

The Extracted Fuel Exemption: Washington State's accidental handout to Big Oil

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For nearly six decades, Washington State has given away hundreds of millions of dollars in tax revenue through an “accidental” loophole with no clear public policy objective. Giving away millions to the state’s oil industry every year is hard to understand. At a time when the state is facing budget shortfalls and is trying to cut emissions, subsidizing Big Oil simply doesn’t add up. **It’s for the legislature to decide whether we’ll close this loophole to help shore up the state budget or continue this hidden handout to oil companies.**

What is the extracted fuel exemption?

The extracted fuel exemption is a loophole allowing companies to avoid paying use taxes on fuel which they produce and burn on-site. The legislature created it for sawmills, which use wood scraps (“hog-fuel”) to power their equipment. Oil refineries produce fuel on-site and use that fuel to refine oil, so **the exemption turned into an accidental subsidy for oil companies.**

What’s this hidden handout costing Washington?

Failing to tighten the loophole to exclude oil refiners would **cost the state an estimated \$41 million over the next two years.**

Who benefits from this accidental loophole?

When the legislature created the loophole, in 1949, Washington had no oil refineries. Yet since 1954, five refineries have set up shop. **These five refineries now receive 98 percent of the benefit of the extracted fuel exemption.** Only 2 percent goes to the “hog-fuel” the legislature intended to cover.

Who will decide the fate of the loophole?

Outgoing Governor Gregoire proposed cutting the extracted fuel exemption in her 2013-2015 state budget. Now, Governor Inslee is proposing to do the same in his budget. **It’s up to the Washington State legislature to decide whether the exemption stays or goes.**

Details and history of the extracted fuel exemption

The extracted fuel exemption is a loophole in the state's use tax. The use tax applies to things that are purchased for use in Washington, but that are not subject to sales tax. (For example, if you buy a vehicle in Oregon, where the state does not assess a sales tax, you pay Washington's use tax when you register your car in Washington). The use tax also applies to substances used in manufacturing processes in cases when sales tax has not been levied on those substances.

In the case of "extracted fuel," the exemption allows firms to avoid paying use tax on fuel that they produce and use internally for the same process which created the fuel. Sawmills can re-use waste by burning wood scraps (called hog-fuel) to fuel on-site manufacturing processes. Similarly, oil refineries can produce fuel on-site and use that fuel for further refining processes.

In 1949, the legislature changed the tax code for use taxes, and created the extracted fuel exemption that we have today. The legislature designed the extracted fuel exemption for hog-fuel, but the original intent was lost long ago.

The language of Washington's exemption is loose enough to allow oil refineries to avoid taxes on the petroleum fuel they use in the process of creating more petroleum products. Up to 60 percent of fuel used in oil refineries is internally produced.

Washington's extracted fuel exemption is an anomaly in the US. Of 45 states that have use taxes, some 29 also have oil refineries. Of these 29 states, only Alabama has a similar exemption, and Alabama has defined its rule more narrowly for petroleum products.

More resources

1. Sightline Institute, *Big Oil's Accidental Tax Loophole* (series), <http://bit.ly/11Tsjzk>:
 - a. "Hog-Wild Loophole," January 10, 2013, <http://bit.ly/TMYEGC>.
 - b. "The Accidental Tax Loophole," March 1, 2013, <http://bit.ly/YcBznN>.
 - c. "What Closing Big Oil's Tax Loophole Could Do for Kids," May 8, 2013, <http://bit.ly/11Tsjzk>.
2. Washington Office of Financial Management, "Tax Exemption Fact Sheets," March 2013, http://www.ofm.wa.gov/budget13inslee/tax_exemption_factsheets.pdf.
3. Joint Legislative Audit & Review Committee (JLARC), "2011 Tax Preference Performance Reviews - Preliminary Report," Revised August 1, 2011, <http://www.leg.wa.gov/JLARC/AuditAndStudyReports/2011/Documents/2011TaxPreferencesPreliminary.pdf#page=63>.
4. Washington State Legislature, RCW 82.12.0263, <http://apps.leg.wa.gov/rcw/default.aspx?cite=82.12.0263>.