until mid-2003 to study incentives will not allow enough time for the agency to implement an incentives program, if it decides to do so, prior to the planned deployment of its new payment information database which, according to IRS, will have the capability to record this detailed data. Therefore, we did not change the report's recommendation.

6. IRS did not fully address our recommendation that the comprehensive plan include milestones for reexamining taxpayer capabilities to provide detailed data in several years and deciding whether to require the data from taxpayers. While IRS indicated that it intends to perform these tasks in four years, we believe that the agency needs to perform these tasks before the deployment of its new payment information database and revenue allocation method, planned for 2004, in order to ensure that IRS will be ready to fully implement these efforts. Furthermore, these tasks, with appropriate milestones, should be included in IRS' comprehensive plan for its database and revenue allocation efforts. Therefore, we did not change the report's recommendation.

7. IRS did not fully address our recommendation that the comprehensive plan include a milestone for determining what changes may be needed—as a result of changes being planned in the revenue allocation method—in Treasury's methods for certifying and adjusting the amounts allocated to the trust funds on the basis of analyses of tax return and payment data. While IRS' letter states that the Secretary of the Treasury is considering this issue, we continue to emphasize that this milestone should be included in IRS' comprehensive plan for its database and revenue allocation efforts. Therefore, we did not change the report's recommendation.
Appendix VII

GAO Contacts and Staff Acknowledgments

<table>
<thead>
<tr>
<th>GAO Contacts</th>
<th>Phyllis F. Scheinberg (202) 512-3650</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gregory D. Kutz (202) 512-3406</td>
</tr>
</tbody>
</table>

| Acknowledgments       | In addition to the individuals named above, Paul Caban, Rita A. Grieco, Judy L. Guilliams-Tapia, Ted Hu, Anne T. McLeod, Sara Ann Moessbauer, Steven J. Sebastian, and Ronald E. Stouffer made key contributions to this report. |
Related GAO Products

Department of Transportation


*Highway Funding: Alternatives for Distributing Federal Funds* (GAO/RCED-96-6, Nov. 28, 1995).

Department of the Treasury

*Tax Systems Modernization: Results of Review of IRS’ March 7, 2000, Expenditure Plan* (GAO/AIMD-00-175, May 24, 2000).


*IRS Modernization: Business Practice, Performance Management, and Information Technology Challenges* (GAO/T-GGD/AIMD-00-144, Apr. 10, 2000).

*Internal Revenue Service: Results of Fiscal Year 1999 Financial Statement Audit* (GAO/T-AIMD-00-104, Feb. 29, 2000).


Excise Taxes: Internal Control Weaknesses Affect Accuracy of Distributions to the Trust Funds (GAO/AIMD-99-17, Nov. 9, 1998).


Ordering Information

The first copy of each GAO report is free. Additional copies of reports are $2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:
U.S. General Accounting Office
P.O. Box 37050
Washington, DC  20013

Orders by visiting:
Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders by phone:
(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet:
For information on how to access GAO reports on the Internet, send an e-mail message with “info” in the body to:

info@www.gao.gov

or visit GAO’s World Wide Web home page at:

http://www.gao.gov

To Report Fraud, Waste, or Abuse in Federal Programs

Contact one:
• e-mail: fraudnet@gao.gov
• 1-800-424-5454 (automated answering system)