

November 12, 2009

TO: TRAC
FROM: Rick Todd, South Carolina Trucking Association
RE: **Fuel Taxes: Local...Sales...Indexed – Analysis of Sister States**

Fuel prices, we have learned, will vary, sometimes sharply. Spikes wreak havoc with businesses that own commercial vehicles. Fluctuations in the price of fuels also puts stress on tax mechanisms that tie the rate of the tax to the price of fuel; that is, state and local sales taxes, and schemes to index fuel tax rates to any index that is affected by price.

For governments, the stress from price increases is not administrative – the mechanisms still operate as they were designed to – it is entirely political. Several states have repealed or suspended their indexing systems, others have suspended increases that would have occurred by reason of the sales taxation of fuel. At least one has invited its local governments to cap their sales taxes. Voters in some places have defeated efforts to establish local fuel taxes or to raise the rates.

We support an increase in the cents-per-gallon tax on gasoline and diesel fuel, not the addition of variable taxes as would be imposed on the sales price, locally, or through an index – provided the money is dedicated to highway system improvements. The cost to the state of collecting the per-gallon fuels tax is probably between 2- 3% (the lowest of all highway-use taxes levied anywhere). Exhibit D shows Diesel Fuel taxes/rates amongst our sister states.

What some of our sister states – who use **various fuel-tax mechanisms** – do:

LOCAL OPTION Fuel Taxes

Local fuel taxes are relatively uncommon, as most state governments are jealous of their own revenue sources, and, evidently they've determined that they need not share their fuel tax base with local government. Another negative view of local fuel taxes is that they are also **subject to easy avoidance by anyone who can buy fuel outside the local jurisdiction, and to an unknown but possibly high degree of evasion. Sixteen states authorize some form of local fuel taxes, but they are in effect in only nine** of these, all of which have had at least some local taxes in place for more than a decade. The status of these levies in our sister states is as follows:

Alabama. Local fuel taxes have been common in AL for many years. Only a few are collected by the state revenue department; most are locally administered and collected. Counties, municipalities, and police districts may impose these taxes by ordinance; there seems to be **no limit** placed on the rate of a tax. The proceeds are **not earmarked for transportation**. Some 25 counties levy fuel taxes, most are on *diesel* as well as *gasoline*, and the rates range from 1 cent a gallon to 5 cents. About 60 AL cities and towns also levy taxes of from 0.25 to 4 cents a gallon; where a police district imposes the tax, the rate is half that imposed by the town the district surrounds.

Florida. There is a **complex system** of local option fuel taxes for FL counties. (a) By popular vote or by a supermajority of the governing body, a county may impose a 1 cent a gallon tax on *gasoline*. 34 counties have done so. All counties in the state must impose this penny tax on *diesel* fuel. (b) Counties may also impose up to 11 cents additional tax on *gasoline*, and must impose a tax of 6 cents on diesel. 66 counties have adopted *gasoline* taxes of from 3 to 11 cents under this provision. (c) Each county must impose an additional tax on *gasoline* at two-thirds the sum of the preceding two taxes, up to 4.7 cents, and a 4.7 cent tax on *diesel*. All these taxes are earmarked for transportation, including transit, except that if all a county's transportation needs are funded, it may use a large portion of the revenues for other capital investments. **Fuel tax evasion** was a serious problem when these taxes were collected locally; for the last twenty years or so all have been collected by the state department of revenue.

Mississippi. The **three MS counties** that border the Gulf of Mexico all levy a 3 cent *gasoline* tax (the highest rate authorized by state statute) to provide for the maintenance of local seawalls and the roads they protect. The tax is collected by the state tax commission.

Tennessee. State law allows a county, city, or special district **that operates a public transit system** to impose a *gasoline* tax of 1 cent a gallon to fund it. Voter approval is required. The state department of revenue is to collect any such tax. **None has actually been imposed.**

LOCAL Option SALES Taxes on FUEL

Local option sales taxes, after the property tax and local business license fees, are probably the most widespread local revenue source today. A majority of the states permit at least some local governments to impose sales taxes, and thousands of them around the country do so. **Such taxes do not often extend to motor fuel**, however. Most states restrict their localities to taxing the same sales as the state does itself, and relatively few states include motor fuel in their sales tax bases (see the next section). In some states where constitution and laws do not actually bar local sales taxation of fuel, localities are strongly encouraged to have the state collect their taxes. **Since most of these states exempt motor fuel, the effect is a local exemption as well.** In other states, constitutional or statutory provisions require the earmarking of taxes on motor fuel for transportation purposes. Since sales taxes are general fund taxes for the most part, this effectively prevents the local sales taxation of fuels.

Although states that impose sales taxes on motor fuel also impose use taxes on the consumption of fuel (at least *diesel* fuel, the use taxes on which can be and are administered through IFTA), there are no local counterparts for the use of fuel on a retail scale. Because of this, local sales taxes do not have to be reduced to a cents-per-gallon rate but can be imposed, as a normal sales tax, at a percentage of the selling price charged purchasers at the pump.

Local governments in six states impose or are authorized to impose local sales taxes on fuel, and five of them actually levy such taxes. Georgia and Virginia's are outlined:

Georgia. GA authorizes three types of local sales tax - general purpose county and city taxes, educational taxes, and, in the Atlanta area, a transportation district (MARTA) tax. Each one is imposed at a rate of 1%, and many localities impose all three. Each of GA's 200-some counties, and a thousand or more cities and towns, have sales taxes, all of which extend to sales of motor fuel. The imposition of a tax must be approved by local voters. The taxes are state-collected. Only the proceeds from the MARTA tax are dedicated specifically to transportation.

Virginia. State law imposes a 2% fuel sales tax on fuel sold in any city or county which is **a member of a transit district** supporting a commuter rail program. This includes the five VA counties and the various independent cities in the Washington, DC, area. The tax is collected by the state. **Local property taxes are to be reduced** by each locality in an amount equal to the contribution which, in the absence of the sales tax, it would have made to support bus and commuter rail services.

STATE SALES Taxes on Motor FUEL

Forty-five states levy broad-based sales and use taxes, **but only nine states extend the tax to sales of highway motor fuels.** The others have reserved highway fuel for the fuel tax, which is so often earmarked for transportation or specifically for highway purposes, sometimes by a state's constitution. The nine states, and the rates of their fuel sales taxes, are:

| | | |
|----------|----------|-------|
| CA 7.25% | HI 4% | MI 6% |
| FL 6% | IL 6.25% | NY 8% |
| GA 4% | IN 5% | WV 5% |

These nine states have all imposed sales tax on motor fuel at these same rates for more than 25 years, and seem to encounter little administrative difficulty in doing so. One problem arose years ago in applying the sales tax as an element of the fuel use tax, which all of these states except HI and IN now do. So that a sales tax can be accommodated on the **IFTA report form, it is necessary to convert the percentage rate to cents per**

gallon. States generally do this by a periodic survey of retail prices at truck stops and service stations either statewide or in the area of the state capital. In the past, some states needed to adjust the gallonage tax quarterly, some annually, a couple rarely if ever did so.

With the recent large **increases in the price of fuel**, adjustments have become larger and more frequent, and there have been **calls for the suspension of the sales tax** in at least GA, IL, and IN. The governor of GA suspended for 2008 an increase that would otherwise have gone into effect by reason of the sales tax on fuel.

Another difficulty concerning IFTA that has appeared with significant fluctuations in fuel prices – either up or down – stems from the **lag between when the IFTA adjustment may be made and when the retail prices on which it is based** were actually in effect. Georgia, for example, changes its IFTA rate pursuant to sales tax changes only twice a year. **Any large discrepancy (in either direction) between current retail prices and the cents-per-gallon sales tax component of the IFTA tax rate will create winners and losers among interstate carriers, depending on whether they have over- or under-purchased fuel in the state.**

Since sales tax is imposed at the retail level, the sales tax base for motor fuels generally includes federal fuel taxes and state gasoline taxes, which are paid at the wholesale level. Where state *diesel* taxes are imposed at the retail level (which is becoming uncommon), these would not normally be included in the sales tax base, but wholesale *diesel* taxes normally would be.

Although many states have sales tax breaks for motor carriers, only IN's sales tax exemption extends to an exemption from the sales tax imposed on motor fuel. Notes on sister states' procedures follow:

Florida. The FL sales tax on fuel is collected as a fuel tax, and the proceeds are transportation monies.

Georgia. 3% of the sales tax rate on motor fuel is considered to be an additional motor fuel tax, with the proceeds earmarked for transportation. The remaining 1% of the 4% total rate represents a general sales tax levy. Both are collected through IFTA. Prior to its entry into IFTA in 1996, GA required interstate motor carriers to use their own average fleet cost of fuel in calculating the sales tax portion of the fuel use tax. This was burdensome for much of the industry. As noted above, the governor of Georgia suspended for 2008 the increase in the fuel tax rates that would otherwise have been required by the sales tax.

INDEXED State FUEL Taxes

The notion of indexing a state's fuel tax attracted serious interest when, in the 1970s, greatly increased fuel prices led first to fuel conservation measures and then to a leveling off of state fuel tax revenues. Legislators faced with the prospect of having to raise fuel tax rates substantially every couple of years felt there ought to be a more comfortable way of ensuring adequate money in the highway fund. A number of states considered, and several adopted, means of indexing the rate of their motor fuels taxes to an indicator, generally fuel prices, that seemed to be moving upward at an appropriate pace.

There turned out to be a number of problems with this approach. Fuel prices proved to be at once more volatile and less prone to increase over the long term than the indexers had initially expected. Sharp swings in prices and then rates, either up or down, led to **calls from taxpayers and transportation departments for rate ceilings and floors, or at least for limits on how much a tax rate could fluctuate at one time.** There were also calls for legislatures to resume the rate-setting functions they had abdicated. Finally, there were disputes over how the index specified in a given state's law should be interpreted and measured fairly.

Soon after 1980, with fuel prices generally stabilized, and the political and practical **problems with indexing fuel tax rates, at least according only to price, having become apparent, interest in indexing faded.** A few states, including Washington, the first state that indexed, abandoned the practice altogether. Others had by this time found a floor or a ceiling against which their indexed rate could rest comfortably, and no longer caused political trouble. **(Several states in this category eventually repealed indexing officially and adopted the per gallon rate at which indexing had left them.)** Yet others looked for more sensitive indices than price alone.

Most recently, the very large increases in the price of fuel have embarrassed some states that still indexed their taxes. **Wisconsin has repealed its indexing feature.** That state employed a road-cost index,

which, over 20 years of indexing, resulted in estimated increases in state fuel tax revenues of some \$800 million. **North Carolina has once or twice recently suspended temporarily small increases** that would otherwise have taken effect. Indexes that rely on fuel prices or the general level of prices can be criticized on grounds that they themselves involve a certain amount of feedback from the fuel tax, and can result in higher tax increases than are strictly warranted.

Only four states continue to index their fuel tax rates today (although indexing continues to be proposed in some legislatures, and currently on the federal level). States that impose sales tax on motor fuel and earmark the proceeds for transportation have to that extent also indexed their fuel taxes to price - see the preceding section. In our region, only North Carolina and Kentucky do:

Kentucky. The tax on gasoline and diesel fuel is set by statute at 9% of the **average price** of fuel in KY, as determined quarterly by the state revenue cabinet. **Despite the indexing of the rate, the tax did not change for some 20 years** until the recent very large price increases.

North Carolina. Most of the tax rate - 17.5 cents of it - is fixed; the remainder is **indexed at 7% of the wholesale sale** of fuel, with a minimum of 3.5 cents. The rate is reviewed every 6 months, and has changed from time to time within a narrow range. **But it currently has a ceiling – and a base – of 29.9, which argues for a flat cents-per-gallon rate.**

3 Old Wholesale Petroleum Taxes

It should be noted that a few states long ago adopted taxes on the petroleum industry that are based on a percentage of the wholesale price of crude oil or petroleum products and that the industry passes on to their customers in the price of gasoline and diesel fuel. Since the tax depends on the price, these states might or might not be considered to have indexed a portion of their fuel tax rates. They are: Connecticut (which retains the tax only on *gasoline, not on diesel*), New York, and Pennsylvania. NY and PA collect these taxes through IFTA as well.

NOTE: **IFTA: International Fuel Tax Agreement** – a federally mandated, base-state fuel tax administration system for the collection and distribution of diesel fuel taxes paid by trucking operations.

IFTA assesses only fuel taxes collected statewide, on a uniform basis, and does not generally include local taxes. (See **Exhibit D: Sister States' Diesel IFTA and "pump" rates.**)

EXHIBIT D

2009 State Net Diesel Fuel Tax

| State | Net Diesel Per Gallon Total | |
|--|--------------------------------|---------------|
| Florida | IFTA = 31.87¢ | Pump = 33¢ |
| <ul style="list-style-type: none">• State sales tax is 6%• Uniform local tax• Clean-up fee <p><i>Explanation: The IFTA rate includes the state fuel tax rate per se, which is 4 cents; the sales tax rate, which is determined once a year by the state DOT according to the increase in the CPI for the US – this is 11.6 cents this year; the uniform local option tax of 13.4 cents; and environmental fees of 2.07 cents. IFTA total rate 31.87 cents for 2008. At the pump, the tax doesn't vary with the price of fuel, since the sales tax, adjusted once a year, depends on inflation rather than actual price, and the local sales taxes aren't imposed on motor fuels. The tax does vary by county, however, since many of the counties impose local option taxes that exceed the uniform rate that's incorporated into the IFTA rate (and a few impose a little less), and there's an additional state inspection fee at the pump of 0.13 cents. <u>So you might add two cents for an average tax at the pump: roughly 33 cents.</u> And again, it doesn't vary with the price of fuel.</i></p> | | |
| Georgia | IFTA = 19.8¢ | Pump = 28-36¢ |
| <ul style="list-style-type: none">• Excise tax is 7.5¢ per gallon• State sales tax is 4%• Local sales taxes can be added <p><i>Explanation: GA imposes a 4% state sales tax on motor fuel (3% of which is used for transportation, and 1% not), and all the counties seem to have an additional 3% and usually 4% sales tax on top of that. The IFTA rate, which is currently 19.8 cents on diesel, may be adjusted every 6 months, so it tends these days to be seriously out of phase. The pump tax rate is the base fuel tax rate of 7.5 cents, plus the state sales tax rate (4%), plus the local sales tax rate (let's say 3% as average), the latter two varying by price. So, at \$3 a gallon, the total pump tax would be 28.5 cents; at \$3.50, 32 cents; and, at \$4.00, 35.5 cents. (IFTA does not include local taxes)</i></p> | | |
| North Carolina | IFTA = 29.9¢ | Pump = 29.9¢ |
| <ul style="list-style-type: none">• Tax is indexed, based on wholesale price of fuel, capped at 29.9¢ per gallon <p><i>Explanation: The tax rate is computed every six months, based on a flat rate of 17.5 cents per gallon plus either 3.5 cents or 7 percent of the average wholesale price of fuel for the preceding six months. The wholesale component of the tax is capped at 12.4 cents per gallon.</i></p> | | |
| South Carolina | IFTA = 16¢ | Pump = 16.75¢ |
| <ul style="list-style-type: none">• Clean-up fees (75¢) paid at pump only | | |
| Tennessee | IFTA = 17¢ | Pump = 18.4¢ |
| <ul style="list-style-type: none">• .4¢ clean-up fee paid at pump only (1¢ inspection fee at pump, and on gasoline only) | | |
| Virginia | IFTA = 21.6¢* | Pump = 16.4¢ |
| <ul style="list-style-type: none">• Wholly intrastate vehicles pay \$100 fee-in-lieu• *Includes a 3.5¢ per gallon surtax paid only through IFTA• 0.6¢ clean-up fee paid at the pump only | | |
| Average (excluding South Carolina) | IFTA = 24.03¢ | Pump = 25.94¢ |

NOTE: Gasoline Taxes are the same as the diesel “pump” price, except in Florida (21.17¢) and in Tennessee (21.4¢).

