

Prince George's County, Maryland
Office of Audits and Investigations

Office of Finance

Special Review – Propane Tax Rate

May 2017



David H. Van Dyke
County Auditor



THE PRINCE GEORGE'S COUNTY GOVERNMENT
Office of Audits and Investigations

May 5, 2017

The County Council and County Executive
of Prince George's County, Maryland

We have conducted a special review of the

OFFICE OF FINANCE'S PROPANE TAX RATE CALCULATION

in accordance with the requirements of Article III, Section 313, of the Charter for Prince George's County, Maryland. Our report is submitted herewith.

We have discussed the contents of this report with appropriate personnel of the Office of Finance, and wish to express our sincere gratitude to them for the cooperation and assistance extended to us during the course of this engagement.

A blue ink signature of David H. Van Dyke, written in a cursive style.

David H. Van Dyke, CPA, CIA, CFE
County Auditor

A black ink signature of Larry Whitehurst, written in a cursive style.

Larry Whitehurst, CPA
Audit Manager

A black ink signature of Amy Lee, written in a cursive style.

Amy Lee
Auditor

Review of Prince George's County Propane Tax Rate Formulation and Calculation

As a result of concerns over the propane tax rate, the County Council requested the Office of Audits and Investigations (A&I) to review the current rate structure and the history and method of how the propane tax rate is calculated. This was prompted by concerns from citizens and a brief presentation to the County Council made by J. Randall Thompson, President of Thompson Gas, at a November 1, 2016 County Council Committee of the Whole hearing. The concerns questioned the following: (1) the level of the current rate; (2) the escalation of the propane tax over past years, and; (3) the formula structure/calculation of the rate. This report addresses the concerns noted and has recommendations for the calculation of the propane tax rate going forward. It should also be noted that A&I is currently conducting an audit of all energy taxes (i.e. electricity, natural gas, fuel oil, and propane) for FY 2016, to ensure compliance with reporting and remitting requirements of energy taxes.

Background

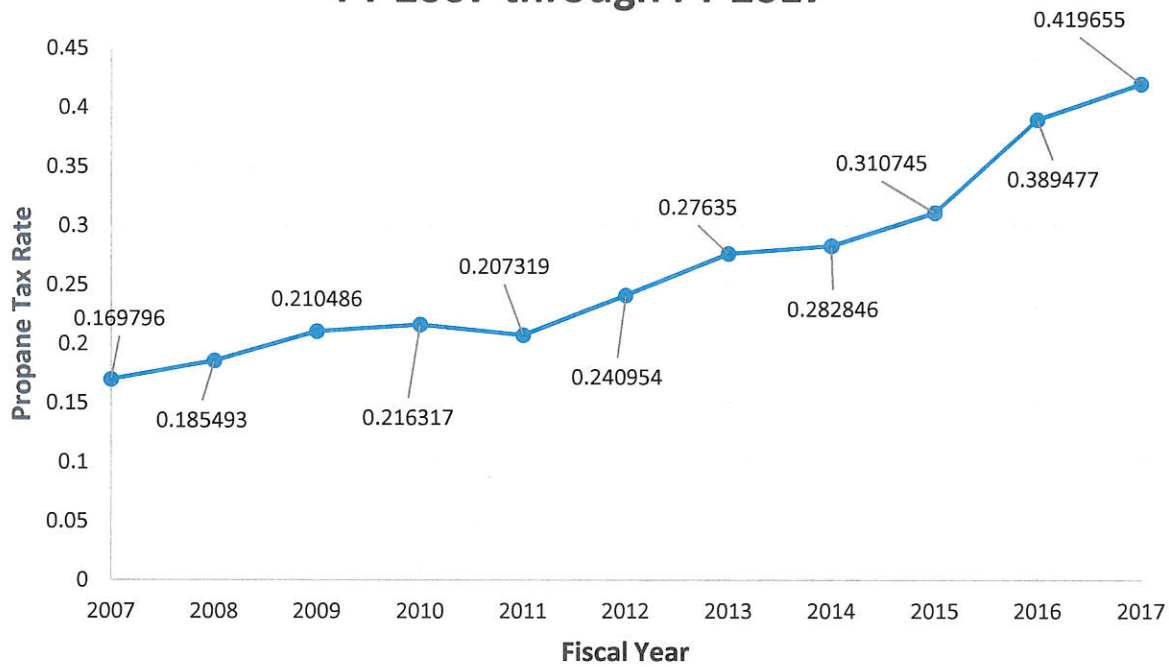
The energy and fuel tax computation is authorized by Section 10-205.01 of the County Code, which gives the County the authority to impose a tax on the sale of electricity, natural gas, liquefied petroleum gas (propane), and fuel oil used, or to be used, in the County, subject to the following exceptions:

- (1) Fuels used by motor vehicles; and
- (2) Fuels used in the production of other forms of energy that are subject to this tax.

The energy tax rates are calculated by the Office of Finance and included in the County Executive's Proposed Budget, transmitted by March 15th of every year, for the ensuing fiscal year. The rates are effectively set by the adoption and approval of the Proposed Budget by the County Council, on or before June 1st, and become effective July 1st.

The current energy tax rate formula became effective starting in FY 1988, as a result of the enactment of CB-56-1987. The only change made to the rate formula since its inception was an increase in the multiplier from 0.05 to 0.075 in FY 1992. The multiplier is the number by which revenue is multiplied to calculate the numerator of the energy tax rate. (See Propane Rate Calculation section for more details). The propane tax rate has grown steadily since inception and increased by 147% since FY 2007. The chart below provides a comparison of the increase in the propane tax rate from FY 2007 through FY 2017.

Propane Tax Rates for FY 2007 through FY 2017



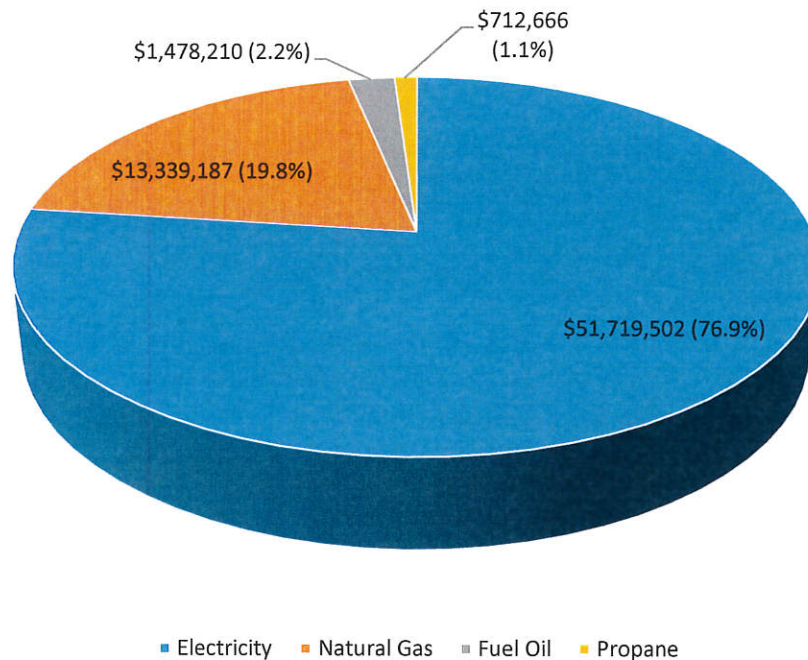
Fiscal Year	FY 2007	FY 2008	FY 2009	FY 2010
Propane Tax Rate	0.169796	0.185493	0.210486	0.216317
% change		9%	13%	3%
Revenue	N/A	N/A	\$6,872,268	\$7,220,300
Consumption	N/A	N/A	2,448,709	2,503,380

Fiscal Year	FY 2011	FY 2012	FY 2013	FY 2014
Propane Tax Rate	0.207319	0.240954	0.27635	.282846
% change	-4%	16%	15%	2%
Revenue	\$6,918,577	\$7,055,526	\$7,473,955	\$6,566,584
Consumption	2,502,873	2,196,127	2,028,393	1,741,211

Fiscal Year	FY 2015	FY 2016	FY 2017
Propane Tax Rate	0.310745	.389477	0.419655
% change	10%	25%	8%
Revenue	\$8,579,121	\$11,608,797	\$11,082,430
Consumption	2,070,620	2,235,461	1,980,633

In FY 2016, total energy tax collections received were \$67,249,565, of which 1.1%, or \$712,666, were from propane tax collections. FY 2017 total energy tax collections are estimated to be \$69,188,600. The propane tax collections have consistently ranged between 0.6% and 1.1% of total energy tax collections since FY 2007. The chart below depicts a breakdown of total energy tax collections for FY 2016.

FY 2016 Energy Tax Collections By Source



Note: The chart excludes adjustments made for circuit breaker and Maryland energy assistance/weatherization rebates included in the computation of total energy tax collections in the Comprehensive Annual Financial Report (CAFR).

Each propane company that sells or distributes propane within Prince George's County is required to file a tax return with the Office of Finance and remit the tax collected every quarter for the periods ending September 30, December 31, March 31, and June 30. These returns show the total amount of propane gallons sold in the County, which is then multiplied by the applicable propane tax rate to determine the amount of tax proceeds to be submitted along with the tax return. The tax returns also report the amount of revenue realized on the reported propane gallons sold.

Scope of Review

In an effort to understand how the propane tax rate is calculated, A&I reviewed the supporting documentation for propane tax remittances. We obtained all propane tax return submissions for FY 2016 from the Office of Finance, Treasury Division. We contacted representatives from each propane company that submitted a tax return and requested documentation to support the information reported on their FY 2016 propane tax returns (i.e. gallons of propane sold, taxes levied, and revenue realized on the sales). In addition, we calculated a price per unit (gallon) for each propane company using the revenue and consumption information that was submitted on each of their returns. Once calculated, we compared each company's price per unit and identified prices that were significantly higher than the calculated prices for other companies. In addition to identifying companies with a higher than normal price per unit, we conducted interviews of various propane company personnel and found all of the companies were not correctly reporting propane revenue on their tax returns. Propane companies are responsible for self-certifying the revenue reported on their quarterly tax returns. These revenue figures are then used in the calculation of the new propane tax rate. The revenue report should represent revenue on propane sales made only in Prince George's County. However, some companies were reporting revenue on their total propane sales for all jurisdictions, as opposed to reporting revenue on total propane sales for just Prince George's County. In other instances, companies were reporting revenue on all their applicable energy source sales (i.e. electricity, natural gas, fuel oil, and propane). The misreporting of revenues by these companies inflated the total propane revenue amount and caused the calculated propane tax rate to skew higher than if it were calculated on Prince George's County propane sales alone.

Once we determined how the FY 2016 propane tax rate was calculated and identified the factors that were causing the rate to be skewed, we met with the Director of the Office of Management and Budget, Deputy Director of Finance, and their support staff on February 2, 2017, to discuss our preliminary findings. All parties generally agreed with the preliminary findings.

A&I stated that we were in the process of requesting documentation from all of the propane companies for calendar years 2014 and 2016, to support the information that was self-reported, and would analyze and review the data. If the supporting documents and analysis resulted in a change to the FY 2018 proposed propane tax rate, a revised propane tax rate for those years would be calculated by A&I and submitted to the Office of Finance for their consideration.

Propane Tax Rate Calculation

Section 10-205.01 of the County Code states, "The Director (of Finance) shall compute the proposed rates of taxation for the next fiscal year by multiplying the sum of the revenues for each classification of energy or fuel delineated in Subsection (h) by 0.075, and then dividing that product by the sums of consumption for each classification". In summary, the total revenue for propane sold in the County, multiplied by 0.075, and divided by the total gallons of propane sold in the County equals the tax rate.

For example:

$$(\text{Total Revenue} \times 0.075) / \text{Total Consumption} = \text{Tax Rate}$$

To develop a fiscal year tax rate, the actual calendar year information from two years prior is used. For example, the fiscal year 2016 rate is based on total revenue and consumption for activity within Prince George's County for calendar year 2014.

In FY 2016, the levied propane tax rate was 0.389477 per gallon. A&I verified 88% of the reported revenue and 85% of the reported consumption data. Additionally, A&I conducted analytical procedures that consisted of calculating a price per unit cost for all of the propane companies using their reported revenue and consumption information. The comparison revealed that the price per unit for all of the propane companies was within a comparable range consistent with all reported information. After conducting our analysis and making the adjustment, we calculated a revised FY 2016 propane tax rate of 0.270965 per gallon. See rate calculation below:

	<u>Initial Calculation</u>	<u>Revised Calculation</u>
Revenue	\$11,608,797	\$8,081,827
Multiplied by	x 0.075	x 0.075
<u>Consumption</u>	<u>÷ 2,235,461</u>	<u>÷ 2,236,960</u>
	\$0.389477/gallon	\$0.270965/gallon

The use of the revised propane tax rate for FY 2016 resulted in a potential overcharge of approximately \$216,853. See calculation below.

FY 2016 Propane Units *	Propane Tax Rate	Propane Tax Collected
1,829,803	0.389477 (initial)	\$712,666
	0.270965 (revised)	\$495,813
Potential Overcharge		\$216,853
* Calculated value based on actual collections		

Note: The change in consumption numbers from 2,235,461 in the initial calculation to 2,236,960 in the revised calculation reveal that the County's propane tax collections during portions of FY 2014 and FY 2015 were understated due to misreporting by some propane companies. A&I estimates the tax collection shortage to be \$445 based upon averaging FY 2014 and FY 2015 approved propane tax rates (.296796) and applying the resulting rate to the net increase in consumption of 1,499 units.

The proposed FY 2018 proposed propane tax rate is 0.259883 per gallon, based on calculations by the Office of Finance. We were able to verify 96% of the reported revenue and 94% of the reported consumption data. Additionally, A&I conducted analytical procedures that consisted of calculating a price per unit for all of the propane companies using their reported revenue and consumption information. The comparison revealed that the price per unit for all of the propane

companies was within a comparable range consistent with all reported information. After conducting our analysis and making the adjustment, we calculated a revised FY 2018 propane tax rate of 0.192840 per gallon.

See the rate calculation below:

	<u>Initial Calculation</u>	<u>Revised Calculation</u>
Revenue	\$6,763,219	\$5,354,780
Multiplied by	x 0.075	x 0.075
<u>Consumption</u>	<u>÷ \$1,951,807</u>	<u>÷ 2,082,601</u>
	\$0.259883/gallon	\$0.192840/gallon

Note: The change in consumption numbers from 1,951,807 in the initial calculation to 2,082,601 in the revised calculation reveal that the County's propane tax collections during portions of FY 2016 and FY 2017 were understated due to misreporting by some propane companies. A&I estimates the tax collection shortage to be \$52,915 based upon averaging FY 2016 and FY 2017 approved propane tax rates (.404566) and applying the resulting rate to the net increase in consumption of 130,794 units.

The difference between the initial calculated rate (as calculated by the Office of Finance) and the revised calculated rate (as calculated by A&I) is a result of A&I conducting a verification and analysis of 96% of the revenue and 94% of the consumption data submitted by the propane companies. The Office of Finance calculated a rate based upon the revenue and consumption information as reported by all of the propane companies with verification from only the largest propane company, which represented 45% of the revenue and 45% of the consumption.

Comparison of Propane Tax Rates with Other Jurisdictions

A&I researched and compared the energy taxes levied on all other jurisdictions within the State of Maryland for FY 2016. There are four other jurisdictions that impose propane taxes: Anne Arundel County, Baltimore City, Montgomery County, and St. Mary's County. The table below provides the FY 2016 propane tax rates for these jurisdictions and Prince George's County:

County	FY 2016 Tax Rate
Prince George's	0.389477/gallon
Anne Arundel	0.015/gallon
Baltimore City	0.147431/gallon (comm.) 0.046699/gallon (resid.)
Montgomery*	0.0367935/lb. (comm.)-.1545327/gallon* 0.02056/lb. (resid.)-.086352/gallon*
St. Mary's	1.25% of sales
* 4.2 pounds = 1 gallon	

Each jurisdiction's energy rates are determined as follows:

- Anne Arundel- not formula driven, codified with changes to rates made through code modifications;
- Baltimore City- codified with adjustments made annually based upon the annual percent change in the Baltimore-Washington Consumer Price Index (CPI);
- Montgomery- not formula driven, codified with changes made by the County Council through resolution;
- St. Mary's- not formula driven, codified set by Board of Commissioners not to exceed 5%.

Recommendation

The proposed propane tax rate for FY 2018 should be amended to reflect the most recent revenue and consumption data as collected and calculated by A&I. The proposed FY 2018 rate is \$0.259883 per gallon. A&I has determined the rate for FY 2018 should be \$0.192840 per gallon.

The tax forms currently in use to report and remit propane tax collections are not clear concerning how revenue should be reported. We recommend that the County clearly state that revenue should include only propane sales made in Prince George's County.

In addition, the Office of Finance should conduct analytical procedures along with periodic verifications of information submitted by each propane company to ensure that accurate information is being used to develop the propane tax rate and that the correct amount of propane tax is being collected.